Inquiry into the South Australian bulk grain export supply chain costs

Final Report

December 2018

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Glossary of terms

ABB Grain	Australian Barley Board (the bulk handler in South Australia before Viterra acquired it in 2009)
ACCC	Australian Competition and Consumer Commission
AEGIC	Australian Export Grains Innovation Centre
ARTC	Australian Rail Track Corporation
Berth 29	A shipping berth within the Inner Harbour – Port Adelaide precinct, set up for the bulk loading of vessels
CAPM	Capital asset pricing model
Cargill	Cargill Australia Ltd (a grain handler and trader, and a subsidiary of multinational agribusiness Cargill Inc.)
CBH	CBH Ltd, based in Western Australia
Commission	Essential Services Commission, established under the Essential Services Commission Act 2002 (SA)
CPI	Australian Bureau of Statistics' consumer price index
DAWR	Department of Agriculture and Water Resources (Australian Government)
DPTI	Department of Planning, Transport and Infrastructure, South Australia
Draft Report	Draft Report for the *Inquiry into the South Australian bulk grain export supply chain costs*, released 7 August 2018
DTF	Department of Treasury and Finance, South Australia
EBIT	Earnings before interest and tax
EP	Eyre Peninsula
ESC Act	Essential Services Commission Act 2002 (SA)
eastern South Australia	The portion of the South Australian land mass east of the Spencer Gulf
economies of scale	When cost per unit of output declines with increasing scale. Economies of scale are usually associated with a cost structure that has high fixed costs relative to variable costs
Final Report	This report
Flinders Ports	The owner and operator of prescribed ports, currently supplying services for all bulk grain exported through South Australia
GIASA	Grain Industry Association of South Australia
Glencore	Glencore Agriculture Pty Ltd (related party to Viterra)
GPSA	Grain Producers South Australia

GWA	Genesee and Wyoming Australia Pty Ltd
market power	A firm's ability to raise price persistently above efficient cost, to exclude competitors or, more generally, to act in an unconstrained manner
MSA Act	Maritime Services (Access) Act 2000 (SA)
NOPAT	Net operating profit after tax
on-farm storage	Grain storage capacity on the farm
operating surplus	Operating revenue less operating expense
PIRSA	Department of Primary Industries and Regions, South Australia
port access regime	A regime established under the MSA Act, allowing third party access to port facilities in South Australia
port terminal services	Bulk loading facilities
PTAC	Port Terminal Access (Bulk Wheat) Code of Conduct, designed to regulate the conduct of bulk wheat port terminal operators, and administered by the ACCC
PTAC Taskforce	Wheat Port Code Review Taskforce established to conduct the review of the PTAC
rail access regime	A regime established under the ROA Act, allowing third party access to intrastate rail in South Australia
RFI	Request for Information
RoA	Return on assets, which is a measure of financial return in relation to the value of the assets employed
ROA Act	Railways (Operations and Access) Act 1997 (SA), legislation governing the operations of intrastate rail infrastructure in South Australia
RoE	Return on equity, which is a measure of the ultimate return to shareholders on their investment
RoIC	Return on invested capital, which is a measure of the underlying operating performance of a firm
SAFC	South Australian Freight Council
supply chain	South Australian bulk grain export supply chain (farm gate to vessel loading)
Terms of Reference	This inquiry's terms of reference (including subsequent variations), as provided by the Treasurer
Treasurer	Treasurer of the South Australian Government
upcountry	An inland site (that is, one not at port)
VAA	Value Adviser Associates Pty Ltd
Viterra	Viterra Holdings Pty Ltd (related party to Glencore Agriculture Pty Ltd). In this report, 'Viterra' refers to the South Australian operations

1 Overview

This is the Final Report of the Essential Services Commission's (**Commission**) inquiry into the efficiency of the South Australian bulk grain export supply chain (**supply chain)**. The previous Treasurer referred the Inquiry to the Commission in March 2017.

As established under the terms of reference (**Terms of Reference**), this Inquiry is into the cost efficiency of the South Australian bulk grain export supply chain, rather than into broader questions of pricing or equity in the grains sector.

The supply chain can broadly be categorised into three segments: freight transport, port facilities, and storage and handling. There are many suppliers of road freight services, placing competitive pressure on each other and on rail transport services. The Commission's regulatory oversight through its role under the rail access regime complements this competition. Given those factors, the Commission considers that the market for freight transport services is competitive. The Commission also considers that port services are subject to sufficient regulatory oversight so as to ensure a suitable proxy to competitive outcomes. As a result, this Inquiry has focused on the performance and behaviour of Viterra, given its position of strength within the supply chain.

As is clear from the Terms of Reference, the Inquiry's findings are intended to assist the Government in considering its policy position on three key State objectives, as follows:

- provide transparency in regards to bulk grain export supply chain costs in South Australia
- determine areas where future efficiencies may be achieved in the South Australian bulk grain export supply chain, and
- review the appropriateness of mechanisms used for funding road and rail components of the bulk grain export supply chain costs.

In that context, it is important to emphasise that this Inquiry's findings constitute neither a regulatory determination nor a binding decision – they are intended to and will inform broader public and policy debates on the cost efficiency of the South Australian grain export supply chain.

It is also important to highlight that this Inquiry report is based on the best evidence currently available to the Commission. Consultation on the draft Inquiry report (**Draft Report**), provided the opportunity for stakeholders to test, challenge and verify the evidence that had at that time been presented to the Commission and the analysis that the Commission utilised (in accordance with the Terms of Reference). Testing, challenging and verifying facilitated the preparation of this final Inquiry report (**Final Report**).

The Commission's finding is that the South Australian supply chain, at this time, is not demonstrably inefficient in terms of its costs. This is on the basis of the Commission not finding, or being presented with, any evidence of market power being exercised to the detriment of competition. This finding is based on:

- the available facts and evidence
- the costs and revenues that the Commission investigated, and
- both an overall and individual supply chain segment perspective.

Whether, and for how long, this situation continues will depend on Viterra's actions as a provider of export supply chain services, given its position of strength within that chain.

The Commission has not provided recommendations for addressing identified inefficiencies in supply chain costs (an option canvassed in the Terms of Reference). This is because it has not found areas where bulk grain supply chain costs are demonstrably inefficient, based on evidence the Commission received for this Inquiry.

1.1 Context

South Australia produces high quality grain and makes that grain available for export in a timely manner. But it is a small player in the worldwide bulk grain export market. For this reason, the South Australian supply chain:

- faces a continuing competitive threat from existing and emerging low cost producers
- has little influence on the global market, and is vulnerable to global trends, and
- operates under an imperative to reduce supply chain costs simply to maintain market share.

This Inquiry has focused on the performance and behaviour of Viterra, given its position of strength within the supply chain. Viterra has successfully extracted efficiencies from the supply chain by carefully controlling and managing bulk grain accumulation and travel within its upcountry-to-port system. These efficiencies, plus a focus on reducing operating costs, have allowed Viterra to drive down real operating costs per tonne—a prerequisite for it to maintain market share in the highly competitive global market for grains. While South Australia's grain growers may not perceive a direct tangible benefit, Viterra's actions have ensured that South Australia's product has remained competitive on the global stage. However, the decline in Viterra's real operating costs per tonne has not been accompanied by a similar drop in the fees charged to growers for its services. The result has been that Viterra's operating surpluses show a strong upward trend (notwithstanding poor returns for some individual years, such as those forecast for 2018-19) and the corresponding cash flow benefits have been retained to date by Viterra's owners and its shareholders.

This situation has both an equity and an efficiency dimension. This Inquiry's Terms of Reference relate only to supply chain cost efficiency and not to equity considerations directly. In that context, Viterra's behaviour from a supply chain cost efficiency perspective is socially and economically inefficient only if it results in Viterra sustaining a return, on average, that is demonstrably above what would be expected in a competitive market for a firm with Viterra's level of risk. For this to occur, Viterra would have to use its position of strength to protect and preserve its return from the eroding effects of competition.

Based on the available evidence, Viterra appears to be earning returns towards the upper end of, but not in excess of, what might be expected for a firm with its level of risk (on average across harvest years, but subject to significant year-on-year variations depending on harvest yields). Viterra appears to have focused on extracting supply chain efficiencies, rather than protecting and preserving unduly high returns.

These findings arise from the available evidence and do not represent an assessment of how the market may evolve. One possibility is that Viterra's operational efficiencies will continue, resulting in stronger returns if service fees are not reduced. In this case, Viterra might use its position of strength to exercise market power to the detriment of competition to protect these returns, or it might share some future gains with users of the supply chain (which may address growers' equity concerns).

1.2 Findings

A consolidation of the specific findings noted throughout the report is set out below.

Findings—overview of the supply chain

Australian grain benefits from being high quality, sustainable and clean. The South Australian grains industry needs to be responsive to changing and potentially more stringent customer demands for safe and traceable grain. While new entrants may need to account for this (depending on markets targeted), it is also the case that quality specifications should relate to genuine customer needs and not impose undue barriers to new competition.

South Australian production is counter-cyclical to the northern hemisphere, so Australian grain has a brief window of opportunity to maximise returns. (Finding 3.1)

South Australia is a small player in the global grain market. It must continue to pursue efficiency in supply chain costs to enable the industry to maintain its global competitiveness. (Finding 3.2)

Responding to the variability of harvests is an important aspect of the supply chain. Participants need to be able to manage costs in poor harvest years, while still having the capacity and capability to manage large harvests. Given the variability in grain production, high returns in good years may be necessary to offset poor returns from bad harvest years for participants to achieve a return commensurate, on average, with the overall level of risk that they face. (Finding 3.3)

The grain trading market in South Australia appears to be competitive, with 11 grain traders having booked shipping slot capacity with Viterra to export the 2016-17 grain harvest and 12 for the 2017-18 harvest. Given the low average per tonne margins on grain trades, traders rely on an efficient supply chain that can respond to variability. (Finding 3.4)

Viterra has a substantial market share of commercial bulk grain storage in South Australia. While total South Australian on-farm storage capacity has increased in recent years, it remains small compared with the eastern States. (Finding 3.5)

Genesee and Wyoming Australia (**GWA**) is the primary provider of freight rail services for bulk grain in South Australia, although the relatively short distances to port means road transport successfully competes with rail. (Finding 3.6)

Viterra has a substantial market share of supply chain port bulk grain loading services, with 91 percent of market share throughput in 2016-17. (Finding 3.7)

Findings—whether the supply chain is efficient

Supply chain freight and port services fees are being set on a competitive basis, as a result of the relevant markets being either competitive or subject to sufficient regulatory oversight. Viterra's upcountry storage and handling facilities are not covered by industry-specific economic regulation. Consequently, it is important that the performance and behaviour of Viterra has been assessed by the Commission, given its position of strength within the supply chain. (Finding 4.1)

Viterra faces some competition (actual and potential), for example, in the case of port operators, LINX-Cargill and Semaphore currently compete with Viterra at Port Adelaide, with new entrant T-Ports intending to compete with Viterra at Port Lincoln from the 2019 harvest. However, the extent to which competition places effective and credible discipline on Viterra's behaviour is not clear. The global market may place more effective discipline on Viterra's behaviour than any local competition could. (Finding 4.2)

Viterra seeks to measure its performance in meeting the customer service needs of growers, and it does so in a robust manner. It submitted evidence of its actions to improve customer service in response to customer feedback. These actions are consistent with a firm seeking to meet customer needs. (Finding 4.3)

Viterra appears to be operating as a cost effective bulk grain accumulator that can meet peak harvest demand and compete in the global context. (Finding 4.4)

Based on a sample of fees and grain paths, total upcountry-to-vessel loading fees have been broadly stable in recent years, having moved at an average rate only slightly above inflation from 2013-14 to 2017-18. Taking into account corporate structural issues, the Commission found no evidence that Viterra's fees are excessive compared with the total fees charged by its Australian counterparts, as shown by the Australian Export Grains Innovation Centre's (AEGIC) latest study of Australian supply chain costs. (Finding 4.5)

Based on the available evidence, Viterra is earning returns, on average, towards the upper end of what might be expected for a firm with Viterra's level of risk. The Commission's analysis of returns is consistent with its fee analysis, which showed that Viterra, to date, has not chosen to share efficiencies with industry through lower fees.

Future concerns may arise if the increasing trend in Viterra's operating surpluses (notwithstanding potentially incurring losses in poor seasons such as 2018-19) continues to the point at which returns become excessive, on average, relative to that expected for a firm with Viterra's risk profile. This may occur if Viterra continues to find efficiencies that reduce costs, without sharing the benefits with industry through lower fees. (Finding 4.6)

In relation to pricing behaviour, the Commission found possible evidence of a pricing structure that potentially serves as a barrier to new competition or expansion by existing competitors (specifically, the Receival at Port Service Fee (from Approved Third Party Storage)). The ACCC monitors this fee as part of its annual bulk wheat ports monitoring. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power.

Given the available evidence, the Commission considers Viterra's behaviour in relation to the remaining fees and practices which were investigated (Export Select, grower direct deliveries to port, capacity booking fee, lost capacity fee, shrinkage and dust rates, and the impact of vertical integration) is not, on its own, detrimental to the efficiency of the supply chain. (Finding 4.7)

A grower faces two sets of fees associated with a grain trade. Some Viterra fees are transparent and clear on the transaction statement that the grower receives from the trader. Other fees and the trader's margin (to earn a return) are not transparent and clear for specific grain movements and probably cannot be made transparent due to the commingled nature of the trader's grain, without a fundamental change in the operations of the industry.

Going forward, it should be possible to gain some understanding of Viterra's future performance through monitoring trends in supply chain fees (publicly available) and service levels (publicly observable). The absence of suitable published financial information places an onus on Viterra to publicly justify to its customers any future fee increases, particularly if service levels remain constant or decline. Failure to do so would result in Viterra risking customer disquiet, increasing the likelihood of future investigations or inquiries being undertaken and subsequent consideration of remedial measures.

The fact that there have been new entrants indicates that a potential competitor to Viterra who seeks to compete generally in the market for grains has access to sufficient information available for it to assess the viability of proposals. It can do this by considering whether or not it can match or better the Viterra fees for a particular service offering. This suggests that there is sufficient information for the market to work effectively from a signalling perspective. However, it is too early to assess the extent to which new and prospective entrants place a competitively significant constraint on Viterra's behaviour. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power that may undermine the potential for new and prospective entrants to provide a competitively significant constraint. (Finding 4.8)

Findings—other issues

Grain pooling is a tool available to growers to manage price risk and the grain industry should be well placed to manage issues associated with grain pooling. (Finding 5.1)

The public release of more grain stock information has both strong industry advocates and strong industry opponents. To the extent that the release of more stock information has net benefits, the grains industry should be able, by itself, to achieve the best outcome. (Finding 5.2)

The freight cost component of the supply chain costs is efficient, within the current economy-wide framework for establishing road user charges and identifying road investment priorities. The competitive road freight industry underpins efficient road and rail freight rates. This competition is complemented by regulatory oversight through the rail access regime. (Finding 5.3)

It is not clear that the practice of quality arbitrage is detrimental to the overall returns achieved by the grain industry. It does not seem to be an issue for growers, so long as they receive a price commensurate with the value of the grain on the global competitive market. (Finding 5.4)

Based on case study evidence, it cannot be concluded that site closures result in Viterra shifting costs to growers. From a total fees perspective, a grower may achieve a net reduction in their overall supply chain costs, despite sites closer to them being closed and having to transport their product to a site further away. (Finding 5.5)

1.3 Report contents and structure

This report presents the Commission's findings:

- Chapter 2 sets out the Commission's method for assessing the efficiency of the supply chain. It also explains various Inquiry process matters.
- Chapter 3 looks at how the South Australian grain export supply chain operates in the context of the world market. It also explains the roles of the major market participants.
- Chapter 4 investigates the efficiency of the supply chain. It reports the Commission's findings on whether any firms providing supply chain services are exercising market power to the detriment of competition. Viterra is the main focus, and the chapter examines Viterra's cost controls, management of assets, responsiveness to customer requirements, and level of financial returns and fees.
- Chapter 5 investigates issues relevant to the Inquiry Terms of Reference that are not covered in chapter 4. It focuses on evidence presented to the Economic and Finance Committee's Primary Producers' Inquiry.

Seven appendices provide supporting detail. Appendix G provides a list of the issues arising from consultation on the Inquiry Draft Report and the approach adopted in addressing them in this Final Report.

2 The approach to the Inquiry

2.1 About the Inquiry

The Inquiry was referred to the Essential Services Commission (**Commission**) under Part 7 of the Essential Services Commission Act 2002 (SA) (**ESC Act**).[1,2] Its Terms of Reference has two parts:

a) *In part 1 the Commission is to inquire into the South Australian bulk grain export supply chain (farm gate to export vessel) costs, including vessel loading charges over the past 10 years, having regard to:*

   (i) *the components of the bulk grain export supply chain costs (including vessel loading charges) and their efficiency*

   (ii) *harvest trends in South Australia over the past 10 years, and*

   (iii) *the basis upon which road and rail components of the bulk grain export supply chain costs are recovered.*

b) *As part 2 of the Inquiry, should the Commission find areas where bulk grain supply chain costs are identified as inefficient, options should be provided for addressing those inefficiencies.*

As established under the Terms of Reference, this Inquiry is into the cost efficiency of the South Australian bulk grain export supply chain (**supply chain**), rather than into broader questions of pricing or equity in the grains sector. As is clear from the Terms of Reference, the Inquiry's findings are intended to assist the Government in considering its policy position on three key State objectives, as follows:

- provide transparency in regards to bulk grain export supply chain costs in South Australia
- determine areas where future efficiencies may be achieved in the South Australian bulk grain export supply chain, and
- review the appropriateness of mechanisms used for funding road and rail components of the bulk grain export supply chain costs.

In that context, it is important to emphasise that this Inquiry's findings do not constitute a regulatory determination nor a binding decision – they are intended to and will inform broader public and policy debates on the cost efficiency of the grain export supply chain. It is also important to highlight that this Inquiry report is based on the best evidence available to the Commission. Consultation on the Inquiry Draft Report provided the opportunity for stakeholders to test, challenge and verify the evidence that had at that time been presented to the Commission and the analysis utilised by the Commission (in accordance with the Terms of Reference). Testing, challenging and verifying facilitated the preparation of this Inquiry Final Report, which will assist the Government's consideration of the State objectives and inform a wider public debate on grain export issues.

Appendix G provides a list of the issues arising out of consultation on the Inquiry Draft Report and the approach adopted in addressing them in this Final Report.

This Final Report presents the Commission's findings for Part 1. The Commission has not proceeded to undertake Part 2 of the Inquiry, given it has not found areas where bulk grain supply chain costs are demonstrably inefficient, based on evidence the Commission received for this Inquiry.

[1] Sections 36–38 of the ESC Act provide for certain requirements when conducting an inquiry.
[2] Appendix A reproduces the referral letter and subsequent variation letters.

The then Treasurer requested a variation to the Terms of Reference, so the timeframe for the Commission's submission of the Inquiry Draft Report to the Treasurer was extended beyond November 2017. The extension allowed the Commission to account for the evidence and findings of the:

- South Australian Parliament's Economic and Finance Committee Inquiry into Issues faced by Primary Producers final report (released 28 November 2017).
- Australian Export Grains Innovation Centre report into supply chain costs across Australia (released 1 November 2018).

A further variation to the Terms of Reference was issued by the Treasurer revising the final report submission date to 31 December 2018. This provided the Commission adequate time to consider issues that arose from consultation on the Inquiry Draft Report.

2.2 How the Commission assesses supply chain efficiency

This section establishes the general methodology or approach the Commission uses in undertaking efficiency assessments and to be adopted for this Inquiry.

The Commission assesses the efficiency of the supply chain by investigating whether there is any market structure or firm behaviour inhibiting a competitive outcome. Competitive markets generally deliver economic efficiency and, in turn, an efficient supply chain that provides and charges for goods and services at efficient cost. First, the Commission examines the structure of the relevant market, to consider a firm's ability to possess market power (section 2.2.2). Then, by examining firm behaviour, it considers whether there is evidence that a firm may be exercising such power in a sustained manner that has a material detrimental effect on competition (section 2.2.3).

However, structural and behavioural factors are not independent of each other. Strategic behaviour can alter market structure by raising or creating entry barriers.[3] It can also differ markedly among firms facing similar market structures.[4] So, the Commission seeks factual evidence of actual behaviour in the market under investigation.

2.2.1 Market power

Market power is a firm's ability to raise price persistently above efficient cost, to exclude competitors[5] or, more generally, to act in an unconstrained manner.[6] The firm may exercise market power to the detriment of competition by:[7]

- raising or maintaining price persistently above the competitive level (efficient cost) by restraining its own output, and/or
- preventing entry or otherwise raising the costs of more efficient potential competitors.[8]

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3 R. Smith and D. Round, 'A strategic behaviour approach to evaluating competitive conduct', *Agenda*, vol. 5, no. 1, 1998, p. 26, available at http://press-files.anu.edu.au/downloads/press/p104931/pdf/article03.pdf.

4 R. Smith and D. Round, p. 26.

5 Essential Services Commission, *2017 Ports Access and Pricing Review*, Final Report, September 2017, 'Glossary of terms', p. ii, available at http://www.escosa.sa.gov.au/ArticleDocuments/1026/20170911-2017PortsAccessAndPricingReview-Final.pdf.aspx?Embed=Y.

6 Essential Services Commission, *2017 Ports Access and Pricing* Review, Final Report, p. 5.

7 T. Krattenmaker, R. Lande and S. Salop, *Monopoly Power and Market Power in Antitrust Law*, Airlie House Conference on the Antitrust Alternative, The United States Department of Justice, 1987 (updated June 2015), viewed 4 June 2018, available at https://www.justice.gov/atr/monopoly-power-and-market-power-antitrust-law.

8 An example is an incumbent firm that owns infrastructure and raises competitor costs by charging higher access fees to the competitor to use the incumbent firm's facilities.

However, an inefficient outcome results from the firm's actual exercise of market power,[9] not from its ability to exercise market power. Accordingly, the Commission seeks evidence that a firm is exercising market power in a sustained manner that detrimentally affects market outcomes.[10]

The Commission also seeks to understand the degree to which any market power is being exercised.[11]

Natural monopolies, for example, have the potential to exercise market power in a sustained manner. They occur when high costs from duplicating the infrastructure to deliver services (such as when economies of scale exist) significantly limit efficient competition in the provision of those services. The absence of competition can adversely affect the long-term interests of consumers if the firm possesses and exercises market power by, for example, imposing unreasonable access terms and conditions on the use of its infrastructure, or setting excessive prices.[12]

While there is a clearly accepted definition of market power, and understanding of what the term means, determining whether a firm is exercising market power to the detriment of competition in a sustained manner is not necessarily straightforward.

2.2.1.1 Efficiency

Evidence that market power is being exercised in a material and sustained manner to the detriment of competition would be evidence that the supply chain is not efficient. Efficient cost is the lowest sustainable cost of providing goods and services at a given service standard, noting that a competitive market will continue to pursue lower costs and improved service standards over time. Alongside efficient prices, it is an expected outcome of effective competition in the market for a good or service.[13] For determining the efficient cost, the presence of any service standards and regulations (such as environmental and health requirements) are relevant.[14]

Various approaches can be used to assess the extent to which costs are efficient, and whether prices reflect efficient costs. These approaches include price (fee) and cost benchmarking, but benchmarking has the risk that some or all peer operators are inefficient. Another approach is to assess whether a firm's financial returns are excessive, on the basis that excessive returns may indicate prices are set well above costs. Efficient cost provides for a firm to earn a rate of (financial) return commensurate with the level of risk it faces.[15]

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9 A term synonymous with 'market power' is 'monopoly power' (see T. Krattenmaker, R. Lande and S. Salop).

10 Even firms in a competitive market might be expected to be able to exercise market power in the short term. Without this ability, firms would have no incentive to innovate or seek efficiencies. But a competitive market, by encouraging competitors to enter (or existing firms to adopt the innovation or efficiencies), means any higher financial return achieved by the innovating firm is soon competed away.

11 As discussed elsewhere in this report, a tradeoff may occur between the efficiencies that a single firm can achieve by fully exploiting scale economies for a given cost function (relationship between output and costs) and the efficiencies that multiple firms can achieve by competing (that is, by moving the cost function down). The presence of multiple firms could result in higher average costs for the overall industry if (notwithstanding the positive impact of competitive pressures) the sharing of industry output among more firms leads to higher unit costs due to the loss of economies of scale. For this reason, a monopolist (single firm) that can exploit economies of scale and that does not exercise market power to the detriment of competition (or does so only to a relatively low level) could achieve a superior outcome to a competitive market.

12 Essential Services Commission, *2017 Ports Access and Pricing Review,* Final Report, p. 7.

13 Economic Regulatory Authority, *The Efficient Costs and Tariffs of the Water Corporation, Aqwest and Busselton Water*, Final Report, 10 November 2017, p. 7, available at: https://www.erawa.com.au/inquiries/completed-inquiries/2016-inquiry-into-the-efficient-costs-and-tariffs-of-the-water-corporation-aqwest-and-busselton-water.

14 Economic Regulatory Authority, *The Efficient Costs and Tariffs of the Water Corporation, Aqwest and Busselton Water*, p. xxi.

15 An economic term for this is a 'normal' rate of return, or 'normal profit'. A return in excess of this can be considered a 'super-normal profit', other similar terms being 'excessive profit', 'economic rent', or 'monopoly rent'.

2.2.2 Market structure

Market structure is examined to assess a firm's ability to possess market power. Compared with assessing market behaviour (section 2.2.3), assessing market structure is generally more straightforward, and accounts for:

- the level of market concentration (and whether an incumbent firm has a large market share)
- the extent of supply side substitution (that is, the ability of alternative firms to increase their output in response to a relative price rise by the incumbent firm), which depends on the extent of any barriers to entry, expansion, mobility or exit,[16] and
- The extent of demand side substitution (that is, the ease with which customers can switch from an incumbent firm to an alternative firm in response to a change in relative price). Put another way, this is the extent of countervailing power held by customers (which may include the ability to threaten other options to constrain the firm).[17]

A single operator (or small number of operators) having a high market share, in a market with low levels of substitutability, would not constitute conclusive evidence that one firm or a group of firms is exercising market power to the detriment of competition. But it would indicate the need to question how all firms in the market operate and interact, to check whether market power is being, or has been, exercised to the detriment of competition (section 2.2.3).

2.2.3 Market behaviour

Observing a firm's market behaviour to assess whether the firm is exercising market power to the detriment of competition is difficult. It involves identifying that a firm's action has the effect of excluding competitors or denying them an equality of opportunity to compete.

New entry (or the expansion of existing competition) drives market efficiency, but such entry has to be sustainable. For a market to be considered contestable (that is, at least open to competition), an incumbent firm needs to feel ongoing pressure from the realistic prospect of a competitor's sustained entry (or from action by an existing competitor). Further, that prospect would have to pose a material threat to any attempt by the incumbent firm to exercise market power ('hit and run' or transient entry will not achieve this threat).[18] Consequently, in a competitive market, any attempt to exercise market power will have only a transitory impact. Behavioural analysis thus needs to cover a period of time (and not be just a static analysis), consistent with competition being a process rather than a situation.

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[16] Economies of scale can act as a barrier to entry, potentially deterring new entrants if they believe they need to sell large volumes before they can be competitive with existing firm(s). Well established firms may respond to a new entrant by lowering prices in an attempt to raise barriers to entry by making a new entrant's services less competitive. This response may be an easy option for an incumbent enjoying economies of scale and previously charging above efficient cost. Well established firms may respond in a similar fashion to existing competitors seeking to expand their production and/or level of services provided. Barriers to exit make it more difficult for a firm to get out of a particular business, and may make a new entrant reluctant to enter for fear of loss of investment (*The Economist*, 'Barriers to entry, exit and mobility', Online extra, 13 July 2009, viewed 4 June 2018, available at http://www.economist.com/node/14025576).
Barriers to entry are a matter of degree; the issue is whether they are high enough to materially impact the efficacy of competition (S. Bishop, S. Meyrick and P. Williams, *Expert joint statement,* Application by Sea Swift Pty Ltd, Australian Competition Tribunal, 1 June 2016, p. 3, available at http://www.competitiontribunal.gov.au/current-matters/tribunal-documents/act-2-2016).

[17] Australian Competition Tribunal, *Application by Sea Swift Pty Limited* [2016] ACompT 9, 28 July 2016, Reasons for Determination, paragraph 269, available at http://www.judgments.fedcourt.gov.au/judgments/Judgments/tribunals/acompt/2016/2016acompt0009.

[18] S. Bishop, S. Meyrick and P. Williams, *Expert Joint Statement*, p. 5.

Table 2.1 Evidence to assess the efficiency of the supply chain

Behaviour	Evidence
Barriers to supply side substitution	Is there evidence that the firm is engaging, or has engaged, in the following types of strategic behaviour systematically and on a sustained basis, or in other behaviour that could be characterised as strategic conduct designed to deter new entry, or expansion by smaller firms? ▶ Physical barriers at port ▶ Pricing practices ▶ Non-pricing practices.
Restriction of competition in upstream and downstream markets	Is there evidence that the firm is engaging, or has engaged, in strategic behaviour, or has engaged in similar types of conduct on a systematic and sustained basis as a result of being part of a vertically integrated entity?
Barriers to demand side substitution	Is there evidence that the firm is engaging, or has engaged, in the following strategic behaviour, or has engaged in similar types of conduct on a systematic and sustained basis? ▶ Restricting or hindering customer access to alternative providers.
Prices above efficient cost	Is there evidence that the firm, on a systematic and sustained basis, is: ▶ setting prices (fees) above efficient cost? ▶ earning a return above that commensurate with its risk? ▶ failing to provide customers with a reasonable share of the benefits of any efficiencies achieved?
Lack of customer service and innovation	Is there evidence that the firm, on a systematic and sustained basis: ▶ is failing to provide service that meets customer needs? ▶ has a poor record in delivering innovation?
Behaviour of new entrants or existing small competitors	What can be learnt from the behaviour of new entrants or existing small competitors failing to expand—for example: ▶ are competitors small in number and satisfied with being niche players? If so, why? ▶ are new entrants operating at a loss for an extended period,[19] which places into question the sustainability of the competition? ▶ are new entrants cherrypicking, with the risk that overall supply chain costs are higher?
Insufficiently informed market	To what extent is there relevant information that is not publicly available and that materially impacts the efficiency of the supply chain?

[19] In a competitive market, a new entrant might be expected to operate at a loss initially.

2.2.3.1 Evidence that the Commission seeks

The Commission seeks evidence (Table 2.1) that enables it to assess whether a supply chain firm is exercising market power to the detriment of competition in a systematic and sustained manner. A specific action or behaviour undertaken by a firm is likely, however, to have more than one interpretation—for example, for an action that might be interpreted as an exercise of market power, the incumbent firm may provide a credible operational efficiency justification. In this case, the Commission has to 'weigh up' the facts and come to an on-balance interpretation of the action or behaviour. Further, while a single specific strategy may appear anti-competitive in isolation, the Commission needs to consider whether the overall impact of a firm's collective actions may result in a competitive outcome.[20]

2.2.4 Other sources of market failure

There are potential sources of market failure[21] other than the exercise of market power to the detriment of competition. Information asymmetries, for example, can result in inefficient outcomes. In this case, one party holds information that is important to another party to a transaction, creating a power imbalance. Markets generally work best when all relevant parties, including potential market entrants, are well informed.

The Commission seeks to identify whether these other sources of market failure exist and impact on the efficiency of the supply chain in a material way.

2.3 Inquiry process

The Inquiry's Terms of Reference (Appendix A) required the Commission to:

- work collaboratively with Primary Industries and Regions SA (PIRSA), the South Australian Department of Planning, Transport and Infrastructure (DPTI) and the Department of Treasury and Finance (DTF)
- investigate the potential to work with the Australian Export Grains Innovation Centre (AEGIC) as a consultant for the Inquiry, and
- conduct a public consultation, in a manner considered appropriate by the Commission.

The Commission established a reference group—comprised of representatives from PIRSA, the DPTI and the AEGIC—to provide expert advisory assistance. It has kept DTF officers informed (in their support role to the Treasurer as referring Minister) of the Inquiry's progress. The Commission appreciates the assistance provided by the Reference Group and DTF.

2.3.1 Consultation

The Commission adopts a systematic approach to consultation to help identify and address all relevant issues, and to allow all stakeholders to provide input.[22]

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[20] A point made in R. Smith and D. Round, p. 26.

[21] In economic terms, a market failure is a situation in which the allocation of goods and services is not efficient. Market failures are often associated with the exercise of monopoly power, information asymmetries, externalities, time-inconsistent preferences and principal-agent problems.

[22] Essential Services Commission, *Charter of Consultation and Regulatory Practice*, September 2014, available at https://www.escosa.sa.gov.au/ArticleDocuments/567/20140910-Corp-CharterConsultationRegulato.pdf.aspx?Embed=Y.

2.3.1.1 Consultation on Terms of Reference

The Commission requested submissions on the Inquiry Terms of Reference in April 2017, and received submissions from:[23]

- PIRSA
- Grain Producers SA (GPSA)
- South Australian Freight Council (SAFC)
- Viterra, and
- John Hill and Philip Norman (private individuals).

The Commission also held meetings[24] to discuss issues related to the Terms of Reference with:

- growers
- traders (buyers)
- grain industry associations
- other state and federal regulators
- other government departments
- supply chain service providers
- Genesee and Wyoming Australia Pty Ltd (GWA)
- Flinders Ports, and
- Viterra.

2.3.1.2 Consultation on Inquiry Draft Report

The Commission released for public comment the Inquiry Draft Report in August 2018, and received submissions from:[25]

- Grain Producers SA (GPSA)
- South Australian Freight Council (SAFC)
- Viterra, and
- John Hill (a private individual).

Commission staff also made presentations on the Inquiry Draft Report to:

- just over 90 stakeholders, mainly growers, across South Australia at the following towns: Wudinna, Cummins, Minlaton, Mallala and Peake, and
- Grain Industry Association of South Australia (GIASA).

[23] All submissions to the Inquiry Terms of Reference are available at http://bit.ly/InquirySABulkGrainSupplyChain.
[24] Face-to-face in most cases, and by teleconference in the case of interstate agencies.
[25] Copies of the Inquiry Draft Report, presentation pack and submissions received are available at http://bit.ly/InquirySABulkGrainSupplyChain.

The Commission appreciates the assistance provided by GPSA, particularly Mr Shane Gale (Policy Officer), in organising and promoting these presentations, and in encouraging growers to attend.

Presentations were also made to:

- GPSA Transport and Supply Chain Committee, and
- New entrants: Steering Committee for the Central Eyre Iron Project Task Force

Meetings, telephone discussions and/or email exchange[26] were held with:

- GPSA
- Viterra
- Australian Competition and Consumer Commission (**ACCC**)
- two traders
- John Hill
- new entrants: T-Ports and a grower involved with the Decres Bay proposal, and
- a small number of growers.

2.3.2 Other evidence

In addition to evidence provided through submissions, the Commission sought to minimise information gaps (where information is not publicly available) by directly requesting information from some of the firms that provide supply chain services. For the initial stages of the Inquiry, the Commission also engaged an industry consultant to advise on technical aspects of the grain sector.

In accordance with the December 2017 variation to the Inquiry Terms of Reference (Appendix A), the Commission has considered:

- the evidence provided to the Economic and Finance Committee, as detailed in chapter 12 of the Committee's November 2017 report *From the paddock to the plate—a fair return for producers*,[27] and
- an AEGIC study of grain supply chain costs across Australia.[28] Throughout the course of the Inquiry, AEGIC provided detailed copies of its spreadsheets, draft versions of its report, and further supporting material requested by the Commission.

The Commission appreciates the assistance provided by AEGIC staff, including Dr Peter White (Senior Projects Manager) and Professor Ross Kingwell (Chief Economist and member of the Commission's Reference Group).

The Commission:

- had access to grain export data supplied to the ACCC by Australian Crop Forecasters
- made ten formal requests for information to Viterra, to which Viterra responded in a timely manner
- made one request for information to GWA, and

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[26] Where emails were received from stakeholders, it was clarified with the sender as to whether they wished the email to be treated as a submission or background information.

[27] Economic and Finance Committee, *From the Paddock to the Plate—a Fair Return for Producers*, 97th Report, 28 November 2017, available at https://www.parliament.sa.gov.au/Committees/Pages/Committees.aspx?CTId=5&CId=173.

[28] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, available at https://www.aegic.org.au/wp-content/uploads/2018/11/FULL-REPORT-Australias-grain-supply-chains-DIGITAL.pdf.

- received from growers a small sample of trader transaction statements.

The Commission appreciates the assistance provided by Viterra management and staff throughout the course of the Inquiry. The Commission appreciates the ACCC's assistance in providing it with a licence to use the data for this Inquiry and to the other stakeholders that assisted the Commission in providing evidence.

2.3.3 Other

The matters raised in consultation have been considered and, where relevant, arguments and submissions have been referred to in this report to assist stakeholders to understand the positions reached. All submissions have been useful in helping to understand the factual underpinning of the industry, key relevant issues and the competing viewpoints. They have informed the Commission's consideration of each of the relevant issues; a failure to reference an argument or submission does not mean that it has not been taken into account. In particular, Appendix G provides a list of issues arising out of consultation on the Inquiry Draft Report, and the approach adopted in addressing them in this Final Report.

Through consultation the Commission has received information from stakeholders over which confidentiality has been claimed. The Commission has decided not to disclose information in this report, in part or in total, which is subject to such a claim. Appendix C outlines the Commission's data verification process.

The Commission thanks all stakeholders that provided input into the Inquiry.

3 Overview of the supply chain

Chapter summary

- The supply chain can broadly be characterised into three segments: freight transport, port facilities, and storage and handling.
- Australian grain benefits from being high quality, sustainable and clean. The South Australian grains industry needs to be responsive to changing and potentially more stringent customer demands for safe and traceable grain. Whilst new entrants may need to account for this (depending on markets targeted), it is also the case that quality specifications should relate to genuine customer needs and not impose undue barriers to new competition.
- Production is counter-cyclical to the northern hemisphere, so Australian grain has a brief window of opportunity to maximise returns.
- South Australia is a small player in the global grain market. It must continue to pursue efficiency in supply chain costs to enable the industry to maintain its global competitiveness.
- Responding to the variability of harvests is an important aspect of the supply chain. Participants need to be able to manage costs in poor harvest years, while still having the capacity and capability to manage large harvests. This means good harvest years cover bad years.
- Grain trading in South Australia appears to be competitive.
- Viterra has a substantial market share of commercial bulk grain storage in South Australia.
- GWA is the primary provider of freight rail services for bulk grain in South Australia, although the relatively short distances to port mean road transport successfully competes with rail.
- Viterra is the main provider of supply chain port bulk grain loading services, with 91 percent of market share throughput.
- South Australia's total on-farm storage capacity has increased in recent years, but remains relatively small compared with the eastern States (as a proportion of total state storage capacity).

This chapter provides an overview of how the supply chain operates in the context of the world market. It also explains the roles of the major market participants in South Australia. It highlights that the supply chain, while operating as a whole system, can be broadly categorised into three market segments (storage and handling, freight transport to port, and port services).

3.1 South Australia's place in the bulk grain export market

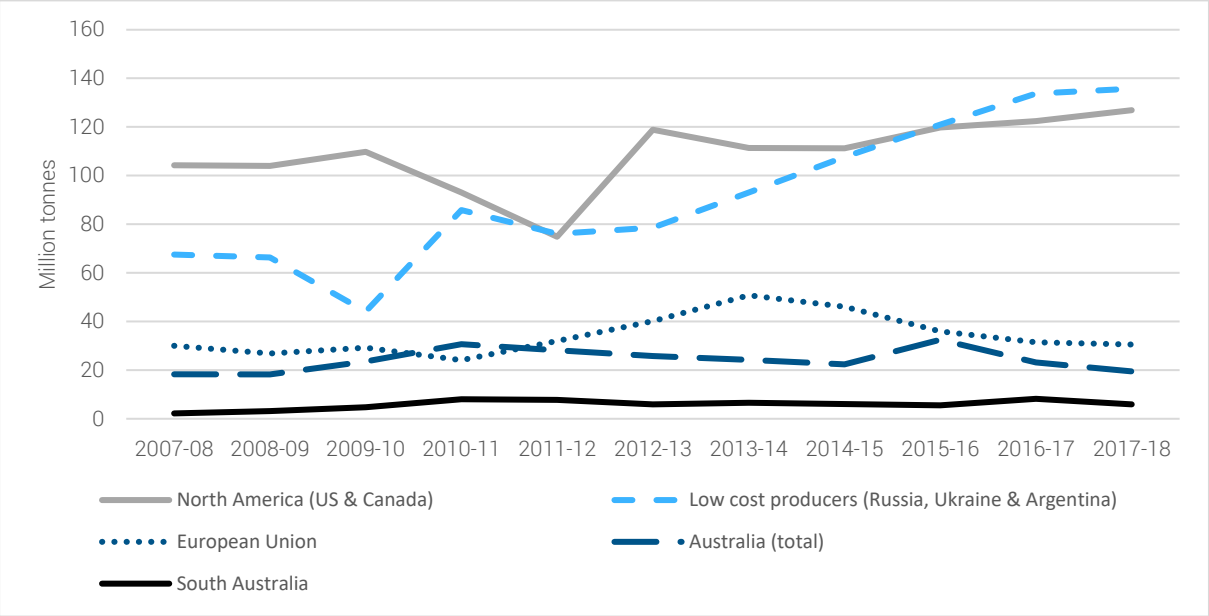
South Australia is a relatively small player in the global market for bulk grain. Figure 3.1 illustrates how South Australia's grain export (by volume) has evolved over the past 10 years. South Australia's presence on the global market is relatively static, despite growing demand from Asia. This characteristic largely reflects continued pressure from international low cost producers (Russia, Ukraine and Argentina) that ensures South Australia has to remain competitive simply to retain market share.[29] As the Department of Agriculture and Water Resources noted, future improvements in the

[29] South Australia's share of global exports (by volume) averaged 2.2 percent for the 11 year period (2007-08 to 2017-18), falling within a range of 1.0–3.6 percent (Figure 3.1).

quality and stability of Black Sea wheat exports could displace exports from higher cost producers, including Australia.[30]

South Australia exports much of its grain production into the global bulk grain export market, which is worth around US$200 billion per year.[31] That market is highly competitive. South Australia competes with other Australian states, Canada, the United States of America, France, Germany, Russia, Ukraine and Argentina to supply grain (Figure 3.1). The 2016-17 South Australian grain harvest was valued at $2.2 billion (value at the farm gate),[32] which is 2 percent of the South Australian gross state product[33] and around 19 percent of the value of total South Australian exports[34]. Its share of total Australian grain exports by volume averaged 24 percent (Figure 3.1) for the period 2007-08 to 2017-18.

Figure 3.1 Grain exports by country versus South Australia, by volume, 2007-08 to 2017-18[35]



Source: US Department of Agriculture.

Australian supply chain costs are higher than most of its competitors, except for Canada. This, in part, explains the increasing market share of the low cost producers.[36] AEGIC estimates that total Australian wheat supply chain costs are 49 percent higher than Ukraine (2015-16), 52 percent higher than Russia (2016) and 14 percent higher than Argentina (2017).[37]

30 Department of Agriculture and Water Resources (DAWR), *Review of the Wheat Port Access Code of Conduct*, Final Report, 18 October 2018, p. 14, available at https://haveyoursay.agriculture.gov.au/review-of-the-wheat-port-code.

31 Rabobank, 'Grow with the flow', *Rabobank Industry Note 541*, March 2016, viewed 4 June 2018, available at https://research.rabobank.com/far/en/sectors/grains-oilseeds/grow-with-the-flow.html.

32 Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 2.

33 South Australian gross state product (GSP) at June 2017 was $101.8 billion. Source: ABS, *Australian National Accounts: State Accounts, Table 1, Gross State Product, Chain Volume Measures and Current Prices*, Series ID A2336349V, available at http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5220.02016-17?OpenDocument.

34 The value of South Australia's overseas goods exports totalled $11.6 billion in the 12 months to July 2017. Source: Department of Premier and Cabinet, Government of South Australia, *SA Overseas Goods Exports, July 2017*, p. 1, available at https://www.dpc.sa.gov.au/__data/assets/pdf_file/0003/20586/OS-Goods-exports_July-2017.pdf.

35 US Department of Agriculture, *Dataset*, viewed 14 November 2018, available at https://apps.fas.usda.gov/psdonline/app/index.html#/app/downloads. In the absence of independently published grain export figures, South Australian export volumes in Figure 3.1 are based on Viterra's export grain tonnages (information request), adjusted from 2015-16 to take account of new entrant port terminal operators (Figure 3.8). 2017-18 South Australian export figure derived using 2016-17 adjustment factor.

36 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p.86.

37 AEGIC, *Australia's Grain Supply chains: Costs, Risks and Opportunities*, October 2018, p.87.

Viterra and GPSA submitted that South Australian grain is high quality, sustainable, traceable and clean.[38] Another advantage (for the other Australian states too) is that South Australian grain production is counter-cyclical relative to the northern hemisphere. South Australian grain producers thus have a window of opportunity (December to May) to sell to international markets when there is less global supply. To maximise the value that can be obtained during that window, participants in the South Australian bulk grain export market need to move bulk tonnages quickly before northern hemisphere grain is available.[39] The task of the supply chain is to maintain quality and facilitate efficient grain movement, which is why it is important to South Australia.

Overall, Australian growers cannot compete in the world market on price alone. High quality product is necessary to maintain existing markets and potentially open the door to new markets. It is important that the grains industry remains vigilant to potentially greater customer demands for even more safe for consumption and traceable grain. All participants (including growers and traders) need to understand the likely consequences of not meeting the quality standards end-users (customers) expect. This includes possible spill over effects for adjacent supply chains, with the potential for whole ports or regions to be blacklisted. However, it is also the case that quality specifications should relate to genuine customer needs and not impose undue barriers to new supply chain competition developing.

Further, to maintain competitiveness in the global grain market, South Australian participants need to operate at scale in a cost-effective manner that gets the right amount of grain to the right place at the right time, and at the required quality. This complex logistical task challenges all operators competing in the global market for bulk grain. If South Australia fails to meet this challenge, end users will find alternative suppliers, to the detriment of the South Australian grain industry.

3.1.1 South Australian grain in a national context

In Australia, on average, Western Australia is the largest grain production state (about 13 million tonnes per year), followed by New South Wales (10 million tonnes), South Australia (7 million tonnes) and Victoria (5 million tonnes) (Figure 3.2).[40] South Australia and Western Australia are export focused markets, each exporting around 85 percent of their grain production.[41] New South Wales and Victoria have larger domestic markets, on average exporting only around 50 percent of their grain production.

A significant portion of South Australia's grain growing occurs close to the coast, with two sea gulfs dividing the growing regions. This arrangement has resulted in railways being divided into the Eyre Peninsula, and that portion of the South Australian land mass east of the Spencer Gulf (**eastern South Australia**) (section 3.3.3), and in a relatively high number of grain port terminals (section 3.3.4).

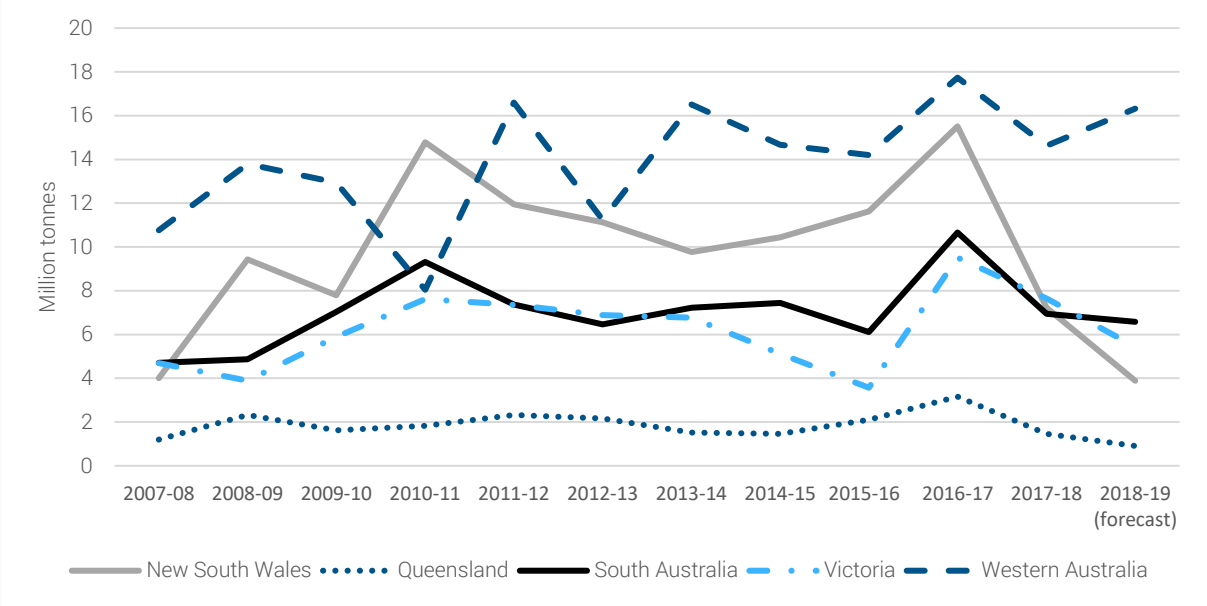
[38] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 2; GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 3.

[39] GPSA submitted grain delivery in a timely, convenient and economical manner with segregation options is the main factor during harvest. Source: GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 3.

[40] PIRSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 4.

[41] PIRSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 4.

Figure 3.2 State grain production, by volume, 2007-08 to 2018-19[42]



Source: ABARES and Commission.

Finding 3.1

Australian grain benefits from being high quality, sustainable and clean. The South Australian grains industry needs to be responsive to changing and potentially more stringent customer demands for safe and traceable grain. While new entrants may need to account for this (depending on markets targeted), it is also the case that quality specifications should relate to genuine customer needs and not impose undue barriers to new competition.

South Australian production is counter-cyclical to the northern hemisphere, so Australian grain has a brief window of opportunity to maximise returns.

Finding 3.2

South Australia is a small player in the global grain market. It must continue to pursue efficiency in supply chain costs to enable the industry to maintain its global competitiveness.

3.2 South Australian harvest trends

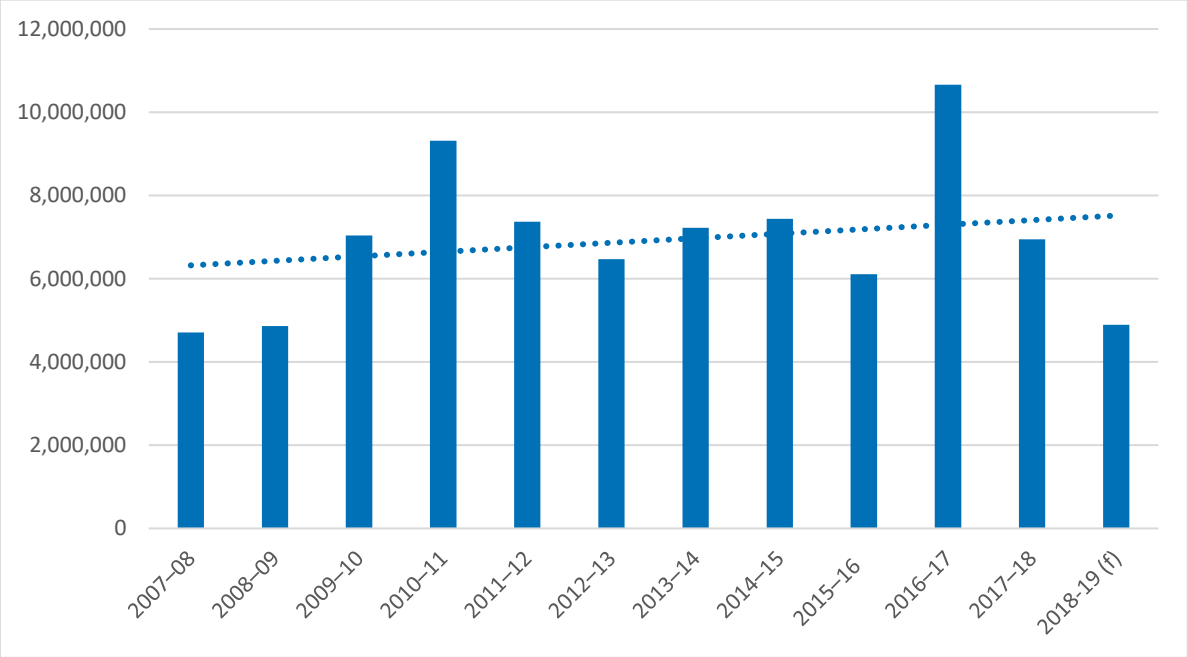
The Inquiry Terms of Reference require the Commission to consider harvest trends in South Australia over the past 10 years.[43] During the period 2007-08 to 2018-19 (forecast), harvest totals have varied from 4.7 million tonnes to 10.7 million tonnes (Figure 3.3). Given South Australian grain production is entirely rain fed, this harvest variation is largely attributable to the climate and seasonal rain. Responding to this variability is an important aspect of the supply chain. To be viable, the supply chain participants should be able to manage costs in poor harvest years, while having the capacity and capability to manage large harvests.

[42] ABARES, *Agricultural Commodities and Trade Data: Australian Crop Report*, September 2018, viewed 14 November 2018, available at http://www.agriculture.gov.au/abares/research-topics/agricultural-commodities/agricultural-commodities-trade-data#crops.

[43] At the start of the Inquiry, 2007-08 represented the first year for a 10 year period. Given time passing in producing this report, the Commission chose to add 2017-18 and 2018-19 forecast as the results became available, effectively creating 12 years of data.

South Australia has about 5000 grain producers, which sow around 4 million hectares of crop each year.[44] The majority of crop is sown in April–May and harvested from late September. Wheat and barley are the largest crops, comprising around 59 and 20 percent respectively of the state's total harvest. Other crops grown include pulses (such as lentils, peas, beans, chickpeas and lupins—9 percent in total), canola (7 percent) and other cereal crops (5 percent).[45]

Figure 3.3 South Australian harvest trends (tonnes) 2007-08 to 2018-19[46]



Source: PIRSA.

3.2.1 Production trends

Improved farming systems and new plant varieties have increased the reliability of the grain yields in South Australia over the past 10 years.[47] Harvests increased as growers increased the proportion of farm area dedicated to crop,[48] and plant breeders continued to deliver higher yielding varieties. In addition, many growers adopted zero tillage techniques, enabled by chemical spraying of weeds, faster seeding equipment, and grain varieties that perform better with early sowing.[49] Combined with the use of more nitrogen fertiliser, those changes increased yields in many regions despite drier conditions.[50]

3.2.2 Technology trends

Advances in technology also increased the rate of harvest. Larger harvesters can harvest greater volumes in less time; when combined with chaser bins and mobile field bins, they led to increased

44 GPSA, *Grain Facts*, viewed 10 May 2018, available at http://grainproducerssa.com.au/about/grain-facts/.

45 PIRSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 4.

46 Revised 2017-18 harvest and 2018-19 forecast from PIRSA, *Crop and Pasture Report South Australia, 2018-19 Spring Crop Performance*, November 2018, available at http://www.pir.sa.gov.au/__data/assets/pdf_file/0008/335960/PIRSA_Crop_and_Pasture_Report_Nov_2018-19.pdf.

47 AEGIC, *Australian Grain Production—a Snapshot*, August 2016, viewed 10 May 2018, available at http://aegic.org.au/australian-grain-production-a-snapshot/.

48 R. Kingwell, 'Changes in grain handling catchments in Australia: an historical perspective', *The Australian Journal of Agricultural and Resource Economics Society,* March 2017, p. 11, available at http://onlinelibrary.wiley.com/doi/10.1111/1467-8489.12206/abstract.

49 GPSA submitted the long-term trend in harvest is due to not only timely rain events, but also improved agronomic practices by grain producers and the use of higher yield varieties: GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 6.

50 AEGIC**,** *Australian Growers are Planting One Month Earlier than 30 Years Ago*, February 2016, viewed 10 May 2018, available at http://aegic.org.au/australian-growers-are-planting-one-month-earlier-than-30-years-ago/.

volumes of grain harvested per day over recent decades. Since the mid-1980s, for example, grain harvest rates increased by over three times.[51] The increases in yield and harvesting capacity led to an increase in the size of grain transport trucks, as many farmers invested in larger trucks to reduce the time taken to remove harvested grain from the farm.

Finding 3.3

Responding to the variability of harvests is an important aspect of the supply chain. Participants need to be able to manage costs in poor harvest years, while still having the capacity and capability to manage large harvests. Given the variability in grain production, high returns in good years may be necessary to offset poor returns from bad harvest years for participants to achieve a return commensurate, on average, with the overall level of risk that they face.

3.3 South Australia's bulk grain export supply chain

The South Australian bulk grain export supply chain can be split logistically and transactionally:

- Logistically, its three main segments are upcountry handling and storage, freight transport to port, and port services (including export bulk loading facilities) (Table 3.1).
- Transactionally, grain trading is undertaken via traders operating on the global market.

Table 3.1 Market segments of the supply chain

Service category	Description
Storage and handling	Getting grain to an off-farm storage facility and storing the grain at that facility. This service covers: ▶ receiving grain (inturning) ▶ storing grain at receival sites and pest management ▶ screening grain before storage to ensure it meets required quality standards ▶ outturning grain.
Freight transport to port	Freight transport of the grain from a storage facility to port. The grain can be freighted from an off-farm storage facility or the grower's own storage facility. Depending on where the grain has come from, this service can include screening the grain before its storage at the port.
Port Services	Port services cover: ▶ access to shipping berths and associated services to bring a vessel to port ▶ access to specialist loading equipment to load grain onto the vessel.

Source: Essential Services Commission.

[51] R. Kingwell, 'Changes in grain handling catchments in Australia: an historical perspective', p. 12.

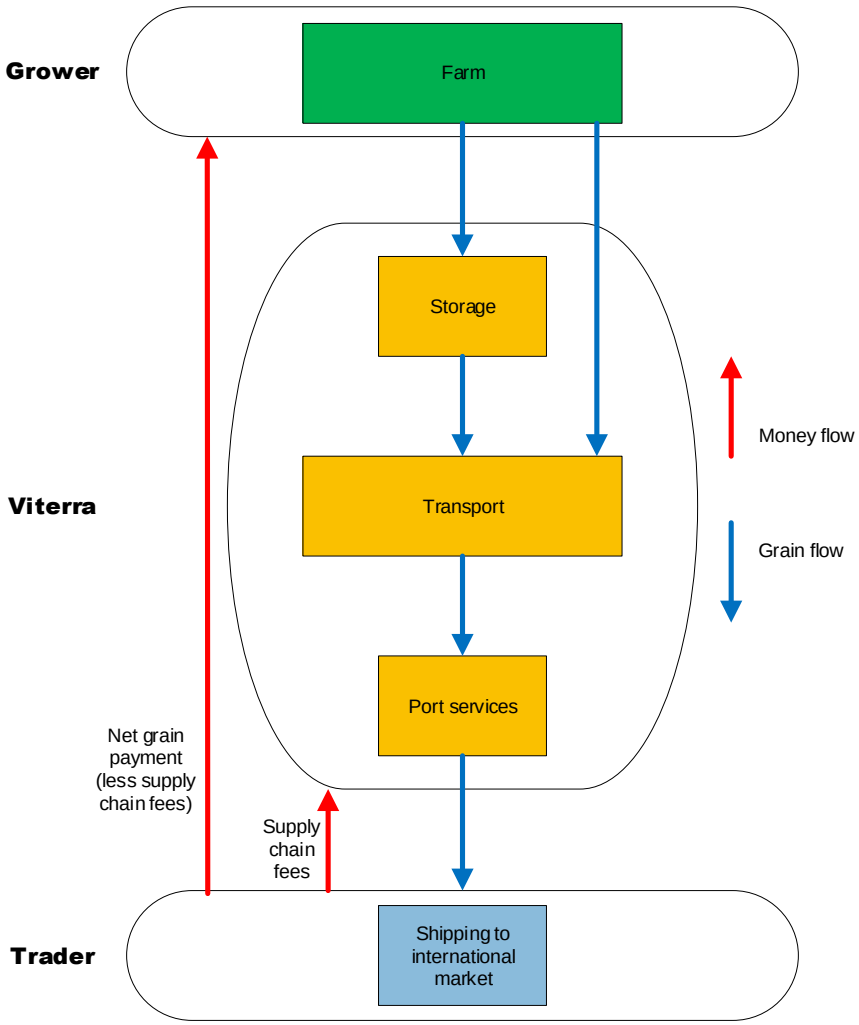
Figure 3.4 shows the logistical (physical) and transactional (financial) flows.[52] The *downward pointing blue arrows* show the physical flows, which are either:

- growers delivering to Viterra's upcountry storage, with Viterra then handling the transport to port storage via Export Select (left-most blue arrow), or
- growers delivering direct to port storage (right-most blue arrow).

From the port storage, the grain is outturned to vessels through the port terminal loading facilities (bottom two blue arrows). The *upward pointing red arrows* show the financial flows, which are:

- traders paying Viterra for all the supply chain services that Viterra provides (right-most red arrow)
- traders then making a net payment (grain price less supply chain fees) to the grower (left-most red arrow).

Figure 3.4 Physical and financial flows on grain export supply chain



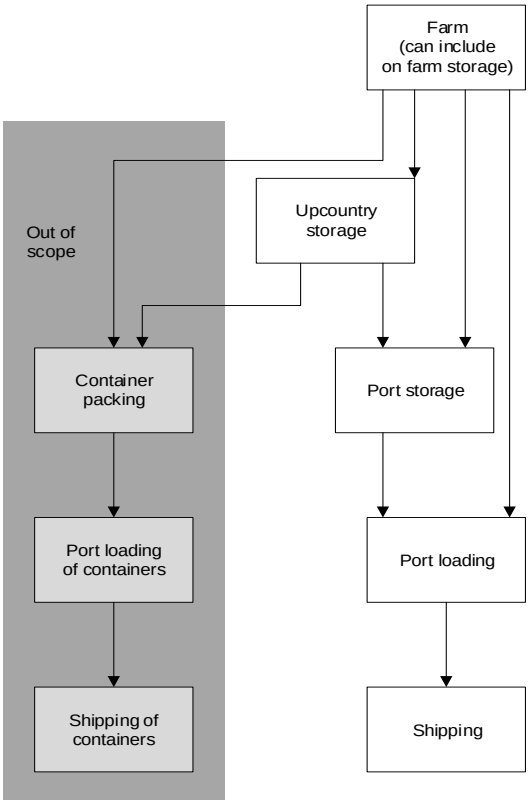
Source: Essential Services Commission.

[52] The Inquiry is not directly concerned with domestic use of bulk grain, or with containerised grain exports. The Inquiry Terms of Reference state 'In Part 1 [of the Inquiry] the Commission is to inquire into the South Australian bulk grain export supply chain (farm gate to export vessel) cost including vessel loading charges …'.

Viterra has a substantial market share of commercial bulk grain storage in South Australia (Finding 3.5). The transport segment comprises rail, which is regulated (section 4.2.1), and road, which is competitive (section 4.2.2). The relevant port services are also regulated (section 4.2.3), with Viterra's market share of supply chain port bulk grain throughput being 91 percent in 2016-17 (Finding 3.7). Viterra's upcountry storage and handling facilities are not covered by any industry-specific economic regulation. Consequently, the Commission has assessed Viterra's performance and behaviour, given its position of strength within the supply chain (Finding 4.1).

In practice, however, bulk grain exports can get to port via a number of paths (Figure 3.5), and a number of grain types are involved.

Figure 3.5 Supply chain pathways[53]



Source: Essential Services Commission.

The Commission investigated the efficiency of the supply chain for the predominant grain type[54] traversing the predominant path.[55] The main supply chain under investigation covers:

- bulk wheat (because wheat is the largest grain crop produced in South Australia)[56]
- bulk grain delivered by farmers to Viterra's upcountry sites (because 75 percent of grain received by Viterra is delivered to an upcountry site)[57]
- use of Export Select by export traders to deliver bulk grain to Viterra's ports (because most bulk grain movement from Viterra upcountry sites to Viterra ports uses Export Select)[58]

53 Shaded area designates services out of the scope of the Inquiry.
54 Other grain types share similar processes and practices.
55 We discuss variations where they are material to the investigation of supply chain efficiency.
56 The five year average wheat (bread plus durum wheats) production for South Australia (2012–2017) was 4,954,400 tonnes over the total of 8,282,300 tonnes for all grain crops, representing 60 percent of total crop production (source: PIRSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 11).
57 Viterra submitted 'direct delivery [to port] is provided as a service to nearby growers and represents 25% of total receivals'.
58 Viterra response to request for information, which Viterra has claimed as confidential.

- loading of bulk wheat onto vessels using Viterra's port terminal facilities (because these facilities service 100 percent of loading for the supply chain pathway adopted).[59]

3.3.1 How grain is traded

Grain export traders' relevance to the Terms of Reference relates to:

- traders being involved in the financial flows associated with the supply chain (Figure 3.4)
- traders' role as an intermediary and the extent to which traders act as a countervailing force to reduce supply chain fees
- traders' potential to provide relevant evidence on the market behaviour of Viterra, and
- the extent to which traders operating in the global context can place competitive pressure on Viterra to operate efficiently (section 4.3.1).

The Terms of Reference do not cover the price growers receive for their grain, or the extent to which the trader market reflects the world price through to the grower.

Grain export traders are 'buyers' that purchase grain from growers for export or to sell to the domestic market and are sometimes referred to as simply exporters or traders. They arrange transport, logistics and shipping options. Grain trading appears competitive in South Australia, with a high number of grain traders having booked shipping slot capacity with Viterra to export grain – 11 for the 2016-17 grain harvest, and 12 for the 2017-18 harvest[60]. Further, no individual trader had more than 50 percent of Viterra's business for 2016-17. The top three exporters for that year were Glencore, CBH Ltd (CBH) and ADM Trading Australia Pty Ltd (ADM).[61]

The Wheat Port Code Review Taskforce noted that grain trading margins are low (averaging $1 to $2 per tonne traded, over the past five years for some Australian trading houses).[62] So trading relies on an effectively functioning supply chain that can deal with high volumes quickly and respond to variability – otherwise it would be difficult for traders to make a profit.

For 2016-17, wheat and barley were the predominant grains exported, representing 61 percent and 32 percent respectively of the total grain exports from South Australian ports.[63] While the number of traders for wheat and barley vary by port, the deep sea ports of Port Adelaide, Port Lincoln and Port Giles had at least five traders for the season at each port, more for wheat than barley. Of the remaining seven percent of grain exports, while limited to one or two traders being involved, it needs to be recognised that the tonnages are small, ranging from 21,000 tonnes for field peas to 316,000 tonnes for canola (2016-17).[64] It might be expected that such small tonnages would only attract a small number of traders.

Typically, growers that deliver grain to storage/warehouse sites retain ownership for a period. That is, title for the grain remains with the grower until the grain is committed, which (in the case of export grain) is when the grower sells the grain to an export trader. From one estimate, 80–90 percent of delivered grain is initially received as grower warehoused stock, with around 50 percent sold within

[59] That is, all users of Export Select must move grain from an upcountry Viterra site to a Viterra port facility.
[60] Viterra, *Inquiry into the South Australian Bulk Grain Export Supply Chain Costs – Response to Draft Report,* October 2018, p.10.
[61] Source: Australian Crop Forecasters.
[62] Department of Agriculture and Water Resources, *Review of the Wheat Port Access Code of Conduct,* 2018, p. 58.
[63] Source: Australian Crop Forecasters.
[64] Source: Australian Crop Forecasters.

30 days and 90 percent sold within three months.[65]

The grower accepts a market price from a trader for a particular tonnage of grain. The contractual terms between the grower and the trader define the payment terms, and when title changes. Cargo passage by vessel is the trader's responsibility; from that point, ownership of the grain depends on the contractual arrangements between the trader and shipping company.

As a bulk handler, Viterra does not own the grain that it handles, and it does not pay the grain grower for the grain. When ownership transfers from grower to trader through a 'Transfer In-store,' the trader agrees (in most cases) to accept responsibility for payment of all outstanding Viterra fees that the grower incurred to that time.[66] The trader pays the grower for the product, netting off fees owing to Viterra and any other applicable fees owed to the trader. They then pay the fees owing to Viterra. The arrangement differs for grain handled by Cargill Australia Ltd (**Cargill**), however, because it is both a trader and a bulk handler. While Cargill executes some grain exports through Viterra, it also manages its own direct supply chain to export through Inner Harbour – Port Adelaide. Further detail on Cargill's operations is provided in section 3.3.2.2.

Finding 3.4

The grain trading market in South Australia appears to be competitive, with 11 grain traders having booked shipping slot capacity with Viterra to export the 2016-17 grain harvest and 12 for the 2017-18 harvest. Given the low average per tonne margins on grain trades, traders rely on an efficient supply chain that can respond to variability.

3.3.2 How bulk grain is stored and handled

Grain storage sites span the state's growing regions and can handle and store peak harvest volumes. Storage types include concrete cells, steel bins, sheds and bunkers, with site capacity ranging up to 750,000 tonnes.

In addition to commercial upcountry sites and ports, an estimated 1 million tonnes of grain storage is managed on-farm.[67] Farms' grain storage capacity (**on-farm storage**) in South Australia is generally used as short-term storage to manage the logistics of harvest.

A small number of growers submitted to the Commission that South Australian grain growers are building an increasing amount of on-farm storage infrastructure in response to concerns about Viterra's storage and handling services. While the Commission has not had access to independently derived data, based on the advice it has received during consultation it concludes that there has been an increase in the amount of on-farm storage in South Australia in recent years, although this is likely to be occurring mainly in eastern South Australia. The level of on-farm storage in South Australia remains relatively small compared to the eastern States.

Some growers have invested in larger scale long-term storage to capitalise on direct grain marketing opportunities (Box 3.1).

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65 P. Reading, *Information Requirements for an Effective Bulk Wheat Export Market: Ensuring a 'Level Playing Field'*, May 2012, p. 22, available at http://www.agriculture.gov.au/Style%20Library/Images/DAFF/__data/assets/pdffile/0011/2157770/information-req-for-an-effective-bulk-wheat-export-market.pdf. AEGIC has assumed that 45 percent of grain delivered to warehouse storage is sold to traders after the first month, 70 percent after the second month and 80 percent after the third month (source: AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p.41).

66 Viterra, Harvest Information 2017/18, clause 24.2, p. 30, viewed 4 June 2018, available at http://www.viterra.com.au/wp-content/themes/viterra/documents/Harvest%20Information%20Booklet%202017/index.html#4: 'For most Transfers In-store Viterra acknowledges that the purchaser will agree to accept responsibility for payment of Charges (including freight expenses and costs that have accrued prior to the date of outturn), but which have not been paid. In that event Viterra will invoice the applicable purchaser'.

67 PIRSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 4.

Box 3.1 On-farm storage

On-farm storage can include temporary solutions (such as grain bags) and longer term storage (such as sheds, bunkers and silos). It provides the flexibility for growers to 'add value' to grain stocks, by increasing options through blending and segregating, or by allowing the grower to hold stocks to increase marketing options.

On-farm storage also increases efficiency, by allowing growers to store stocks temporarily when transport cannot keep up with the rate of harvest. In this case, the grain can be turned around faster and spends less time in silo queues.

Risks and costs are associated with on-farm storage, however. Longer term storage, for example, can be a significant investment. Also, the grower is responsible for managing the quality of the stored grain, so will need a proactive management plan to control for pests.

No authoritative data source has been found for the current total capacity of South Australian on-farm storage. However, the Grains Research & Development Corporation's (GRDC) 2017 annual grower survey shows the number of South Australian growers storing grain at 84 percent. The GRDC states this is a statistically significant increase since 2013. Despite this, average storage capacity does not show a statistically significant increase since 2013.[68]

The GRDC 2017 survey also provides some insight into on-farm storage use, showing marketing (waiting for best price) as the main reason (60 percent of respondents) for on-farm storage for the southern region (most likely to reflect eastern South Australia). However, for the western region (most likely to reflect Eyre Peninsula) marketing is only reported as a reason by 37 percent of respondents, with feed and seed storage the main reasons, 49 percent and 53 percent respectively.

The trend to on-farm storage in South Australia has been a lot slower than in the eastern states. Eastern states have significant domestic consumption that has driven growers to invest in on-farm storage, giving them the option to enter the export supply chain.[69] In contrast, Eyre Peninsula farmers are unlikely to participate in the supply chain through on-farm storage, because for most seasons their primary market is export; they use such storage for logistical reasons, to deal with the volume of grain coming off the field during harvest.[70]

3.3.2.1 Viterra's operations

Viterra is a bulk handler with a substantial market share of the commercial grain storage capacity in South Australia.[71] Its storage capacity exceeds 10 million tonnes (almost double its average annual receival of 6.3 million tonnes).[72]

Viterra's focus on cost effective scale operation has led to the rationalisation of Viterra's storage sites from 116 (1998), to 114 (2010) and then 83 (2017), noting that 80 percent of the grain was received by around 30 sites in 2016.[73] This results in less fragmentation, thereby improving scale effects. Scale and accumulation benefits may also have been enhanced through the use of Viterra's fee structure,

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68 GRDC, *2017 GRDC Grower Surveys*, p. 67 and p. 70, available at https://grdc.com.au/about/corporate-governance/grower-and-researcher-surveys. GRDC's Grower Survey questionnaire includes both annual and cyclical metrics and this is why the 2017 survey result is compared with the 2013 result in this instance, being the last time on-farm storage was surveyed by State.

69 Economic and Finance Committee, *Hansard*, 27 September 2017, pp. 161–2.

70 Economic and Finance Committee, *Hansard*, 27 September 2017, p. 162.

71 Based on Viterra's 83 sites operating in 2016-17 (source: Viterra, *Inquiry into the South Australian Bulk Grain Export Supply Chain Costs – Response to Draft Report*, October 2018, p.13, with the addition of five ports sites to the 78 upcountry sites), Cargill's four sites (section 3.3.2.2) and having regard to the operations of other commercial bulk handlers (section 3.3.2.3).

72 Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 9.

73 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p.41. Note that 2017 was a record harvest year. All available storage sites would have been utilised to ensure delivery of the harvest. Indeed, Viterra invested in constructing 0.9 million metric tonnes of additional storage to cope with record harvest levels.

particularly the embedding of its Export Select product (section 4.4.3.1). While Export Select is optional for Viterra's customers, it is used by nearly all export customers (that is, traders).

Viterra is not a buyer of grain. Viterra is a related party to Glencore Agriculture Pty Ltd (Glencore), which is a global player in the trading of grain and operates an Australian trading arm.

3.3.2.2 Cargill Australia's operations

Cargill is a bulk handler and grain trader. It trades and acquires grain, and it operates (through AWB Grainflow, owned by Cargill) grain receival and storage sites at Pinnaroo, Crystal Brook, Maitland and Mallala. Grain from those sites is transported to port and loaded directly from trucks onto vessels at Inner Harbour – Port Adelaide (Berth 29). Cargill represents fringe competition for Viterra, handling 420,000 tonnes (around 5 percent) of the 2016-17 grain harvest.[74] Because it does not have storage facilities at port, it provides only a 'just in time' service.[75] Cargill uses Viterra's facilities for any exports not associated with Berth 29.

3.3.2.3 Other bulk handlers

Other bulk handlers operating in South Australia include:[76]

- AGT Food Australia (grain receival, processing and packing site at Bowmans)
- Australian Grain Exports (grain receival, storage, cleaning and processing facility at Dublin)
- Australian Growers Direct (storage site at Balaklava)
- AW Vater & Co (grain receival and storage site at Saddleworth)
- Kangaroo Island Pure Grain (grain receival and storage site at Kingscote)
- Pilgrim Grain Storage (grain receival and storage site at Bordertown)
- San Remo (grain receival sites at Balaklava and Kulpara)
- Semaphore Container Services (Semaphore) (grain receival, packing and bulk export site at Osborne)
- TE Storage and Logistics (grain storage site at Naracoorte), and
- Tremlett Grain and Fertiliser (grain receival and storage site at Shea Oak Log).

These bulk handlers are relatively small in scale. Many serve the domestic market and some provide container exports.

Finding 3.5

Viterra has a substantial market share of commercial bulk grain storage in South Australia. While total South Australian on-farm storage capacity has increased in recent years, it remains small compared with the eastern States.

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74 Market share data derived from data supplied to the ACCC by Australian Crop Forecasters. The ACCC provided the Commission with a licence to use the data for this Inquiry.

75 A 'just in time' service delivers grain just in time to load onto the export vessel. In other words, the grain is not stored at port.

76 For example, refer Viterra, *Review of the Port Terminal Access (Bulk Wheat) Code – Response to Interim Report,* August 2018, pp.11-12, viewed 27 November 2018, available at https://s3-ap-southeast-2.amazonaws.com/ehq-production-australia/32c09de7e6c227cbb42514d0ef8257180ada522f/documents/attachments/000/090/153/original/wpcr-rd2-09-viterra.pdf?1539730519.

3.3.3 How bulk grain is transported

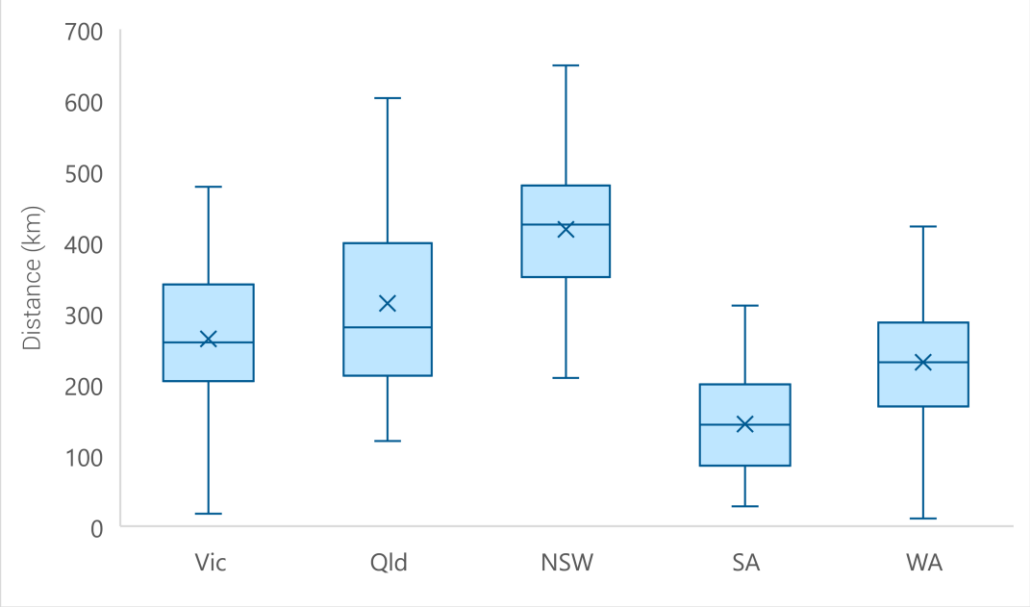
The freight transport-to-port sector is a competitive market, with a choice of road or rail transport in many cases.

GWA is the main supplier of intrastate freight rail services in South Australia, and the primary provider of rail haulage of the state's export grain. It operates the rail transportation services that Viterra uses to transport grain across the Eyre Peninsula (from Kimba and Wudinna into Port Lincoln). Viterra submitted that the Eyre Peninsula rail service provides important capacity and is used effectively.[77] Grain is the only commodity moved on the Eyre Peninsula lines, which are restricted in weight and speed due to their age and condition.

GWA also operates bulk grain services for Viterra on the Australian Rail Track Corporation (ARTC) owned interstate rail network. Viterra uses the ARTC lines to move grain into Inner Harbour–Port Adelaide, and Outer Harbor–Port Adelaide. The ARTC network has multiple users, and the trains can travel at higher speeds and carry greater weight than the intrastate lines.

Road transport in South Australia is very competitive with rail, given the relatively short distances between farm and port (Figure 3.6). Its cost to port is generally competitive with rail transport costs for distances of up to 200 kilometres.[78] Distances from upcountry grain sites to port by road are generally shortest in South Australia (averaging about 144 kilometres) and longest in New South Wales (averaging about 418 kilometres).[79] The short haul length—combined with volatile grain production and the absence of other users of the rail services—means the use of intrastate rail services is generally low. This low use has contributed to the cessation of some grain railway services (for example, rail services in the Murray–Mallee region).[80]

Figure 3.6 Road distance from upcountry receival site to closest export port, by state[81]



Source: AEGIC.

77 Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 22.
78 DAWR, *Wheat Port Code Review*, Interim Report, p. 10.
79 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 22.
80 Essential Services Commission, *South Australian Rail Access Regime Review*, Final Report, August 2015, p. 22.
81 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, Figure 7. Mean distance is indicated by X; median distance is indicated by horizontal line. The box indicates distances for 50 percent of all values bounded by the first and third quartiles. The upper and lower bars indicate the full range of distances.

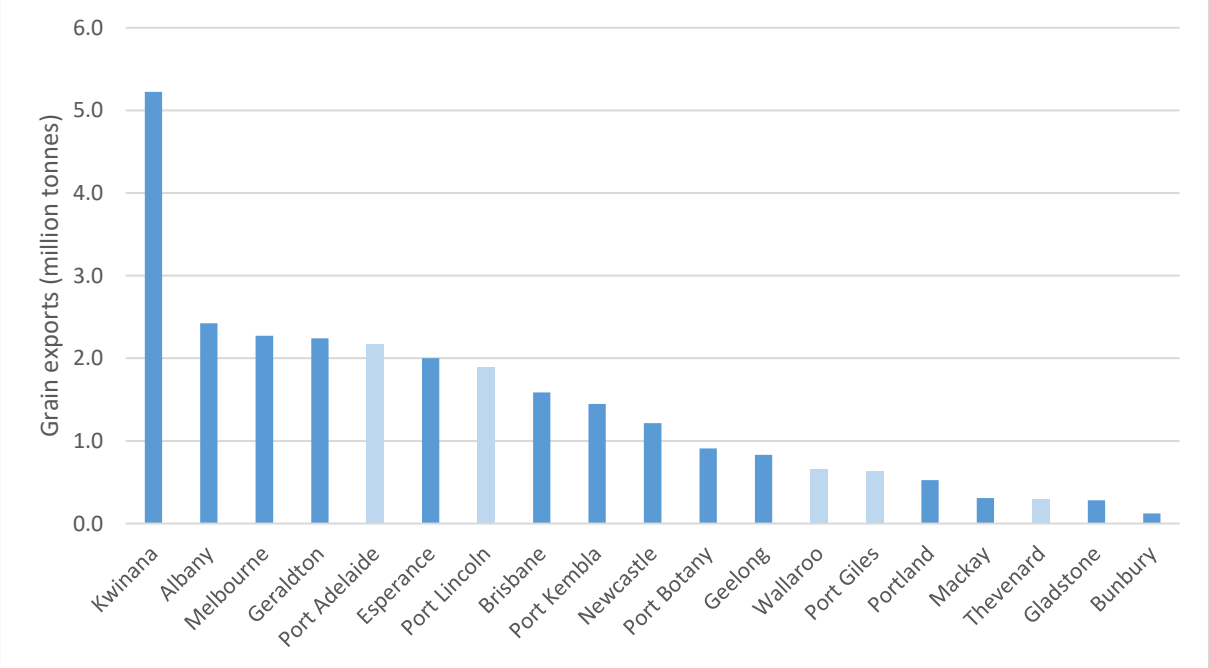
Finding 3.6

GWA is the primary provider of freight rail services for bulk grain in South Australia, although the relatively short distances to port means road transport successfully competes with rail.

3.3.4 Grain throughput at port

With six ports handling grain exports,[82] South Australia has more grain shipping terminals than the other states. CBH in Western Australia, for example, uses four ports with an annual terminal capacity of 19 million metric tonnes, compared with Viterra's 7 million metric tonne terminal capacity (across six port terminals).[83] Figure 3.7 compares average exports per port for Australian grain ports. This shows that, aside from Port Adelaide and Port Lincoln, South Australian grain ports have relatively low throughput, which would be expected to place pressure on costs. The relatively high number of ports in South Australia is partly due to the grain growing regions being located along the coast, and the two large gulfs.

Figure 3.7 Average grain throughput, by port, average over 2008-09 to 2016-17[84]



Source: AEGIC (Ports Australia).

Within South Australia, Viterra is the main provider of port bulk grain loading services. Before the 2015-16 grain season, Viterra's market share of port terminal throughput was 100 percent, dropping to 96 percent (2015-16) and then 91 percent (2016-17), with the introduction of competition at Inner Harbour – Port Adelaide (Figure 3.8).[85]

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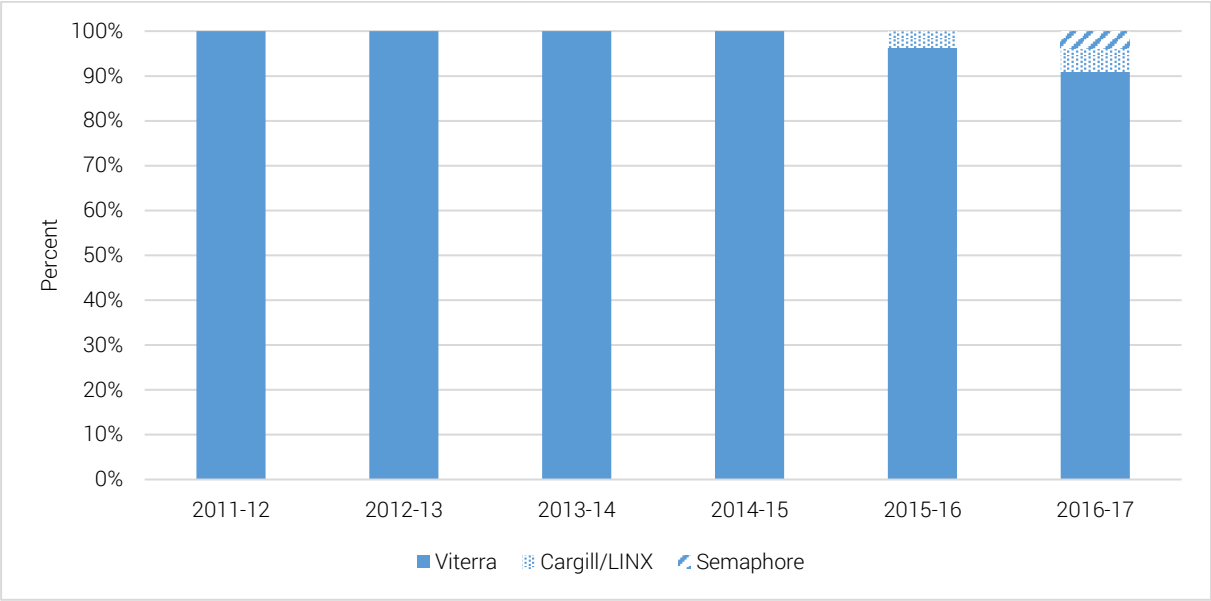
82 Grain export port terminals are located at Flinders Ports owned sites (deep sea ports at Port Lincoln, Port Giles and Outer Harbor – Port Adelaide; shallow ports at Thevenard, Wallaroo and Inner Harbour – Port Adelaide). It is noted that some stakeholders treat Port Adelaide as a single port comprising Outer Harbor and Inner Harbor, resulting in five grain ports on this basis.

83 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, Figure 22.

84 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, Figure 19. The figure shows the total mass of grain exported from Australian ports, averaged from 2008-09 to 2014-15. Where multiple service providers operate at a port (for example, Port Adelaide), figures indicate total mass of grain exported by all service providers.

85 That is, Cargill commenced operations in 2015-16, using loading facilities operated by Patrick and then LINX. Semaphore Container Services, which now also handles bulk grain exports, commenced during the 2016-17 harvest.

Figure 3.8 Market share of South Australian bulk grain loading port service providers, 2011-12 to 2016-17[86]



Source: Australian Crop Forecasters.

Near-monopoly suppliers provide access to appropriate shipping berths, and loading and unloading facilities, and the related fees: Flinders Ports for shipping berths and associated services and Viterra for bulk grain loading facilities. The ports can load various size vessels depending on exporters' needs: deep seas ports can load vessels of sizes up to and including Panamax vessels (70,000 tonnes, up to 300 metres in length), while some smaller ports are constrained to smaller vessel sizes (for example, Thevenard is limited to vessels less than 180 metres in length). The ports' loading rates range from 800 to 3000 tonnes per hour, with some ports able to offer 24 hour loading operations to ensure vessels are loaded as quickly as possible.[87]

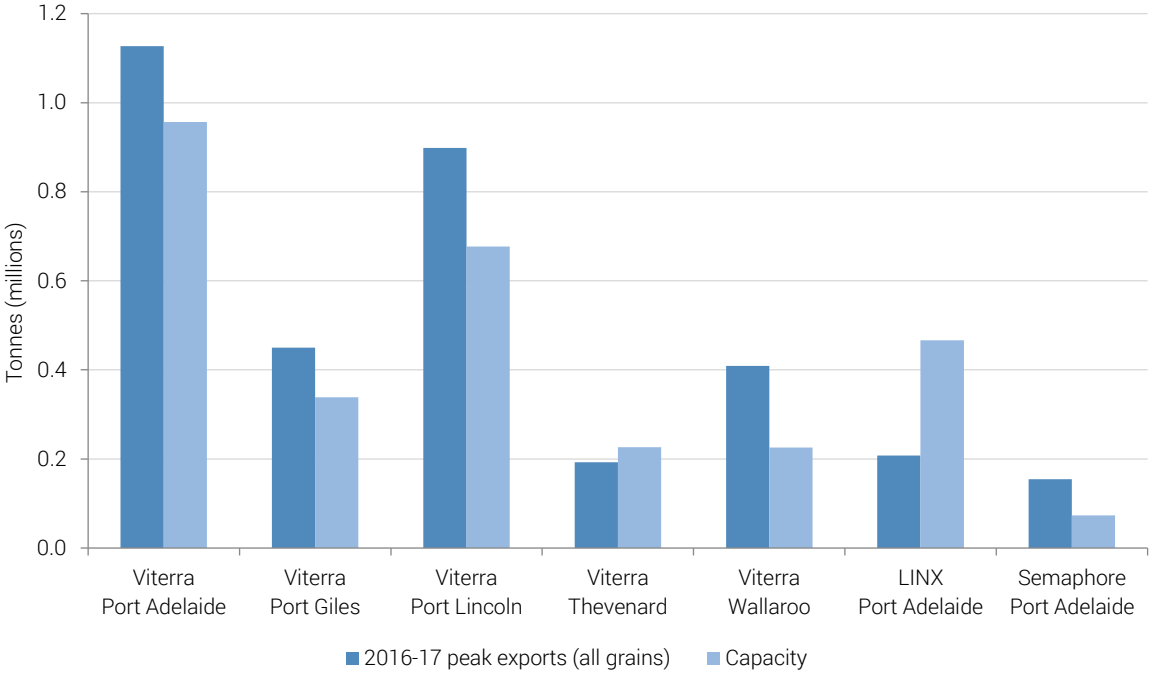
The South Australian market for port bulk loading services has little excess capacity. Figure 3.9 shows estimated port capacity use for the peak period (February to May 2017) of the record 2016-17 harvest, by port and port operator. At all ports except Thevenard and Berth 29, exports exceeded estimated capacity.[88] Figure 3.10 shows peak period port terminal use for 2015-16, when there was little excess capacity even for an average season.

[86] Market share data derived from data supplied to the ACCC by Australian Crop Forecasters. The ACCC provided the Commission with a licence to use the data for this Inquiry. It should be noted that Cargill/LINX has data for 2015-16 and 2016-17 and Semaphore has data for 2016-17 only; it is possible both shipped minor amounts of grain in earlier years.

[87] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 11.

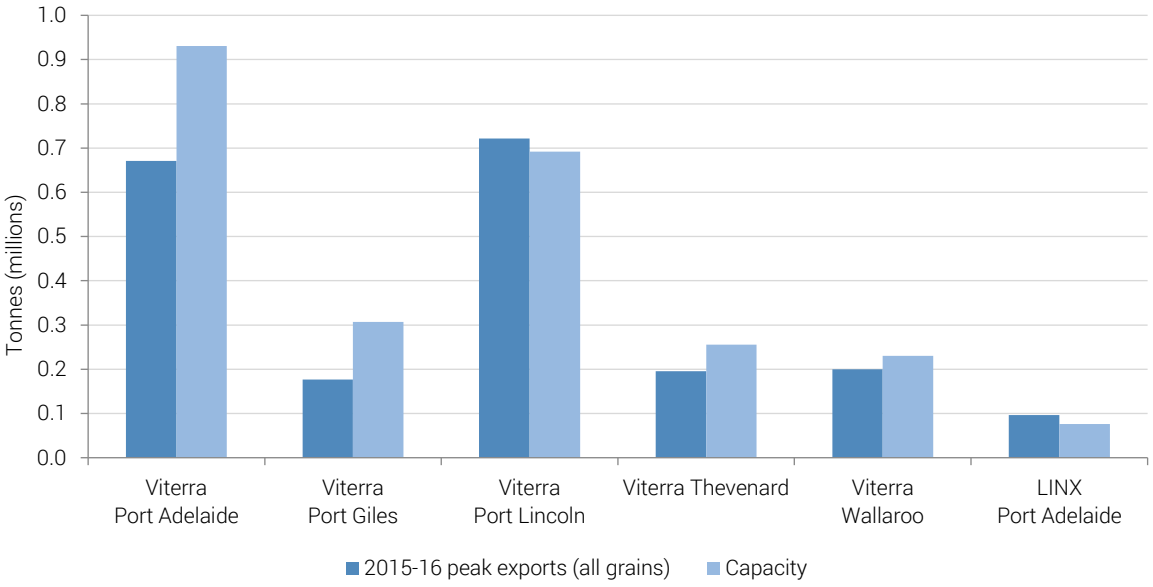
[88] The additional capacity to deal with the record harvest came from Viterra and Semaphore introducing operational efficiencies at port and across relevant supply chains, extending operating hours, and employing additional staff (ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, December 2017, p. 42, available at https://www.accc.gov.au/publications/serial-publications/bulk-wheat-ports-monitoring-reports/bulk-wheat-ports-monitoring-report-2016-17).

Figure 3.9 Peak period port terminal capacity use, South Australia, 2016-17[89]



Source: ACCC.

Figure 3.10 Peak period port terminal capacity use, South Australia, 2015-16[90]



Source: ACCC – with Commission reformatting to match Figure 3.9.

89 ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, Figure 18, p. 41.

90 ACCC, *Bulk Wheat Ports Monitoring Report 2015-16*, December 2016, Figure 17, p. 38, available at https://www.accc.gov.au/system/files/RAWP%20-%20Bulk%20wheat%20ports%20monitoring%20report%202015-16%20%5Bv2%5D.pdf.

In addition to tight capacity levels, long-term capacity agreements are in place. In 2008, port terminal capacity in South Australia was allocated on a 'first in, first served' basis. Then, in 2012, Viterra introduced an auction system, which allocated residual capacity on the 'first in, first served' basis. Following stakeholder concerns with the auction system, the ACCC approved the introduction of long-term agreement capacity allocation, along with a system to allocate short term capacity.[91] This system came into effect from the 2016-17 grain season.

Against this background, Viterra's port operations are subject to regulation at both the federal and state level.[92]

Finding 3.7

Viterra has a substantial market share of supply chain port bulk grain loading services, with 91 percent of market share throughput in 2016-17.

3.3.5 Other services in the supply chain

Apart from the services offered in each of the logistical segments, a number of ancillary services cut across market segments. Quality management, for example, is an important service relevant to all market segments. It is carried out to meet regulatory obligations and the importing countries' requirements. Quality management starts at receival, where all grain is tested to meet specifications for quality. For this reason, bulk handlers undertake processes such as fumigation, to minimise or remove the impacts of moisture, insects and pests.

The port terminals must be registered and certified by the Department of Agriculture and Water Resources (DAWR). Grain samples are taken continuously on vessel loading:

- Officers authorised by the DAWR ensure the grain meets the relevant importing country's phytosanitary requirements.
- The bulk handler conducts further analysis to ensure each parcel of grain meets the customer's contract quality specifications.
- The customer may also appoint an independent, internationally accredited surveyor.

Segregation and blending are also key quality management services of the supply chain. Grain is segregated by type, grade and specification. To meet quality specifications required by end users, grades of grains are blended homogenously, 'averaging' the specifications across a cargo. This practice can create a market for lower grades if they can be blended at rates that maintain the required quality specifications.

3.3.6 Changing risk profile

It was evident from consultation on the Inquiry Draft Report that some growers would prefer the former single desk arrangements (for wheat, removed in 2008), and regret the demutualisation of the former cooperative[93] and its subsequent sale.[94] It is likely that some of this arises from a change in the level of risks growers now face, compared with those that they faced prior to the industry reforms adopted around the beginning of the 10-year period covered by this Inquiry. Table 3.2 seeks to show this change

[91] The ACCC approval was provided under the Port Terminal Access (Bulk Wheat) Code of Conduct. This mandatory Code is prescribed under the Competition and Consumer Act 2010 (https://www.accc.gov.au/business/industry-codes/wheat-port-code-of-conduct). How much long term capacity can be allocated to an individual exporter at each port within a quarter is capped (ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, p. 56).

[92] At the federal level, the Port Terminal Access (Bulk Wheat) Code of Conduct regulates access to port terminal capacity. At the state level, the Commission has a role under the Maritime Services (Access) Act 2000.

[93] GPSA, *Submission by GPSA to Essential Services Commission Draft Report*, 3 October 2018, p. 6, available at http://bit.ly/InquirySABulkGrainSupplyChain.

[94] Grower discussions during consultation on Draft Report.

in grower risk profile, based on the example of bulk wheat. While, in some areas, there has been an increase in risk post-reform, there also appear to be risk mitigation measures available.

Table 3.2 Change in grain grower risk profile – bulk wheat

Risk category	Current risk compared to pre-deregulation – before application of risk mitigation measures[95]	Impact on grower
Production risk	same	Production risk: relates to the variability that occurs in relation to the volume of grain produced, its quality and the timing of the harvest.[96] Factors affecting: variations in weather; pests, diseases and fire; and costs of key inputs such as fuel and fertiliser. Risk mitigation: crop insurance is available to help manage production risk. Technological improvements provide access to higher yielding grain varieties. Growers can diversify across a number of crops or livestock activities. Overall impact: No material increase in production risk associated with deregulation.
Storage risk	same	Storage risk: relates to potential for grain stock spoilage. Factors affecting: variations in storage practices to avoid pest, diseases and fire. Risk mitigation: commercial storage alternative exists to avoid risks associated with on-farm storage. Also, industry standards and consultants available to provide grower support. Overall impact: No material increase in storage risk associated with reform. Growers now have more opportunities to pursue higher value outcome, against which any additional costs (such as the potential for higher spoilage from on-farm storage) must be considered.
Supply chain fee shock risk	same	Supply chain fee shock risk: relates to potential for growers to face uncontrolled large increases in supply chain fees, noting that all supply chain fees are ultimately passed through to growers. Factors affecting: lack of effective grower countervailing power against supply chain service providers that enjoy a monopoly position. Risk mitigation: growers form collectives to provide countervailing power. Overall impact: No material increase in supply chain fee shock risk associated with reform. This issue relates more to grower ownership of key supply chain infrastructure rather than reform. In the case of South Australia, the biggest fee shock in relation to the time period considered for this Inquiry occurred during the period of grower ownership (refer Figure 4.2).
Cross-subsidy risk	lower	Cross-subsidy risk: relates to the potential for individual growers to face costs significantly higher than the underlying resource cost associated with handling their grain. Factors affecting: extent to which there is transparency in costs and extent to which costs are pooled and distributed across growers. Risk mitigation: limited ability for individual growers to mitigate this risk under the single desk.[97] While some growers are concerned with transparency in fees, in general most stakeholders can now receive quotes for fees from multiple sources and a multiple points in the supply chain.[98] Overall impact: Reduced risk.
Grain price risk	higher	Grain price risk: relates to the variability in the price growers receive for their grain.[99] Factors affecting: the key drivers of the export price of wheat are: ▶ the global demand for, and supply and stocks, of wheat

[95] Being prior to the removal of the single desk, which for wheat occurred in 2008. 'Single desk' is a term used to describe the monopoly marketing of wheat by the Australian Wheat Board (1939-1999) and its privatised successor, AWB (International) Limited (1999-2008) – source: Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 4, available at pc.gov.au.

[96] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 100.

[97] Grain Growers Limited, *The State of the Industry Report,* A Report of the State of the Australian Grains Industry, June 2011, p .54, available at https://www.graingrowers.com.au/state-of-the-industry-report-2011/. Also, Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, pp. 6-7.

[98] Grain Growers Limited, *The State of the Industry Report,* A Report of the State of the Australian Grains Industry, June 2011, p .54.

[99] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 101.

Risk category	Current risk compared to pre-deregulation – before application of risk mitigation measures[95]	Impact on grower
		▶ the exchange rate, and ▶ relative transport costs from port to export markets.[100] Risk mitigation: Prior to reform, the relevant marketing body dealt with this risk and growers received a pooled price. As noted in section 5.1, there are many tools available to growers to manage this risk in the post-deregulation era. Also, growers can diversify across a number of crops or livestock activities. Overall impact: Increased risk to individual growers, but recognised risk mitigation measures exist. The current marketing arrangements have made the price risks associated with growing and marketing grain more transparent to growers than they were under the compulsory national pool. However, the potential returns to individual growers are also greater.
Port terminal access risk	higher	Port terminal access risk: relates to the ability for export trader(s) to gain access to shipping facilities when they need them. Factors affecting: extent of congestion at the port and the number of traders wishing to access port facilities at any given time. Risk mitigation: PTAC is the post-regulation measure imposed for users of non-exempt port facilities. Traders have the ability to pursue new entrant alternatives not subject to the full provision of PTAC. Overall impact: The overall impact is more difficult to assess in the case of this risk, but recognised risk mitigation measures exist. For growers, the risk is that they will incur higher costs to reflect any risk premium associated with traders facing an increased risk. But it is only due to reform that there can be more than one trader. Nevertheless, when the Australian Wheat Board (and successors) managed the single desk it was able to spread shipping across the whole year and avoid peak capacity issues.[101] As a result, the level of risk to trading overall will have likely increased. However, the potential returns to individual growers (from multiple traders bidding for grain) are also greater.
Receiver of last resort risk	higher	Receiver of last resort risk: relates to the risk growers now have that they may not be able to locate a buyer for their grain. Pre-reform the marketing bodies acted as receiver of last resort, so growers were guaranteed their grain would be purchased. Although the Australian Wheat Board (and successors) did not always accept grain of any quality at all receival sites, with growers sometimes required to deliver poor quality grain at a site some distance away and incur the additional associated transport costs.[102] Factors affecting: generally an issue confined to poor quality grain. Risk mitigation: see risk mitigation measures for production risk. Providing grain is within specification, blending may provide a market not otherwise available. Overall impact: Increased risk, but recognised risk mitigation measures exist.
Counter-party risk	higher	Counterparty risk: relates to the risk the grower faces from dealings with firms defaulting on payment or service provision.[103] Factors affecting: a trader defaulting on payment or going into liquidation after the grower has delivered grain to the trader. Transport and storage service provider being unable to deliver grain for export at the required time and location. Risk mitigation: Growers are responsible and liable for managing business dealings and need to undertake appropriate due diligence, as required for any other commercial engagement. Overall impact: Increased risk, but recognised risk mitigation measures exist.

[100] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 27.
[101] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 72.
[102] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, pp. 114-115.
[103] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 102.

3.4 Conclusion

South Australia exports much of its grain production into the global bulk grain export market, where it is a small player with a less than three percent (by volume) market share (section 3.1). The South Australian grains industry needs to be responsive to changing and potentially more stringent customer demands for safe and traceable grain. While new entrants may need to account for this (depending on markets targeted), it is also the case that quality specifications should relate to genuine customer needs and not impose undue barriers to new competition. Another advantage is that our grain production is counter-cyclical to the northern hemisphere, providing a brief window of opportunity to maximise export returns. However, the industry must pursue efficiency in supply chain costs to maintain its global competitiveness (section 3.1).

South Australian grain harvests are highly variable, ranging from 4.7 million tonnes to 10.7 million tonnes, during the period 2007-08 to 2018-19 (forecast). So, responding to harvest variability is an important aspect of the supply chain. Participants need to be able to manage costs in poor harvest years, while still having the capacity and capability to manage large harvests. In other words, high returns in good years may be necessary to offset poor returns from bad harvest years, to achieve a return commensurate with the level of risk, on average (section 3.2).

The South Australian bulk grain export supply chain can be split logistically and transactionally. Logistically, it has three main segments: upcountry storage and handling, freight transport to port, and port services (including export bulk loading facilities) (Table 3.1). From a transactional perspective, the grain trading market in South Australia appears to be competitive, with 11 grain traders having booked shipping slot capacity with Viterra to export the 2016-17 grain harvest and 12 for the 2017-18 harvest (section 3.3.1).

Viterra has a high market share of service provision in key segments of South Australia's supply chain. In 2016-17, it had a substantial market share of commercial bulk grain storage sites (section 3.3.2.1) and was the main provider of port bulk grain loading services, with 91 percent market share of throughput (section 3.3.4).

GWA is the primary provider of freight rail services for bulk grain in South Australia, although the relatively short distances to port mean road transport successfully competes with rail (section 3.3.3).

Among the changes growers need to cope with since the industry reforms introduced some ten years ago is a change in risk profile (section 3.3.6). In addition to the traditional production risk, growers now need to be alert to risks in areas such as the price they receive for their grain. While in some areas there has been an increase in risk faced by growers following removal of the single desk marketing arrangements, there also appear to be adequate risk mitigation measures available, as well as the opportunity for individual growers to obtain greater returns.

4 Whether the supply chain is efficient

Chapter summary

To assess the efficiency of the grain export supply chain, the Commission investigated whether anything is inhibiting a competitive outcome. It focused largely on the performance and behaviour of Viterra, the major provider of storage and handling facilities, given the market for freight and port services is either competitive or subject to suitable regulatory oversight.

While opportunities to improve the efficiency of the supply chain will always exist, the Commission's finding is that the supply chain is not demonstrably inefficient:

- in terms of the supply chain costs that the Commission investigated
- from both an overall and individual supply chain segment perspective, and
- based on available facts and evidence at this time.

This finding reflects the following conclusions:

- While Viterra faces some competition (actual and potential), the extent to which that competition places effective and credible discipline on Viterra's behaviour is not clear. Compared with local competition, the global market may place more effective discipline on Viterra's behaviour.
- The Commission has not found or been presented with any conclusive evidence of Viterra exercising market power to the detriment of competition.
- Viterra seeks to provide good customer service and, in recent years, proved highly capable of reducing the operating costs for the main grain export supply chain. But it does not appear to be passing on these efficiencies to growers through lower fees.
- Viterra's operational performance is, on average, producing financial returns towards the upper end of, but not exceeding, what might be expected for a firm with its level of risk. Having four good seasons in a row, as Viterra recently experienced, is unusual.
- The level and trend in Viterra's fees are consistent with financial analysis showing Viterra is choosing not to share efficiencies with industry through lower fees. However, taking into account corporate structural issues, Viterra's fees are not considered excessive at this time, compared with the total fee levels charged by its Australian counterparts.
- This Inquiry represents a snapshot. It is a little over six years since Viterra's acquisition, which renewed the firm's focus on achieving efficiencies. If Viterra continues to run an efficient operation and earns only a rate of return commensurate with its level of risk in the mid to long term, on average, then the supply chain can continue to be considered efficient. But, if Viterra continues its trend of increasing operating surpluses (notwithstanding potentially incurring losses in poor seasons such as 2018-19), it may start to earn excessive returns for a firm with its risk profile. This would not represent an efficient outcome. In this situation, the competitiveness of the supply chain would become questionable if Viterra did not share its continuing efficiencies with industry through lower fees.
- In relation to pricing behaviour, the Commission found possible evidence that Viterra's pricing (specifically, the Receival at Port Service Fee (from Approved Third Party Storage)) serves as a barrier to new competition or expansion by existing competitors. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power.

4.1 Segments of the supply chain

The Commission assessed the efficiency of the supply chain by investigating whether anything is inhibiting a competitive outcome within each segment of the supply chain.[104] It undertook its investigation by first examining the market structure, to consider a firm's ability to possess market power (section 2.2.2). Then, by examining the behaviour of the firm, the Commission considered whether the firm may be exercising such power in a sustained manner to the detriment of competition (section 2.2.3).

The supply chain can be split logistically into three main segments: upcountry storage and handling, freight transport to port, and port services (including export bulk loading facilities) (section 3.3). In turn, its structure is largely defined by three firms that each have high market share in providing services across one or more key segments: Viterra, Flinders Ports, and GWA (section 3.3). Each of these firms can be considered a near-monopoly supplier. Their high market share results from the large amount of fixed infrastructure that they operate: the high level of fixed costs associated with major infrastructure may make it difficult for a competitor to achieve costs as low, for the same service. In contrast, the road freight industry is highly competitive (so considered efficient in the provision of services) because minimal market entry barriers allow a large number of participants (section 4.2.2).

Each of these three firms (Viterra, Flinders Ports and GWA) has the potential to exercise market power to the detriment of competition. The fact that there are near-monopolies operating in the supply chain is not a problem for growers and traders per se. Growers and traders need only be concerned by the behaviour of these firms– whether market power is exercised persistently in any segment of the supply chain, to the detriment of growers and traders.

4.2 Segments of the supply chain that warrant review

The Commission previously assessed rail services provided by GWA, the general port services provided by Flinders Ports, and Viterra's bulk loading facilities at port, in separate industry-specific reviews. The Commission's findings are discussed in sections 4.2.1 (for rail) and 4.2.3 (for ports), including any matters raised during this Inquiry that are relevant to these services.

4.2.1 Rail freight services

The South Australian rail access regime (rail access regime) is established under the Railways (Operations and Access) Act 1997 (ROA Act). The Commission did not find, and was not presented with, any new evidence to change the recommendations made in its 2015 Rail Access Regime Review. That is, there is no new evidence that market power is being (or has been) exercised in the rail services provided by GWA to the detriment of competition. Box 4.1 summarises the rail access regime and the results of the Commission's most recent review.

[104] It is the exercise of market power by a firm that leads to a non-competitive (and inefficient) outcome, not whether a firm has the ability to exercise market power.

Box 4.1 Rail access regime

A negotiate–arbitrate access regime exists for certain South Australian railway infrastructure services (below-rail services), established under the Railways (Operations and Access) Act 1997 (**ROA Act**).[105] This rail access regime covers the infrastructure owned by GWA, covering lines in the Murray–Mallee region (services currently suspended), the Mid-North region (services no longer operating) and the Eyre Peninsula. In addition, GWA operates some bulk grain services for Viterra on **eastern South Australia** (the portion of the South Australian land mass east of Spencer Gulf), using Australian Rail Track Corporation (**ARTC**) owned mainlines.

The Commission conducted its last review of the rail access regime in 2015. The evidence before the Commission did not support a finding that market power had been exercised to the detriment of competition. Specifically, the Commission found, while the service operators could exercise market power, factors may offset that potential exercise. These factors include:[106]

- the railway users being generally large firms, which can devote significant resources to negotiating access (including price), and
- there being few users of the South Australian intrastate rail infrastructure services, so railway use is relatively low. In this environment, railway operators have a strong incentive to increase railway use to recover fixed costs.

The Commission's final recommendation to the Minister for Transport and Infrastructure was that the rail access regime should continue for a further five years, which the Minister accepted. This regime is now in place until 31 October 2020.[107]

Rail transport of grain in South Australia has some natural disadvantages due to the proximity of grain growing regions to ports. As noted in chapter 3, road transport is very competitive with rail for the three quarters of South Australian upcountry receival sites that are within 200 kilometres of an export port (section 3.3.3).

In its submission to the Inquiry, GPSA raised concern about the operation of the rail access regime, stating 'A declining amount of SA's grain is transported by rail each season' and 'Reasonable maintenance levels and longevity of rail lines are in jeopardy'.[108] Similar submissions were made to the Economic and Finance Committee's primary producers' inquiry,[109] suggesting a deteriorating rail infrastructure is likely to lead to more grain transported by road, with adverse impacts on the community. That is, while the movement of grain onto road trains in the Mid-North and Mallee regions was considered appropriate, the higher road maintenance costs will have a cost impact.[110] It was also submitted to the Economic and Finance Committee that the Eyre Peninsula rail infrastructure is deteriorating to a point at which it will be more economic to remove the rail tracks, whereas the infrastructure has been maintained in Western Australia.[111]

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105 Access regime established under the ROA Act.

106 Essential Services Commission, *South Australian Rail Access Regime Review,* Final Report, August 2015, p. 26, available at http://www.escosa.sa.gov.au/ArticleDocuments/358/20150907-SARailAccessRegimeReview-FinalReport.pdf.aspx?Embed=Y.

107 South Australian Government Gazette, 29 September 2016, p. 3921, available at http://governmentgazette.sa.gov.au/sites/default/files/public/documents/gazette/2016/September/2016_058.pdf.

108 GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 8.

109 Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers,* Final Report, 2017, Submissions.

110 Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers,* Final Report, pp. 130–3.

111 Economic and Finance Committee, *Hansard*, 27 September 2017, p. 166, paras 282–3.

In relation to the declining condition of rail infrastructure, the Commission noted that GWA is working with DPTI on an infrastructure review for the Eyre Peninsula.[112] That review will consider the transport infrastructure needs for the region. The Commission has not sought to duplicate that assessment as part of this Inquiry.

In its submission to the Inquiry, GPSA raised a concern that:[113]

> *Based on publicly available information it is not possible to prove road and rail cost components of the bulk grain export supply chain as cost inefficient or cost efficient.*

Viterra's submission noted its rail mode share has not declined, based on total tonnes received at port.[114] The South Australian Freight Council (SAFC) submitted, based on net tonne kilometres (distance multiplied by tonnage), that rail's share of the bulk grain freight task fell over the past 10 years (the period covered by the Inquiry) due to deteriorating track conditions and the closures of services on some rail branch lines.[115] It submitted that the Inquiry should look for options to increase rail's share.[116]

AEGIC concluded that the overall modal share of grain transport to port remains at about 50 percent rail and 50 percent road, and that the loss of the South Australian Mallee services (which resulted in around 180,000 tonnes of grain move from rail to road) was offset by operational efficiencies in other parts of the rail network, which saw a slight increase in the proportion of grain transported by rail.[117]

Providing the policy settings are correct, how much of the freight task travels on rail compared with road should be a commercial decision, based on moving grain in the most cost-effective manner.

4.2.2 Road freight services

Little industry specific regulation covers road freight transport, and what exists is generally limited to road safety and route restrictions for over-mass vehicles. In addition, the road freight industry benefits from large numbers of participants, with minimal market entry barriers.[118] Accordingly, the Commission accepts the road freight industry is competitive, and no further investigation is warranted for this Inquiry.

4.2.3 Port services

Two industry-specific regulatory regimes cover the export of bulk grain through South Australian sea ports, as summarised in sections 4.2.3.1 and 4.2.3.2.

4.2.3.1 Ports access and pricing regulatory regime

General port services and specialist grain loading equipment (port terminals) are covered by a ports access and pricing regime (port access regime) established by the Maritime Services (Access) Act 2000 (MSA Act) and administered by the Commission. Box 4.2 outlines this regime and the results of the Commission's 2017 ports access and pricing review.

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[112] DPTI, *Regional Freight Study to Determine Future Options for Eyre Peninsula Rail Network,* December 2017, viewed 27 November 2018, available at https://dpti.sa.gov.au/news?a=394782.

[113] GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 9.

[114] Averaging 50 percent over 10 years (Inquiry timeline) and 52 percent for the most recent four years, across Viterra's operation. Source: Viterra, *Response to Public Submissions*, June 2017, unpublished and claimed as confidential.

[115] SAFC *Inquiry into SA Bulk Grain Supply Chain Costs*, 12 May 2017, p. 1 and SAFC, *Inquiry into SA Bulk Grain Supply Chain Costs*, 14 September 2018, p.2, available at http://bit.ly/InquirySABulkGrainSupplyChain.

[116] SAFC, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 12 May 2017, p. 2.

[117] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p.50.

[118] Bureau of Infrastructure, Transport and Regional Economics, *Road and Rail Freight: Competitors or Complements?*, Information Sheet 34, 2009, p. 9, viewed 4 June 2018, available at https://bitre.gov.au/publications/2009/files/is_034.pdf; Bureau of Transport and Regional Economics, *An Overview of the Australian Road Freight Transport Industry,* Working Paper 60, 2003, p. 5, available at https://bitre.gov.au/publications/2003/files/wp_060.pdf.

Box 4.2 Ports access and pricing regimes

Two port services are relevant to the grain export supply chain, and they are covered by the South Australian access regime (**port access regime**) established by the Maritime Services (Access) Act 2000 (**MSA Act**):

- access to shipping berths and associated services to bring a vessel to port (Flinders Ports), and
- access to specialist loading equipment to load grain onto the vessel (Viterra).

The MSA Act also provides the Commission with a price regulation function for certain prescribed fees charged by Flinders Ports (but not for Viterra's bulk loading facilities). No customer raised the absence of regulatory price oversight of Viterra's bulk grain loading operations as an issue (either under the port access regime or for this Inquiry).

The Commission conducted its most recent review of the port access regime for proclaimed South Australian ports in 2017. It concluded 'although there is the potential for market power to be exercised by port operators [Viterra and Flinders Ports] to the detriment of competition, there is no evidence to suggest that port operators are exercising such market power'.[119] It recommended the port access regime and the price regulation of Flinders Ports (which consists of annual price monitoring) continue for a further five years, to October 2022.[120] The Minister accepted the recommendation, and the regime's continuation was gazetted in October 2017.

The Commission considers the port services provided by Flinders Ports and the bulk loading services provided by Viterra are efficient, given it did not find, and was not presented with, any new evidence that the two firms have exercised market power since the 2017 review to the detriment of competition. The efficiency of Viterra's grain receival and accumulation at port services is an exception: the Commission did not examine these services in the 2017 review, so investigated them as part of this Inquiry (section 4.4).

4.2.3.2 Port Terminal Access Code

The Port Terminal Access Code (**PTAC**) is an Australia-wide mandatory industry code of conduct made under the Competition and Consumer Act 2010 (Cth) and administered by the ACCC. Its purpose is to ensure exporters of bulk grain have fair and transparent access to bulk loading facilities (**port terminal services**).[121] Box 4.3 outlines the key elements of the PTAC.

Since the PTAC commenced in 2014, a capacity auction system has been replaced with an allocation system providing for short- and long-term allocations of port terminal capacity (to provide access by traders to the bulk loaders to move the grain onto vessels). The new system emphasises long-term allocations through long-term agreements with traders. All sections of industry appear to generally support the move away from the auction system.[122] However, one export trader submitted that the reduced operational flexibility imposed by the PTAC can make it difficult for the trader to have a good commercial relationship with Viterra.[123] Nevertheless, no trader has yet raised a formal dispute over an allocation.[124]

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119 Essential Services Commission, *2017 Ports Access and Pricing Review,* Final Report, p. 2.
120 South Australian Government Gazette, 17 October 2017, p. 4326, available at http://governmentgazette.sa.gov.au/sites/default/files/public/documents/gazette/2017/October/2017_072.pdf.
121 DAWR, *Wheat Port Code Review*, Interim Report, p. 5.
122 ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, p.56. AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 36.
123 Source: Commission staff discussion with a major trader, August 2017.
124 ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, p.16.

Viterra also raised with the Commission some concerns about the PTAC. It submitted that the PTAC's 'disproportionate' focus on South Australia places the state's grain industry at a competitive disadvantage, because the PTAC affects the industry's ability to meet export traders' demands and increases industry costs.[125] Viterra submitted that it could easily allocate more capacity through long-term agreements,[126] but the PTAC requires Viterra to make available at least 500,000 tonnes of capacity per quarter as short-term allocations.

DAWR, more specifically the Wheat Port Code Review Taskforce (**PTAC Taskforce**), recently completed a review of the PTAC and found:[127]

- PTAC should be retained and reviewed again in 2022 to ensure it remains fit for purpose as competitive forces in global wheat trade evolve.
- Further, PTAC should be amended to cover all grains (that is, not limited to wheat as is currently the case)
- No clear justification for extending the PTAC to cover upcountry grain services and/or require enhanced grain stocks reporting (as advocated by the ACCC).
- An industry solution should be pursued in the first instance to deal with any issues associated with the practice of site swapping.

The PTAC Taskforce recommendations will now be considered by the Australian Government. The Commission has not sought to duplicate the assessment of PTAC as part of this Inquiry. However, given the importance of the site swap issue for South Australia, the Commission considers the PTAC Taskforce Recommendation 12 relevant to this Inquiry (refer section 4.4.5.1).

Viterra has not sought exemption for any of its ports, and neither has GrainCorp in the case of Mackay and Gladstone (which are the sole bulk grain terminals in those locations).[128] In the case of Portland, no directly competing port terminal facility provides a significant competitive constraint.[129]

[125] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 23. As noted above, all Viterra's grain export terminals are non-exempt from the full provisions of the Code.

[126] Sourced from Viterra's response to request for information.

[127] DAWR, *Review of the Wheat Port Access Code of Conduct*, Final Report, 18 October 2018, available at https://haveyoursay.agriculture.gov.au/review-of-the-wheat-port-code

[128] ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, p.30.

[129] ACCC, *Exemptions in Respect of: Emerald's Melbourne Port Terminal Facility; GrainCorp's Geelong Port Terminal Facility; and GrainCorp's Portland Port Terminal Facility,* Final Determination, 25 June 2015, p. i, available at https://www.accc.gov.au/system/files/ACCC%20Final%20Determinations%20-%20Victorian%20wheat%20ports%20exemption%20assessments%20-%2025%20June%202015_0.pdf .

Box 4.3 Port Terminal Access Code[130]

In addition to the ports access regime established under the MSA Act (South Australia), the Port Terminal Access (Bulk Wheat) Code of Conduct (**PTAC**) also covers Viterra's port bulk loading facilities. The PTAC, which commenced in 2014, is a mandatory industry code of conduct made under the Competition and Consumer Act 2010 (Cth) and is administered by the ACCC.

The code's purpose is to ensure exporters of bulk grain[131] have fair and transparent access to port terminal services. Its key additional protections largely relate to ensuring port terminal capacity is allocated efficiently and fairly, from both long- and short-term perspectives.

If appropriate, the ACCC may reduce regulation at a port terminal, by exempting the relevant port terminal service provider from certain provisions of the PTAC. All of Viterra's South Australian port facilities are non-exempt, and the only other non-exempt Australian grain ports are Mackay, Gladstone and Portland.[132]

Non-exempt operators must:

- allocate available port terminal capacity through a mechanism that applies equally to all exporters (the capacity allocation system approved by the ACCC)
- have an access agreement in place when providing services
- publish certain information on their websites, such as the amount of capacity available on a weekly and annual basis, performance indicators, and grain stocks at each port terminal
- undertake a process for amending port loading protocols, including the requirement to consult, and
- comply with dispute resolution processes (including mediation and arbitration).

The PTAC does not provide the ACCC with a role in price setting or price negotiations for access to bulk wheat loading facilities. Rather, it assumes commercial negotiation will achieve a commercially advantageous result for both parties.[133] This approach is similarly adopted under the South Australian ports access regime (for bulk handling facilities).

In addition to its regulatory protections, the PTAC operates within the context of the broader competition regime administered by the ACCC. Recent amendments to the Competition and Consumer Act 2010 have strengthened the misuse of market power prohibition provisions available under general competition law, although such changes are still to be fully tested.

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130 Based on content from DAWR, *Wheat Port Code Review,* Interim Report; and ACCC, *ACCC Role in Wheat Export*, viewed 4 June 2018, available at https://www.accc.gov.au/business/industry-codes/wheat-port-code-of-conduct.

131 While PTAC was established to cover bulk wheat, it involves the allocation of capacity for all grains. As the ACCC noted, PTAC 'plays an important role in promoting port access for the exporters that buy bulk wheat and other grains from Australian growers' (source: ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, p. 5).

132 On 11 October 2017, the ACCC released a final determination granting exempt service provider status to LINX Cargo Care Group at its Berth 29, Port Adelaide facility, having earlier exempted Patrick for its operations at Berth 29 (available at https://www.accc.gov.au/regulated-infrastructure/wheat-export/wheat-export-projects/linx-port-adelaide-exemption). On 28 July 2017, the ACCC released a final determination granting exempt service provider status to Semaphore, at its port terminal facility at Osborne Berth 1, Inner Harbour – Port Adelaide (available at https://www.accc.gov.au/regulated-infrastructure/wheat-export/wheat-export-projects/semaphore-port-adelaide-wheat-port-exemption-assessment).

133 ACCC, *Viterra Application Seeking Capacity Allocation System Approval,* Final Decision, 3 December 2015, p. 29, available at https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20Viterra%27s%20application%20to%20vary%20its%20capacity%20allocation%20system%20-%203%20December%202015_0.pdf.

4.2.4 Grain handling, storage and grain outturn to vessel services

Viterra's upcountry storage and handling facilities are not covered by any industry-specific economic regulation. With Viterra having a substantial market share of commercial storage capacity (section 3.3.2.1) and operating just over 90 percent of exports in 2016-17, the market for grain handling, storage and grain outturn to vessel services is highly concentrated. Given Viterra has substantial market shares across key elements of the supply chain, the Commission investigated whether there is any evidence that Viterra is exercising market power and, if so, whether that behaviour is detrimental to grain export supply chain efficiency. Sections 4.3 and 4.4 report the results of this investigation, and section 4.5 presents an overall conclusion.

Based on the Inquiry method for assessing the efficiency of the supply chain (section 2.2) and the evidence necessary to make this assessment (Table 2.1), the Commission developed a detailed set of questions (Table B.1, Appendix B) to examine Viterra's market power. In practice, more than one interpretation is likely for a firm's specific action or behaviour, as reflected in the positive and negative interpretation of each question. Table B.2 summarises the evidence obtained from the questions.

Finding 4.1

Supply chain freight and port services fees are being set on a competitive basis, as a result of the relevant markets being either competitive or subject to sufficient regulatory oversight. Viterra's upcountry storage and handling facilities are not covered by industry-specific economic regulation. Consequently, it is important that the performance and behaviour of Viterra has been assessed by the Commission, given its position of strength within the supply chain.

4.3 Market structure for services that Viterra provides

Viterra has a substantial market share in both grain storage and port terminal operations respectively (sections 3.3.2 and 3.3.4). Consistent with the Inquiry method (section 2.2), the Commission investigated the extent to which these services offered by Viterra face competition that would constrain the firm's ability to exercise market power to the detriment of competition (sections 4.3.3–4.3.5).

4.3.1 Global context in which Viterra operates

In investigating the degree of market power that Viterra may exercise, it is useful to consider the global context in which the firm operates (particularly given the Commission is investigating the supply chain for the movement of bulk grain for export). As discussed in section 3.1, the global bulk grain export market is highly competitive, and South Australia's share is less than three percent (by volume). The market is characterised by a small number of global traders (which includes Viterra's related company, Glencore)[134] operating across many countries.

The South Australian bulk grain industry is a price taker[135] within the global market. Globally, Viterra faces pressure to be efficient in outturning bulk wheat to vessels, and to keep fees as low as possible, while maintaining the quality at required specification. To do so, Viterra should focus on the efficiency of its whole supply chain, from receiving bulk grain upcountry to transporting it to port and then loading it onto vessels. Otherwise, Viterra risks losing business to interstate and overseas competitors.

4.3.2 Defining the market

For this Inquiry, the (local) market for supply chain services is defined as the area bounded by the South Australian borders. Within that area, two separate geographic markets may be defined: the

[134] For more detail on Glencore Agriculture Pty Ltd, see its website http://www.glencoreagriculture.com/.
[135] Price taking is when the seller has no ability to affect the market price through their own actions, so has to accept the prevailing prices in the market.

Eyre Peninsula and eastern South Australia (remainder of the South Australian land mass). Factors such as the location of grain producing areas, the isolated Eyre Peninsula rail network, and the distance from the Eyre Peninsula to domestic markets means the potential for substitution between these two geographic areas is low. For practical purposes, therefore, they have been considered as separate markets for the purposes of the Inquiry.[136] Notwithstanding this, grain movements are not geographically constrained between South Australia and the eastern States, but respond to price spreads and the extent to which these signal profitable opportunities, such as in times of eastern Australian drought.[137]

While this Inquiry focuses on assessing market behaviour within the Eyre Peninsula and eastern South Australia, the global context may be important in explaining market behaviour at the local level (section 4.3.1). If Viterra could be considered to be operating efficiently, despite a lack of credible and constraining entry by new local operators (or the expansion of existing competitors), then the competitive pressures exerted on Viterra by the global bulk grains market may be driving this efficiency.

4.3.3 Direct localised competition from other operators

In 2011, Cargill entered the South Australian bulk grain export market (with the purchase of AWB Grainflow). Other potential competing bulk handlers to Viterra are listed in section 3.3.2.3.

In the case of port operators, Cargill has exported wheat from Berth 29 at Port Adelaide (operated by LINX) since 2015-16.[138] Viterra also competes with Semaphore, which exports bulk grain through Osborne Berth 1 at Port Adelaide.[139] Based on the ACCC Australian Crop Forecasters' data, Cargill and Semaphore had a combined 21 percent share of exports through Port Adelaide in 2016-17. Port Adelaide throughput represented 43 percent of total state grain exports in 2016-17.

There is no reason to assess the behaviour or financial performance of Cargill or any other new entrant given their position in the market. That is, there is no reason to believe that a new entrant has any market power to exercise to the detriment of competition and the efficiency of supply chain costs.

Viterra faces potential competition on the Eyre Peninsula, particularly for its grain operations at Port Lincoln. Table 4.1 provides a summary of new port proposals in South Australia.

No exits have been identified for storage and port terminal operators over the period covered by the Inquiry, but the number of traders fluctuates over time (section 3.3.1).

The test will be the extent to which this level of completion is maintained and/or increased.

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136 Further, eastern South Australia has limited access to the domestic bulk grain market whereas the Eyre Peninsula, given its location and an unconnected rail system, is largely confined to the export market. This confinement is notwithstanding the potential for the shipment of grain from the Eyre Peninsula ports to eastern state ports for domestic consumption when harvests in those states are insufficient to service domestic demand (Liz Wells, 'Southern grain cruises into Brisbane market', *Grain Central*, 29 January 2018, viewed 4 June 2018, available at www.graincentral.com).

137 For more discussion on this point refer to the commentary for item 2, Appendix G.

138 For detail on Cargill's grain operations at Port Adelaide, see ACCC, *Patrick Stevedoring Pty Ltd, Port Adelaide—Exemption Assessment of a Bulk Wheat Port Terminal Facility under the Port Terminal Access (Bulk Wheat) Code of Conduct,* Final Determination, 1 April 2016, available at https://www.accc.gov.au/system/files/20160401%20Exemption%20assessment%20-%20Patrick%20%28Port%20Adelaide%29%20-%20final%20determination_0.pdf.

139 For detail on Semaphore grain operations at Port Adelaide, see ACCC, *Semaphore Container Services Pty Ltd, Port Adelaide—Exemption Assessment of a Bulk Wheat Port Terminal Facility under the Port Terminal Access (Bulk Wheat) Code of Conduct,* Final Determination, 28 July 2017, available at https://www.accc.gov.au/system/files/FOR%20WEB%20-%20Semaphore%20final%20determination_0.pdf.

Table 4.1 New port proposals, South Australia[140]

Location and proponent	Elements of proposal
Port Bonython, Spencer Gulf Spencer Gulf Port Link, *led by Flinders Ports*	▶ bulk commodity port ▶ 3 kilometre jetty with covered conveyor ▶ Load cape-size vessels to 180,000 tonnes ▶ fully enclosed shed storage ▶ approximately 25 kilometre rail connection to national railway line ▶ Capacity of 75 million tonnes per year
Lucky Bay, Eyre Peninsula[141] T-Ports	▶ bulk storage facility at port (430,000 tonnes) and upcountry storage at Lock (150,000 tonnes) ▶ transhipment (barge) operation (from shallow harbour) to load Panamax vessels ▶ capacity of 377,000 tonnes per year ▶ multi-user and multi-commodity
Cape Hardy, Eyre Peninsula[142] Iron Road Ltd and Emerald Grain *Central Eyre Iron Project – working with Eyre Peninsula Co-operative Bulk Handling (EPCBH)*	▶ 1.3 kilometre jetty with covered conveyor ▶ load cape-size vessels to 220,000 tonnes ▶ open stockpile storage – 650,000 tonnes ▶ 150 kilometres of rail from mine to port ▶ capacity up to 25 million tonnes per year ▶ multi-user and multi-commodity (including grain)
Port Spencer[143] Free Eyre	▶ deep water port, located between Tumby Bay and Port Neill ▶ 620 metre wharf ▶ panamax sized vessels ▶ ship loader, multi-commodity (including grain) conveyor system, silos and sheds
Wallaroo, Yorke Peninsula[144] *Sea Transport*	▶ potential barging facility to service the grain industry ▶ capacity currently unknown
Decres Bay, Eyre Peninsula	▶ potential new port located western Eyre Peninsula, designed to compete with the port of Thevenard.
Smith Bay, Kangaroo Island[145] KI Plantation Timbers	▶ deep water, multi-user, multi-cargo facility. ▶ storage facilities for timber and containers ▶ multi-user and multi-commodity

Source: DPTI and Commission.

[140] Based on information provided by the DPTI, February 2017, for all but T-Ports' Lucky Bay proposal. Source: *GrainCentral*, 14 March 2018, viewed 14 March 2018 available at https://www.graincentral.com/.

[141] In May 2018, T-Ports announced an 87 metre transshipment vessel capable of carrying 3500 tonnes had been officially launched in China, and was expected to be available for 2018 grain harvest exports through Lucky Bay, starting in December 2018. Source: *GrainCentral*, 15 May 2018, viewed 15 May 2018 available at https://www.graincentral.com/trade/export-trade/t-ports-transhipment-vessel-launches-in-china/ . The operation is now expected to receive and export grain for the 2019 harvest. See also the T-Ports and Sea Transport Solutions websites.

[142] For more detail see *Cape Hardy Iron Road Deep-Sea Port* available at https://www.sa.gov.au/topics/planning-and-property/land-and-property-development/building-and-property-development-applications/major-development-applications-and-assessments/historical-listing-of-proposals-previously-assessed/cape-hardy-deep-sea-port .

[143] Port Lincoln Times, *Port Spencer Deep Sea Wharf reaches second stage of funding*, 22 October 2018, available at https://www.portlincolntimes.com.au/story/5714382/project-reaches-second-stage/.

[144] Sea Transport, potential for T-Ports Lucky Bay solution to be utilised in Wallaroo (Yorke Peninsula), viewed 30 November 2018, available at https://www.seatransport.com/new-transhipping-port-australia/

[145] For more detail see https://www.sa.gov.au/topics/planning-and-property/land-and-property-development/building-and-property-development-applications/major-development-applications-and-assessments/proposals-currently-being-assessed/kangaroo-island-plantation-timber-port-at-smith-bay.

Some prospective mining operations are proposing new deep sea ports on the Eyre Peninsula. In time, these ports could compete for grain exports. There is also a proposed shallow grain port operation (T-Ports), requiring double-handling of grain via barge to deeper parts of the Spencer Gulf. Such competition could result in a material loss of throughput at Viterra's Port Lincoln operation. It would also result in duplicated infrastructure and, while benefiting some geographically advantaged growers, might increase supply chain costs across the whole state (at least in the short to medium term). In the long term, however, such competition might result in lower supply chain costs if it drives efficiency across the industry.

More generally, third party access could potentially be achieved at all of Viterra's bulk loading infrastructure under the ports access regime, subject to land availability. This potential competition would likely constrain the extent to which Viterra might exercise market power to the detriment of competition: that is, the higher the returns that Viterra earns, the greater the likelihood that it will attract new entrants to erode such returns. Yet, GPSA submitted to the Economic and Finance Committee's primary producers' inquiry that the grain supply chain is well positioned with ports and storage located in the right spots, making it difficult for a competitor to compete with the existing infrastructure.[146]

While not covered by the Terms of Reference, containers provide potential competition and an avenue for possibly earning a higher return from on-farm storage in the case of high quality grains.

4.3.4 Competition from on-farm storage and grower cooperatives

The development of on-farm storage (which provides growers with greater choice and control) has been particularly slow in South Australia and Western Australia relative to the eastern states. Reasons for the small volume of on-farm storage include growers having access to a smaller domestic market. However, the Commission does find that there has been a material increase in the amount of on-farm storage in South Australia in recent years (section 3.3.2).[147]

Viterra's service model is based on trying to handle, accumulate and move bulk grain as quickly and efficiently as possible. To support this model, Viterra segregates its storage according to grain type classifications, and accounts for the costs of doing so. At times, this segregation may not favour certain growers. In those instances, some growers may decide to pursue markets demanding low volume, high quality grains.[148] However, the impact on Viterra's operations of growers pursuing such markets would be unlikely to be significant.

The potential competition on the Eyre Peninsula (section 4.3.3) also provides some evidence of growers' willingness to consider the merits of forming their own cooperatives to compete with Viterra in storage and handling.[149]

4.3.5 Interstate bypass through traders

On occasion, some traders bypass Viterra port facilities by transporting grain interstate by rail. This behaviour is evidence that grain growers in eastern South Australia are not limited to using Viterra's export facilities. But it is likely to be commercially viable only when poor harvests in the eastern states' push up domestic grain prices.

Viterra also submitted that it faces competition from interstate grain handlers (in areas such as western Victoria and south west New South Wales) seeking to capture South Australian harvested

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146 Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers,* Final Report, p. 134.

147 AEGIC understands more than 80 percent of an average harvest for the eastern states can now be placed in permanent on-farm storage. On-farm storage in South Australia and Western Australia is much less, but continues to grow, albeit as at slower pace. (Source: AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 11).

148 One instance presented to the Commission involves Mr Mark Shilling, who grows high quality grains on the Yorke Peninsula, particularly lentils. Mr Schilling identified that the market is willing to pay a premium for the higher specifications that he can produce, but Viterra's system does not cater for this willingness.

149 *Australian Financial Review*, 'Aussies fight to stay cream of the crop', 7–8 October 2017, p. 26, available at www.afr.com.

grain.[150] But, again, this competition would seem limited at best, given the proximity of most South Australian grain growing regions to South Australian ports.

Finding 4.2

Viterra faces some competition (actual and potential), for example, in the case of port operators, LINX-Cargill and Semaphore currently compete with Viterra at Port Adelaide, with new entrant T-Ports intending to compete with Viterra at Port Lincoln from the 2019 harvest. However, the extent to which competition places effective and credible discipline on Viterra's behaviour is not clear. The global market may place more effective discipline on Viterra's behaviour than any local competition could.

4.4 Investigating Viterra's market behaviour

Because Viterra has a high market share across a number of the supply chain segments, and faces only niche competition (that is, competitors operating a combined total of less than 15 percent of commercial sites) (section 4.3.3), the Commission investigated whether Viterra may exercise market power in a sustained manner to the detriment of competition:

- First, it examined customer satisfaction with Viterra's services (section 4.4.1) and how effectively Viterra is managing its costs and assets (section 4.4.2). If Viterra is not performing well in these areas, it might not be operating in a competitive market (given the expectation that in a competitive market it would be displaced by firms that can meet customers' expectations and effectively manage their costs and assets).
- Next, the Commission examined fee levels (section 4.4.3), because excessive fees might underpin an excessive return, on average, relative to that expected for a firm with Viterra's risk profile. It assessed Viterra's financial returns to determine whether they are greater than might be expected for a firm with Viterra's risk profile (section 4.4.4). Excessive returns or fees would not be sustainable in a competitive market.
- The Commission also investigated a sample of Viterra fees and practices, to determine whether Viterra is engaging in any sustained behaviour that inhibits a competitive outcome, such as pricing to create a barrier to new competition or expansion by existing competitors (section 4.4.5).
- Finally, the Commission looked at the market transparency of Viterra's operations (section 4.4.6). A market failure resulting from lack of market information could mean competitors cannot make an informed decision on the returns available from entering the market (or expanding existing operations). Similarly, growers and traders need transparency to enable them to understand the basis of the fees being charged, and enable them to assess the merits of alternatives. In this case, Viterra would not face the level of competition that it might otherwise.

Section 4.5 presents the Commission's overall conclusion on Viterra's market behaviour. In reaching a conclusion, the Commission considered the grain industry's significant restructuring since 2008, and firms' possible response to such a restructuring. Viterra, for example, has engaged in a range of pricing practices (meaning growers have moved from a single pool price through other pricing approaches), so some growers could feel the price structure changes have not been to their advantage. The Commission is seeking, however, to identify the efficiency of the overall supply chain, not the impact on individual growers.

[150] Viterra, *Response to Public Submissions*, June 2017.

4.4.1 Are customers satisfied with Viterra's services?

Within and across the broad service categories of the supply chain, a range of activities define, or contribute to, service levels. Some services are easily observable to customers when they transact with Viterra, while others may be less apparent. (This section does not examine the regulatory standards that drive service levels and, therefore, supply chain costs.)

Viterra classifies its customers into three distinct customer groups:

- growers (about 5000 trading entities in 2017)—section 4.4.1.1
- export traders (12 for the 2017-18 harvest)—section 4.4.1.2
- End use customers, who are customers of Viterra's bulk grain in receiving countries (exact number unknown). This Report does not discuss these customers because they are not within scope of the supply chain market (as defined for this Inquiry).

The service requirements within, and between, customer 'groups' are different.

4.4.1.1 Growers

Customer satisfaction varies from grower to grower, based on individual experiences with each service provided by Viterra, and these experiences may vary from year to year. Based on available facts and evidence, Viterra seeks to measure its performance in providing services to growers and it does so in a robust manner. It submitted evidence that it acted to improve customer service in response to customer feedback. The Commission considers Viterra, as a near-monopoly service provider, would not have taken these actions unless it is self-motivated to provide good customer service. This section reports the data and information from Viterra that supports this finding.

Viterra submitted that it uses both formal and informal (including ad hoc) methods to capture grower feedback, such as:

- annual grower customer surveys,[151] which seek to measure grower satisfaction with Viterra's service levels
- silo committees, which are established on a regional basis and used to disseminate information and negotiate optimal outcomes between Viterra and growers on harvest matters, and industry and supply chain matters
- pre- and post-harvest meetings, which are attended by growers and silo committee chairs, and used to receive feedback on previous harvests and future harvests (including regional production trends)
- complaint resolution procedures, which exist across many aspects of Viterra's activities, including grain classification, warehousing and port services.

[151] Viterra contracted a market research company to conduct its annual post-harvest grower survey.

(a) General customer satisfaction measures

Viterra's overall customer satisfaction was 78 percent in 2016-17 compared with 80 percent in 2015-16.[152] Having reviewed the customer feedback, the Commission considered that:

- There may not be one 'customer voice' among Viterra's customers. The services that Viterra offers can vary regionally as well as from year to year, and customers may have differing requirements at different times. The Commission also recognised Viterra aims to optimise its supply chain on a network basis, which may lead to undesirable outcomes for individual growers.
- Based on annual grower surveys, Viterra's overall level of customer satisfaction rose from 2013-14, which may be evidence of a greater focus by Viterra on addressing customers' issues.

(b) Specific customer satisfaction measures

The Commission considered views and evidence on aspects of Viterra's service provision that customers and Viterra raised. Table 4.2 lists the Commission's observations.

Table 4.2 Customer satisfaction measures, Viterra

Area of service	Commission's observations
Opening hours for silos	▶ Customer satisfaction information on this service is not consistent. Customer satisfaction for this measure fell between 2015-16 and 2016-17 in Viterra's annual grower survey, but it increased in GPSA's survey. ▶ Viterra determines its opening hours after considering a range of factors, including expected grain deliveries, operating costs and safety issues (for example, staff fatigue).[153] Viterra is best placed to consider the extent to which it offers fee for service.
Classification accuracy and consistency	▶ Viterra recorded a relatively large fall in satisfaction from 2015-16 to 2016-17 in this measure. However, pressures in dealing with the record 2016-17 harvest might have influenced this outcome. ▶ Viterra allows multiple opportunities for classification: if a grower is not happy with the classification, they can return as many times as they want for re-classification (at Viterra's expense). If the grower is still not happy with the result, they can lodge a formal complaint with Viterra. ▶ Viterra is working to introduce automatic classification technology, which should reduce any subjectivity (or perceived subjectivity) in grain classification. ▶ To improve classification accuracy, Viterra is introducing dynamic binning for wheat, from the 2018-19 harvest. Dynamic binning seeks to provide growers with more flexibility to access a higher grade for loads just outside of the receival standards.[154]

Source: Viterra and customer representatives.

[152] As measured in Viterra's 2017 annual grower post-harvest survey. The sample for 2016-17 was 289, out of approximately 3500 growers contacted. The question posed was *'Overall, how well did Viterra meet your grain handling needs across all sites that received your grain – whether delivered by you or a carrier?'* Answers were based on a 1–5 scale. The average level of satisfaction for all regions was 3.9 in 2016-17 and 4.0 in 2015-16.

[153] Viterra offers some flexibility in opening hours and times, with various fees as set out in its *Pricing, Procedures and Protocols Manual*. A Domestic Outturn Surcharge, for example, applies if a client requests labour at a port terminal outside normal operating hours (Source:Viterra, *Pricing, Procedures and Protocols Manual*, 2017, p. 22, viewed 14 May 2018, available at http://viterra.com.au/wp-content/uploads/Pricing-Procedures-and-Protocols-Manual-Schedule-A-L-2017_18.pdf.

[154] Viterra, *Inquiry into the South Australian Bulk Grain Export Supply Chain Costs – Response to Draft Report*, October 2018, p. 20.

4.4.1.2 Export traders

There is an absence of survey information on export customer satisfaction. GPSA submitted to the Economic and Finance Committee's primary producers' inquiry that no grain marketing individual, grain marketing organisation or organisation representing marketers of grain made a submission to Part 1 of the Commission's Inquiry (consultation on Terms of Reference).[155] This was also the case for consultation on the Inquiry Draft Report. However, the Commission discussed matters with some export traders in preparing the Inquiry Draft Report and during the consultation period following its release. Commission staff made a presentation on the Draft Report to the traders' association (GIASA). Section 4.2.3.2 covers one of the issues raised during these discussions (operational flexibility concerns with the operation of PTAC).

Viterra submitted that typical demands from its export customers include:

- shipping capacity: higher demand for shipping capacity early in the season, certainty of shipping capacity and pricing in future years, and flexibility to move bookings for shipping capacity between ports, time periods and exporters
- vessel sizes: ability to accommodate changing vessel sizes and configurations
- vessel loading: timely loading of vessels with grain that meets exact specifications.

> Finding 4.3
>
> Viterra seeks to measure its performance in meeting the customer service needs of growers, and it does so in a robust manner. It submitted evidence of its actions to improve customer service in response to customer feedback. These actions are consistent with a firm seeking to meet customer needs.

4.4.2 Is Viterra managing its costs and assets well?

Viterra needs to manage its costs in the context of highly volatile grain production. There is pressure on Viterra to work its assets hard for half of the year, during harvest and the peak export period. The evidence provided to the Commission is that Viterra seeks to maximise throughput and its operating surplus.[156]

In forming a view on Viterra's behaviour in terms of its costs and asset management practices, the Commission investigated the firm's:

- capital expenditure and asset management—section 4.4.2.1
- operating expenditure trends and drivers (with a focus on labour, and transport and logistics)[157] – section 4.4.2.2, and
- capital and operating efficiencies—section 4.4.2.3.

[155] GPSA, *Submission to Economics and Finance Committee*, 21 July 2017, p. 4.

[156] While maximising throughput leads to an efficient use of fixed infrastructure, the fees charged are not necessarily efficient. That is, maximising profits is a function of quantity (throughput) and price. If no, or limited, substitutes exist, then a firm that can exercise market power will have greater ability to increase prices without any significant reduction in demand. For this reason, the Commission investigated Viterra's fees (section 4.4.3) and financial returns (section 4.4.4).

[157] These are the two highest operating expenditure categories for Viterra. Together, they accounted for 70 percent of the firm's operating expenditure in 2016-17.

4.4.2.1 Capital expenditure and asset management

Evidence considered by the Commission supports the view that Viterra's capital expenditure and asset management practices are sound. In forming this view, the Commission relied on information provided by Viterra, including:[158]

- recent examples of Viterra's capital expenditure efficiencies (section 4.4.2.3)
- a submission from Viterra on its capital expenditure controls
- a submission from Viterra that it maintains a 'sustainable level of capital expenditure', informed by external engineering and internal assessments, and
- a submission from Viterra that it considers the overall efficiency of the supply chain when making expenditure decisions (for example, by temporarily or permanently closing inefficient supply chain sites, including silos,[159] or by balancing vertical and horizontal storage capital assets[160] to maximise network efficiency).

4.4.2.2 Operating expenditure trends and drivers

Evidence to date supports Viterra's approach to managing labour costs, and its associated policies and procedures, being sound. The Commission examined Viterra's labour force expenditure, including its recruitment practices, training and safety procedures and strategies,[161] strategy for staffing during harvest, and other strategies for reducing labour costs. The firm's labour is, on average, its largest operating cost driver (approximately 35 percent of Viterra's annual operating expenditure in 2016-17). Table 4.3 summarises some labour cost data.

Table 4.3 Viterra's management of labour costs

Labour cost consideration	Results
Total labour costs	▶ As a result of implementing labour efficiencies (see labour portfolio mix below), labour costs per tonne of grain received have fallen (by around 7 percent per year in real terms) since 2013.[162]
Labour portfolio mix	▶ Viterra demonstrated it actively considers its mix of casual, part-time and full-time labour. In June 2017, for example, Viterra transferred 100 positions from casual and permanent part-time positions to permanent positions[163] to reduce its total labour costs. In addition, it negotiated flexible arrangements within the Enterprise Agreements.
Managing wage increases	▶ Average annual Enterprise Agreement wage increases (costs per hour) fell between 2014 and 2017, from 3.17 percent to 2.39 percent.[164] This increase remains, however, above CPI and marginally above the ABS wage price indices.

Source: Viterra.

[158] The Commission undertook a limited form of review of Viterra's capital and asset management practices, which was neither a comprehensive audit nor an engineering review.

[159] Viterra's permanently closed sites progressively increased from 200,000 tonnes per year in 2007 to 500,000 tonnes per year in 2017, due to lower grower use and/or ageing infrastructure (source: Viterra response to request for information).

[160] The capital costs of these two asset types vary considerably. Viterra demonstrated it considers these costs when determining the optimum mix of these assets within its business, and it has increased horizontal assets in recent years (source: Viterra response to request for information).

[161] Viterra's labour costs include training and safety costs (source Viterra response to request for information).

[162] The Commission sought to benchmark Viterra's labour costs against those of other grain handling firms. Except for CBH, this information is not publicly available. CBH labour costs are available for 2013–2016 and are comparable, on a dollar per tonne basis, with those of Viterra. Care should be taken when comparing Viterra and CBH (section 4.4.3.3).

[163] Viterra website, viewed 15 May 2018, available at http://viterra.com.au/index.php/2017/06/22/100-permanent-jobs-created/.

[164] Equal to an average of 2.65 percent per year across the period.

Transport and logistics, on average, are the second largest operating cost driver for Viterra (around 35 percent of Viterra's annual operating expenditure in 2016-17). The majority of these costs are rail costs (mainly Viterra's contracted costs with GWA) and road costs (mainly Viterra's contracted costs with its road freight service providers). The freight segment of the supply chain is highly competitive, so the Commission expects these costs to be efficient (sections 4.2.1 and 4.2.2).

4.4.2.3 Capital and operating efficiencies

Viterra demonstrated it seeks to maximise tonnage handled in an effort to achieve its best possible operating surplus. Similarly, GPSA submitted 'South Australia's providential port infrastructure and port terminal service operators have a consolidated interest in maximising volume through bulk grain export terminals'.[165] Viterra submitted that it has been able to capture the benefits of the competitive freight transport by regularly tendering for its road and rail services.[166] In particular, it has:[167]

- sought and achieved additional efficiency improvements in managing both rail and road costs in recent years, and
- demonstrated a willingness to work with the rail operator (GWA) to achieve the best commercial outcome for both parties, and to the benefit of growers through reduced freight rates.[168] Table 4.4 contains examples of efficiency initiatives.

Table 4.4 Examples of road and rail related efficiencies

Initiative	Explanation and efficiency improvement
Cessation of inefficient rail services	▶ Based on its financial assessment, Viterra did not renew its contract for rail services in the Pinnaroo and Loxton lines meaning that this service ceased in 2015.
Renegotiation of rail service pricing method	▶ In 2015, Viterra renegotiated pricing arrangements with GWA. It submitted that this change resulted in a significant reduction in overall costs. A fixed price contract provided GWA with sufficient certainty to undertake necessary expenditures to achieve the standard of service that Viterra seeks.
Consolidation of road freight service providers	▶ Before 2009, Viterra had over 300 road freight service providers. It submitted that the arrangements were 'localised and fragmented.' Since 2009, it has conducted several consolidations and now has only seven providers. Viterra submitted that this consolidation has resulted in efficiency benefits from reduced staffing levels, greater port capacity released to export markets, and greater confidence in meeting export, compliance and safety requirements.

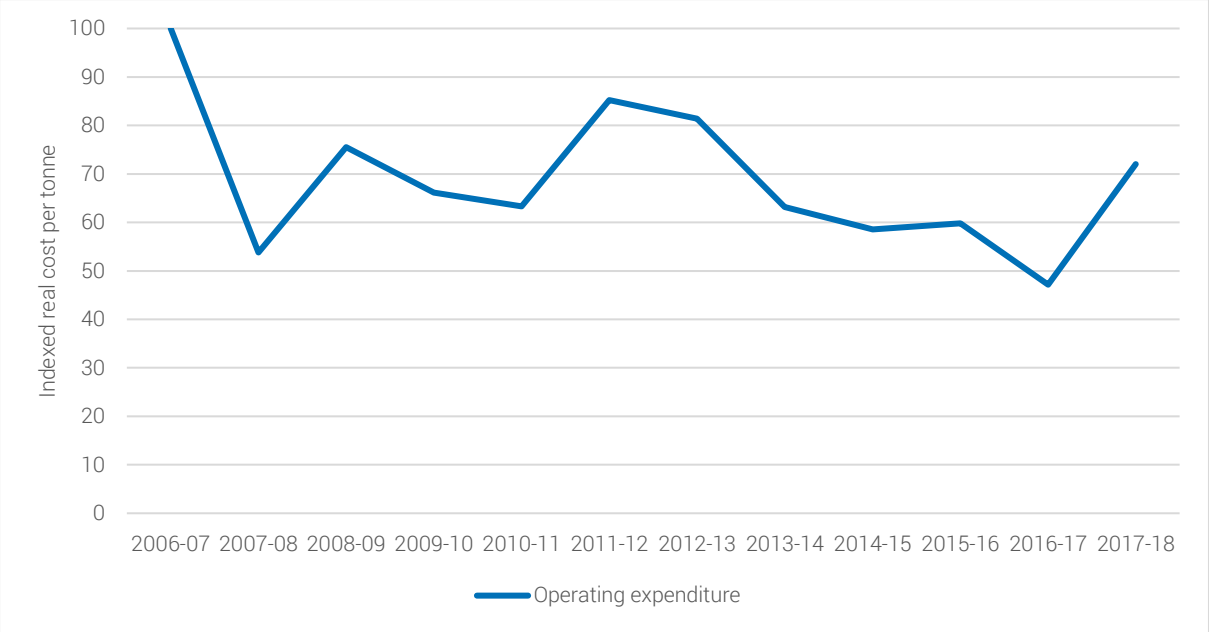
Source: Viterra.

Figure 4.1 tracks movements in Viterra's operating expenditure for 2006-07 to 2017-18. The real dollar per tonne financial figures provided by Viterra have been indexed in a manner that shows trend but does not identify the absolute values - termed 'indexed real cost per tonne'.[169] It shows a pronounced

[165] GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 6.
[166] The last tendering process for rail services occurred in 2013, and the last tendering process for road was in 2015.
[167] Viterra response to request for information.
[168] Noting freight rates are only one component of supply chain fees.
[169] The Commission has received information from Viterra over which confidentiality has been claimed. As a result, at this time, the Commission has decided not to disclose information in this report, in part or in total, which is subject to such a claim (section 2.3). Consequently, the Commission has converted this data into an index as Viterra has claimed it is commercial in confidence.

downwards trend in costs over the period covered by the Inquiry (Figure 4.1). Viterra's operational practices thus suggest an efficient business from a logistical perspective.[170]

Figure 4.1 Movement in operating expense, Viterra, 2006-07 to 2017-18[171]



Source: Commission analysis of Viterra provided data.

Finding 4.4

Viterra appears to be operating as a cost effective bulk grain accumulator that can meet peak harvest demand and compete in the global context.

4.4.3 Are Viterra's fees excessive?

This section examines Viterra's fees, by first discussing fee structure (section 4.4.3.1), then identifying fee trends (section 4.4.3.2), and comparing them with Viterra's counterparts (section 4.4.3.3).

When the Commission examined specific supply chain fees for this Inquiry, it was considering whether there was any exercise of market power to the detriment of competition. It was not seeking to verify whether each fee reflects the efficient cost of the specific service being provided,[172] (that is, it did not undertake the bottom-up review of costs that a price determination would use.)[173] However, the level of fees are only one consideration, with service quality also being important. As noted in section 4.4.1,

[170] The operating expense line increases in 2017-18 (Figure 4.1). Due to the extent of Viterra's costs being fixed in nature, the indexed cost per tonne is impacted by the volume over which these costs are spread in any given year, with 2017-18 volumes being notably lower than any of the previous four years. Nevertheless, comparing Viterra's 2017-18 performance with its performance in 2012-13, given receival tonnages are almost the same for these years (within 100,000 tonnes), shows operating expense is significantly lower in 2017-18, which is consistent with Viterra pursuing cost efficiencies over this time.

[171] The financial information provided by Viterra includes revenues and expenses associated with both domestic and export bulk grain handling activities. To disaggregate this information in order to isolate the export supply chain component would require apportionment. In this context, on average, around 90 percent of Viterra's grain receivals are exported. Given asset values are also based on sites used for both domestic and export bulk grain handling, the financial return estimates have been derived on a consistent basis, noting that export is the dominant element.

[172] Fees that reflect efficient costs are referred to as efficient fees (prices). Economic theory suggests efficient costs and prices are an outcome of effective competition. Effective or workable competition exists when competitors (new or existing) constrain the market power of suppliers to raise price persistently. Workable competition limits the firm's ability to extract excessive profits. Firms earn profits in a competitive market, but at levels (on a sustainable basis) just sufficient to encourage and reward investment, efficiency and innovations. For further discussion on this point, see Economic Regulatory Authority, *The Efficient Costs and Tariffs of the Water Corporation, Aqwest and Busselton Water*, 2017, p. 7.

[173] Such as the Commission might undertake when assessing efficient costs for a regulated firm, such as SA Water.

Viterra submitted evidence of the manner in which it acted to improve customer service in response to customer feedback.

Further, a reliable and efficient grains operator is crucial in enabling the South Australian grain industry to retain a competitive position in the global market. To this end, Viterra submitted that the 2016-17 harvest proved the strength of its South Australian bulk grain supply chain. It managed record receivals, set records at many of its sites, and fully used its upcountry, logistics and terminal assets, including new storage added before harvest, in response to grower feedback.[174]

4.4.3.1 Fee structure

Viterra submitted that it sets fees on a whole of supply chain (network) basis; it does so to maximise the use of its network and achieve efficiencies from scale, spreading network fixed costs across the supply chain. This approach means individual fees may not necessarily reflect costs for a specific service at any location or time. Viterra's Export Select service is an example (Box 4.4) of how it seeks to encourage greater use of its network. Section 4.4.5 considers the efficiency implications for the grain export supply chain of Viterra's strategic approach to fee setting.

Two key aspects of Viterra's Export Select product make it an effective tool for encouraging and managing the accumulation of grain:

- First, Export Select provides traders with a straightforward option for getting grain onto a vessel, thereby reducing their transaction costs. If the trader has confidence that Viterra will deliver its grain as required, it has a strong incentive to use Export Select because the trader can choose the extent to which the costs and rebate are passed through to growers.[175] Any given transaction between a grower and a trader, therefore, can result in the use of the Export Select product, regardless of the grower's preference.
- Second, in the majority of cases, access to Viterra's freight rates is conditional on the use of Export Select. Since Viterra was acquired (late 2012)[176], the firm has focused on driving cost efficiencies from Viterra's freight operations through numerous initiatives across the supply chain. As a result, Viterra reduced its reported transport and logistics costs by 43 percent between the 2013 and 2017 harvest years (based on change in real $ per tonne[177]). The overall effect of this is that, in order to be able to benefit from Viterra's freight rates (Export Select), the trader must use Viterra's upcountry storage and handling facilities.

A benefit–cost analysis of the merits of Export Select is not possible without knowing the cost of alternative transport paths. The Commission has not undertaken such a task for the Inquiry, because Export Select covers only a component of supply chain costs and there is no evidence that the freight component is not efficient.[178]

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[174] Viterra, *Submission to the Inquiry into the South Australia Bulk Grain Export Supply Chain Costs*, May 2017, p. 2.

[175] The Commission understands that traders use locational differentials set by Grain Trade Australia in developing contracts with growers. Grain Trade Australia sets the South Australia locational differentials using the freight charges published by Viterra. The Commission has taken Export Select to encompass the freight rates.

[176] Glencore Xstrata, *Annual Report 2013*, p. 177, available at http://www.glencore.com/dam/jcr:3947c394-5d53-4e00-b5a8-16fe4eb62ee9/GLEN-2013-Annual-Report.pdf.

[177] All references to per tonne calculations in this report are based on actual receival tonnage, unless otherwise stated.

[178] Export Select covers Export Select freight rates, Viterra's outturn fee and Viterra's port inloading fee (and the rebate if applicable). Source: Viterra website, viewed 4 June 2018, available at http://viterra.com.au/index.php/export-select-freight-rates/.

Box 4.4 Export Select

Export Select is a logistics service that Viterra offers to grain traders. The bundled service consists of an end-to-end process to move grain from a Viterra upcountry receival site to a Viterra port. It covers: grain accumulation; upcountry outturn of grain (but not receival or storage services); transport to port; and port inloading (but not storage at port or outloading onto vessels). According to Viterra, Export Select 'allows Viterra to handle the handling and logistics task in the most efficient manner possible'.[179]

Users of Export Select transfer their grain stock into Viterra's system.[180] Traders can combine their accumulation with grain from other sources. On behalf of the trader, Viterra consolidates, accumulates and manages the logistics task from the upcountry sites to port.[181] It classifies certain sites, or commodities or grades at sites, as Export Select-only. Viterra submitted that this process facilitates its ability at certain sites to outturn in an efficient and cost-effective manner. It submitted that it will swap customers out of Export Select-only sites to alternatives, if those customers wish to organise their own transport, or outturn domestically. Alternatively, Viterra may allow the customer to outturn from an Export Select-only site, subject to the timing or the efficiency of the movement.[182]

Export Select is optional for Viterra's customers, but it is the preferred method for export traders.[183] Viterra submitted that potential Export Select benefits to traders include:

- an increased probability, while not guaranteed, that an exporter's grain is received at port on time and meets the required specifications
- protection from adverse freight rate movements, because rates are fixed at the time of transfer[184]
- known freight rates between upcountry sites and ports, with Export Select rates published every month
- the adoption of Export Select rates by Grain Trade Australia as the location differentials,[185] and
- a rebate for using Export Select, which was introduced in 2009.[186]

[179] Viterra, *Pricing, Procedures and Protocols Manual*, p. 29, viewed 15 May 2018, available at http://viterra.com.au/wp-content/themes/viterra/documents/Pricing,%20Procedures%20and%20Protocols%20Manual%202016_17%20(Schedule%20A-L)2.pdf.

[180] That is, while Export Select does not cover receival and storage services, the grain must be in Viterra's upcountry storage for the trader to use the Export Select service.

[181] Viterra, *Submission to the Inquiry into the South Australia Bulk Grain Export Supply Chain Costs*, May 2017, p. 10.

[182] Viterra, *Response to Public Submissions*, June 2017.

[183] Viterra, *Submission to the Inquiry into the South Australia Bulk Grain Export Supply Chain Costs*, May 2017. Export Select covers most deliveries from Viterra's upcountry facilities to a Viterra port (source: Viterra response to request for information).

[184] ACCC, *Viterra Application Seeking Capacity Allocation System Approval,* Draft Decision, 16 July 2015, p. 44, available at https://www.accc.gov.au/system/files/accc%20draft%20decision%20on%20viterra%20long%20term%20agreement%20proposal.pdf .

[185] Buyers deduct location differentials from port prices to establish a grain price at each site.

[186] This rebate has gradually been reduced over time, resulting in progressive increases in fees. For 2017-18 season grain, the rebate was $0.60 per tonne for client transfers before 15 January 2018. Source: Viterra, *Export Supply Chain Fees 2017/18 Explained*, viewed 15 May 2018, available at http://viterra.com.au/wp-content/uploads/Export-supply-chain-fees-201718-explained.pdf.

Subject to issues of detail, the Commission considers Viterra's pricing to maximise network throughput is not an unreasonable method for setting fees (if it does not detrimentally affect supply chain efficiency), because:

- Maximising throughput is necessary to achieve cost competitiveness in a global market.
- This method allows Viterra to manage throughput efficiently and minimise congestion that may occur when demand is high (for example, at ports during the export intensive months). Viterra provided the Commission with an example (Jamestown and Gulnare) of how cost-reflective supply chain fees at an individual site during harvest can lead to an inefficient use of network resources (Box 4.5).
- There is likely to be a trade-off between a theoretical pricing approach and one that can be cost-effectively administered. Setting fees for each individual site to reflect costs at a point in time, for example, could result in significant price differences between and within harvests and locations, which may be difficult to explain to growers and may be costly to administer.

However, the view that network based pricing is reasonable has limitations. Such pricing should not be conducted in a way that is anti-competitive. Section 4.4.5 reports on the Commission's investigation of whether Viterra is engaging in any sustained behaviour that inhibits a competitive outcome.

Box 4.5 Changing prices to encourage greater use of network—the Gladstone, Gulnare and Jamestown sites

Viterra's Gladstone, Gulnare and Jamestown sites are located in the upper Central region. Its Yongala and Caltowie sites (in the same region) had already closed, due to low use and high capital requirements.

In 2015, Viterra's post-harvest analysis identified reduced receivals and use at Gulnare and Jamestown would result in the closure of these sites. But both sites were in good condition and did not require significant capital expenditure.

For network efficiency, Gulnare and Jamestown sites needed to remain open to:

- reduce overall site labour and capital expenditure to meet deliveries
- segregate smaller volumes and/or less mainstream grains without interrupting higher volume activities
- reduce expenditure on extra storage at Gladstone in 2016-17.

In response, Viterra lowered freight rates for these sites, which encouraged increased receivals and led to the better use of existing network assets.

4.4.3.2 Viterra fee trends

The Commission compared 2013-14 and 2017-18 supply chain fees[187] for a sample of upcountry to port pathways (Table 4.5). Box 4.6 explains why the Commission chose the four pathways.

Table 4.5 Fees comparison, by sample grain pathway ($ nominal)[188]

Pathway to port	2013-14 $/tonne	2017-18 $/tonne	Total increase over period	Average annualised increase
Cummins to Port Lincoln—rail	$46.16	$50.82	+10.1%	+2.4%
Poochera to Thevenard—road	$57.75	$63.76	+10.4%	+2.5%
Roseworthy to Outer Harbor—road	$48.50	$53.67	+10.7%	+2.6%
Tailem Bend to Outer Harbor—rail	$53.61	$58.42	+9.0%	+2.2%
Average increase—sample grain pathways			**+10.0%**	**+2.4%**
Consumer price index[189]			**+7.0%**	**+1.7%**
Simple average of producer price indexes[190]			**+8.4%**	**+2.0%**

Source: Essential Services Commission, using publicly sourced Viterra fee schedules.

Appendix E contains a full breakdown of fees for each of the grain pathways. This breakdown shows fee movements from 2013-14 to 2017-18 for the following fee categories (annualised in parentheses):

- upcountry storage and handling:[191] simple average increase of 15.7 percent (+3.7 percent per year)
- freight transport to port:[192] simple average decrease of 0.1 percent (-0.02 percent per year), and
- port services:[193] simple average increase of 11.6 percent (+2.8 percent per year).

[187] All fees were sourced from publicly available information: *Viterra Wheat Reference Prices—Port Terminal Services*; *Viterra Export Select Group Fees*; and *Viterra Schedule A – Storage and Handling Charges*. Supply chain fees will vary depending on the month of shipping chosen for comparison. Viterra amended its shipping charging structure in 2014-15.

[188] The Inquiry fee analysis has not been updated for Viterra's 2018-19 fees as the most recent AEGIC comparison data available is for 2017-18 (refer Figures 4.3 to 4.5). However, the Commission has analysed the 2018-19 Viterra fees for the sample grain pathways in Table 4.5, and can confirm that the increases in fees continue to be broadly in line with those observed in Table 4.5 (that is, at a level only marginally above inflation).

[189] ABS, *Consumer Price Index (CPI)—All Groups—Weighted Average Of Eight Capital Cities*.

[190] ABS, *Producer Price Indices*, established to monitor price changes for inputs to specific industry groups.

[191] Comprising the following fees: upcountry receival; upcountry outturn; storage at notional port (for three months) less rebate. Excludes shrinkage and dust fees.

[192] Export Select freight rate.

[193] Comprising the following fees: port inloading; port handling and shipping; and capacity booking fee. Excludes miscellaneous port/wharf fees or levies.

Box 4.6 Explanation of Viterra fee comparison

A sample of fees is necessary, given the multiple pathways and different times of the year for delivering grain to South Australia's six ports, and the different lengths of time for which grain may be warehoused.

The four sample pathways adopted:

- are based on bulk wheat, using Export Select (given wheat is the primary crop, and Export Select covers most deliveries from Viterra's upcountry facilities to a Viterra port)
- have two grain pathways on the Eyre Peninsula and two on eastern South Australia (the two chosen South Australian markets), to check whether fees vary by market, driven by factors such as varying levels of actual competition
- include two grain pathways using rail transport and two using road transport, to check whether customers may be disadvantaged by their access to one freight mode over another
- are based on receival in December, with three months storage, then outturn to vessel in March,[194] so the fees reflect levels that customers face in a typical peak period.

Within the sample pathways, the Commission chose the following actual pathways to test a range of possible scenarios, and compare the two markets (the Eyre Peninsula and eastern South Australia):

- Cummins to Port Lincoln (Eyre Peninsula), as an example of an upcountry site located within a Viterra Grower Delivery Zone, delivering to a port that is covered by a Grower Delivery Zone
- Poochera to Thevenard (Eyre Peninsula), as an example of an upcountry site not located within a Viterra Grower Delivery Zone, delivering to a port that is not covered by a Grower Delivery Zone
- Roseworthy to Outer Harbor (eastern South Australia), as an example of an upcountry site located within a Viterra Grower Delivery Zone, delivering to a port that is covered by a Grower Delivery Zone (enabling comparison between Eyre Peninsula and eastern South Australia markets)
- Tailem Bend to Outer Harbor (eastern South Australia), as an example to compare a Viterra Export Select pathway with a competitor third party operator not located within a Viterra Grower Delivery Zone delivering to a port that is covered by a Grower Delivery Zone, which is covered in section 4.4.5.

These upcountry sites are all Viterra tier 1 sites, which is where most grain is delivered.[195] While receival fees vary between tier 1 ($12.90 per tonne in 2017-18) and tier 2 ($13.65 per tonne in 2017-18), the difference (6 percent) is not considered large enough to risk introducing distortions into the analysis. Poochera is a confirmed operational site for deliveries to Thevenard (road-served), which is far enough away from the port to have a material freight rate. Roseworthy is a key road-served mid-north (eastern South Australia) site. Tailem Bend is a major rail outturn site on eastern South Australia, as is Cummins on the Eyre Peninsula.

Table 4.5 shows total upcountry-to-vessel loading fees across the sample grain pathways are broadly stable, having moved at an average rate only slightly above inflation over 2013-14 to 2017-18. Across the four pathways, fees vary by only a few percentage points from the average. This result does not appear to support, one way or other, whether Viterra is engaging in pricing behaviour to respond to the actual competition that it faces on eastern South Australia.

[194] While Viterra submitted that the first month of storage is free, it charges a monthly storage fee for grain on-hand as at the first of each month (*Pricing, Procedures and Protocols Manual*, *Schedule A—Storage And Handling Charges 2017/18*). Consequently, grain delivered mid-December would face its first monthly fee on 1 January, then 1 February and finally 1 March (three months in total) before export in March.

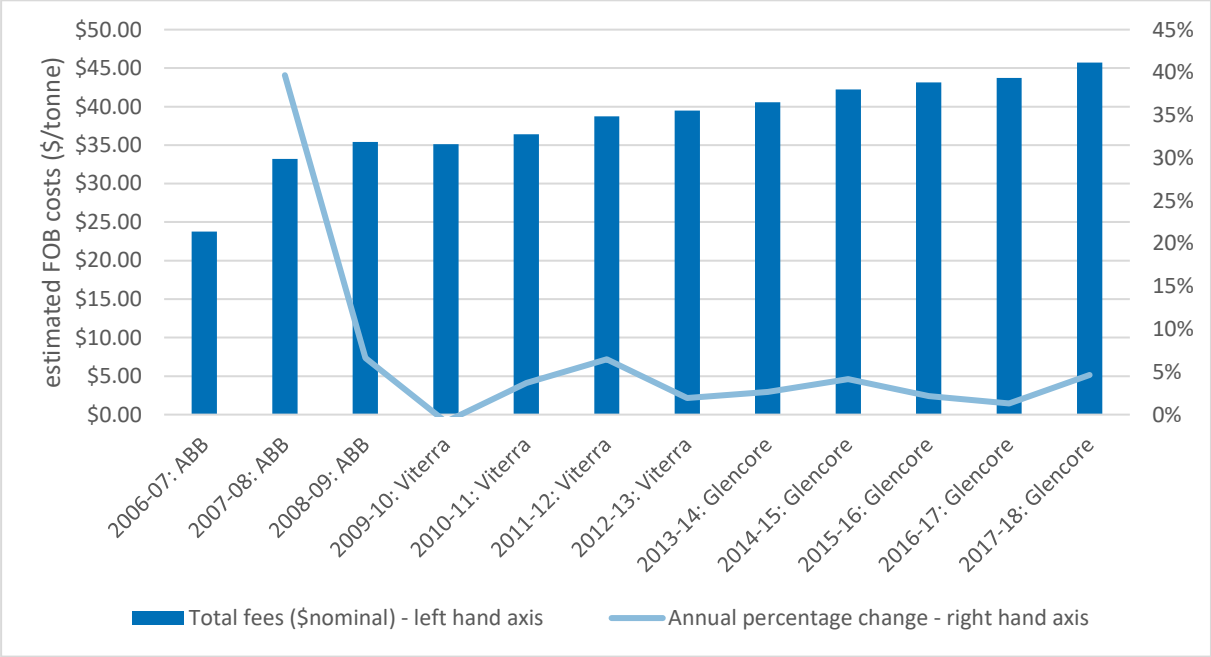
[195] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 42.

However, it is worth noting how this fee structure supports Export Select. Based on the four pathways sample, freight rates are declining after adjusting for inflation but can be accessed only via Export Select.[196] For each of the sample pathways over the period, the absolute increases in the Export Select outturn and port inloading fees are materially higher than any change in the freight rate component of Export Select, with the largest freight rate change over the period being $0.11 per tonne ($ nominal) for Poochera to Thevenard (Appendix E).

Extended Viterra fee trend

Some stakeholders were keen to see the movement in fees across the entire period covered by the Inquiry, rather than since the current owner (Glencore) took control in late 2012 (with 2013-14 fees being the first fees set under Glencore ownership). Figure 4.2 provides this by using the fee information contained in chart 1 of GPSA's submission to the Terms of Reference, updated for 2017-18.[197] It is important to note that GPSA has employed different assumptions to those adopted by the Commission in deriving the fees presented in Table 4.5.[198] However, this is not considered an issue providing the focus is on examining trends in fee movement.

Figure 4.2 Fee movement- export out of Outer Harbor, 2006-07 to 2017-18[199]



Source: GPSA and Commission.

Figure 4.2 shows a flat trend in fee movements since 2013-14, consistent with the result shown in Table 4.5. While some stakeholders recall times when supply chain fees were much lower, Figure 4.2 shows a significant increase in fees occurred in the lead up to the sale of the co-operative to Viterra (as shown by the light blue line in Figure 4.2). Since the change in ownership, fee increases have been relatively flat.

196 Referring to Appendix E, the largest increase in freight to port fee is +0.7 percent total increase from 2013-14 to 2017-18 for Poochera to Thevenard. But as Table 4.5 shows, the total CPI increase over this period was 7.0 percent.

197 GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 5.

198 For example, GPSA's fee analysis: does not include freight rates; assumes grain is delivered in November and shipped out in January; and includes fees for shrinkage and dust.

199 The Commission has derived a fee value for 2017-18 using the GPSA approach. A wheat price of $300 per tonne was used, which is only relevant to the calculation of shrinkage and dust. A ±$100 per tonne variation in wheat price would result in a $0.75 per tonne variation in total fee. Note: while Glencore completed the acquisition of 100% interest in Viterra Inc. on 17 December 2012 (source: Glencore Xstrata Annual Report 2013, p. 176), the 2012-13 fees would have already been published by Viterra Inc. Consequently, the first occasion Glencore had to set fees was for 2013-14.

4.4.3.3 Comparison with Viterra counterparts

The Commission sought to compare Viterra's fees with those of its counterparts to see how fee movements in South Australia compare with other Australian states. To do so, it had access to the results of AEGIC's most recent review of Australia's export grain supply chains. The AEGIC review compared fee changes since 2013-14.

In submissions to the Commission's Inquiry and other reviews, growers compared Viterra and interstate counterpart fee levels as evidence that South Australian supply chain costs are too high. Mr Chris Heinjus, Agribusiness Consultant and Lower Mid North farmer, for example, submitted to the Economic and Finance Committee's primary producers' inquiry that there is some confusion as to why South Australia's supply chain costs are more expensive. He argued that Western Australia and South Australia can be compared, given both have predominantly export markets.[200]

The Commission recognises that analysis, such as AEGIC's, needs to be used carefully for benchmarking Viterra's fees against other grain firms. There can be differences in business and ownership models, fee structures, geographic characteristics, and grain volumes through each firm's network. There is also often a range of assumptions (relating to grain type and the time of grain movement) behind the data used to make these comparisons.

As an example, CBH (Western Australia) operates under a cooperative structure, while the other operators are private shareholder owned entities that are primarily under foreign ownership.[201] Accordingly, these entities have differing commercial drivers relative to CBH. CBH can concentrate on maximising value to its member grain farmers, whereas the privately owned companies need to earn an adequate return on the funds invested by their shareholders (the majority of which are unlikely to be Australian grain farmers). Further, as a result of its cooperative structure, CBH is not liable to pay tax on returns generated by its storage and handling division, which accounts for three-quarters of its pre-tax profit.[202] Particularly in recent years, Western Australian grain farmers (as CBH members) received sizeable rebates when using CBH services.[203]

Given the potential differences in definitions and fee methods, the Commission gave most weight to comparisons of total supply chain fees, and to trends over the period 2013-14 to 2017-18 (the period covered by the AEGIC review).[204] However, the analysis in this section focuses on upcountry handling and storage fees, and port fees (Figures 4.3 and 4.4 respectively) and does not include freight costs covering transport to port in the combined fees Figure 4.5 given:

- the lack of publicly reported freight rates for New South Wales, Victoria and Queensland, [205] and
- the varying pathways and grain haulage distances across different Australian states (Figure 3.6).

The AEGIC analysis shows a trend of increasing real fees. Such a trend is not inconsistent with the increasing trend found in the fee analysis of Viterra in section 4.4.3.2. Here again, CBH is an outlier with fees reducing, while most operators show fees either flat or increasing over the period.

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200 Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers, final report*, p. 137.

201 Aside from CBH and GrainCorp, the remaining top four wheat exporting companies (Glencore, Emerald Grain, Cargill Australia and Plumgrove/Mitsui) are foreign owned.

202 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 12.

203 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 73.

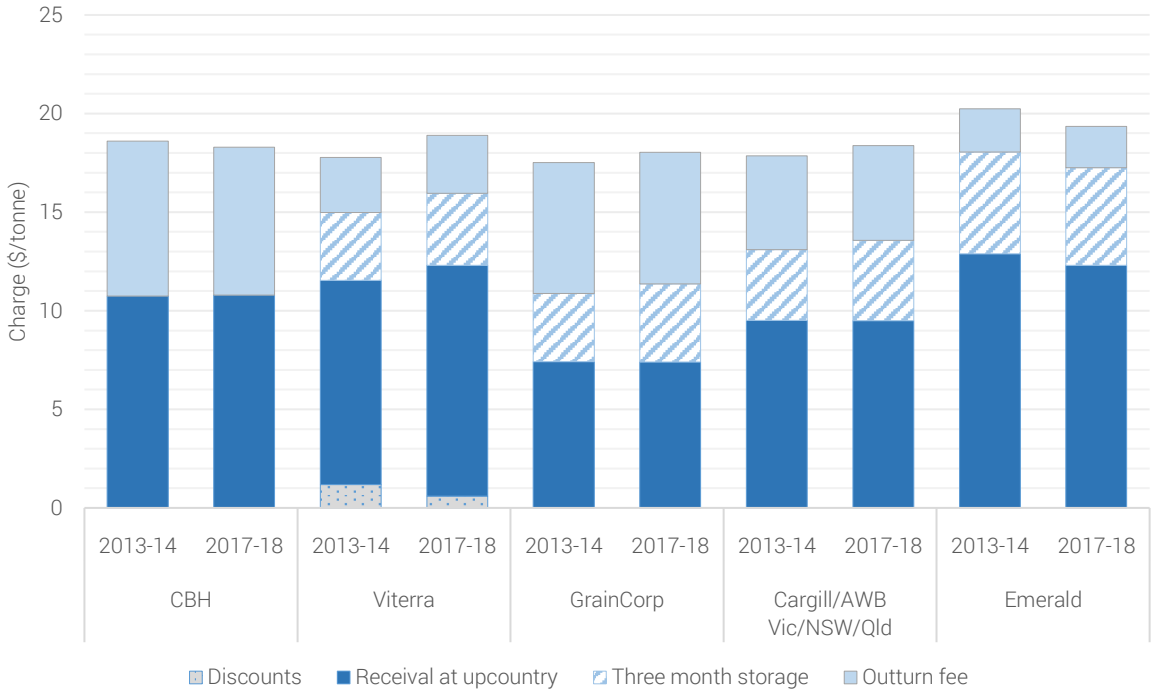
204 AEGIC has adjusted the 2013-14 fee values (using a CPI index) to be equivalent with 2017-18 prices, so any differences already account for the effects of inflation.

205 AEGIC does not present a single table comparison of total supply chain costs over this period of the form used in Figures 4.3 and 4.4. AEGIC noted it had to rely on Grain Trade Australia location differentials to estimate freight rates for New South Wales, Victoria and Queensland, which are not freight rates; in some cases, these differentials led to an inadequate estimate because freight rates can vary greatly in these states. AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p. 59.

In the process of finalising its report, GrainCorp provided AEGIC with execution freight rates, enabling AEGIC to compare these New South Wales' rates with published CBH and Viterra freight rates. However, it is not possible to simply derive a freight cost using these freight rates to add to the combined upcountry and receival fees and port fees for major bulk grain handlers (the latter provided in Figure 4.5). This is because upcountry locations to port (needed to derive freight costs) have not been identified by AEGIC for each State, for its upcountry and receival charges comparison. Given this, the approach adopted by the Commission has been to derive indicative freight cost differentials between Viterra and, in turn, GrainCorp (NSW) and CBH (WA) using typical South Australian supply chain distances. For further detail on the approach used for comparing Viterra's freight rates with its Western Australian and New South Wales counterparts, refer to item 26, Appendix G.

The result of this analysis is that Viterra's freight rates are higher than CBH by $3 to $5 per tonne (2017-18). When combined with the upcountry and port fee differential, this freight differential results in a total differential that is still within the bounds of the analysis explaining why CBH's other supply chain fees are significantly lower than Viterra's (being differences in corporate structure and operational advantages). GrainCorp freight rates are higher than Viterra's, so the result is to reduce the size of the differential based only on upcountry and port fees.

Figure 4.3 Comparison of upcountry and receival fees, by major bulk grain handler, 2013-14 and 2017-18[206]

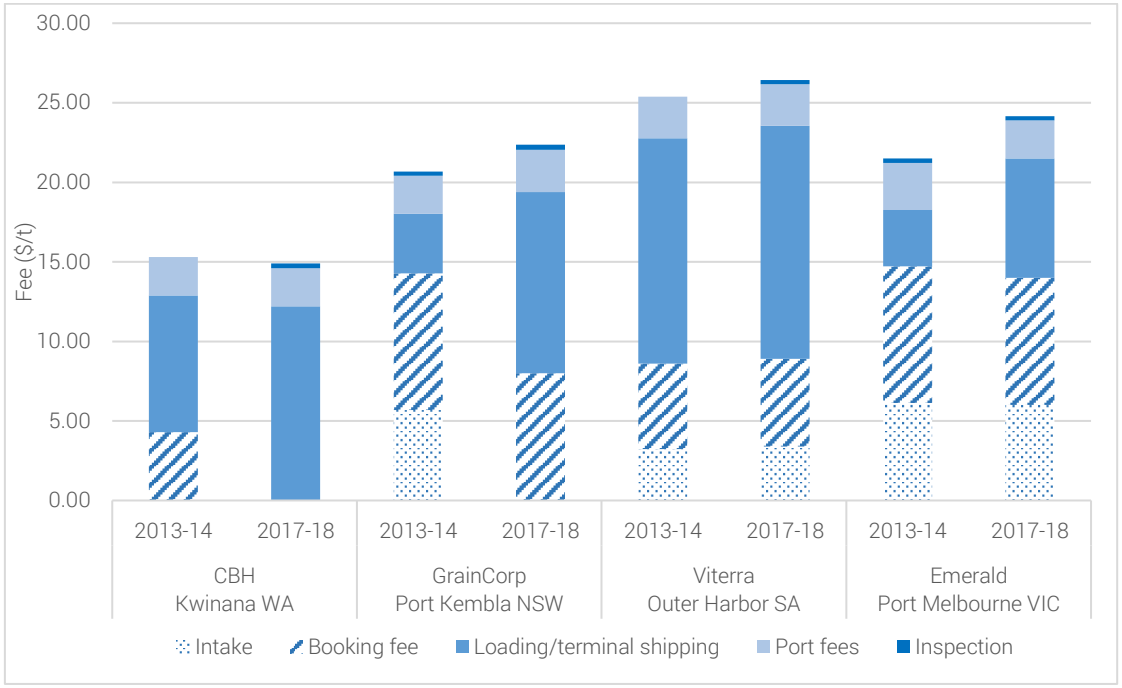


Note: AEGIC has adjusted the 2013-14 fees to be in 2017-18 equivalent prices.

Source: AEGIC data.

[206] 'Discounts' refers to the Export Select rebate. AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, Figure 24. For South Australia, Viterra's Tier 1 sites are used for outturn by rail.

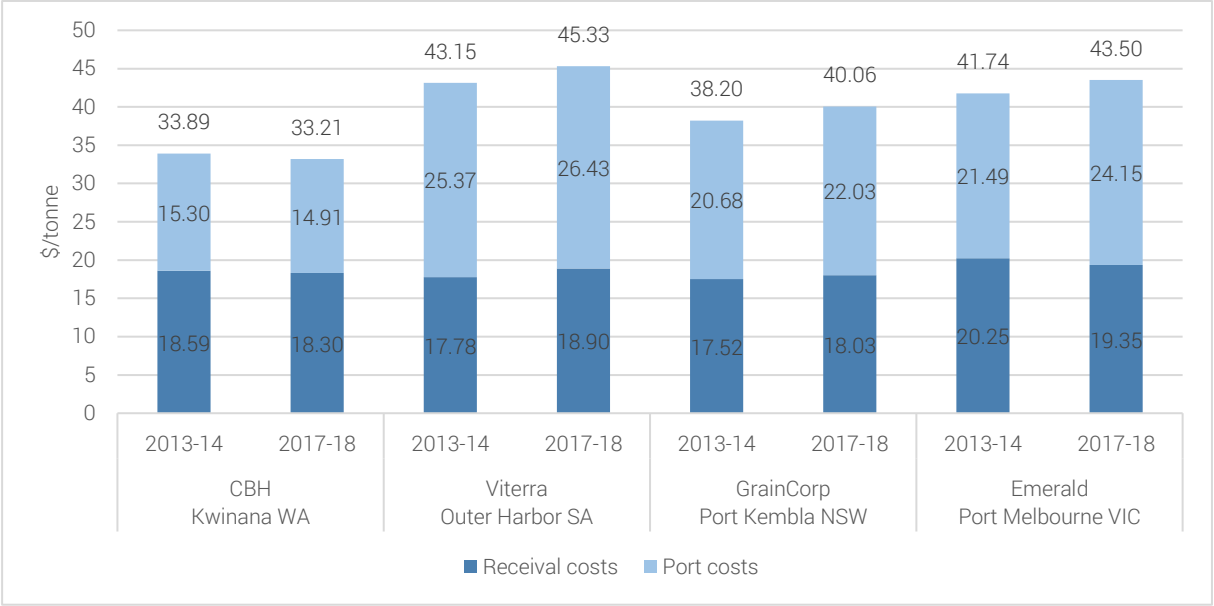
Figure 4.4 Comparison of port fees, by major port service providers, 2013-14 and 2017-18[207]



Note: AEGIC has adjusted the 2013-14 fees to be in 2017-18 equivalent prices.

Source: AEGIC data.

Figure 4.5 Comparison of combined upcountry and receival fees for major bulk grain handlers, and port fees, 2013-14 and 2017-18



Note: AEGIC has adjusted the 2013-14 fees to be in 2017-18 equivalent prices.

Source: AEGIC data, combined Figures 4.3 and 4.4.

[207] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, Figure 48.

Finding 4.5

Based on a sample of fees and grain paths, total upcountry-to-vessel loading fees have been broadly stable in recent years, having moved at an average rate only slightly above inflation from 2013-14 to 2017-18. Taking into account corporate structural issues, the Commission found no evidence that Viterra's fees are excessive compared with the total fees charged by its Australian counterparts, as shown by AEGIC's latest study of Australian supply chain costs.

4.4.4 Is Viterra earning excessive returns?

For its investigation of Viterra's financial returns, the Commission considered the results against the following three broad market scenarios (which have differing but significant implications for Part 1 of the Inquiry):

- Scenario 1: Viterra faces sufficient competitive pressure (actual and/or potential) to ensure the supply chain is efficient.
- Scenario 2: Viterra is actively pursuing operational efficiencies, but not necessarily passing them onto grain growers.
- Scenario 3: The supply chain is not efficient, or the evidence raises serious questions about the level of efficiency.

Scenario 1 would support the supply chain being efficient. Competition is an ongoing process, so such an outcome would not rule out potential for the market to deliver further efficiencies.

Scenario 2 could be considered a sub-set of scenario 1—for example, costs may be trending down faster than fee levels (or against increasing fee levels). In this case, returns to Viterra may be increasing, while growers are not sharing sufficiently in any efficiencies that Viterra achieves. Evidence that Viterra is pursuing efficiencies would indicate the presence of efficiency drivers, and the potential for lower supply chain costs (reflected in lower fees to users). But, if fee levels are not following the downward trend in costs (or at least doing so at a much slower pace), perhaps Viterra is not facing sufficient competitive pressure to ensure the supply chain is efficient (unless Viterra is in a period of transition—that is, getting its operation on a more commercial footing before moving to share efficiencies with industry).

Scenario 3 could occur if evidence indicates the supply chain is a natural monopoly. In such a case, a single operator may achieve lower average costs for the industry as a whole, than if several operators were competing. This scenario is the one most likely to justify government intervention in some form, given no demonstrated sufficient competitive pressures (for example, global markets, as discussed in section 4.3.1) are being exerted.[208]

These scenarios will depend on the level of Viterra's financial returns, with the following three potential outcomes:

- Financial return outcome 1: Viterra is not earning a rate of return that is above that which might be expected for a firm with its level of risk (on average).
- Financial return outcome 2: Viterra is earning a rate of return that is above that which might be expected for a firm with its level of risk (on average), but this situation is likely to be transitory.
- Financial return outcome 3: Viterra is earning a rate of return that is above that which might be expected for a firm with its level of risk (on average), and is likely to continue to do so.

[208] To this extent, scenario 3 could be seen to co-exist with scenario 1.

If Viterra were shown to be operating efficiently, financial return outcome 1 would suggest Viterra is optimising the scale effects needed to compete effectively on the global market, and additional competition may fragment the end-to-end supply chain, resulting in a worsening outcome. But, if Viterra were shown to be earning a rate of return, on average, above that commensurate with its level of risk, as per financial return outcomes 2 and 3, then the sustainability of those earnings is important, because it suggests the extent to which Viterra's actions may be an exercise of market power that detrimentally impacts on the efficiency of South Australia's bulk grain export supply chain.

The Commission's investigation of Viterra's financial returns involved three steps:

- First, the Commission sought financial information from Viterra to determine the firm's level of returns, given Viterra does not release publicly audited accounts in a form that is useful for this Inquiry—section 4.4.4.1.
- Second, the Commission engaged financial consultants Value Adviser Associates Pty Ltd (VAA) to advise on the rate of return that an investor would require to invest in a firm in a similar market and with similar characteristics to Viterra—section 4.4.4.2.
- Finally, the Commission compared estimates of Viterra's actual returns with VAA's advised reasonable rates of return, and developed findings on the extent to which Viterra's returns can be considered, on average, within the bounds expected for a firm with Viterra's risk profile—section 4.4.4.3.

The Commission made its assessment across a suite of financial measures (as defined in Appendix D).

4.4.4.1 Viterra's financial performance

Figure 4.6 shows movements in Viterra's revenue, operating expense and operating surplus for 2006-07 to 2017-18.[209] The real cost per tonne financial figures provided by Viterra have been indexed in a manner that shows trend but does not identify the absolute values - termed 'indexed real cost per tonne':[210]

- Operating revenue was relatively flat from 2013-14 (Figure 4.6).[211] This result is consistent with Viterra's fees increasing only marginally since 2013-14 and being essentially flat in real terms on a total fee basis (section 4.4.3.2).

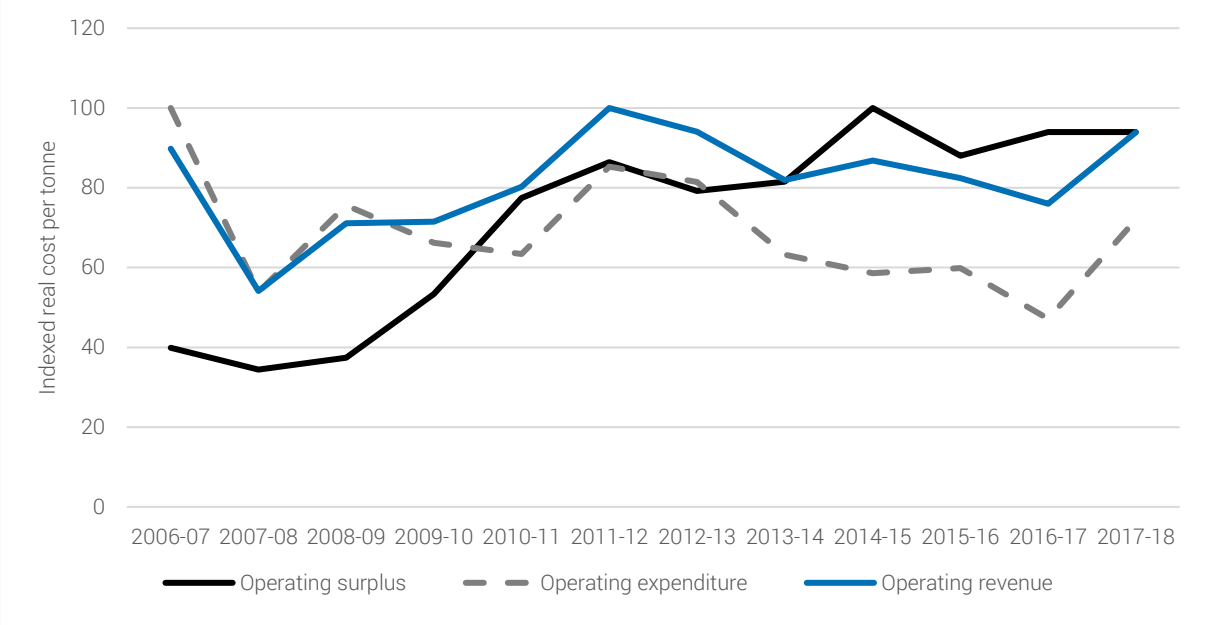
[209] In response to a request of information, Viterra provided forecast financial performance data for 2018-19. This data was not included in Figure 4.6 given its preliminary nature, with the forecast provided early in the season (October 2018). As might be expected, the forecast surplus showed a marked decline reflecting the predicted poor season for Viterra. However, regard was had to the 2018-19 forecast in the financial analysis reported in section 4.4.4.3, to ensure this modelling took account of volatility.

[210] The Commission has received information from Viterra over which confidentiality has been claimed. As a result, at this time, the Commission has decided not to disclose information in this report, in part or in total, which is subject to such a claim (section 2.3). Consequently, the Commission has converted this data into an index as Viterra has claimed it is commercial in confidence.

[211] While the operating revenue and operating expenditure lines increase in 2017-18 (Figure 4.6), it is important to recognise that these figures are per tonne, real and subject to the indexing approach adopted to maintain data confidentiality. This is why it is important to focus on trends. Further, due to some costs being fixed in nature, the indexed cost per tonne is impacted by the volume over which these costs are spread in any given year, with 2017-18 volumes being notably lower than any of the previous four years. Nevertheless, Viterra's 2017-18 performance has been compared with its performance in 2012-13, given receival tonnages are almost the same for these years (within 100,000 tonnes). This comparison shows operating revenue per tonne (real$) as almost the same for these years. However, operating expenditure is significantly lower in 2017-18, which is consistent with Viterra pursuing cost efficiencies over this time. The result is that operating surplus is materially higher in 2017-18 (compared with 2012-13), consistent with the trend line provided in Figure 4.6.

- By controlling how grain accumulates and travels within its system, Viterra has extracted scale benefits from its supply chain. These scale efficiencies, coupled with a focus on reducing labour and freight costs, has enabled Viterra to drive down real operating costs on a per tonne basis (Figures 4.1 and 4.6). This result is a prerequisite for the firm to maintain competitiveness in the global market.
- The decline in Viterra's real operating cost per tonne was has not been accompanied by a corresponding drop in fees (section 4.4.3.2), resulting in Viterra's operating surpluses consistently trending upwards from 2012-13.

Figure 4.6 Indexed movements in Viterra's revenue, operating expenditure and operating surplus 2006-07 to 2017-18



Source: Essential Services Commission analysis of Viterra data.

Appendix D explains the Commission's approach to deriving Viterra's asset values and comparable return values, providing stakeholders with access to as much information as possible on the basis for the Commission's findings.

4.4.4.2 The return that an investor might require

The Commission engaged VAA to provide independent advice on the rates of return that an investor would require to invest in a firm in a similar market and with similar characteristics to Viterra. It compared these investor-required rates with the Viterra returns (estimated by the Commission, see section 4.4.4.1) to assess whether the financial returns being earned by Viterra are excessive, on average, relative to that expected for a firm with Viterra's risk profile. Section 4.4.4.3 reports the Commission's assessment.

This section summarises VAA's approach and results.[212] VAA estimated the return on assets (RoA), return on equity (RoE) and return on invested capital (RoIC) financial measures (as defined in Appendix D). It employed the following two approaches:

[212] For further details of VAA's approach, see VAA, *Study of Financial Returns Benchmarks—Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, Report prepared for the Essential Services Commission of South Australia, 26 April 2018, available on the Commission's website at http://www.escosa.sa.gov.au/projects-and-publications/projects/inquiries/inquiry-into-the-south-australian-bulk-grain-supply-chain-costs/inquiry-into-the-south-australian-bulk-grain-supply-chain-costs.

- **Comparable firms**: Identify the financial returns from public data (Bloomberg) for a total of 24 firms, across two business segments considered to have similar operational and risk profiles to Viterra—namely, *grains storage and handling*, and *ports and port service providers*.
- **Reasonableness test**: Use standard Capital Asset Pricing Model (**CAPM**) principles to derive rate of return estimates.

The Commission relied more heavily on VAA's comparable firms' results. Those results are based on a sample of actual firm returns being earned, and the objective is to determine the rate of return that an investor would require if the investor were to invest in a firm in a similar market and with similar characteristics to that of Viterra. The Commission considers this sample is more akin to the outcome required when competing for capital resources in the unregulated context on competitive global capital markets.

Nevertheless, the results identified for the sample comparable firms are broadly consistent with the results of the more theoretical CAPM approach (at least in a comparison of the comparable firm median results with the CAPM high results).[213] Table 4.6 summarises the results of both approaches.

Table 4.6 Summary of VAA advice on comparable firm returns

	VAA results: all comparable firms[214]		VAA results: CAPM	
	Median	75th percentile	Low	High
Return on equity (30% gearing)	7.9%	10.6%	6.6%	7.5%
Return on equity (50% gearing)	11.1%	14.7%	8.3%	9.6%
Return on invested capital	6.2%	8.3%	5.4%	6.1%
Return on assets	6.7%	9.1%	Not applicable	

Source: VAA.

4.4.4.3 Whether Viterra's financial returns are excessive

Section 4.4.4.1 shows Viterra's operating surpluses have consistently increased since its ownership change in 2013 late 2012. In this context, the question of whether Viterra's operating surplus growth translates into financial returns being earned by Viterra that are excessive, on average, relative to that expected for a firm with Viterra's risk profile, is important. The Commission thus needs to appropriately interpret Viterra's actions to not share the benefits of its improving operational performance with growers and traders through lower fees.

While this behaviour is a point of contention with growers, it may be relevant from an economic efficiency perspective only if Viterra is sustainably earning a rate of return, on average, above that commensurate with its level of risk. In that specific instance, the bulk grain export supply chain could be perceived as inefficient because, if there were at least workable competition, persistent returns above this would be competed away. In effect, competitive forces can be expected to drive a redistribution of excessive returns through lower fees and improved service levels. Viterra could only

[213] This is not a regulatory determination (section 2.1) and, consequently, Commission staff have not sought VAA adopt CAPM parameter values in line with what the Commission would apply for a regulatory determination, such as for SA Water. The Commission deliberately sought not to bias VAA in its approach. The Commission has, however, adopted some of VAA's parameter values in modelling Viterra's returns (such as gearing levels) in order to produce results that can be compared with those of VAA.

[214] VAA used Bloomberg financial results over five years (subject to data availability) to derive returns (Value Adviser Associates Pty Ltd, p.11). This approach takes account of the variability of outcomes that firms operating in these markets are likely to report between years.

earn returns consistently above those commensurate with the risk it faces if it could exert market power to reduce the likelihood of market entry, thereby reducing competitive tensions and causing inefficient supply chain outcomes.

The Commission has compared the VAA-advised reasonable return (based on three measures of return) with Viterra's actual estimated return based on the information that Viterra supplied. On the basis of the adopted approach to estimate Viterra's actual returns, and having regard to normal estimation errors, Viterra is assessed by the Commission as currently earning returns, on average, towards the upper end of what might be expected for a firm with Viterra's level of risk. This is noting that actual returns vary materially from year to year, depending on the level of harvest. This analysis does not, however, suggest that, Viterra's returns provide evidence of it exercising market power to the detriment of competition.

This might suggest that, to date, Viterra's operations may simply be effective—that is, it is optimising the scale effects needed to compete effectively on the global market. Viterra's reward for driving operational efficiencies has been a higher operating surplus per tonne, and South Australia benefits by maintaining its competitiveness in the global bulk grain market, thereby ensuring the grain industry's continued contribution to the South Australian economy.

But opportunities to improve the efficiency of the supply chain will always remain. In this context, it might be concerning if the increasing trend in Viterra's operating surpluses (notwithstanding potentially incurring losses in poor seasons such as 2018-19) continues to the point at which returns become excessive, on average, relative to that expected for a firm with Viterra's risk profile. This scenario might occur if Viterra continues to find efficiencies to reduce costs, without sharing the benefits with industry through lower fees. Evidence of Viterra's financial returns being excessive, on average, relative to that expected for a firm with Viterra's risk profile would suggest Viterra is exercising market power to the detriment of competition, or the market is not operating as it should (that is, competitors are not entering, or expanding existing operations, to compete away excessive returns).

In the context of the above, the Commission notes that there are overseas examples where firms seeking cost efficiencies (for example, rationalising sites) have shared some of the resulting efficiency benefits with growers through lower fees (offsetting any cost increase faced by growers). For example, in Canada the contraction in receival site numbers and closure of short rail lines caused farmers to cart grain from their farms by truck over longer distances to reach receival sites. This increased the cost and risk of the grain haulage borne by the farmer but was offset by lower receival site and rail transport costs. Further, multi-wagon discounts offered by rail companies were passed on, in-part, to farmers by the grain companies in the form of trucking premiums and higher grain prices. Similarly, efficiency gains from high throughput receival sites enabled grain companies to offer higher grain prices to farmers to attract higher grain volumes. [215]

Finding 4.6

Based on the available evidence, Viterra is earning returns, on average, towards the upper end of what might be expected for a firm with Viterra's level of risk. The Commission's analysis of returns is consistent with its fee analysis, which showed that Viterra, to date, has not chosen to share efficiencies with industry through lower fees.

Future concerns may arise if the increasing trend in Viterra's operating surpluses (notwithstanding potentially incurring losses in poor seasons such as 2018-19) continues to the point at which returns become excessive, on average, relative to that expected for a firm with Viterra's risk profile. This may occur if Viterra continues to find efficiencies that reduce costs, without sharing the benefits with industry through lower fees.

[215] AEGIC, *The Puck Stops Here! Canada Challenges Australia's Grain Supply Chains,* May 2015, p. 27, available at https://www.aegic.org.au/wp-content/uploads/2016/04/Canadian-Supply-Chain-Full-Report.pdf

4.4.5 Is there evidence of Viterra exercising market power through its fee structure?

This section reports on the Commission's investigation of whether Viterra is engaging in any sustained behaviour that inhibits a competitive outcome (section 2.2). In undertaking this investigation, the Commission has examined the cost efficiency of the bulk grain export supply chain, rather than broader questions of pricing or equity in the grains sector, in accordance with the Inquiry's Terms of Reference.

The Commission understands there is the potential for a firm's behaviour or action (section 2.2) to be interpreted in more than one way. In particular, it considers a given behaviour or action (practices) is less likely to lessen competition when:

- There are clear and practical operational reasons for the behaviour, which Viterra applies consistently.
- The fee (and its level) or action is a response to a demonstrated opportunity cost and/or can be demonstrated to encourage an efficient user response.
- The fee (and its level) or action is adopted by most, if not all, counterpart firms (that is, other commercial grain storage and handling operators in South Australia and interstate).[216]

For practical purposes, the Commission confined its investigation to a sample of fees and practices, individually or in combination. It chose the fees and practices for their potential to be used by Viterra as a means of exercising market power to the detriment of competition, and/or because stakeholders specifically raised them. The fee analysis which supports the market power analysis for Export Select (section 4.4.5.1), grower deliveries direct to port (section 4.4.5.2) and competitor direct deliveries to port (section 4.4.5.3) is presented in section F1, Appendix F.

Of the sample of Viterra fees and actions investigated, and based on the evidence available, the Commission is concerned with only the fees charged by Viterra to third party operators delivering direct to port (section 4.4.5.3).

4.4.5.1 Export Select

Export Select is a bundled service. A bundled price is inconsistent with efficient pricing when it is used to act as a barrier to entry or expansion (for example, by dissuading new entry and forcing the early exit of new entrants), potentially resulting in Viterra being able to maintain excessive returns, on average, relative to that expected for a firm with Viterra's risk profile. So, the Commission sought to identify whether Viterra's Export Select service can be considered inconsistent with efficient supply chain pricing (see question 4, Appendix B).

(a) How does Export Select operate?

Export Select is a logistics service that Viterra offers to grain traders. This bundled service provides an end-to-end service to move grain from a Viterra upcountry receival site to a Viterra port (Box 4.4). It covers:

- outloading upcountry storage (but not receival into store or storage services)
- freight transport to port, and
- port inloading (but not storage at port or outloading onto vessels).

[216] In this sense, the Commission is seeking to determine the relative efficiency, rather than the absolute efficiency, of the South Australian supply chain. That is, the risk for this exercise that all operators are inefficient (Viterra and its interstate counterparts) is less than if the Commission were undertaking a price determination for a regulated firm.

Users of Export Select are predominantly traders. Traders can combine their accumulation within Viterra's system with grain from other sources. On behalf of the trader, Viterra then consolidates, accumulates and manages the logistics task from the upcountry sites to port.[217]

Viterra determines which sites, or commodities or grades at sites, are classified as Export Select. It submitted that the service's benefits to grain traders include:

- more chance that a trader's grain is received at port on time and meets the required specifications (although not guaranteed)[218]
- protection from adverse freight rate movements, because these rates are fixed at the time of transfer,[219] and
- known freight rates between upcountry sites and ports, because Export Select rates are published every month.[220]

Most grain moved from upcountry Viterra sites to Viterra ports goes via Export Select. The financial incentives to use Export Select include a rebate (introduced in 2009). This rebate has gradually been reduced over time from a maximum of $2.45 per metric tonne in 2009-10, resulting in progressive fee increases (other factors being equal). The rebate is highest in the main harvesting months. For 2017-18 season grain, the rebate was $0.60 per tonne for transfers into Export Select before 16 January 2018, and nil thereafter.[221]

Two key aspects of Export Select make it an effective tool for encouraging and managing the accumulation of grain (section 4.4.3.1). First, it provides traders with a straightforward option for getting grain onto a ship, thereby reducing traders' transaction costs. Second, in the majority of cases, access to Viterra's freight rates is conditional on using the Export Select service. That is, a trader needs to access all Viterra services to benefit from Export Select: the grain must be in Viterra's upcountry storage for the trader to use the Export Select service. For this reason, Export Select could lock out competitors, particularly small start-up firms.

(b) Is there a sound basis for Viterra's behaviour?

Given Export Select could lock out competitors, the Commission examined Viterra's behaviour in terms of the practices identified in section 4.4.5. In addition, Viterra's behaviour was considered in light of the findings of the PTAC Taskforce. While the PTAC Taskforce review did comment on the role of site swaps in the South Australian supply chain, it did not recommend any specific immediate regulatory response regarding the role of site swaps or Export Select. More detail is provided in item 32, Appendix G.

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217 Viterra, *Submission to the Inquiry into the South Australia Bulk Grain Export Supply Chain Costs*, May 2017, p. 10.
218 Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 17.
219 ACCC, *Viterra Application Seeking Capacity Allocation System Approval*, Draft Decision, 16 July 2015, p. 44.
220 Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 10.
221 Viterra, *Export Supply Chain Fees 2017/18 Explained*, viewed 6 March 2018, available at http://viterra.com.au/wp-content/uploads/Export-supply-chain-fees-201718-explained.pdf. Viterra submitted that the rebate differential 'reflects … the fact that the early nomination of grain to the Export Select pathway reduces Viterra's costs and also improves productivity due to efficiencies gained in respect of cargo accumulation'. Source: Viterra response to the ACCC's request for information dated 15 April 2011, 5 May 2011, p. 12, available at https://www.accc.gov.au/system/files/20110505%20Viterra%20Operations%20response%20to%20ACCC%20RFI%2015%20April%202011.pdf .

Are there clear and practical operational reasons for Viterra's behaviour?

There appear to be sound operational reasons for Viterra's behaviour:

- Viterra submitted that Export Select facilitates its ability at certain sites to outturn in an efficient and cost-effective manner.[222]
- Export Select is consistent with Viterra's approach to pricing on a network basis.

Export Select is optional,[223] which reduces the risk of competitors being locked out. Notwithstanding this, the vast majority of traders elect to use it. Viterra also submitted that it will swap customers out of Export Select-only sites if they wish to organise their own transport or outturn domestically, and it may allow the customer to outturn from an Export Select-only site, subject to the timing or the efficiency of the movement.[224]

Is Viterra using fees to encourage an efficient user response?

Without evidence to the contrary, Export Select appears to result in an efficient use of Viterra's network. It is designed to help Viterra maximise throughput in its network—an outcome necessary to achieve cost competitiveness in a global market. Additionally, customers can opt out, although few choose to do so.

How do Viterra actions compare with those of its counterparts?

Viterra's approach is not unique across Australia's bulk grain export industry. Other grain accumulation firms also develop fee structures to encourage accumulation in a manner suited to their supply chain logistics. CBH's Grain Express, for example, is a bundled service similar to Viterra's Export Select, and anyone storing wheat in CBH's upcountry storage must use it.[225]

4.4.5.2 Grower direct deliveries to port

Growers' ability to deliver direct to port and bypass Viterra's upcountry facilities could place an important competitive constraint on Viterra exercising market power upcountry. The Commission sought to identify the extent to which grower direct deliveries to port constrain Viterra (see question 3, Appendix B). If there is no competitive constraint, then the Commission must consider whether Viterra's behaviour is consistent with the practices identified in section 4.4.5.

(a) Can growers deliver directly to port?

Viterra restricts grower direct deliveries to Port Lincoln, Port Adelaide and Wallaroo to Viterra defined Grower Delivery Zones (section F2, Appendix F). In 2016-17, 83 percent of grain exports were made through these ports. On first consideration, delivering direct to port might seem cheaper for growers, given it would eliminate one inturn and an outturn from an upcountry silo. Yet, the fee analysis[226] in section F1 (Appendix F) shows, while growers delivering direct to the port of Thevenard (no delivery restriction) could save an estimated $2.80 per tonne over delivering upcountry and using Export Select, growers delivering direct to Port Lincoln and Port Adelaide are likely to do no better than breakeven relative to delivering upcountry and using Export Select.

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[222] According to Viterra, Export Select *'… allows Viterra to handle the handling and logistics task in the most efficient manner possible'.* Source: *Viterra Pricing, Procedures & Protocols Manual* (2016/17), p.29, viewed 6 March 2018, available at http://viterra.com.au/wp-content/themes/viterra/documents/Pricing,%20Procedures%20and%20Protocols%20Manual%202016_17%20(Schedule%20A-L)2.pdf See also, Viterra, *Response to the ACCC's* request for information *Dated 15 April 2011*, 5 May 2011, pp.12-13.

[223] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 17.

[224] Viterra, *Response to Public Submissions*, June 2017.

[225] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 274. GrainCorp also has a logistics/freight offering.

[226] Based on a fee comparison of a sample of grain pathways to port, excluding freight rates.

For this reason, Viterra's pricing and operational behaviour might limit the potential for grower direct deliveries to port to constrain Viterra's exercising of market power upcountry to the detriment of competition.

(b) Is there a sound basis for Viterra's behaviour?

Given Viterra's behaviour might limit the potential for grower direct deliveries to port, the Commission examined Viterra's behaviour in terms of the practices identified in section 4.4.5.

Are there clear and practical operational reasons for Viterra's behaviour?

Viterra accepts 25 percent of its total receivals from deliveries local to port, providing this service to growers located near the relevant port covered by a Grower Delivery Zone.[227] By their location, these growers would not be expected to deliver upcountry. There appear to be sound logistical/operational reasons for Viterra's behaviour in this regard. As an example, Viterra submitted that grain invariably ripens earlier at higher latitudes (northern):[228] if growers at Lock (150 kilometres north of Port Lincoln)[229] were permitted to deliver direct to Port Lincoln, then the silos could be full by the time the wheat of growers close to Port Lincoln had ripened. Given only 25 percent of Viterra's storage capacity is located at port, growers close to port would be forced to either construct more on-farm storage or deliver to upcountry silos (in a direction away from the port). Either result would appear inefficient from an industry-wide perspective.

In addition, Viterra submitted that accepting too much grain, or grain that is not in demand for immediate shipment, can result in the port 'blocking' (when the port has insufficient capacity to efficiently process grain for shipment). In this case, Viterra might invest in more storage capacity at port, assuming adequate land is available. But the resulting additional costs would be unlikely to represent an efficient investment for the supply chain, which already has sufficient total storage capacity to cope well with even the biggest harvest.

Consequently, considering Viterra's behaviour against the assessment practices identified in section 4.4.5, it appears to have clear and practical operational reasons for behaving in these ways.

Is Viterra using fees to encourage an efficient user response?

The evidence shows Viterra is pricing (setting fees) to reinforce its logistical/operational requirements. There are not considered to be any issues with Viterra's pricing approach in this instance.

How do Viterra actions compare with those of its counterparts?

The Commission did not review interstate operator practices in receiving grower direct deliveries to port, because Viterra's behaviour appears to have sound logistical/operational reasons in the context of the South Australian supply chain.

On the issue of fee levels, section 4.4.3.3 compares Viterra's total supply chain fees with those of its counterparts. Viterra's fees do not appear to be excessive compared with the total fees charged by its eastern Australian counterparts, as shown by the fee comparison presented in Figure 4.5 (Finding 4.5).

4.4.5.3 Competitor direct deliveries to port

Competitors' ability to bypass part or all of Viterra's facilities could place a competitive constraint on Viterra's ability to exercise market power. The Commission sought to identify any fees charged only to

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[227] Viterra provides a direct service to nearby growers, which represents 25 percent of total receivals. Source: Viterra, *Response to Public Submissions*, June 2017. Viterra attempts to provide growers from outside the local delivery zone an option to deliver to port on the basis of Viterra requiring the growers' grain for shipping. Growers will be advised via SMS, if they are registered for SMS alerts.

[228] Viterra response to request for information.

[229] AEGIC spreadsheet for AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018.

competitors, and to investigate the extent to which such fees reflect actual costs incurred by Viterra (see question 5, Appendix B). If the fees do not reflect costs, then the Commission needs to consider whether Viterra's behaviour is consistent with the practices identified in section 4.4.5.

(a) Does Viterra charge third party operators differential fees?

Viterra will accept grain for export at its ports from approved third party stores, subject to a Receival at Port Service Fee (from Approved Third Party Storage) (**Receival at Port Service Fee**).[230] Viterra publicly justifies this fee on the basis that it:

> *… reflects the provision of services which are necessary to manage food quality risks in relation to grain delivered into Viterra's network, and to protect both the integrity of the grain held on behalf of all clients and the efficient operation of Viterra facilities.*[231]

For 2017-18, the Receival at Port Service Fee was $2.70 per tonne.[232] There is a corresponding fee (Receival at Viterra Facility Fee (Ex Approved Third Party Stores)) if grain is delivered from an approved third party store to a Viterra upcountry site.

Analysis reported in section F1, Appendix F shows that the differential increases to $3.30 per tonne, given a third party operator would also not receive the Export Select rebate when available.

On the other hand, growers delivering direct to Port Adelaide appear to face a near neutral fee outcome (Table F.1).

(b) Is there a sound basis for Viterra's behaviour?

Given Viterra's pricing behaviour appears to disadvantage third party operators that deliver grain direct to port, the Commission examined Viterra's behaviour in terms of the practices identified in section 4.4.5.

Are there clear and practical operational reasons for Viterra's behaviour?

According to Viterra's published wheat reference prices schedule, the Receival at Port Service Fee covers:

- a review of grain treatment histories
- sampling and testing on delivery[233]
- potential segregation and storage for risk mitigation, residue and fumigation periods
- performance of road 'chain of responsibility' mass management procedures and requirements, including issuance of breach warnings and recording, and
- potential fumigation to prevent cross-infestation of insects (as a precautionary measure, not for grain detected with insects).

Viterra submitted that it has no oversight or guarantee of the quality checks that third party handlers perform, so not performing its own checks would expose Viterra's system and the grain within it to risk. Such checking should be required for all deliveries (by grower and third party operator) to any part of the supply chain, including upcountry sites. But the Receival at Port Service Fee applies only at port. Viterra's approach thus might appear designed to direct traders using third party operators to use

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230 Viterra, *Wheat Reference Prices—Port Terminal Services 2017/2018*, clause 2.2.3.

231 Viterra, *Pricing, Procedures and Protocols Manual*, p. 15, viewed 14 May 2018.

232 Viterra, *Wheat Reference Prices—Port Terminal Services 2017/2018*, clause 2.2.3. It was increased to $2.76 per tonne for 2018-19 (source: Viterra, *Wheat Reference Prices—Port Terminal Services 2018/2019*, clause 2.2.3, available from http://viterra.com.au/wp-content/uploads/Viterra_1819-Harvest-Documents_Wheat-Reference-Prices_v1.pdf.)

233 Grain from third party storages is charged a quality screen fee even if the third party bulk handler performed its own check to legislative standards.

Viterra's upcountry facilities and then Export Select to the port. However, it is not clear why this would be a commercial proposition under normal circumstances, as such grain could be liable for other standard Viterra fees (where delivered from third party operator facilities to Viterra's upcountry facilities), with the potential for a duplication of fees given the grain would then be handled by two operators. In any case, it is understood that there is a similar third party fee operating upcountry.

Is Viterra using fees to encourage an efficient user response?

The Commission has not been able to establish that the $2.70 per tonne Receival at Port Service Fee is efficient. This fee was $2.50 per tonne in 2008-09 and increased by an average 0.8 percent per year over the past 10 years, which was an increase well below inflation for the period.[234] The Commission made two formal requests of Viterra for evidence to support the Receival at Port Service Fee and its level. In response, Viterra submitted that little tonnage of grain has attracted the fee. But the Commission considers this situation, rather than demonstrating the fee's lack of impact, might demonstrate the fee's effectiveness in deterring competition. Viterra submitted that it is not aware of any formal complaints about the fee other than the complaint that resulted in an arbitration in 2006 (see discussion below). Viterra's submission to the Inquiry Draft Report reiterates its rationale for the Receival at Port Service Fee (from Approved Third Party Storage), based on the cost and risk that receival from third party storage introduces to its operations (refer item 34, Appendix G).

How do Viterra's actions compare with those of its counterparts?

The ACCC is monitoring the Receival at Port Service Fee for apparently the same reason that the Commission is interested in this fee.[235] That is, it wants to check that Viterra is not using the differential fee to third party receivals at port to advantage, in an anti-competitive manner, its own upcountry storage and handling facilities and transport services. In its bulk wheat ports monitoring report for 2015-16, the ACCC showed Viterra was charging a Receival at Port Service Fee of $2.65 per tonne for bulk wheat.[236] This fee was marginally higher at the time than the amount charged by the only other two operators with such a fee that year (Emerald and Quattro, at $2.50 per tonne).[237]

Further, in its 2017 monitoring report,[238] the ACCC reported Viterra as the only port terminal service provider charging this fee on grain received from an approved third party storage site.[239] Quattro was the only other service provider charging such a fee, and it charged for only third party non-approved storage without adequate fumigation.

Viterra submitted to the Commission that it does not intend to remove this fee. The ACCC monitors this fee as part of its annual bulk wheat ports monitoring. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power.

Is the level of fee or action broadly consistent with that adopted by Viterra's counterparts?

As noted, Viterra is the only Australian terminal operator charging such a fee to competitors at port. Even if the Receival at Port Service Fee is considered in isolation, an additional fee of $2.70 per tonne is material. Viterra submitted that the Receival at Port Service Fee was subject to a confidential arbitration in 2006, which found in favour of Viterra. Viterra submitted that the fee has since increased by an average of less than 1 percent per year, including a freeze on the fee for six out of 10 years.[240]

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234 Viterra collected only a small amount of revenue from this fee in 2016-17.

235 ACCC, *Bulk Wheat Ports Monitoring Report 2015-16*, p. 60 and ACCC, *Bulk Wheat Ports Monitoring Report 2016-17,* December 2017, p. 71

236 The 2016-17 value for the Receival at Port Service Fee (source: Viterra, Wheat Reference Prices—Port Terminal Services 2016/17, clause 2.3.3). It increased to $2.70 per tonne for 2017-18.

237 ACCC, *Bulk Wheat Ports Monitoring Report 2015-16*, p. 58.

238 ACCC, *Bulk Wheat Ports Monitoring Report 2016-17,* p. 71.

239 Storage site as approved by the port terminal service provider. Quattro's (operates in the eastern States) second tier fee applies to third party non-approved storage without fumigation; at the time of publication, Quattro had received grain from only approved storage sites (source: ACCC, *Bulk Wheat Ports Monitoring Report 2016-17,* p. 71).

240 Viterra response to request for information.

The Commission is not privy to the detail of the 2006 arbitration, so cannot determine the extent to which it considered all the factors noted in this section.

Viterra also submitted that the published fee is a negotiable standard rate, and that it provides a discounted package to bring grain from third parties through the Viterra ports. But it offered no evidence on the level or extent to which it provides such packages.

There is some evidence, therefore, that the Receival at Port Service Fee might act as barrier to new competition or expansion by existing competitors. The Commission is not satisfied with Viterra's response that this is not the case. The Commission's concerns relate to the following matters:

- While Viterra may have good reason to check all grain being received (even from Viterra third party approved facilities), the Commission has not received evidence that this fee is cost reflective.[241]
- When the Commission asked Viterra why it is the only operator charging this fee (from approved storage), Viterra submitted that it had 'no comment on why (or why not) other [port terminal operators] charge (or do not apply a fee) for this service and under what conditions'.[242]
- Viterra submitted that it has 'no current intention to remove this fee.'[243] The ACCC monitors this fee as part of its annual bulk wheat ports monitoring. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power.

4.4.5.4 Capacity booking fee

Additional fees charged by Viterra may act as a barrier to entry or expansion if they increase the cost structure of competitors. The Commission thus sought to identify whether the terminal capacity booking fee reflects actual costs incurred by Viterra and applies to all users of Viterra's port terminal facilities (see question 5, Appendix B), and whether Viterra's behaviour is consistent with the practices identified in section 4.4.5.

(a) How does the fee operate?

This fee seeks to ensure overbooking of capacity does not occur. Export traders are subject to a capacity booking fee when they book Viterra's port terminal services for loading bulk grain onto vessels for terminal capacity allocated under the PTAC arrangements. Viterra submitted that the booking fee is essentially a part payment of the total shipping fee. This fee is $5.50 per tonne from 1 October 2017.[244]

(b) Is there a sound basis for Viterra's behaviour?

The Commission examined Viterra's behaviour in terms of the practices identified in section 4.4.5.

Are there clear and practical operational reasons for Viterra's behaviour?

The Commission accepts the use of Viterra's bulk grain vessel loaders has a clear opportunity cost, particularly in South Australia where there is limited spare capacity (at least at peak times). Viterra submitted that the fee reflects a cost associated with setting aside the capacity, and ensures a commitment from grain buyers. In other words, the fee reserves capacity for the trader, which creates obligations that Viterra must honour.

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241 As noted above, the Commission is not privy to the detail of the 2006 arbitration and so is not able to determine the extent to which all the factors referred to in this section were considered in the arbitration.

242 Viterra response to request for information.

243 Viterra response to request for information.

244 Viterra, *Pricing, Procedures and Protocols Manual 2017/18*, p. 5, and *Wheat Reference Prices—Port Terminal Services 2017-18 Fee Schedule*, p. 1, both viewed 16 May 2018. Viterra submitted that the 2017-18 fee is $5.00 per tonne for existing bookings and $5.50 per tonne for new bookings (source: Viterra response to request for information). This fee was retained at $5.50 per tonne for 2018-19.

The ACCC approved the fee application and the method for refunds/part refunds, in consultation with stakeholders. The port loading protocols (Part D, items 4–6) deal with moving, transferring and surrendering bookings. And Viterra's *Pricing procedures and protocols manual 2017/18* (clause C1, p. 17) explains how the booking fee applies. Viterra has not received any formal complaints about the capacity booking fee.

Is Viterra using the fee to encourage an efficient user response?

Viterra submitted that the fee shares the risk between traders and Viterra of traders overbooking capacity. In the case of Glencore, the fee may represent an intercompany transfer, but any overbooking of capacity would still represent a resource cost to Viterra, and thus to the combined Glencore–Viterra entity.

There may be concern that, given the capacity booking fee (investigated in this section), the lost capacity fee investigated in the next section (section 4.4.5.5) duplicates the potential cost to the trader. However, the capacity booking fee seeks to ensure overbooking of capacity does not occur, whereas the lost capacity fee ($5 per tonne) seeks to ensure any capacity booked is used. In any event, the combined fees still appear to be less than the resource cost (based on Viterra's submitted revenue forgone):[245] if a trader fails to fill the capacity booked for 2017-18 in relation to Outer Harbor shipping, Viterra estimated the revenue forgone is:

- the shipping fee of $12.07 to $14.65 per tonne (Port Adelaide – Outer Harbor, with fees varying across the season)
- port inload fees of $3.40 to $4.70 per tonne (depending on the port, and whether road or rail delivery).

How do Viterra's actions compare with those of its counterparts?

Interstate grain handlers charge an equivalent fee.

Is the level of fee or action broadly consistent with that adopted by Viterra's counterparts?

The Viterra fee is below the average equivalent fee charged by similar organisations, with only CBH (Western Australia) charging a lower fee.

4.4.5.5 Lost capacity fee

Additional fees charged by Viterra may act as a barrier to entry or expansion when such fees increase the cost structure of competitors.

The Commission sought to identify whether the lost capacity booking fee reflects actual costs incurred by Viterra and applies to all users of Viterra's port terminal facilities (see question 5, Appendix B), and whether Viterra's behaviour is consistent with the principles identified in section 4.4.5.

(a) How does the fee operate?

This fee seeks to ensure any capacity booked is used. If a trader (including related company Glencore) executes[246] less than 90 percent of the terminal capacity that is the subject of a booking,[247] a lost capacity fee of $5.00 per tonne applies. Viterra introduced the fee in 2014-15 at that rate, and it has remained unchanged.[248]

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[245] Viterra response to request for information.

[246] Capacity is executed if the client's vessel arrives at the port terminal during the booking slot, or the relevant grace period, and the tonnes are loaded onto the vessel (source: Viterra, *Pricing, Procedures and Protocols Manual, 2017/18*, p. 17, viewed 14 May 2018.

[247] Viterra, *Pricing, Procedures and Protocols Manual, 2017/18*, p. 17, viewed 14 May 2018.

[248] This fee was retained at $5.00 per tonne for 2018-19.

The lost capacity fee is payable for capacity that is intended for execution on or after 1 October 2017 (for the 2017-18 season), regardless of when the capacity was booked. Traders can avoid this fee if they can transfer the allotted time and/or capacity to another trader. When applied, the fee is calculated on the difference between:

- 90 percent of the capacity that is the subject of the booking, and
- the actual tonnes executed by the client under the booking.[249]

(b) Is there a sound basis for Viterra's behaviour?

This section examines Viterra's behaviour in terms of the practices identified in section 4.4.5.

Are there clear and practical operational reasons for Viterra's behaviour?

The Commission accepts the use of Viterra's bulk grain vessel loaders has a clear opportunity cost, particularly in South Australia where there is limited spare capacity (at least at peak times). The value of the lost capacity fee (this section) and capacity booking fee (section 4.4.5.4) combined is still less than the revenue forgone (section 4.4.5.4(b)).

Viterra submitted that it has not received any formal complaints about the lost capacity fee being levied.

Is Viterra using the fee to encourage an efficient user response?

Viterra submitted that it designed the fee to incentivise desired trader behaviour rather than penalise traders for non-compliance, and that:[250]

- Initial iterations of Viterra's port loading protocols showed there is no incentive (over the forfeit of the booking fee) for clients to surrender capacity in an efficient manner (or at all).
- Viterra had identified instances when a client, with capacity they did not intend to use, was not motivated to surrender the unwanted capacity in a timely manner to allow access for a second client without capacity.
- Under the conditions of the lost capacity fee, traders can divest themselves of capacity that they are not going to use, and thus avoid the fee or incur only part of the fee.[251]
- Item 5 of Viterra's port loading protocols under the PTAC (approved by the ACCC after consultation with the industry) sets the process for the transfer of bookings between clients.
- When a transfer is effected, the responsibilities associated with the slot transfer with the slot (that is, the capacity obligation is also transferred).
- Where capacity is taken up, the lost capacity fee is reduced or removed.
- The lost capacity fee is used on a discretionary basis, and is not always levied in cases where communication between Viterra and the other party is transparent and a clear explanation as to unforeseen circumstances is given.
- The export tonnage affected by the lost capacity fee has declined significantly over the three years from 2014-15, representing less than 0.5 percent[252] of exports in 2016-17.

[249] Viterra, *Pricing, Procedures and Protocols Manual, 2017/18*, p. 18, viewed 14 May 2018.
[250] Viterra response to request for information.
[251] 'Partial' given the lost capacity fee is only levied on the specific booked capacity not used.
[252] Sourced from Viterra response to request for information.

How do Viterra's actions compare with those of its counterparts?

Viterra's counterparts charge an equivalent fee. 'Take or pay' fees are not uncommon in firms with high cost infrastructure assets (for example, rail).

Is the level of fee or action broadly consistent with that adopted by Viterra's counterparts?

The lost capacity fee charged by Viterra has been consistently below CBH's fee (Western Australia), with the equivalent CBH fee being $6–7 per tonne over the period 2011-12 to 2017-18.[253]

The Commission's considerations in assessing this fee are the same as made for the capacity booking fee, namely that the:

- use of Viterra's loaders has a clear opportunity cost
- level of fee would not appear excessive and is consistent with the level charged by industry counterparts
- fee (if not the level) has been approved by the ACCC as an integral component of the PTAC.

4.4.5.6 Shrinkage and dust rates

The Commission examined Viterra's shrinkage and dust rates as a result of stakeholder concern. In its submission to the Commission, GPSA asked:

- what is the technical and financial basis for shrinkage and dust rates?
- why should the grain grower making the first sale into the storage and handling system bear the cost for what growers consider to be an operational risk?[254]

(a) How are the rates determined?

Shrinkage refers to the 'cost' of the weight loss that occurs during the grain drying process in storage and handling. The shrinkage rate is this weight loss as a percentage of the original grain tonnage received. Applied to all grain delivered to a Viterra facility, the rate is 0.60 percent for wheat, barley, minor cereals and canola, and 0.85 percent for pulses, charged on a tonnage basis.[255] Viterra submitted that the shrinkage rate addresses grain volume and quality loss in normal storage and handling activities, including:

- mass loss through change in moisture content
- volume loss through handling and waste
- quality loss while grain is stored (for example, pulses become more brittle with time)
- costs associated with clean-up/removal.

Similar to the shrinkage rate, the dust rate accounts for changes in saleable grain volume.[256] Dust is generated during grain handling. On one estimate, it comprises approximately 70 percent organic matter (which may include particles of grain kernels, spores of smuts and moulds, insect debris and

[253] Viterra response to request for information. Given that the AEGIC analysis generally shows CBH fees being the lowest, on this occasion a comparison has not been made with eastern Australian counterparts.

[254] GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 9.

[255] Assuming a wheat price of $250 per tonne, shrinkage fee would be $1.50. Both shrinkage and dust rates have been maintained at 2017-18 levels for 2018-19.

[256] AEGIC, *The Cost of Australia's Bulk Grain Export Supply Chains,* An Information Paper, January 2014, p.16, available at https://aegic.org.au/wp-content/uploads/2016/04/The-cost-of-Australias-bulk-grain-export-supply-chains-Full-Report.pdf.

field dust that becomes airborne during grain handling).[257] Environmental requirements at port generally require dust capture, so at port it is feasible to measure the amount of dust generated.

An adjustment is also made to the price a grower receives for 'dust' losses which occur from the movement of grain to the point of vessel loading. This dust adjustment is 0.15 percent levied on all tonnes outturned by Viterra for export.[258] Viterra submitted that this fee recovers the cost of extracting and disposing of dust (which arises from receiving, handling and loading grain) as per its EPA licence requirements.

(b) Is there a sound basis for Viterra's behaviour?

This section examines Viterra's behaviour in terms of the practices identified section 4.4.5.

Are there clear and practical operational reasons for Viterra's behaviour?

Based on Viterra's submission, shrinkage and dust are inevitable consequences of supply chain processes. Viterra submitted that:

- its shrinkage and dust fees reflect losses, due to the nature of the commodity, that occur as the grain moves through the supply chain:
  - Viterra's shrinkage rate is based on system volume and quality losses
- its shrinkage and dust fees are standard components of grain networks and represent a direct and unavoidable cost that would be incurred whether shown as a disaggregated fee (as currently occurs) or bundled into storage and handling fees
- Viterra constantly reviews its practices to minimise losses, and is working towards best practice
- its losses will vary each year depending on weather conditions and seasons, and other factors such as storage type:
  - shrinkage rates are not directly measurable against an individual event, and shrinkage may take multiple years to be determined because grain may be in storage for multiple years[259]
  - less capital intensive storage options (such as bunkers) have greater losses, as grain is handled more frequently and at a greater risk to weather
- installing suitable measuring equipment across the network to measure actual losses would be cost prohibitive.

Is Viterra using the fees to encourage an efficient user response?

Given the nature of the 'fee', it is not clear that traders or growers can take any action to minimise the costs, and the shrinkage and dust rates are set independently of any action of traders or growers. However, this is an instance where the fee applied by Viterra to receival from third party sites is lower,

[257] J. Boac, R. Maghirang, M. Casada, J. Wilson and Y. Jung, Size Distribution and Rate of Dust Generated During Grain Elevator Handling, *Applied Engineering in Agriculture*, 2009, Vol. 25(4): pp. 533-541, available at https://www.ars.usda.gov/ARSUserFiles/30200525/417SizeDistrandRateofDust.pdf .

[258] Viterra, *Pricing, Procedures and Protocols Manual*, p. 7, viewed 14 May 2018. This equates to 38 cents per tonne, assuming a grain price of $250 per tonne.

[259] Viterra response to request for information. From conversations with Viterra, the Commission understands it may take a number of years to fully clear a silo of grain, which is needed before a full reconciliation is possible to determine actual shrinkage.

with Viterra charging a lower shrinkage rate for grain received from third party operators.[260]

Viterra also submitted that it is conscious of grower concerns and continually acting to minimise dust and shrinkage losses, through:[261]

- implementing the objective of emptying grain at sites every three years
- transferring knowledge across sites by moving key staff to assist other locations
- ongoing cleaning as a task is performed
- tarping bunkers faster (which has potential to lower waste levels but can increase labour costs)
- addressing the overfilling of bunkers (and spillage), which may involve investment in automation technology, and
- placing grid covers on overnight (which has potential to lower waste levels but can increase labour costs).

Viterra also submitted that as dust collection plants improve in removing dust from the operating environment, the extent of dust losses can increase as more dust is removed. As a result, dust rates may increase over time, even though Viterra may become more efficient in dealing with dust.

How do Viterra's actions compare with those of its counterparts?

Viterra's counterparts adopt similar shrinkage and dust rates.

Is the level of fee or action broadly consistent with that adopted by Viterra's counterparts?

Viterra's shrinkage rate is lower or equal to all of its interstate counterparts other than CBH, with CBH 0.1 percent lower. Viterra's dust rate (0.15 percent) is lower than GrainCorp (0.30 percent) and CBH (0.25 percent).[262]

In relation to the practices identified in section 4.4.5:

- Operational factors appear to make some level of shrinkage and dust rates inevitable, with all operators applying shrinkage and dust rates.
- The rates adopted by Viterra are at comparable levels to those of its counterparts.
- The Commission accepts Viterra is actively pursuing ways to reduce shrinkage and dust, but is yet to pass on the benefits to customers (other than via lower shrinkage rates charged to receivals from third party operators).

In terms of GPSA's submission:

- The above first two points address the technical and financial basis for the rates.
- Given all supply chain costs are ultimately passed back to growers, the grain grower selling within the storage and handling system will inevitably bear the cost.

[260] Although, whether the total 'fee' to the customer would be lower is not clear. The fact that the grain has come from a third party site means that it has been handled by another operator before being delivered to Viterra. That other operator might impose its own shrinkage rate on the customer. If so, the total shrinkage rate (lower Viterra shrinkage rate plus the third party operator shrinkage rate) might exceed the single Viterra shrinkage rate to other (than third party operator) customers.

[261] Viterra response to request for information.

[262] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p.71.

4.4.5.7 Impact of vertical integration

The Commission investigated whether there is evidence that Viterra is using its vertical integration with Glencore to exercise market power to the detriment of competition in a sustained and material manner (see question 12, Appendix B). Glencore is the largest grain export trader operating in South Australia (by volume),[263] and Viterra could benefit from the resulting scale and scope economies.

(a) Is there evidence of any behaviour issues?

Quality arbitrage

The Commission considered the potential for Viterra to take advantage of its position as a vertically integrated entity (incorporating Glencore) through quality arbitrage. This potential arises from Viterra's knowledge of the stocks that it holds, and its ability to blend the grain under its control to extract value in addition to that paid to growers. However, the Commission understands this issue of quality arbitrage relates to the role of traders in general, so addresses this issue in section 5.4. That is, the issue is not specifically relevant to Viterra's potential to exercise market power to the detriment of competition.

Scale and scope economies

Viterra submitted that it obtained some operational savings from having access to Glencore's bulk buying power.[264] It also submitted that, on one occasion, Glencore provided harvest shipping assistance when Viterra was finding it difficult to get traders to ship grain for the 2016-17 harvest season. On this occasion, Viterra was facing the prospect of its key sites filling to capacity. Viterra submitted that shipping assistance from Glencore kept the supply chain operating effectively, which meant it could continue to receive grain upcountry.

Finding 4.7

In relation to pricing behaviour, the Commission found possible evidence of a pricing structure that potentially serves as a barrier to new competition or expansion by existing competitors (specifically, the Receival at Port Service Fee (from Approved Third Party Storage)). The ACCC monitors this fee as part of its annual bulk wheat ports monitoring. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power.

Given the available evidence, the Commission considers Viterra's behaviour in relation to the remaining fees and practices which were investigated (Export Select, grower direct deliveries to port, capacity booking fee, lost capacity fee, shrinkage and dust rates, and the impact of vertical integration) is not, on its own, detrimental to the efficiency of the supply chain.

[263] PIRSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 9.

[264] Viterra submitted that it secured, as a result of having access to Glencore's bulk buying power, savings from the acquisition of front end loaders and safety cost-related savings. It also submitted that it is pursuing other savings by leveraging off Glencore's buying power, in areas such as the purchase of fumigant gases (which are one of the largest harvest consumable costs), future electrical infrastructure upgrades and tarpaulins.

4.4.6 Whether market transparency is sufficient

Section 2.2 (Table 2.1) stated the need to investigate the extent to which the market is sufficiently informed (see question 14, Table B.1). This matter is important because markets generally work best when participants are well informed. Specifically, the Commission wanted to know whether there is sufficient information available for:

- growers and traders to understand the basis of the fees being charged, and to assess the merits of alternatives
- growers and traders to check whether financial returns and fees are excessive or not, relative to what a firm with Viterra's risk profile-would be expected to earn, on average, and
- competitors to make informed decisions on profitable opportunities to enter the market.

Section 5.2 addresses the availability of grain stock information.

4.4.6.1 Fees

Potentially, growers could face issues with fee transparency for two reasons:

- First, although Viterra maintains a comprehensive list of current fees on its website, it may not be a simple exercise to determine the total fees that should be charged for a specific grain movement.
- Second, growers generally transfer responsibility for the payment of fees to traders, on the sale of grain.[265] The trader then pays Viterra and netts off the supply chain fees from the grain payment made to the grower.[266] The resulting trader transaction statement may not contain the detailed level of information sought by some growers.

Viterra submitted that communication and transparency of supply chain fees as part of the grain price is at the discretion of the trader.

While the export market appears highly competitive (section 3.3.1), it is not clear that traders consider Viterra fees as other than a simple pass through to growers. Growers may not be able to rely on traders to act on their behalf to achieve the lowest possible Viterra fees. In such a situation growers, or some other party working in growers' interests, need to be able to monitor supply chain fees for themselves. Even if growers do not have an option to change supply chain service provider in a given season, access to transparent information is still important to enable an effective response over time. This, in turn, should place some pressure on Viterra to charge fees that only provide it with a financial return commensurate with its level of risk, on average over time.

Overall, based on a small sample of trader transaction statements to growers, it appears a significant amount of information is provided by traders to growers. These statements typically include details such as delivered weight, site price, freight and storage fees (refer item 38, Appendix G for more detail).

The Commission understands that the issue some growers have is in being able to reconcile the upcountry site price, accepted by the grower and presented in the trader's transaction statement to the grower, with the equivalent publicly available at port price (which the grower monitors, given the grower's expectation that their grain is destined for port). This is because a number of supply chain fees are not included in the traders' transaction statements to growers. Examples being receival, outturn, port inload, port handling and booking fee, and dust and shrinkage. But Viterra publishes these fees on its website. So it should be possible for growers to approximate the balance of fees, so they are in a position to query the trader if the grower believes a material discrepancy exists (between the site

[265] Viterra, *Harvest Information 2017/18*, clause 24.2.

[266] Economic and Finance Committee, *Hansard*, 27 September 2017, pp. 157–8, and *Inquiry into Issues Faced by Primary Producers,* Final Report, p. 137.

and at port prices). Indeed, the chart reproduced as Figure 4.2 is the GPSA's approach to assisting growers in estimating total supply chain costs for a particular year.

Further, it is not possible to provide growers with a fully itemised list of charges attributable to each specific delivery to Viterra's system, given the nature of a commingled grain system, Viterra is only able to bill the trader for specific services it provides in handling the trader's commingled grain. This will likely comprise a number of growers' products and may be for a domestic and/or export customer. The trader, having regard to the aggregate supply chain costs expected to be incurred, sets the site price which incorporates a margin to provide a return to the trader. It is this margin a trader adds to Viterra's fees that is not transparent. The grower is reliant on an efficient trader market (Finding 3.4) for such margins to be kept in check. Here it is worth noting the PTAC taskforce's observation that trader margins are generally slim (section 3.3.1). For a more detailed discussion on this point refer to item 38, Appendix G.

4.4.6.2 Financial information

The publicly available financial information[267] on Viterra's performance is for a consolidated group of seven businesses, reports calendar years (not harvest years), and provides little commentary on the operational performance of the business (section 4.4.4.1). By contrast, stakeholders in Western Australia and eastern Australia have access to the published annual report and accounts of CBH and GrainCorp respectively that are more reflective of their grain storage and handling business operations in the relevant States.

However, Viterra does publish a comprehensive list of its fees. It should, therefore, be possible for consumers to gain an understanding of Viterra's future performance through monitoring trends in supply chain fees (publicly available) and service levels (publicly observable). It would be a potential concern to see fees increasing materially above inflation and/or service levels deteriorating. Such circumstances, if they occurred, would place an onus on Viterra to publicly justify to its customers the fee increases. Failure to do so would result in Viterra risking customer disquiet, increasing the likelihood of future investigations or inquiries being undertaken and subsequent consideration of remedial measures.

Further, there have been new entrants. So a potential competitor to Viterra who seeks to compete generally in the market for grains[268] has access to sufficient information regarding fees and service levels for it to assess the viability of proposals. It can do this by considering whether it can match or better the Viterra fees for a particular service offering. That being said, it is too early to assess the extent to which recent and prospective entrants will place a competitively significant constraint on Viterra's behaviour.

Indeed, in the case of new and prospective entrants, the central concern is that their chances of success should not be adversely impacted by any misuse of market power (with the success being based instead on the product offering and customer's willingness to support the venture). Ultimately, it is the role of the ACCC to undertake any investigation into possible misuse of market power under section 46 of the Competition and Consumer Act 2010.

[267] Available from ASIC for a nominal fee.
[268] Rather than serve a particular customer.

Finding 4.8

A grower faces two sets of fees associated with a grain trade. Some Viterra fees are transparent and clear on the transaction statement that the grower receives from the trader. Other fees and the trader's margin (to earn a return) are not transparent and clear for specific grain movements and probably cannot be made transparent due to the commingled nature of the trader's grain, without a fundamental change in the operations of the industry.

Going forward, it should be possible to gain some understanding of Viterra's future performance through monitoring trends in supply chain fees (publicly available) and service levels (publicly observable). The absence of suitable published financial information places an onus on Viterra to publicly justify to its customers any future fee increases, particularly if service levels remain constant or decline. Failure to do so would result in Viterra risking customer disquiet, increasing the likelihood of future investigations or inquiries being undertaken and subsequent consideration of remedial measures.

The fact that there have been new entrants indicates that a potential competitor to Viterra who seeks to compete generally in the market for grains has access to sufficient information available for it to assess the viability of proposals. It can do this by considering whether or not it can match or better the Viterra fees for a particular service offering. This suggests that there is sufficient information for the market to work effectively from a signalling perspective. However, it is too early to assess the extent to which new and prospective entrants place a competitively significant constraint on Viterra's behaviour. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power that may undermine the potential for new and prospective entrants to provide a competitively significant constraint.

4.5 Conclusion

The market for freight and port services is either competitive or subject to regulatory oversight that ensures a suitable proxy to competitive outcomes. For these reasons, the Inquiry focused largely on the performance and behaviour of Viterra (section 4.2). While opportunities to improve the efficiency of the supply chain will always remain, the Commission's finding is that the supply chain is not demonstrably inefficient:

- in terms of its costs that the Commission investigated
- from both an overall and individual supply chain segment perspective, and
- based on available facts and evidence, at this time.

While Viterra faces some competition (actual and potential), the extent to which it places effective and credible discipline on Viterra's behaviour is not clear (section 4.3.3). The global market may place more effective discipline on Viterra's behaviour than any local competition could (section 4.3.1).

Viterra generally seeks to provide good customer service (section 4.4.1) and, to its credit in recent years, has proven capable of reducing the operating costs of South Australia's main grain export supply chain (section 4.4.2). Viterra also demonstrated to the Commission that it is an innovative firm with a strong focus on efficiency.

The level and trend in Viterra's fees are consistent with the financial analysis that shows Viterra is choosing not to share efficiencies made with industry through lower fees. However, taking into account corporate structural issues, Viterra's fees are not considered excessive compared to its Australian counterparts (section 4.4.3).

Based on the available evidence, Viterra is earning returns, on average, towards the upper end of what might be expected for a firm with Viterra's level of risk. The assessment of Viterra's returns, along with advice from the Commission's consultant (VAA), was a key input into the Commission's investigation of whether Viterra is earning returns, on average, above those commensurate with the risk it faces (section 4.4.4).

Given the upward trend of Viterra's operating surpluses, however, it is not clear whether the trend will flatten out in the mid to long term, or continue to increase to the point that returns become excessive, on average, relative to that expected for a firm with Viterra's risk profile. If the latter occurs, and Viterra does not adequately share its efficiency gains with its customers, then the competitiveness of the supply chain would come into question.

In relation to pricing practices, the Commission considers Viterra's Receival at Port Service Fees (from Approved Third Party Storage) may serve as a barrier to new competition or expansion by existing competitors (section 4.4.5). The ACCC monitors this fee as part of its annual bulk wheat ports monitoring. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power.

There is a high degree of transparency in supply chain fee information, but the nature of a commingled grain system means that it is not possible to assign a total supply chain fee to an individual grain delivery (section 4.4.6.1)

Based on the fact that there are new entrants, a competitor of Viterra has sufficient information available to assess viable proposals, by considering whether its proposal can match or better the Viterra fees for a particular service offering. Despite the lack of suitable published Viterra financial performance information, it should be possible to gain some understanding of Viterra's future performance through monitoring fee and service levels over time, either publicly available or observable. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power (section 4.4.6.2).

Table B.2 (Appendix B) summarises the evidence that the Commission obtained on whether Viterra is exercising market power to the detriment of competition.

5 Other issues

Chapter summary

- Grain pooling is a tool available to growers to manage price risk, with the grain industry well placed to manage issues associated with grain pooling.
- The public release of stock information has both strong advocates and strong opponents. To the extent that the release of more stock information has net benefits, the grain industry should be able, by itself, to achieve the best outcome.
- The freight cost component of the supply chain costs should be efficient, within the current economy-wide framework for establishing road user charges and identifying road investment priorities.
- It is not clear that the practice of quality arbitrage is detrimental to the overall returns achieved by the grain industry. It does not seem to be an issue for growers, so long as they receive a price commensurate to the value of their grain on the global market.
- Based on case study undertaken by the Commission, it cannot be concluded that Viterra is improving its efficiency by cost-shifting onto growers.

Chapter 4 focused on the efficiency of the supply chain in terms of the performance and behaviour of the key firms providing supply chain services. This chapter focuses on other issues.

From the Economic and Finance Committee's primary producers' inquiry, Recommendation 13 was:[269]

> *In the Treasurer's consideration of the ESCOSA's Inquiry into the South Australian Bulk Grain Export Supply Chain Costs, the Committee strongly recommends that he consider the evidence received by this Committee during this Inquiry in relation to the current issues that face primary producers in the State's grain industry.*

A variation to the Inquiry Terms of Reference (Appendix A) requires the Commission to consider the evidence provided to the Economic and Finance Committee (chapter 12 of the committee's report). This consideration, to the extent not covered in chapter 4, covers grain pooling (section 5.1) and grain stock information (section 5.2).

The Terms of Reference also require the Commission to consider the basis on which road and rail components of supply chain costs are recovered (Appendix A), which section 5.3 addresses. Additionally, given submissions raised quality arbitrage, section 5.4 looks at this issue. Following an issue raised during consultation on the Draft Report, section 5.5 looks at whether there is an evidence of Viterra pursuing efficiencies by cost shifting to growers.

5.1 Grain pooling

GPSA submitted to the Economic and Finance Committee's primary producers' inquiry that growers choosing to sell to a grain pool are quoted only an estimated price, and the actual price received could be much lower. Pool providers are not obliged to pay the estimated returns, and GPSA submitted farmers thus have little or no negotiating power. GPSA suggested a possible solution is for growers to be quoted a guaranteed pool return (net of all pool provider fees at a designated price basing point), as the minimum price paid to pool participants.[270]

[269] Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers,* Final Report, p. 138.
[270] Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers,* Final Report, p. 126.

In GPSA's 2015-16 grower survey, 37 percent of respondents rated pool performance and transparency as having a moderate or large impact on the profitability of their grain producing business.[271] Conversely, the majority of growers did not rate this matter as an issue.

The Productivity Commission considered grain pools in its 2010 wheat export marketing arrangement review. It found some merit in improving pool transparency, but it considered the change would be best undertaken by the industry (through a more detailed code of conduct), and there was no role for government.[272]

Some growers may be looking back to the former wheat single desk (removed in 2008), which had a compulsory wheat pooling scheme designed to protect growers from volatile wheat prices.[273] In the deregulated era, pools are only one of many tools available for growers to manage risk (for example, other tools include use of the spot market and various forms of financial hedging[274]). Further, pools have commercial risks. Growers are still indirectly incurring costs for marketing and price risk management, through the management fees that the pool manager deducts from the pool return (which was also the case under the compulsory national pool).[275]

It appears fundamental to a harvest pool that the operator cannot provide the certainty that the growers seek when they do not have pre-harvest commitments (which would enable the pool operator to enter contracts with overseas customers, hedge etc.). But such a commitment would mean the grower effectively substitutes one risk (the risk that production is less than that committed) for another (the risk of less certainty in grain price received).

Finding 5.1

Grain pooling is a tool available to growers to manage price risk and the grain industry should be well placed to manage issues associated with grain pooling.

5.2 Grain stock information

The public release of stock information has both strong advocates and strong opponents. An argument in support is that it could promote competition by encouraging a larger number of traders buying a range of grades and grain types (because traders would be more confident of sufficient supply to fill vessels). As an example, the SA Barley Advisory Committee submitted to the Economic and Finance Committee's primary producers' inquiry that a key problem for the barley industry is the lack of transparency around how much feed stock is being sold as malt.[276] It submitted that competing traders, if they knew the quality of the feedstock, could compete and pay more, giving growers a 'fairer price'.

During consultation on the Draft Report, some stakeholders stated that more 'transparent information' for export traders would enhance efficiency. In particular, GPSA submitted 'access arrangements designed to increase transparency of available capacity, pricing and stock information would be of benefit to any export marketer'.[277]

An argument against is that the release of more stock information could undermine the South Australian grain industry's global competitiveness. That is, most other countries do not release such information (or at least to the extent envisaged by advocates), so the release would benefit only

[271] GPSA, *Issues faced by South Australian Primary Producers*, submission to the Economic and Finance Committee, 21 July 2017, p.3.
[272] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 27.
[273] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 46.
[274] For a discussion of marketing and risk management tools, see Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, Appendix B.
[275] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 104.
[276] Economic and Finance Committee, *Inquiry into Issues Faced by Primary Producers,* Final Report, p. 127.
[277] GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 6.

global traders and end users that can react to stock information by switching their demand to other origins at short notice. South Australia is a small player in the global bulk grain export industry (chapter 3), and its lack of scale may make it less able to recover from a lack of competitiveness resulting from asymmetrical stock information.

An initial task is to understand what specific stock information would be useful (given the information already routinely issued to the market) and what might be the benefit of its release. The Productivity Commission considered the availability of stock information in its 2010 wheat export marketing arrangement review. It characterised three tiers in the extent of data disaggregation:[278]

- 'Tier 1' information is stock information in its most aggregated form (namely national wheat stock information). This information is suggested to be most useful for international market participants and supports the competitiveness of the Australian wheat market in the global context.
- 'Tier 2' information further disaggregates the tier 1 information, to wheat stocks by state. This information is suggested to be useful for facilitating the operation of the Australian export and domestic wheat markets, and the interactions between those markets.
- 'Tier 3' information captures all subsequent disaggregation of stocks information (such as stock information by port zone or receival site). This information would predominantly influence the supply and demand decisions of particular economic agents in the wheat market.

Further, stock information needs to be current. Based on the Productivity Commission review, it would require the collection and release of the following information:[279]

- grain volumes in the bulk handling and storage system, held by grain users and stored on-farm
- committed (for export or domestic use) and uncommitted, and
- new stock (carry-in) and old stock (carry-out).

The Productivity Commission considered the availability of tier 1 (national) stock information is critical for the success of Australia's wheat export industry. But it also considered the grain industry should pay for its collection and release, given most of the benefits accrue to industry. The potential cost seems modest, with some estimates suggesting a cost of less than $1 million per year.[280] Further, Viterra offers growers an 'opt-in' for the release of information on their warehoused stock to registered buyers.

Overall, the Commission finds for this Inquiry that no regulatory/institutional response is needed. Despite the free-rider risk (that growers that might support the information release fail to opt-in, hoping enough other growers do), regulation/institutional intervention would appear to be a blunt instrument to resolve this issue. As suggested by the Productivity Commission, growers already contribute to a number of levies that might be used as an efficient funding mechanism.

Finding 5.2

The public release of more grain stock information has both strong industry advocates and strong industry opponents. To the extent that the release of more stock information has net benefits, the grain industry should be able, by itself, to achieve the best outcome.

[278] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 321. This Productivity Commission categorisation refers only to wheat, given its inquiry was into wheat export marketing arrangements. However, it is considered that the categorisation should be applicable to all grain types.

[279] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 296.

[280] This estimate is based on the cost to industry (Australia-wide) of producing the Wheat Export Sales Survey and Grain Handler Stock Survey, and a revamped *Wheat Use and Stocks, Australia* report through the Australian Bureau of Statistics. The cost was estimated to be around $0.85 million ($ 2012) per year (source: P. Reading, May 2012, p. 29).

5.3 The basis of road and rail cost recovery

The Terms of Reference require the Commission to consider the basis on which road and rail components of the bulk grain export supply chain costs are recovered. This section seeks to address the following questions:

- What is the current basis on which road and rail components of the supply chain are recovered?
- What are the implications for the supply chain?

5.3.1 Current basis of cost recovery

Unlike other areas investigated by the Inquiry, the presence of inefficient road charging would affect the efficient land transport of all commodities and services produced in the economy. The Commission did not undertake its own investigation of the basis on which road and rail components of the supply chain costs are recovered. Rather, it could rely on a considerable body of work undertaken by others with expertise in this field. In the recovery of road pavement costs, efficiency issues have been identified by the Council of Australian Governments (COAG), and assessed by agencies such as the Productivity Commission and the National Transport Commission. Solutions are being progressed at the state and national levels, to varying timelines.

Based on the literature reviewed by the Commission, there appears to be a broad consensus that heavy vehicles pay sufficient charges in aggregate to recover the cost of the infrastructure that they consume.[281] However, whether recovery is achieved at the level of specific road types (particularly rural local roads and some rural arterial roads) is less certain.[282] As a result, the cost of heavy vehicles using many rural local roads and lightly-used arterials may be well above the network average charge that they face.[283] It is at the level of rural roads that heavy vehicles are most likely to compete with rail at the margin, given most grain farms are well away from urban centres (and thus from urban arterial and local roads). The competitive nature of the road transport industry means any under-charging of road user charges for heavy road transport would likely be fully reflected in lower than efficient road freight rates.

A fully commercial operation, such as GWA, might be expected to recover its own rail operational costs efficiently. However, because GWA has regard to road freight rates in developing its rail freight rates,[284] the flow on effect of any inefficient road charges may be that GWA has difficulty fully recovering its infrastructure costs through the rail freight rates that it charges its customers.

5.3.2 Whether there are implications for the supply chain

As discussed in section 4.2.2, the road freight industry is competitive, and the freight rates charged by road transport operators to Viterra and other bulk grain customers would also be expected to be competitive. For this reason, those rates appear to be efficient from the viewpoint of the grain industry.

The Commission previously concluded that rail haulage rates for grain are constrained by the competitive rates set by road, noting GWA's operations are also covered by the rail access regime (section 4.2.1). As a result, the Commission found the freight cost component of the supply chain costs should be efficient, within the current economy-wide framework for establishing road user charges and identifying road investment priorities.

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281 National Transport Commission, *Exploring the Opportunities for Reform: Discussion Paper—Smart Transport for a Growing Nation Project*, 2011, p. 61, available at https://www.ntc.gov.au/Media/Reports/(8AE2B7CC-07CE-1C8B-72FD-53BCBEE67CAB).pdf.

282 Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 292.

283 Productivity Commission, *Road and Rail Freight Infrastructure Pricing,* Inquiry Report, no.41, 22 December 2006, p. XXXVI, available at http://www.pc.gov.au/inquiries/completed/freight/report/freight.pdf.

284 GWA has advised the Commission that its rail freight rates need to be competitive with those charged by road transport (GWA letter to Commission dated 23 June 2017).

Pending the development of a national integrated efficient pricing, funding and infrastructure investment system, initiatives are underway to improve the productivity of the road network through more responsive regulation of the road network. Road access prioritisation initiatives such as PIRSA's 90 Day Change @ SA Project (Improving Road Transport for the Agriculture Industry) [285] appear to be useful approaches for addressing grain industry needs in the interim.

Finding 5.3

The freight cost component of the supply chain costs is efficient, within the current economy-wide framework for establishing road user charges and identifying road investment priorities. The competitive road freight industry underpins efficient road and rail freight rates. This competition is complemented by regulatory oversight through the rail access regime.

5.4 Quality arbitrage

GPSA suggested to the Commission that Viterra takes advantage of its position to extract value for the vertically integrated entity (incorporating Glencore) through quality arbitrage.[286] Such an advantage would arise from Viterra's knowledge of the stock that it holds, and its ability to blend the grain under its control.

The Commission understands quality arbitrage to be standard practice of traders to extract the maximum value from their grain purchases. The trader would ask the operator, such as Viterra, to blend different grades of grain and prepare the blended product to a quality specification for shipment. In essence, traders combine inputs to produce a higher overall product, for which they create value and receive a commensurate return. Viterra provided the Commission with a detailed explanation of its approach to blending (Box 5.1).[287]

[285] A project status update (dated April 2017) is available at http://pir.sa.gov.au/major_programs/improving_road_transport_for_primary_production_project_2. The project is a joint initiative of PIRSA, Primary Producers SA, and the Department of Planning, Transport and Infrastructure.

[286] GPSA suggested: 'By [Viterra] having control of vessel loading, the upstream storage and handling firms are responsible for the sampling and receival standards, controlling segregations, undertaking selected blending and reserving grains to meet customer specifications effectively making available a particular lot of grain to meet the required grade standards for a customer. There is the potential for the 'devaluing' of higher than specified grain by way of blending with or to lesser lower grades. It is unclear how the benefit of blending grain grades is shared among other holders of the same commodity in the supply chain who aspire to be sellers to international markets. The current grading system with blending benefits is impossible to quantify and any benefit may not be shared with other marketers or passed back to grain growers. There is no certainty a grain owner or warehouser will receive the same grain they paid for or harvested'. GPSA, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, 11 May 2017, p. 5.

[287] Viterra, *Response to Public Submissions*, June 2017.

Box 5.1 Viterra's explanation of its approach to blending

- On receival, grain is classified by Viterra and segregated according to industry standards. Growers are issued with a record of their grade and tonnage, which has a market value based on that information and the location of the grain. Buyers bid for growers' grain, taking ownership within the Viterra storage network.
- Viterra's bulk handling system is a commingled system, with multiple owners delivering like grades into the same silo, bunker or shed (cell). The benefits of a commingled system include the efficient use of storage and logistics that would otherwise involve significant asset duplication to perform the same volume task.
- On delivery, individual loads are mixed with other loads that are within the quality specifications for an individual grade.
- Commingling of more than one grade into a single cell occurs from time to time, for operational efficiency. It maximises the storage space by (when required):
  - removing the need for the addition of another segregation
  - receiving a grade that would otherwise be downgraded, delivered to another site, or not received.
- These actions may increase receival efficiency and reduce turnaround times by effectively using plant and equipment, allowing more timely export to the world market.
- Commingling does not affect the price received by the grower. Viterra must ensure stock is outturned to the grade owned by each trader.
- Traders (marketers) make sales based on specific quality specifications rather than the industry standard receival grades or outturn specifications.
- To meet quality specifications, grades are blended homogenously across a cargo. The ability to blend grades is reflected in the pricing to the grower of each grade. This practice creates a market for lower grades, if they can be blended at rates maintaining the required quality specifications.
- Viterra argued that it and the trader are incentivised to maximise the value of grain in the storage system. It must provide all customers (including growers who may outturn grain to themselves) with grain that meets the quality specifications of the grade in their ownership.
- The commingled system makes it highly unlikely that a grain owner or warehouser will receive the same grain that they paid for or harvested. However, each owner will receive grain meeting the grade that they delivered or purchased.

The benefit to Viterra is limited to the fees paid to it for its services (blending and preparation for shipment). But the trader (Glencore or another trader) has created value through the blending process. As with any production process, the producer (trader), not the input supplier, gains from combining the inputs to produce the new product. Once the grower sells their grain to the trader, they forfeit the right to share in the future value created by the trader.

As noted in Table 4.2, to improve classification accuracy, Viterra is introducing dynamic binning for wheat, from the 2018-19 harvest. Dynamic binning seeks to provide growers with more flexibility to access a higher grade for loads just outside of the receival standards.

Given the global trading market appears competitive, is there any evidence that growers do not receive an efficient (world) price for their grain for their trades? The Commission sought but was not provided with such evidence.

The Commission is addressing this issue in Chapter 5 of the Final Report, rather than Chapter 4, by reason of Viterra providing a service in this case. Viterra, by providing a service, does not have the opportunity to exercise market power to the detriment of competition. Glencore, or any other trader, is simply having its purchases processed in a manner that maximises the value to the trader.

While in the days of the single desk and the cooperative bulk handling model, growers may have shared in the value created through the whole supply chain, it is not clear how this can be the case now. Growers have the option to form their own trading cooperatives if they consider the value creation sufficient to warrant the additional costs involved, which include locating overseas customers and supplying grain of the require specification and delivered at the time specified.

Finding 5.4

It is not clear that the practice of quality arbitrage is detrimental to the overall returns achieved by the grain industry. It does not seem to be an issue for growers, so long as they receive a price commensurate with the value of the grain on the global competitive market.

5.5 Cost shifting

During consultation on the Draft Report, some growers raised concern that Viterra is achieving efficiency at their expense, through cost shifting to growers. In particular, through the closure of sites leading to additional freight costs being incurred by growers, as a result of having to transport grain to a site further away

The Commission undertook analysis to gain an understanding of the additional costs some growers might face from site closures. A case study approach was adopted, assessing the impact resulting from the closure of Yongala and Caltowie, the retention of Gulnare and Jamestown, with Gladstone the main centre for the area. The assumptions adopted and detailed calculations are presented in Box 5.2. This case study extends the case study on cost-reflective pricing (in the case of Jamestown and Gulnare) presented in Box 4.5.

Viterra's Gladstone, Gulnare and Jamestown sites are located in the upper Central region. Yongala and Caltowie sites (in the same region) had already closed (Yongala's last season was 2010-11 and Caltowie's 2014-15), due to low utilisation and high capital requirements. These latter sites provide a good example of an actual case where growers potentially faced additional costs.

The study assessed the incremental rise in average farm to upcountry site trucking costs (marginal trucking cost multiplied by distance) for a grower having to travel further from the 'closed' site to the alternative. It also took account of any potential fee savings resulting from lower Export Select rates (given the nature and location of the Gladstone site) and from Gladstone being a tier 1 site having lower receival fees to Caltowie, which was a tier 2 site.[288]

Other than for marginal trucking cost, all fees reflect rates that applied for the year following the relevant decision to close or retain site. This is so the fees reflect the relevant inputs into the decision at the time. The marginal trucking cost rates have not been deflated because it is not known how well the

[288] Tier 1 and tier 2 upcountry receival facilities reflect the difference between a receival site's efficiency within Viterra's network. Tier 1 sites being more efficient that tier 2. Source: Viterra, *Fees, Terms and Conditions: Warehouse Storage and Handling Service Fees 2017/18*, available at http://viterra.com.au/wp-content/uploads/Storage-and-handling-service-fees-201718.pdf (as viewed 12 November 2018).

resulting deflated costs would reflect the actual costs of the time. Deflating trucking costs would serve to reduce the grower costs reported in this case study.

Closure of Caltowie and Yongala

For Caltowie, the nearest alternative receival site is Gladstone. The additional freight costs incurred by local growers are estimated at $1.96 per tonne. However, this is more than offset by reduced fees once grain is in the Viterra supply chain, with Export Select freight rates being $9.69 per tonne cheaper from Gladstone, and upcountry receival fees also being $0.75 per tonne lower (with Caltowie a tier 2 site). Overall, grower fees are lower by $8.48 per tonne (2015-16 fees).

Similarly, while Yongala is 53 kilometres from Gladstone, the incremental road freight costs, estimated at $5.83 per tonne, are more than offset by reduced Export Select fees of $11.60 per tonne. Overall, grower fees are lower by $5.77 per tonne (2011-12 fees).

Retention versus closure of Gulnare and Jamestown

In 2015, Viterra's post-harvest analysis identified reduced receivals and use at Gulnare and Jamestown would result in closure of these sites. But both sites were in good condition and did not require significant capital expenditure. For network efficiency, Gulnare and Jamestown sites needed to remain open to:

- reduce overall site labour and capital expenditure to meet deliveries
- segregate smaller volumes and / or less mainstream gains without interrupting higher volume activities
- reduce expenditure on extra storage at Gladstone in 2016-17

In order to test the potential impact that closing Gulnare and Jamestown would have had on local growers, the Commission has modelled the additional costs (and savings) that growers would have incurred had these sites closed.

For Gulnare, the nearest alternative receival site is Gladstone. The additional freight costs, which would have been incurred by growers, are estimated at $3.80 per tonne. However, this would have been more than offset by reduced fees once grain is in the Viterra supply chain, with Export Select freight rates being $6.76 per tonne lower from Gladstone. Overall, grower fees are lower by $2.96 per tonne (2014-15 fees).

Similarly, for Jamestown the nearest alternative receival site is Gladstone, with incremental road freight costs estimated at $3.42 per tonne, more than offset by reduced Export Select fees of $7.16 per tonne. Overall, grower fees are lower by $3.74 per tonne (2014-15 fees).

This case study has not addressed all potential costs, such as if the additional travel time resulted in the need for a grower to employ an additional truck. But against this, no assessment has been made of the impact of efficiencies achieved at remaining open sites through investment undertaken in areas such as improving elevator speeds to enable faster truck turnaround. Also, the assessment implicitly assumes that all growers have to travel the full distance from the closed site to the nominated site, whereas many growers' farms are likely to be closer to the open site than that.

Box 5.2 Cost Shifting Case Study – Assumptions and detailed calculations

The model has taken Gladstone as the closest site for each site under closure consideration. Google Maps was used to find the distance between the 'closure site' and Gladstone, being: Caltowie 16.3 kilometres; Yongala 53.0 kilometres; Gulnare 31.7 kilometres; and Jamestown 28.5 kilometres.

Marginal trucking costs estimates were based on data provided by AEGIC, verified against published Viterra freight rates.[289] Only the marginal freight cost has been used, $0.12 ($/tonne-km) for up to 50 kilometres and $0.11 ($/tonne-km) for 50 to 250 kilometres. This is on the basis that once the grower's truck is on the road, then only the additional (marginal) cost involved in travelling further to the next available site is relevant.

The calculated resulting incremental rise in freight costs (marginal cost by distance), are: Caltowie $1.96 per tonne; Yongala $5.83 per tonne; Gulnare $3.80 per tonne; and Jamestown $3.42 per tonne.

However, there are offsetting savings, with Gladstone having lower Export Select rates than the 'closure' sites. The difference in the Export Select freight rate was calculated using rates that applied for the year following the relevant decision (to close or retain site), calculated as:

- Caltowie: $23.91 per tonne (Gladstone) less $33.60 per tonne (Caltowie) = -$9.69 per tonne.
- Yongala: $23.15 per tonne (Gladstone) less $34.75 per tonne (Yongala) = -$11.60 per tonne.
- Gulnare: $19.19 per tonne (Gladstone) less $25.95 per tonne (Gulnare) = -$6.76 per tonne.
- Jamestown: $19.19 per tonne (Gladstone) less $26.35 per tonne (Jamestown) = -$7.16 per tonne.

In addition, there is a further saving in upcountry receival fees in the case of Caltowie, as Caltowie was a tier 2 site: $12.35 per tonne (Gladstone) less $13.10 per tonne (Caltowie) = -$0.75 per tonne. The resulting net impact is:

- Caltowie: -$8.48 per tonne (saving)
- Yongala: -$5.77 per tonne (saving)
- Gulnare: -$2.96 per tonne (saving)
- Jamestown: -$3.74 per tonne (saving).

Based on this case study, it cannot be concluded that Viterra is improving its efficiency by cost-shifting onto growers. Indeed, there appears to have been a measured approach to site rationalisation, to the benefit of all parties, and to improve the overall efficiency of the industry. Should there be specific instances where growers believe that a site closure would result in additional costs to them, then there is sufficient transparency in fees for growers to undertake the type of analysis used in the case study to mount a case to Viterra, by employing the approach detailed in Box 5.2. The important point is that such analysis must incorporate all relevant costs. The fact that a site is being considered for closure as a result of low utilisation might suggest that growers have already identified for themselves the benefit of using an alternative site.

Finding 5.5

Based on case study evidence, it cannot be concluded that site closures result in Viterra shifting costs to growers. From a total fees perspective, a grower may achieve a net reduction in their overall supply chain costs, despite sites closer to them being closed and having to transport their product to a site further away.

[289] AEGIC, *Australia's grain supply chains: Costs, Risks and Opportunities*, October 2018, Note 2c to Figure 4, p.18 for the cost up to 50 kilometres. AEGIC advice for 50 to 250 kilometres.

Appendix A—Terms of Reference

Original Terms of Reference

The Hon Tom Koutsantonis MP
Member for West Torrens

Government of South Australia

Treasurer
Minister for Finance
Minister for State Development
Minister for Mineral Resources and Energy
Level 8
State Administration Centre
200 Victoria Square
Adelaide SA 5000
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Tel 08 8226 1866
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minister.koutsantonis@sa.gov.

TRS16D0688

Mr Brett Rowse
Chairperson
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Mr Rowse Brett,

Request for advice on the South Australian bulk grain supply chain costs

In my capacity as Treasurer I seek advice from the Essential Services Commission of South Australia (Commission) to assist the Government's pursuit of key objectives in relation to the costs associated with the South Australian bulk grain supply chain.

Background:

1. The Essential Services Commission is established under the *Essential Services Commission Act 2002* (ESC Act).
2. Section 5 of the ESC Act establishes the Commission's powers and functions.
3. Part 7 (s35) allows any industry Minister to refer a matter to the Commission for an inquiry, following consultation with the relevant Minister. The relevant 'Minister' for the purposes of the ESC Act is me, as Treasurer. The Act (s38) prescribes public notification processes involved for conducting an inquiry and the requirement to provide the report before both Houses of Parliament.
4. I seek an inquiry from the Commission which will assist the Government, pursuant to Part 7, on the reasonableness of the costs underpinning the South Australian bulk grain supply chain achieving the key objectives outlined below.

State's key objectives:

The State's key objectives in relation to bulk grain supply chain costs are to:

a) provide transparency in regards to bulk grain export supply chain costs in South Australia;

SOUTH AUSTRALIA

b) determine areas where future efficiencies may be achieved in the South Australian bulk grain export supply chain; and

c) review the appropriateness of mechanisms used for funding road and rail components of the bulk grain export supply chain costs.

Referral:

I, Tom Koutsantonis, Treasurer, request the Commission undertake an inquiry pursuant to Part 7 (s35) of the ESC Act, on the matters set out below in relation to the bulk grain supply chain, subject to the terms of reference set out in this request for an inquiry.

Terms of Reference

The following are the terms of reference in 2 parts for this inquiry:

a) In part 1 the Commission is to inquire into the South Australian bulk grain export supply chain (farm gate to export vessel) costs including vessel loading charges over the past 10 years, having regard to:

   (i) the components of the bulk grain export supply chain costs (including vessel loading charges) and their efficiency

   (ii) harvest trends in South Australia over the past 10 years

   (iii) the basis upon which road and rail components of the bulk grain export supply chain costs are recovered.

b) As part 2 of the Inquiry, should the Commission find areas where bulk grain supply chain costs are identified as inefficient, options should be provided for addressing those inefficiencies.

Requirements for this Inquiry

In undertaking the Inquiry, the Commission must:

a) Work collaboratively with PIRSA, DPTI and DTF to obtain costs, harvest trend data and other information required.

b) Investigate the potential to work with the Australian Export Grains Innovation Centre (AEGIC) as a consultant for the review as this organisation has already been involved in various publications on the grain supply chain and has the necessary analysts available.

c) Conduct public consultation, in a manner considered appropriate by the Commission.

d) Submit a draft report on part 1 of the Inquiry to me no later than 6 months from the commencement of the review.

e) Provide a final report on part 1 and, if required, part 2 of the Inquiry to me no later than 9 months from the commencement of the review.

If the Commission requires further information in relation to this request for advice, it should contact Mr Mike Wilde, Planning and Transport Policy, Department of Planning and Infrastructure on 7109 7333.

Yours sincerely

Hon Tom Koutsantonis MP
Treasurer
Minister for Finance

16th March 2017

First variation

The Hon Tom Koutsantonis MP
Member for West Torrens

Government of South Australia

Treasurer
Minister for Finance
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Minister for Mineral Resources and Energy
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TRS17D0688

Mr Brett Rowse
Chairperson
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Mr Rowse Mr Rowse,

Inquiry into the South Australian bulk grain export supply chain costs – variation to terms of reference

Thank you for your letter seeking a variation to the terms of reference for the inquiry into the South Australian bulk grain export supply chain costs.

I understand that ESCOSA would like to analyse and include the results of the study currently being undertaken by Australian Export Grains Innovation Centre into grain supply chain costs across Australia and I support your proposed date for the draft report on part 1 of the inquiry being submitted to me no later than 30 November 2017.

I have also approved a revised date for the submission of the final report to me on part 1 (and part 2 if needed) of no later than 30 March 2018.

Please contact Ms Jane Burton, Manager, Budget, Analysis and Performance, Department of Treasury and Finance on 8429 0595 should you have any queries regarding the revised terms of reference.

~~Yours sincerely~~ Regards,

Hon Tom Koutsantonis MP
Treasurer
Minister for Finance

11 August 2017

SOUTH AUSTRALIA

Second variation

17/0013

The Hon Tom Koutsantonis MP
Member for West Torrens

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TRS17D1714

Mr Brett Rowse
Chairperson
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Mr Rowse

Inquiry into the South Australian bulk grain export supply chain costs – variation to terms of reference

Thank you for the letter seeking a variation to the terms of reference for the inquiry into the South Australian bulk grain export supply chain costs.

I understand that the study currently being undertaken by Australian Export Grains Innovation Centre (AEGIC) into grain supply chain costs across Australia is now anticipated to be released in February 2018 and ESCOSA are seeking a variation to allow sufficient time to analyse the AEGIC study.

As a result of the variation being sought and the 97th report of the Economic and Finance Committee, *From the Paddock to the Plate — a fair return for producers*, being tabled in November 2017 I am seeking ESCOSA to consider the evidence provided to the Committee as detailed in Chapter 12 of the Committee's report.

To allow sufficient time for ESCOSA to consider the AEGIC report and the Economic and Finance Committee 97th Report I have approved a revised date for the draft report on part 1 of the inquiry being submitted to the Treasurer by no later than 30 June 2018.

I have also approved a revised date for the submission of the final report to the Treasurer on part 1 (and part 2 if needed) of no later than four months after the draft report has been submitted to the Treasurer.

Please contact Ms Jane Burton, Manager, Budget, Analysis and Performance, Department of Treasury and Finance on 8429 0595 should you have any queries regarding the revised terms of reference.

Yours sincerely

Hon Tom Koutsantonis MP
Treasurer
Minister for Finance

18th December 2017

SOUTH AUSTRALIA

Third variation

The Hon Rob Lucas MLC

Government of South Australia

TRS18D1153

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Mr Adam Wilson
Chief Executive Officer
Essential Services Commission of South Australia
GPO Box 2605
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Dear Mr Wilson

Thank you for your letter of 24 September 2018, seeking a variation to the terms of reference for the inquiry into the South Australian bulk grain export supply chain costs.

Pursuant to Section 35(6) of the *Essential Services Commission Act 2002*, I approve a variation to a requirement under the Inquiry such that the submission date for the final Inquiry report (Part 1 and Part 2 if required) be no later than 31 December 2018.

Yours sincerely

Hon Rob Lucas MLC
Treasurer

13 October 2018

Appendix B—Evidence to assess the efficiency of the supply chain

Table B.1 Evidence required to assess efficiency and its interpretation

No.	Question	Positive	Negative	Evidence required
	Market structure			
1	To what extent does Viterra[290] possess a substantial market share across the supply chain?[291]	Positive: if Viterra possesses a substantial market share across the supply chain due to falling average costs (due to scale economies)[292] and the Inquiry finds that a reasonable proportion of these lower costs are being passed on to customers through lower prices (fees) and/or improved service levels[293]	Negative: if the high market concentration results in inefficient supply chain costs This outcome may arise if Viterra chooses to exercise market power to the detriment of competition through maintaining barriers to entry (or against expansion by existing operators) which leads to growers facing, on an on-going basis,[294] prices that are higher and/or service levels that are lower than if the industry segment was competitive.[295]	For each major segment of the supply chain,[296] for each of the defined South Australian geographic markets (Eyre Peninsula and eastern South Australia)[297]: ▶ identify the number of firms operating and the trend in market share of each[298] ▶ identify the level and pattern (trend) of new entrant (and exit) activity ▶ investigate the extent of customer switching between service suppliers ▶ investigate Viterra's market behaviour to determine whether a reasonable proportion of any cost advantages achieved are being passed on to customers (section 4.4).

290 As discussed in chapter 4 (section 4.2), Viterra is the focus for evidence gathering for the Inquiry given the Commission has previously found no evidence, nor been presented with new evidence during the course of this Inquiry, that market power is being exercised to the detriment of competition by incumbent service providers of freight transport and port services.

291 The South Australian bulk grain export supply chain (supply chain), as defined for the Inquiry, includes all shipments to overseas markets of commercial quantities of unpackaged (bulk) grain, but excludes the export of containerised grain and grain sold to domestic Australian markets (Figure 3.5). The supply chain market is geographically defined to be contained within the South Australian state borders, further separated into 'Eyre Peninsula' and "eastern South Australia' (section 4.3.2). While this definition does not extend to the international market (section 4.3.1), our analysis does not preclude consideration of the influence of the international (global) market.

292 Scale economies occur when cost per unit of output declines with increasing scale and is usually associated with a cost structure that has high fixed costs relative to variable costs. A firm with scale economies can have an incentive to attract even small parcels of additional grain providing the firm can charge fees above the variable cost associated with handling the parcels (enabling the firm to spread its fixed costs over an increased tonnage).

293 In the presence of scale economies, it is possible that splitting service delivery over a number of smaller competitive firms could result in higher overall industry supply chain costs, unless the resulting competitive pressures on costs were sufficient to offset the loss of scale economies.

294 A competitive market can experience prices above efficient cost for a period of time (section 2.2). But in a competitive market, new entrants are attracted (or existing competitors expand production) which competes away any excessive returns being earned by incumbent firms, with prices returning to efficient levels.

295 This outcome would be driven by Viterra not sharing benefits of scale effects with customers (see adjoining Positive entry) and new entrant firms struggling to compete on price if operating with higher average costs due to their smaller scale (barrier to entry).

296 The major segments here being: upcountry storage and handling; freight transport to port; and port services (Table 3.1).

297 Section 4.3.2 defines these markets.

298 Any references to 'trend' refer to the period covered by the Inquiry. Trend is important to identify any barriers to expansion of existing operators, as well as assessing the history of any new entry.

No.	Question	Positive	Negative	Evidence required
2	How competitive are upstream (e.g., growers), downstream (e.g., global grain market) and related[299] markets?	Positive: even when Viterra possesses a substantial market share in the bulk grain export supply chain, the level of competition existing in other markets may place some constraint (act as a countervailing power) on Viterra's ability to exercise market power to the detriment of competition in the market as defined for the Inquiry.[300]	Negative: if the constraint placed on Viterra by the operation of these other markets were to be so great that Viterra could not sufficiently recover costs (e.g., downstream pressures placed by global markets), then the sustainability of its operations may be placed at risk.[301] Negative: to the extent that Viterra loses supply to competitors, it may result in increased average cost (due to the scale economies effect), which are not sufficiently offset by the competitive pressures acting to reduce overall industry supply chain costs.	Identify the number of firms operating, the tonnage of grain handled[302] and trend, for each of the defined South Australian geographic markets (Eyre Peninsula and eastern South Australia) for the following: ▶ upstream market: grain growers ▶ related market: domestic trade and containerised grain exports[303] ▶ downstream market: export grain traders.
	Market behaviour[304]			
3	Do competitors[305] and/or customers encounter physical barriers to operating in the market?	Positive: when restrictions on access occur for sound operational reasons[306]	Negative: when restrictions are consciously imposed and form a barrier to entry or expansion of competitor operations (foreclosing activity), leading to negative impact on supply chain efficiency	Investigate the nature, extent and reasons for any restrictive activity (current and historical), including for the following areas: ▶ any restrictions imposed on competitors building storage facilities at or near existing Viterra upcountry sites and having access to transport facilities (such as rail sidings)

299 The term 'related' as used here applies to the market for domestic use or containerised exports, given the same grain facilities (either owned by Viterra or a competitor) can be used to provide services for bulk export, containerised export and domestic end use (in the case of storage facilities).

300 For example, a competitive global market may incentivise Viterra sufficiently to maintain an efficient operation or risk losing business to interstate and overseas competitors (see section 4.3.1). As a further example, it would be expected that a vibrant domestic market would provide greater ability for growers to bypass Viterra's upcountry storage and port facilities, reducing Viterra's ability to exercise market power to the detriment of competition (monopoly price) in delivering these services.

301 A potential (non-Viterra) example is the Eyre Peninsula rail network; even though operated by a dominant incumbent firm, some concerns have been expressed over its sustainability.

302 From which market share can be derived. Tonnage evidence also required to assess the extent to which such markets represent a credible countervailing power (for example, a domestic market with a 10 percent share of total grain handled would be expected to have much less influence than one representing a 50 percent share).

303 Noting Viterra supplies the domestic market from its upcountry and port storage facilities and also provides container filling services.

304 Any assessment of firm behaviour should have regard to the firm's actions over time, not just at the time of investigation or a time in the past.

305 New or potential entrant competitors, or existing competitors seeking to expand their operations.

306 Some potential examples of sound operational reasons might include: (i) limiting direct farm to port deliveries to maximise the efficiency of port loading operations and avoid costly duplication of storage infrastructure; and (ii) purchasing sufficient land for buffer zones, to minimise adverse impact on adjoining land use.

No.	Question	Positive	Negative	Evidence required
				▶ any restrictions imposed on competitors transferring grain from upcountry silos to end user (to port for export, or domestic end use) ▶ any restrictions imposed on competitors building storage facilities and vessel loading facilities on Viterra sites at port ▶ the extent to which Viterra owns all the strategic land at the ports (limiting ability for competitors to develop their own sites) ▶ the outcome of any approach by competitors to access Viterra's facilities (noting that an access regime exists covering facilities at port) ▶ any restrictions on growers bypassing Viterra's upcountry storage and delivering direct to port.
4	Are Viterra's prices (fees) inconsistent with efficient cost–locational pricing principles?	Positive: if prices are instead set to maximise throughput over Viterra's substantial fixed asset base and this can be demonstrated to result in lower overall industry supply chain costs	Negative: when pricing is used to act as a barrier to entry or expansion (for example, by dissuading new entry and forcing the early exit of new entrants), potentially resulting in Viterra being able to maintain above normal profits	Investigate the extent, if any, of Viterra's fees exceeding efficient cost (point in time and trend), including: ▶ extent to which Viterra adopts bundled pricing, and if so, whether such practice is consistent with efficient pricing ▶ analysing any material differences in the level of Viterra's fees and those of its counterparts and the reasons for any differences. Investigate Viterra's pricing response to new entrants and exits (or expansion) to the supply chain market, to identify any deviation in pricing approach over time.
5	Do Viterra's competitors face any separate fees if they choose to use Viterra's services?	Positive: if such fees reflect efficient cost incurred by Viterra to provide services to competitors	Negative: when the additional fees dissuade competition by increasing the cost structure of competitors	Identify any fees charged only to competitors and investigate the extent to which such fees reflect actual costs incurred by Viterra.
6	Is Viterra earning above normal returns?	Positive: if transitory, because even competitive markets experience firms having short-term above normal returns that	Negative: if above normal returns are sustained, which could indicate market	Investigate and analyse whether Viterra's financial returns are persistently above those that might be expected or are observed for a firm with a similar risk

No.	Question	Positive	Negative	Evidence required
		encourage innovation, but in time competitors act to compete away any super profits[307]	power to the detriment of competition is being exercised in some form	profile (as a potential indicator of whether prices are being set in excess of efficient cost). Investigate the extent to which Viterra shares efficiencies achieved with its customers, including through: ▶ lower prices ▶ pass-through mechanisms or rebates.
7	Is Viterra a well-managed firm, receptive to customer needs and pursuing innovation?	Positive: because these are all the elements expected of an efficient competitive firm	Negative: if customers are being 'over serviced' leading to higher costs, to crowd out competition Negative: running down assets to support an aggressive pricing strategy (to prop up profits in the short term)	Investigate the extent to which Viterra is: ▶ actively pursuing lower cost solutions ▶ investing sufficiently to maintain a sustainable asset base ▶ providing good service to customers consistent with stated need ▶ actively pursuing innovation, the encompassment of technological change and the achievement of product and service differentiation.
8	Has Viterra adopted a business growth strategy?	Positive: if seeking to maximise throughput to achieve lower costs and/or if meeting a service need and matching demand	Negative: if an aggressive strategy is adopted to crowd out competitors	Identify whether Viterra is adopting a business growth strategy and, if so, investigate the underlying motive, including: ▶ the number of sites operating and trend ▶ capacity levels and trend ▶ level of capital expenditure, trend and forecast.
9	How does Viterra seek to retain customers?	Positive: if the strategy to retain customers involves seeking to meet their needs at a price that is reflective of cost, noting that the higher the throughput of grain the lower average costs should be	Negative: if restrictive practices are used to retain customers, such as Viterra subsequently refusing in some manner to service customers that are using competitors	Investigate the nature, extent and reasons for any restrictive activity by Viterra (current and historical), including for the following areas: ▶ whether Viterra's customers (growers and traders) are free to engage with competitors without fear of reprisal ▶ whether services are being denied to competitors that operate their own supply chain facilities.

[307] An efficient firm is entitled to a normal level of profit, commensurate with risks.

No.	Question	Positive	Negative	Evidence required
10	Does Viterra seek to lock customers into long-term agreements?	Positive: if Viterra is using it as a strategy to reduce risk and maximise throughput, to achieve lower costs—and the benefits of which are, at least in part, passed on to customers	Negative: if used as an aggressive strategy designed to crowd out competitors, particularly in the presence of tight capacity and were it to be targeted at particular traders[308]	Identify whether Viterra is pursuing long-term agreements and, if so, investigate the underlying motivations, through analysing factors such as: ▶ trader share of port capacity against size of peak harvest.
11	Does Viterra engage in extensive product differentiation?	Positive: if the intent is to better meet the needs of its customers	Negative: if an aggressive strategy designed to crowd out competitors and results in higher costs for the supply chain	Identify the extent of product differentiation and investigate the extent to which it is driven by demonstrated customer need, including: ▶ number of grain storage segregations and trend ▶ how Viterra determines customer requirements.
12	Is Viterra operating in an integrated manner with its related party trader Glencore?	Positive: if maximises the value of the grain, noting the need for the supply chain to be efficient given South Australia is a small player in a global market	Negative: if Viterra was found to be favouring its related trader firm to the detriment of downstream competition and value to growers	Investigate evidence of adverse market behaviour, including: ▶ access by competitor traders to ports (identify number of firms operating, the tonnage of grain handled (market share) and trend, for each of the defined South Australian geographic markets (Eyre Peninsula and eastern South Australia)) ▶ whether Glencore gains more favourable access to grains that meet its specifications and/or access to vessel loading facilities.
	New entrant behaviour			
13	What can the behaviour of competitors tell us about the competitiveness of the market?	Positive: when competitors provide a credible threat to the incumbent that spurs the incumbent to be more efficient and to share the resulting benefits with customers	Negative: when competitors lead to tonnage leakage from an incumbent operator without at least a commensurate positive impact on efficiency, overall resulting in higher cost per tonne for the industry	Investigate the extent to which: ▶ competitors are niche-only players and, if so, why ▶ new entrants are operating at a loss for an extended period (which would place into question the sustainability of the competition)[309]

[308] For example, were Viterra to use long-term agreements as a device to favour its related party Glencore. A potential scenario might be one where: (i) Viterra encourages particular traders to use its facilities during periods of low receivals (poor seasons) when it is keen to receive any additional grain to improve its financial returns; but (ii) blocks access in favour of Glencore during good harvests (most critical were infrastructure to be nearing full capacity) and when other traders are looking for good returns to offset low returns during poor seasons. If signalled in advance by Viterra (such as via its contracting terms), the result may act as a barrier to entry by dissuading new entrants looking to achieve commercial returns over a full grain handling cycle.

[309] Noting that in a competitive market it might be expected that a new entrant operates at a loss initially.

No.	Question	Positive	Negative	Evidence required
				▶ new entrants 'cherry-pick' (with the risk that overall supply chain costs are higher).
	Efficiency of market information			
14	Is the market sufficiently informed?	Positive: markets generally work best when well informed	Negative: for grain stocks an argument has been put that being too transparent may place grain growers at a global competitive disadvantage. It may prove of most benefit to overseas buyers and those bidding for grain from growers to understand how long or short Australian grain growers' positions are.[310] For example, in Western Australia following harvest growers are normally long (ample amount of grain on-hand) and so the supply of greater detail on stocks could enable buyers to exert downward pressure on prices	Investigate the extent to which relevant information is publicly available and, if not, the resultant impact on the efficiency of the supply chain, covering: ▶ information available to growers and traders to enable them to understand the basis of the fees being charged and enable them to assess the merits of alternatives, and the reasonableness of the levels of such fees ▶ information available to competitors to enable informed decisions on profitable opportunities ▶ stock information on grain held at port terminals.

[310] Australian Senate, *Rural and Regional Affairs and Transport Legislation Committee—Wheat Export Marketing Amendment Bill 2012 [Provisions]*, June 2012, pp. 49–50, available at https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Completed_inquiries/2012-13/wheatexport2012/report/index.

Table B.2 Evidence obtained through the Inquiry

No.	Question	Evidence required	Evidence/inferences
	Market structure		
1	To what extent does Viterra possess a substantial market share across the supply chain?	For each major segment of the supply chain, for each of the defined South Australian geographic markets (Eyre Peninsula and eastern South Australia): ▶ identify the number of firms operating and the trend in market share of each ▶ identify the level and pattern (trend) of new entrant (and exit) activity ▶ investigate the extent of customer switching between service suppliers ▶ investigate Viterra's market behaviour to determine whether a reasonable proportion of any cost advantages achieved are being passed on to customers (see section 4.4).	On the evidence available to the Commission, Viterra possesses substantial market share across key elements of the supply chain. **Market share** Road transport—large number of operators, no material aggregate change in operator numbers over the 10 year Inquiry period (section 4.2.2) Rail—primary provider is Gensesee and Wyoming Australia Pty Ltd (**GWA**) for both Eyre Peninsula (**EP**) and eastern South Australia. Modal market share remains at about 50 percent rail and 50 percent road (section 4.2.1) General port services—current sole provider is Flinders Ports for both EP and eastern South Australia, with no change over the 10 year period (section 4.2.3) Viterra has a substantial market share for both EP and eastern South Australia bulk grain markets. Limited material change over the 10 year period (albeit two changes of ownership). Details as follows: Storage market share Viterra has 83 sites (2017), down from 114 (2010) and 116 (1998). Cargill has 4 storage sites (section 3.3.2.2), all on eastern South Australia. There is also some minor upcountry storage held by other commercial entities (section 3.3.2.3). There are no details of tonnages handled (and trends) but these other bulk handlers are understood to be small in scale, with many serving the domestic market and some providing container exports (both of which are outside the scope of this Inquiry). Using the number of sites as the basis for calculating market share, Viterra has a substantial market share of commercial bulk grain storage in South Australia. Total on-farm storage has increased in recent years but is relatively small in South Australia, compared with other States (with the exception of Western Australia). Port terminals market share From 2011-12 to 2014-15, Viterra had 100 percent of export terminal throughput, which dropped to 96 per cent (2015-16) and then 91 percent (2016-17) (section 3.3.4)—statewide figures (source: Australian Crop Forecasters). Competitors Cargill and Semaphore Container Services operate only on eastern South Australia.

No.	Question	Evidence required	Evidence/inferences
			Trader market share Glencore export trader market share (Viterra's parent) averaged 40 percent statewide by volume over 2011-12 to 2016-17, with regional market shares of 39 percent EP and 40 percent eastern South Australia. Statewide market share for Glencore fluctuated over this period from a low of 30 percent (2014-15) to a high of 45 percent (2012-13), with an average of 40 percent statewide over the period (source: Australian Crop Forecasters). **New entrant and exit activity** Impact of new entrants reflected in market share change figures in previous section. No exits identified for storage and port terminal operators, but the number of traders fluctuates over time (see response to question 9). **Extent of customer switching between service suppliers** Limited data. But Cargill still uses Viterra for EP exports, even though it has set up in direct competition with Viterra on eastern South Australia. **Are customers sharing in efficiencies achieved?** Refer to section 4.4.
2	How competitive are upstream (e.g., growers), downstream (e.g., global grain market) and related markets?	Identify the number of firms operating, the tonnage of grain handled, and trend, for each of the defined South Australian geographic markets (Eyre Peninsula and eastern South Australia) for the following: ▶ upstream market: grain growers ▶ related market: domestic trade and containerised grain exports ▶ downstream market: export grain traders.	On the evidence available to the Commission, the grain trading market appears competitive, but Viterra faces only limited competition from related markets and direct competitors. **Upstream** There were about 5000 grower trading entities in 2017 (section 4.4.1). South Australian harvest trend data is provided in Figure 3.3. **Related market** South Australia is export-focused, exporting around 85 percent of grain production (section 3.1.1). Conversely, the South Australian domestic market is small (15 percent). Containers make up a small proportion of grain exports from South Australia, when compared with interstate. The Department of Primary Industries and Regions, South Australia (PIRSA) estimates 300,000 tonnes of grain is exported in shipping containers, compared with around 5.5 million tonnes exported annually as bulk dry cargoes.[311]

[311] Department of Primary Industries and Regions, South Australia (PIRSA), *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 6.

No.	Question	Evidence required	Evidence/inferences
			Downstream market Eleven grain traders booked shipping slot capacity with Viterra to export the 2016-17 grain harvest and 12 for the 2017-18 harvest (section 3.3.1). Further, no individual trader had more than 50 percent of Viterra's business for 2016-17.
	Market behaviour		
3	Do competitors and/or customers encounter physical barriers to operating in the market?	Investigate the nature, extent and reasons for any restrictive activity (current and historical), including for the following areas: ▶ any restrictions imposed on competitors building storage facilities at or near existing Viterra upcountry sites and having access to transport facilities (such as rail sidings) ▶ any restrictions imposed on competitors transferring grain from upcountry silos to end user (to port for export, or domestic end use) ▶ any restrictions imposed on competitors building storage facilities and vessel loading facilities on Viterra sites at port ▶ the extent to which Viterra owns all the strategic land at the ports (limiting ability for competitors to develop their own sites) ▶ the outcome of any approach by competitors to access Viterra's facilities (noting that an access regime exists covering facilities at port) ▶ any restrictions on growers bypassing Viterra's upcountry storage and delivering direct to port.	On the evidence available to the Commission, to the extent that competitors and/or customers encounter physical barriers to operating in the market, such barriers appear to be justifiable on operational grounds. However, some pricing practices have been assessed in section 4.4.5. **Any restrictions on competitors building infrastructure upcountry?** The Commission is not aware of evidence of any restrictions imposed by Viterra on competitors building storage facilities at or near existing Viterra upcountry sites and having access to transport facilities (such as rail sidings). **Any restrictions on competitors transferring grain from upcountry to end user?** GWA is the primary provider of rail haulage of grain for export from South Australia, supplying such services solely to Viterra. The Commission has not found, or been presented with, any new evidence that market power is being (or has been) exercised to the detriment of competition in respect of the rail services provided by GWA (section 4.2.1). The Commission is not aware of evidence of physical restrictions being imposed on competitors transferring grain from their upcountry silos. But some pricing practices are assessed in section 4.4.5, with the Commission retaining some concern that Viterra may be charging fees that potentially act to inhibit the development of third-party competition, specifically the 'Receival at Port Service Fee (from Approved Third Party Storage)'. **Any restrictions on growers bypassing Viterra's upcountry facilities?** Some growers are restricted in their ability to bypass Viterra's upcountry storage and deliver direct to port. Viterra has established Grower Delivery Zones for Port Adelaide, Port Lincoln and Wallaroo (section F2, Appendix F). This matter is discussed in detail in section 4.4.5.2.

No.	Question	Evidence required	Evidence/inferences
			Any restrictions on competitors building infrastructure at port? The Commission is not aware of evidence that Viterra owns all the strategic land at the ports (which could limit the ability for competitors to develop their own sites). While yet to be tested through a formal dispute or complaint, competitors seeking to build storage facilities or vessel loading facilities on Viterra's sites at port should be covered by the ports access regime, established by the Maritime Services (Access) Act 2000 (MSA Act) and administered by the Commission. Table 4.1 lists many new port proposals, in areas away from Viterra's facilities, suggesting that Viterra's current ownership of land at port, of itself, is not restricting some forms of new entry.
4	Are Viterra's prices (fees) inconsistent with efficient cost–locational pricing principles?	Investigate the extent, if any, of Viterra's fees exceeding efficient cost (point in time and trend), including: ▶ extent to which Viterra adopts bundled pricing, and if so, whether such practice is consistent with efficient pricing ▶ analysing any material differences in the level of Viterra's fees and those of its counterparts and the reasons for any differences. Investigate Viterra's pricing response to new entrants and exits (or expansion) to the supply chain market, to identify any deviation in pricing approach over time.	On the evidence available to the Commission, Viterra's pricing practices appear efficient. However, rather than locational pricing, Viterra sets fees on a whole of supply chain (network) basis, in seeking to maximise use of its network and achieve efficiencies from scale, spreading network fixed costs across the supply chain. **Extent of bundled pricing being adopted** Viterra's Export Select is a bundled service. An analysis of Export Select is reported in section 4.4.3.1, with market behavioural aspects considered in detail in section 4.4.5.1. The Commission's finding is that Viterra's behaviour relating to Export Select is not serving to lessen the efficiency of the supply chain in and of itself (section 4.4.5.1(b)). Viterra submitted that it sets fees on a whole of supply chain (network) basis, and in doing so seeks to maximise the use of its network and achieve efficiencies from scale. This means that individual fees may not necessarily reflect costs for a specific service at any location or time (section 4.4.3.1). The Commission has not found any evidence that this results in a less efficient outcome in practice, compared with the adoption of locational pricing. Viterra submitted an example of network pricing resulting in a superior outcome (Box 4.5). To fully test the efficiency implications of Viterra's approach, a comprehensive modelling exercise of Viterra's fee structure relative to other hypothetical alternatives might be required. Based on the evidence available for this Inquiry, the Commission has not conducted such a study. In any event, it not clear that such an exercise would provide significant benefit, given the underlying complexity and the number and range of assumptions that would be required.

No.	Question	Evidence required	Evidence/inferences
			Comparing Viterra's fees with fee levels of counterparts Viterra's fees are compared with its counterparts in section 4.4.3.3. Viterra's fees do not appear excessive when compared with its eastern Australian counterparts. They are generally high when compared with CBH (Western Australia). But some reasons for this are that CBH operates under a cooperative structure, with the other operators being private shareholder-owned entities, primarily under foreign ownership. Accordingly, these other entities (including Viterra) have differing commercial drivers relative to CBH. As a result of its cooperative structure, CBH also enjoys tax-exempt status for much of its operations. **Viterra's response to new entrants** Based on an investigation of fees undertaken by the Commission for a sample of grain pathways, the evidence is that over the period 2013-14 to 2017-18 Viterra's fees in total have been relatively flat. On average, fees increased at a rate only marginally above inflation. It was over this period that Viterra faced competition commencing at Port Adelaide. The fee sample chosen covers grain pathways on EP and eastern South Australia. The average annualised increase for Port Adelaide fees (+2.2 percent) over the period is similar to the rate of increase at Port Lincoln (+2.4 percent), both based on rail delivery to port (Table 4.5). It might be expected that were Viterra to exercise market power against new entrants in this case, it would reduce fees at Port Adelaide (to reduce potential returns to competitors to dissuade them operating) and maintain overall Viterra revenue by increasing fees at Port Lincoln where it faced no direct competition. Consequently, flat fee movements over time at both ports does not provide direct evidence of Viterra using pricing in this manner as a strategic response export terminal competition at Port Adelaide, which was introduced in 2015-16.
5	Do Viterra's competitors face any separate fees if they choose to use Viterra's services?	Identify any fees charged only to competitors and investigate the extent to which such fees reflect actual costs incurred by Viterra.	Viterra's $2.70 per tonne Receival at Port Service Fee (from Approved Third Party Storage) is the only fee identified as being charged only to competitors. This fee is discussed in section 4.4.5.3. The Commission's finding is that this fee might act as a barrier to new third party operator competition or expansion by existing third party competitors.
6	Is Viterra earning above normal returns?	Investigate and analyse whether Viterra's financial returns are persistently above those that might be expected or are	The results for this question are reported in section 4.4.4. Viterra's returns were compared with the returns investors might require if they were to invest in a firm in a similar market and with similar characteristics to that of Viterra. The Commission's

No.	Question	Evidence required	Evidence/inferences
		observed for a firm with a similar risk profile (as a potential indicator of whether prices are being set in excess of efficient cost). Investigate the extent to which Viterra shares efficiencies achieved with its customers, including through: ▶ lower prices ▶ pass-through mechanisms or rebates.	finding is that Viterra is currently not earning financial returns, on average, greater than what might be expected for a firm with its level of risk. The financial analysis shows Viterra choosing not to share efficiencies with industry through lower fees. However, this would only become an efficiency concern if the increasing trend in Viterra's operating surpluses (notwithstanding potentially incurring losses in poor seasons such as 2018-19) continues to the point at which returns become excessive, on average, relative to that expected for a firm with Viterra's risk profile (section 4.4.4.3).
7	Is Viterra a well-managed firm, receptive to customer needs and pursuing innovation?	Investigate the extent to which Viterra is: ▶ actively pursuing lower cost solutions ▶ investing sufficiently to maintain a sustainable asset base ▶ providing good service to customers consistent with stated need ▶ actively pursuing innovation, the encompassment of technological change and the achievement of product and service differentiation.	On the evidence available to the Commission, Viterra is a well-managed firm, receptive to customer needs and pursuing innovation. **Actively pursuing lower cost solutions** Viterra appears to be operating effectively as a cost-effective accumulator of bulk grain that can meet peak harvest demand and compete in the global context. Viterra has achieved a consistent downward trend in real $/tonne operating costs (Figure 4.1). **Investing sufficiently to maintain sustainable asset base** Viterra submitted that it continues to invest in its existing asset base, to maintain functionality and ensure compliance with changing legislation (e.g., the provision of additional guarding in response to safe work requirements), while seeking to maximise opportunities to drive incremental efficiency through these investments. The Commission did not carry out an engineering review of the current condition of Viterra's grain supply chain assets. But, it received financial data on annual capital expenditure and depreciation over recent years. This information, and the supporting representations from Viterra management about managing assets and planning investments, gave the Commission no cause for concern about the current levels of investment in sustaining the asset base. **Providing good customer service** The Commission's finding is that Viterra generally seeks to provide good customer service, informed by the processes it has in place to capture grower customer feedback. Viterra submitted evidence about when it acted to improve customer service in responding to customer feedback. These actions are consistent with a firm seeking to meet customer needs (section 4.4.1).

No.	Question	Evidence required	Evidence/inferences
			In response to the record 2016-17 harvest, Viterra demonstrated itself receptive to customer needs by investing to construct 0.9 million tonnes of additional storage at short notice, to ensure timely handling and processing of grain. In practice, it would be unlikely that Viterra could meet all customer expectations and also achieve a cost-effective supply chain capable of competing in the global market. **Actively pursuing innovation** Viterra's submission to the Inquiry provides some examples of it actively pursuing innovation, such as drive over hoppers for bunker loading and adopting leading electronic sampling and quality control devices.[312]
8	Has Viterra adopted a business growth strategy?	Identify whether Viterra is adopting a business growth strategy and, if so, investigate the underlying motive, including: ▶ the number of sites operating and trend ▶ capacity levels and trend ▶ level of capital expenditure, trend and forecast.	On the evidence available to the Commission, Viterra is not engaging in a business growth strategy. Viterra's business strategy appears to be one of maximising throughput to achieve lowest possible average costs per tonne, with minimal capital outlay to sustain the existing infrastructure, coupled with an ability to respond to harvest trends if needed (through the addition of low cost horizontal bunkers if, and where, seasonal demand requires). **Sites** As noted in the evidence to question 1, rather than expanding its operation, Viterra has been rationalising its storage sites from 116 (1998), to 114 (2010) and then 83 (2017). Eighty percent of the grain was received by around 30 sites in 2016 (section 3.3.2.1). **Capacity** Viterra submitted that incremental storage capacity has been added over the 10 year Inquiry period. Storage capacity over this period has trended up as follows: ▶ open sites: 8.4 million tonnes (2006-07) to 10.2 million tonnes (2016-17) ▶ total sites (including mothballed and permanently closed): 9.1 million tonnes (2006-07) to 10.8 million tonnes (2016-17). It would appear to be a reasonable observation that the additional 2016-17 capacity was a prerequisite to maintain South Australia's global market position. **Capital expenditure** Over the 10 year period of the Inquiry, Viterra submitted that it focussed on sustainment capital expenditures, with augmentation capital expenditure occurring in two phases: (i) a significant capital investment earlier in the period predominantly to

[312] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Exports Supply Chain Costs*, May 2017, p. 16.

No.	Question	Evidence required	Evidence/inferences
			fund the Outer Harbor development; and (ii) additional storage capacity added in 2010-11 and 2016-17 to meet storage requirements in large harvest seasons.
9	How does Viterra seek to retain customers?	Investigate the nature, extent and reasons for any restrictive activity by Viterra (current and historical), including for the following areas: ▶ whether Viterra's customers (growers and traders) are free to engage with competitors without fear of reprisal ▶ whether services are being denied to competitors that operate their own supply chain facilities.	On the evidence available to the Commission, there are no issues with how Viterra seeks to attract and retain customers. **Attracting customers** Viterra submitted that it actively sought to maximise the number of traders using its port terminal facilities, to maximise throughput and as a risk mitigation measure. Using Australian Crop Forecasters data, the number of traders using Viterra's facilities peaked at 18 in 2014-15, dropping to 10 in 2016-17. Including all South Australian port terminal operators produces only a marginal change, with the number of traders dropping to 11 in 2016-17, with 12 for the 2017-18 harvest. It might be expected that trader numbers would fluctuate from time to time, as new operators seek to test the market. What is important is that a sufficient number of active traders are available to achieve a competitive outcome. **Freedom to engage with competitors** On the evidence available, Viterra does not appear to engage in any form of reprisal activity. For example, Cargill still uses Viterra's services on EP, even though it is in direct competition at Port Adelaide.
10	Does Viterra seek to lock customers into long-term agreements?	Identify whether Viterra is pursuing long-term agreements and, if so, investigate the underlying motivations, through analysing factors such as: ▶ trader share of port capacity against size of peak harvest.	On the evidence available to the Commission, while Viterra seeks to implement long-term agreements in a number of areas, its actions appear consistent with sound business practice or in accordance with regulatory requirements. **Pursuit of long-term agreements for rail freight** Viterra has pursued long-term agreements with GWA for rail services (section 4.4.2.3). The available evidence is that Viterra's motivation is to achieve a good business outcome, rather than this representing evidence of an exercise of any market power to the detriment of competition. To support this claim, Viterra submitted that this long-term agreement with GWA significantly reduced Viterra's overall freight costs, and provided GWA with sufficient certainty for it to undertake necessary expenditures to achieve the standard of service sought by Viterra. **Pursuit of long-term agreements for port terminal capacity** Viterra enters into long-term agreements (LTAs) with traders for access to port terminal loading capacity. Such arrangements are consistent with protocols approved

No.	Question	Evidence required	Evidence/inferences
			by the Australian Competition and Consumer Commission (**ACCC**) under the Port Terminal Access (Bulk Wheat) Code of Conduct (**PTAC**) (section 4.2.3.2). Viterra submitted that the benefits of LTAs include:[313] ▶ known demand for services in the future ▶ ability to invest in infrastructure, knowing confirmed demand ▶ confidence to growers, knowing demand exists for their product ▶ multiple buyers allow for competitive marketplace for grain ▶ certainty of origin for clients ▶ certainty of execution for clients ▶ ability to enter multi-year supply agreements. Under ACCC approved Viterra Port Loading Protocols, Viterra must hold back at least 2 million tonnes per year (500,000 tonnes per quarter) for short-term capacity, against a 7 million tonnes per year terminal capacity, across six port terminals (section 3.3.4). Viterra's long-term capacity allocations commenced from 1 October 2016,[314] so the current arrangements have been in operation only for a short period. In addition, the PTAC was recently reviewed by the responsible Australian Government department (section 4.2.3.2), with a recommendation that PTAC be retained. Fees associated with these agreements, the Capacity booking fee and Lost capacity fee, have been investigated with the findings provided in sections 4.4.5.4 and 4.4.5.5 respectively. The Commission's findings are that Viterra's behaviour relating to these fees is not serving to lessen the efficiency of the supply chain. The lost capacity fee can be avoided where the unused capacity is transferred in time. **Trader share of port capacity against size of peak harvest** Trader share of port capacity was mapped against size of peak harvest, with the results showing no discernible relationship.
11	Does Viterra engage in extensive product differentiation?	Identify the extent of product differentiation and investigate the extent to which it is driven by demonstrated customer need, including:	On the evidence available to the Commission, Viterra is not engaging in extensive/excessive product differentiation. To the extent Viterra engages in product differentiation, it appears to be in response to, or consistent with, customer demand. Viterra is unlikely to be able to meet every customer's expectation. It is likely growers will never be fully satisfied with the level of segregation if they perceive it undervalues

[313] Viterra response to request for information.
[314] Viterra, *Submission to Review of the Port Terminal Access (Bulk Wheat) Code*, 29 January 2017, p. 8, available at https://haveyoursay.agriculture.gov.au/review-of-the-wheat-port-code.

No.	Question	Evidence required	Evidence/inferences
		▶ number of grain storage segregations and trend ▶ how Viterra determines customer requirements.	their specific product. So, Viterra is limited to the extent that it can meet customer expectations in a cost-effective manner. **Product differentiation** For a firm such as Viterra, product differentiation can be at the level of an individual service or differentiation for a whole package of services. Export Select is an example of Viterra seeking to achieve differentiation in an overall package of services and in doing so, make it an effective tool for encouraging and managing grain accumulation (section 4.4.3.1). Pitched at traders, it provides traders with a straightforward option for getting grain reliably onto a vessel, thereby reducing their transaction costs. The Commission's finding on Export Select is that it is not serving to lessen the efficiency of the supply chain in and of itself (section 4.4.5.1). **Storage segregations and trend** Viterra submitted that for the 2016-17 harvest it provided 57 segregations.[315] Viterra submitted information on the number of segregations by commodity and grade for the 10 year period of the Inquiry.[316] This data shows a downward trend from a high of 90 segregations in 2008-09 to 69 in 2017-18. Much of this decline can be explained by the elimination of segregations for Minor cereals (11 in 2008-09) and a reduction in the number of malting barley segregations (reduction of 12 from 2008-09 level). Growers gain access to information on available site segregations through Viterra's online Ezigrain service. Viterra submitted that the segregation plan, outlining which commodities and grades will be received at each site, is structured to maximise the port terminal capacity for growers, minimise overall turnaround times and increase receivals over time.[317] Further, Viterra submitted that it consults with growers in deciding on segregations, with the objective of maximising grower and export trader value.[318] Viterra submitted evidence of the detailed segregation planning and setting process that occurs based on an annual cycle of activities, using grower surveys and feedback from strategic site committees and the chairs of these committees.

[315] Viterra response to request for information.
[316] Viterra response to request for information.
[317] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Exports Supply Costs*, May 2017, p. 16.
[318] Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Exports Supply Costs*, May 2017, p. 17.

No.	Question	Evidence required	Evidence/inferences
			Determining customer requirements Viterra submitted that it uses a combination of formal and informal (including ad hoc) methods to capture grower feedback (section 4.4.1.1).
12	Is Viterra operating in an integrated manner with its related party trader Glencore?	Investigate evidence of adverse market behaviour, including: ▶ access by competitor traders to ports (identify number of firms operating, the tonnage of grain handled (market share) and trend, for each of the defined South Australian geographic markets (Eyre Peninsula and eastern South Australia)) ▶ whether Glencore gains more favourable access to grains that meet its specifications and/or access to vessel loading facilities.	Evidence the Commission obtained to date does not support a finding that Viterra seeks to favour Glencore to the disadvantage of other traders in a material and sustained manner (section 4.4.5.7). The Commission did not receive evidence to suggest Viterra actively discriminates against other traders; indeed Viterra submitted that it actively seeks traders as a means of mitigating operational risk (to support maximising throughput). Market share information was provided in response to question 1, above.
	New entrant behaviour		
13	What can the behaviour of competitors tell us about the competitiveness of the market?	Investigate the extent to which: ▶ competitors are niche-only players and, if so, why ▶ new entrants are operating at a loss for an extended period (which would place into question the sustainability of the competition) ▶ new entrants 'cherry-pick' (with the risk that overall supply chain costs are higher).	On the evidence available to the Commission, Viterra faces only niche competition (that is, competitors operating a combined total of less than 15 percent of commercial sites), but the reasons for this are not clear. The Commission has obtained only limited evidence to respond to the questions posed in the adjoining column. The Commission received no submissions from Viterra's competitors. Discussions with some traders provided only limited insight on their motivation and future direction. As noted in the response to question 9, there is no evidence that competitors face any threat of reprisal from Viterra. In the absence of any evidence to the contrary, it appears that existing competitors are content to undertake niche operations.

No.	Question	Evidence required	Evidence/inferences
	Efficiency of market information		
14	Is the market sufficiently informed?	Investigate the extent to which relevant information is publicly available and, if not, the resultant impact on the efficiency of the supply chain, covering: ▶ information available to growers and traders to enable them to understand the basis of the fees being charged and enable them to assess the merits of alternatives, and the reasonableness of the levels of such fees ▶ information available to competitors to enable informed decisions on profitable opportunities ▶ stock information on grain held at port terminals.	Apart from a lack of suitable published financial information for Viterra, there is a high degree of transparency in fee information (section 4.4.6). **Information on fees** There is a high degree of transparency in supply chain fee information, but growers may need some assistance in tailoring it to reflect their individual needs. However, the nature of a commingled grain system means that it is not possible to assign a total supply chain fee to an individual grain delivery. (section 4.4.6.1) **Financial information** Based on the fact that there are new entrants, a competitor of Viterra has sufficient information available to assess viable proposals, by considering whether its proposal can match or better the Viterra fees for a particular service offering. In the absence of suitable published financial information, it should be possible to gain some understanding of Viterra's future performance through monitoring trends in supply chain fees (publicly available) and service levels (publicly observable). (section 4.4.6.2) **Stock information** The grain industry has a range of views about public release of stock information, with some strong advocates and some strong opponents. Arguments in support include that it would promote competition; arguments against include that the release of more stock information would undermine the South Australian grain industry's global competitiveness. (section 5.2)

Appendix C—Data verification process

C1 Information collection

The Commission sought information from Viterra and GWA on a number of matters through a request for information (RFI) process. That information was supplied as requested.

Viterra was prepared to engage with the Commission in a cooperative manner, providing the Commission was prepared to respect the confidentiality of Viterra's information. As a result, the Commission has decided not to disclose information in this report, in part or in total, which is subject to such a claim.

As a matter of course, the Commission does not disclose information when it is satisfied that information is confidential, unless compelled to by law (for example, by the Freedom of Information Act 1991 or the Data Sharing Act 2016) or when it decides it is clearly in the public interest to do so.

C2 Process for verification of information

The Commission sought to verify the accuracy of data submitted by Viterra and used for the purposes of the Inquiry, as follows:

(1) Operating revenues and costs of Viterra

Viterra provided details of the operating revenue and operating expenses for its grain storage and handling business. These were based on internal reports run against Viterra financial systems to compile relevant revenues and costs, and recast from calendar years to harvest years (1 October to 30 September). Commission staff substantiated the level of costs and revenues by sighting internal management accounting reports, through further discussions with Viterra, and via written RFI queries, to ensure costs were comprehensive (for example, to understand the level of business overheads included).

(2) Other information received from Viterra

All information received from Viterra in response to RFIs was cross-checked with existing information previously received, both from Viterra and from other sources. Any inconsistencies were then rechecked with Viterra, to ensure accuracy.

(3) Fees analysis

The analysis of Viterra fees was based on information published by Viterra on an annual basis, as part of its grain handling and storage operations (for example, Viterra's *Pricing, procedures and protocols manual* (schedule A), and Wheat Reference Prices—Port Terminal Services).

(4) Written assurance

Viterra provided the Commission with written assurance that the data and information Viterra provided to the Commission (both through the RFI process, and in meetings and discussions), for the purposes of the Commission's Inquiry into the South Australian bulk grain export supply chain costs, is accurate, and that Viterra has not subsequently become aware of any material inaccuracies in any of the data and information provided. Further, Viterra advised the Commission that if, after providing this assurance, it became aware that anything it has provided is inaccurate, it would advise the Commission, and provide the correct updated data or information.

(5) VAA financial returns benchmarks

The base financial returns information for the comparator firms was sourced by Value Adviser Associates Pty Ltd (**VAA**) from Bloomberg financial and capital market data service. Commission staff then carried out checks on the VAA financial analysis modelling.

Appendix D—Financial analysis

D1 Derivation of returns

The Commission derived Viterra's returns for the 2010–2018 (and 2018-19 forecast) period using the following method:

Inputs

The following input information was used to calculate Viterra's returns:

- *Operating revenue* and *operating expenses* were provided to the Commission by Viterra.
- *Asset values* were derived as explained in section D3.
- *Interest rates* were based on Reserve Bank of Australia cash rates, with a risk premium added (based on advice received from Value Adviser Associates Pty Ltd (VAA)).
- *Depreciation* was based on information provided by Viterra.
- *Corporation tax* was assumed to be constant at 30 percent.

Calculation of net profit after tax

The above inputs were used to calculate notional net profit after tax, as follows:

	$
Operating revenue	*a*
less Operating expense	*b*
Operating surplus/deficit	*c=a–b*
less Depreciation	*d*
less implied Interest	*e*
Net profit before tax	*f=c–d–e*
less Corporation tax	*g*
Net profit after tax	*h=f–g*

D2 Financial analysis measures

The key financial measures were then calculated based on the above information, as follows:

1) Return on equity (RoE)—defined as:

$$\frac{\text{Net profit after tax (NPAT)}}{\text{Shareholder equity (average for year)}}$$

This ratio provides a measure of the ultimate return to shareholders on their investment. It is widely used in comparing performance, both over time and between entities.

2) Return on assets (RoA)—defined as:

$$\frac{\text{Earnings before interest and tax (EBIT)}}{\text{Total assets (average for year)}}$$

This ratio provides a measure of how well a firm is using its assets to generate returns. It is also widely used in comparing performance, both over time and between entities.

3) Return on invested capital (RoIC)—defined as:

$$\frac{\text{Net operating profit after tax (NOPAT)}}{\text{Invested capital (Debt +Equity)}}$$

The numerator is based on operating profit (that is, it excludes abnormal items, such as adjustments for gains/losses on currency exchange/hedges). For this reason, this ratio provides a measure of the underlying operating performance of a firm.

While RoIC is less widely used than RoE or RoA, it is arguably more useful in comparable firm analysis, because one-off items that have the potential to skew the results are removed from the ratio.

Gearing

The return on equity (RoE) calculation depends on the level of gearing of the firm.

The Commission used 30 percent and 50 percent gearing scenarios to estimate values for RoE. Discussions with VAA confirmed this range forms a conservative estimate of the levels of debt that a firm in a similar market, and with similar characteristics to that of Viterra, could carry, were it operating as a stand-alone firm.

D3 Estimation of Viterra asset values

Asset values were estimated using a combination of publicly available information, and information provided by Viterra. The following text explains the approach taken.

The Commission used two methods to establish a lower and upper bound range for the value of Viterra's assets.

Method 1—Roll forward from 2009 sale

Australian Barley Board (ABB Grain) was sold to Viterra in September 2009, in an open market transaction, for $1,655 million. The Commission derived an asset value at 2018 by rolling forward this value, accounting for all subsequent capex and depreciation, and the one significant asset sale (Joe White Maltings, $420 million, August 2013).

This value is consistent with the asset value held on Viterra's books. Viterra contends, however, that this is not an appropriate base to assess returns, due to the acquisition accounting impacts on these values. In Viterra's view, these accounting impacts deflated the book value of the remaining assets. The Commission accepts that the sales values, and the accounting treatment of these values, have the potential to deflate the asset value held in Viterra's books.

The Commission used this method to establish a lower bound asset value.

Method 2—Remaining useful life of assets

As an alternative method, the Commission considered the remaining useful life of the assets to establish a fair asset value.

The Commission compared the sale price in September 2009 of $1,655 million with the estimated replacement value of assets at that time. This comparison provided an indicative view of the remaining useful life of the assets at 2009. The Commission then rolled this asset life forward to 2018, accounting for the assets continuing to age, offset by capital investment in new and replacement assets across this period.

Applying this derived 2018 remaining useful life to the current indicative asset gross replacement value, as provided by Viterra, provides an alternate asset valuation.

The Commission recognises this method relies on an indicative asset replacement value provided by Viterra, and is based on its estimates of current construction costs. Therefore, a revaluation of assets to 2018 prices is implicit in this method.

The Commission used this method to establish an upper bound asset value.

Mid-range asset value

To calculate Viterra's returns, the Commission used a mid-point asset value between these lower and upper bound values.

The Commission's considers this estimate is a prudent approach that makes best use of the available information, to derive an asset value on which to estimate Viterra's returns.

Adjustments to asset values following stakeholder feedback on Draft Report

During consultation with stakeholders following publication of the Draft Report, two issues were identified that the Commission has adopted to refine its estimation of Viterra's asset values (and consequently returns) for the Final Report, as follows:

1) Redundant Assets (upcountry grain storage sites no longer in use)

Over time, and in common with a trend observed globally, Viterra has rationalised the number of upcountry grain storage sites in use. Stakeholders suggested that this should be accounted for in the analysis.

The Commission considers that it is appropriate to adjust the asset values to account for permanently closed sites (not those mothballed for strategic purposes), and has used the storage capacity of sites as a basis to do this. Closed sites represented 5.6 percent of Viterra's total storage.[319] The asset value for upcountry storage sites has, therefore, been adjusted down by 5.6 percent, for both the upper and lower bound asset values, with the reductions phased in across the period that site rationalisation occurred.

However, much of Viterra's asset value is in assets at ports, rather than at upcountry storage sites.[320] Consequently, the impact of reducing the asset value on which Viterra earns a return is to only marginally increase the level of returns across all three financial ratios.

2) Port of Thevenard (use of port for non-grain exports)

The Port of Thevenard is also used to export non-grain commodities (that is, gypsum, salt, and mineral sands). This was raised in the context of discussion of the Decres Bay new port proposal, with the Port of Thevenard being the only Viterra multiuse port.

The Commission considers that it is appropriate to adjust the asset values to account for non-grain use of the Port of Thevenard, and has used the relative revenues generated by grain and non-grain commodities as a basis to do this. The values of commodities exported through Port of Thevenard are broadly consistent year on year, with approximately 80 percent of the total revenue being non-grain commodities, and grain accounting for only 20 percent of total revenue generated. The asset value for Thevenard has, therefore, been adjusted down by 80 percent, for both the upper and lower bound asset values, with the reduction applied consistently across all years.

However, the Port of Thevenard has a lower asset value than most of Viterra's other ports.[321] Consequently, the reduction in the total asset value on which Viterra earns a return, results in only a modest increase the level of returns across all three financial ratios.

[319] Viterra response to request for information.
[320] Viterra response to request for information.
[321] Viterra response to request for information.

Appendix E—Breakdown of grain pathway fees

The following tables provide a detailed breakdown of fees for each of the four grain pathways in Table 4.5.

Table E.1 Cummins to Port Lincoln, by rail

Fee category	2013-14 $/tonne	2017-18 $/tonne	Total increase over period	Average annualised Increase
Upcountry storage and handling				
Upcountry receival	$11.85	$12.90		
Upcountry outturn	$2.60	$2.95		
Export Select rebate	–$1.10	–$0.60		
Storage (3 months)	$3.15	$3.61		
Total	$16.50	$18.86	+14.3%	+3.4%
Freight				
Freight to port	$8.46	$8.25	–2.5%	–0.6%
Port services				
Port inloading	$3.00	$3.40		
Port handling and shipping fee	$13.20	$14.81		
Capacity booking fee	$5.00	$5.50		
Total	$21.20	$23.71	+11.8%	+2.8%
Total fees	**$46.16**	**$50.82**	**+10.1%**	**+2.4%**

Source: Commission estimates using publicly sourced Viterra fee schedules.

Table E.2 Poochera to Thevenard, by road

Fee category	2013-14 $/tonne	2017-18 $/tonne	Total increase over period	Average annualised Increase
Upcountry storage and handling				
Upcountry receival	$11.85	$12.90		
Upcountry outturn	$2.60	$3.40		
Export Select rebate	–$1.10	–$0.60		
Storage (3 months)	$3.15	$3.61		
Total	$16.50	$19.31	+17.0%	+4.0%
Freight				
Freight to port	$16.65	$16.76	+0.7%	+0.2%
Port services				
Port inloading	$4.25	$4.70		
Port handling and shipping fee	$15.35	$17.49		
Capacity booking fee	$5.00	$5.50		
Total	$24.60	$27.69	+12.6%	+3.0%
Total fees	**$57.75**	**$63.76**	**+10.4%**	**+2.5%**

Source: Commission estimates using publicly sourced Viterra fee schedules.

Table E.3 Roseworthy to Outer Harbor – Port Adelaide, by road

Fee category	2013-14 $/tonne	2017-18 $/tonne	Total increase over period	Average annualised Increase
Upcountry storage and handling				
Upcountry receival	$11.85	$12.90		
Upcountry outturn	$2.60	$3.40		
Export Select rebate	–$1.10	–$0.60		
Storage (3 months)	$3.15	$3.61		
Total	$16.50	$19.31	+17.0%	+4.0%
Freight				
Freight to port	$9.55	$9.51	-0.4%	-0.1%
Port services				
Port inloading	$4.25	$4.70		
Port handling and shipping fee	$13.20	$14.65		
Capacity booking fee	$5.00	$5.50		
Total	$22.45	$24.85	+10.7%	+2.6%
Total Fees	**$48.50**	**$53.67**	**+10.7%**	**+2.6%**

Source: Commission estimates using publicly sourced Viterra fee schedules.

Table E.4 Tailem Bend to Outer Harbor – Port Adelaide, by rail

Fee category	2013-14 $/tonne	2017-18 $/tonne	Total increase over period	Average Annualised Increase
Upcountry storage and handling				
Upcountry receival	$11.85	$12.90		
Upcountry outturn	$2.60	$2.95		
Export Select rebate	–$1.10	–$0.60		
Storage (3 months)	$3.15	$3.61		
Total	$16.50	$18.86	+14.3%	+3.4%
Freight				
Freight to port	$15.91	$16.01	+0.6%	+0.1%
Port services				
Port inloading	$3.00	$3.40		
Port handling and shipping fee	$13.20	$14.65		
Capacity booking fee	$5.00	$5.50		
Total	$21.20	$23.55	+11.1%	+2.7%
Total Fees	**$53.61**	**$58.42**	**+9.0%**	**+2.2%**

Source: Commission estimates using publicly sourced Viterra fee schedules.

Appendix F—Market power analysis

F1 Fee analysis

This fee analysis supports the market power analysis presented in section 4.4.5 for the following three Viterra fees/practices:

- Export Select (section 4.4.5.1)—does this bundled service and its pricing present any adverse competition concerns?
- Growers' direct deliveries to port (section 4.4.5.2)—is it viable for growers to bypass Viterra's upcountry storage services and, therefore, provide competition to Viterra's upcountry services?
- Competitors' direct deliveries to port (section 4.4.5.3)—is it viable for commercial third party operators to bypass Viterra's upcountry storage services and, therefore, provide competition to the Viterra's upcountry services?

The Commission used a sample of four grain pathways to port (Box 4.6), for two reasons. First, this sample is the minimum necessary to provide sufficient breadth of analysis, given the two adopted local markets (the Eyre Peninsula and eastern South Australia), the two transport modes of delivery to port (road and rail), and the existence of Viterra Grower Delivery Zones covering some ports (section F2). Second, the sampling accounts for the multiple pathways and different times of the year for delivering grain to the state's six ports, and for the different warehousing times. Further, some Viterra fees vary with the time of the year when Viterra provided the service.

Following consultation on the Draft Report, in addition to substituting Poochera for Waramboo, the 'new entrant' pathways have been revised to:

- 'Pinnaroo to Port Adelaide Outer Harbor-Road and Export Select' (Table F.1, column 8); and
- 'Pinnaroo to Port Adelaide Outer Harbor-Road and Third Party Operator' (Table F.1, column 9).

The reasons for these changes are:

- Viterra confirmed that it was possible for a third party operator to deliver grain direct to Outer Harbor using its own rail or road transport
- The use of road to Outer Harbor, given road has been the mode used by new entrants in recent years[322]
- The use of Pinnaroo (rather than Tailem Bend) is consistent with an actual example of a third party operator having a site outside Viterra's Port Adelaide grower delivery zone (GrainFlow, a wholly owned subsidiary of Cargill Australia Ltd, operates a site at Pinnaroo, as does Viterra).

Table F.1 presents the fee comparison for four supply chain pathways, with each pathway comparing an Export Select service with a non-Export Select service. The Export Select fee is only a component of the fees in Table F.1, which covers upcountry outturn, port inloading and the Export Select rebate. However, for ease of expression, table columns 2, 4, 6 and 8 are called the Export Select option.

[322] Viterra has provided the Commission with examples of third party operators that have organised their own road transport to Outer Harbor in 2017 and 2018, whereas an independent use of rail has not occurred in recent years. Source: Viterra response to request for information.

Table F.1 Comparison of fees across four sample supply chain pathways, for Export Select and non-Export Select—major wheat season, 2017-18 ($ per metric tonne)

Fee category (column 1)	Cummins to Port Lincoln Rail Export Select (column 2)	Cummins to Port Lincoln Road Grower direct (column 3)	Poochera to Thevenard Road Export Select (column 4)	Poochera to Thevenard Road Grower direct (column 5)	Roseworthy to Outer Harbor Road Export Select (column 6)	Roseworthy to Port Adelaide - Inner Harbour Road Grower direct (column 7)	Pinnaroo to Outer Harbor Road Export Select (column 8)	Pinnaroo to Outer Harbor Road Third party operator (column 9)
Upcountry receival	$12.90	–	$12.90	–	$12.90	–	$12.90	$9.75
Upcountry outturn	$2.95	–	$3.40	–	$3.40	–	$3.40	$6.55
Port inloading	$3.40	$16.65	$4.70	$16.65	$4.70	$16.65	$4.70	$7.40
Export Select rebate	–$0.60	$0.00	-$0.60	$0.00	–$0.60	$0.00	–$0.60	$0.00
Storage (three months)[323]	$3.61	$5.18	$3.61	$4.56	$3.61	$5.18	$3.61	$3.61
Port handling and shipping	$14.81	$14.81	$17.49	$17.49	$14.65	$16.46	$14.65	$14.65
Capacity booking	$5.50	$5.50	$5.50	$5.50	$5.50	$5.50	$5.50	$5.50
Total	$42.57	$42.14	$47.00	$44.20	$44.16	$43.79	$44.16	$47.46
Difference		–$0.43		–$2.80		–$0.37		$3.30

Source: Viterra published fees[324] and GrainFlow published fees.[325]

[323] The storage fee of $3.61 for Export Select is the three month fee covering storage at the Notional Port, with grain potentially stored at an upcountry site (to be transported to port for just in time loading). For grower direct to port, the storage fee is the relevant storage at port fee. For the third party operator pathway (as discussed in section F1 (d)), limited storage time at port is assumed, so the storage fee relates to the upcountry storage fee charged by the third party operator.

[324] Viterra, *Pricing, Procedures & Protocols Manual*, *2017/18* and *Wheat Reference Prices—Port Terminal Services 2017/18* (published).

[325] For third party operator fees in column 9 covering upcountry receival, upcountry outturn and three months storage (January to March) GrainFlow 2017-18 prices. 2017-18 fees are no longer published. 2018-19 fees available at https://www.grainflow.com.au/doc/1432087722643/gfpricebook-sa.pdf.

Box F.1 further details the assumptions used to develop the fees in Table F.1. It also explains why this analysis, as opposed to the fee analysis in section 4.4.3.2, does not include freight rates.

Box F.1 Assumptions underpinning the fees in Table F.1

The fees are based on grain receival in December, with three months storage, then outturn to vessels in March.[326] They reflect, therefore, the fees that customers face in a typical peak period. Further, adoption of a three month storage period is consistent with the storage period that AEGIC used. Such a period would appear conservative, noting that it can be up to three months before 90 percent of grain is sold by a grower to a trader (section 3.3.1), after which a trader must then organise export through a terminal.

Table F.1 does not include freight rates because:

- a direct comparison of fees across the four grain pathways (comparing Viterra's fees other than Export Select Freight Rates) would be more difficult if fees also varied across the pathways as a result of different distances to port
- the cost of freight for the grower and third party operator direct deliveries to port are not known, whereas the other fees are known or can be reliably estimated, and
- sections 4.4.3.2 and 4.4.3.3 contain the Commission's analysis of total upcountry-to-vessel loading fees.

An explanation of the basis of, and results for, each of the four grain pathways is provided below:

(a) Grower direct—Cummins to Port Lincoln (Table F.1, columns 2 and 3)

This pathway seeks to compare (i) the supply chain cost for a grower on the Eyre Peninsula, located within Viterra's Port Lincoln Grower Delivery Zone, delivering by road direct to Port Lincoln (column 3), with (ii) the equivalent cost for the grower delivering to a Viterra silo located at Cummins, and the grain then being delivered to Port Lincoln by rail using Export Select (column 2). The Commission selected this pathway to understand the extent to which Viterra might use Export Select as a device to capture grain into its network. On first consideration, direct delivery to port seems to be cheaper than the double handling when a grower delivers upcountry and then the grain is outturned for delivery to port.

In addition, comparing column 2 fees (Export Select) with equivalent Export Select fees for the other pathways helps identify the extent to which fees differ according to:

- the market, by comparing column 2 (Eyre Peninsula) with column 8 (eastern South Australia)
- the mode of transport delivery to port, by comparing column 2 (rail delivery) with column 6 (road delivery).

Notably, in the absence of freight rates, there is very little difference in the overall fee incurred by a grower delivering direct to Port Lincoln compared with the Export Select equivalent (around $0.40 per tonne lower). This suggests that the avoidance of double handling is not as material as might be expected. Viterra submitted that many ports cannot avoid double handling, because grain received from the grower is placed in a non-shipping position and then requires some movement to a shipping position before being loaded onto a vessel.

As noted, this analysis excludes freight costs. However, given the finding that Viterra is an efficient contractor of freight services (section 4.4.2), Viterra's Export Select freight rates would likely be cheaper

[326] Viterra submitted that March is the peak shipping month based on a 10 year average (source: Viterra response to request for information).

than those for a grower located close to Cummins choosing to deliver direct to Port Lincoln.[327] The Export Select product (which likely includes lower freight rates and higher service reliability) is discussed in more detail in section 4.4.3.1. So, rather than a small positive differential to the grower in this instance (comparing column 2 with column 3), it may be negative or zero when accounting for freight rates.

Further, Table F.1 does not factor in any on-farm storage costs. So, when considering those costs plus freight rates, it is not clear whether any grower benefits, in terms of supply chain cost, from delivering direct to port. Indeed, a grower is likely to benefit only if delivering straight from harvest (and, therefore, not incurring on-farm storage costs) and/or the grower freight costs are much lower than those charged under Export Select.[328]

(b) Grower direct—Poochera to Thevenard (Table F.1, columns 4 and 5)

This pathway seeks to compare (i) the supply chain cost for a grower on the Eyre Peninsula, delivering by road direct to Thevenard (column 5), with (ii) the equivalent cost for the grower delivering to a Viterra silo located at Poochera,[329] and the grain then being delivered to Thevenard by road using Export Select (column 4). Thevenard is not covered by a Viterra Grower Delivery Zone (section F2).

Notably, growers delivering to a port that is not covered by a Viterra Grower Delivery Zone may save around $3.00 per tonne ($2.80) on Viterra fees, when excluding on-farm storage costs and freight rates. Once on-farm storage costs and freight rates are included, this (absolute) differential might be eroded, but the fee relativities should still hold. That is, a grower delivering direct to a port not covered by a grower delivery zone should face materially lower fees.[330]

(c) Grower direct—Roseworthy to Port Adelaide (Table F.1, columns 6 and 7)

This pathway seeks to compare (i) the supply chain cost for a grower on eastern South Australia, located within Viterra's Port Adelaide Grower Delivery Zone, delivering by road direct to Port Adelaide (column 7), with (ii) the equivalent cost for the grower delivering to a Viterra silo located at Roseworthy, and the grain then being delivered to Port Adelaide by road using Export Select (column 6). This scenario assumes Viterra would use Export Select to deliver to Outer Harbor, whereas a grower could deliver direct to only Inner Harbour (because Outer Harbor has no warehouse storage). Viterra submitted that Outer Harbor has no storage, with just in time 60,000 tonne capacity.[331]

Similar to sample pathway (a), the result for pathway (c) is a small differential in total Viterra fees, excluding freight and on-farm storage costs.

(d) Competitor direct—Pinnaroo to Outer Harbor (Table F.1, columns 8 and 9)

This pathway seeks to compare (i) the supply chain cost for a competitor third party operator on eastern South Australia, located outside Viterra's Port Adelaide Grower Delivery Zone, delivering by road

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327 This result does not mean the efficiencies achieved have been fully passed on to customers, as this Inquiry found (Finding 4.6). However, Viterra submitted that Export Select delivers efficiency across the industry, with road and rail operators gaining access to larger volumes than provided by each individual trader. The benefits are then reflected in pricing and service offerings. Source: Viterra, *Submission to the Inquiry into the South Australian Bulk Grain Export Supply Chain Costs*, May 2017, p. 17.

328 AEGIC estimated the cost of three month on-farm storage to be around $19 per tonne (Source: AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, Figure 5). Viterra submitted that some growers prefer local sites even though the fee is higher than for other sites, on the basis that they can create more value.

329 Poochera is located 145 kilometres south east of Thevenard.

330 Given road freight rates for an equivalent distance should not vary by type of port, the $2.80 per tonne differential between pathways (a) and (b) should reflect the underlying differences in fees (for delivering to a port covered by a Grower Delivery Zone and delivering to one that is not covered). Also, on-farm storage costs should be similar across growers for a given storage and handling specification, so should not influence any comparison of grain pathways.

331 From notes of a meeting between Commission and Viterra staff on 6 February 2018.

direct to Outer Harbor (column 9), with (ii) the equivalent cost for grain delivered to a Viterra silo located at Pinnaroo, and the grain then being delivered to Outer Harbor by road using Export Select (column 8).

The costing for the competitor third party operator pathway is the only pathway that does not incorporate a Viterra (three) month storage fee; instead, it includes a GrainFlow storage fee (Table F.1, column 9).[332] This scenario assumes grain received by Viterra at port from a third party operator does not attract a Viterra storage fee, consistent with Viterra submitting[333] that grain from an approved third party storage would normally be transferred in a short time to the vessel nominated. But, because the total fees incurred are relevant in this fee comparison (excluding freight rates for both Export Select and the third party operator path), it is important to include a storage fee for the cost that would be incurred upcountry and charged by the competitor third party operator (namely, the GrainFlow $3.61 per tonne fee for the relevant three months in Table F.1, column 9).

Notably, the comparison (column 9 compared with column 8) shows a trader using a third party operator paying $3.30 per tonne more than the alternative Export Select pathway. This comprises $2.70 per tonne Receival at Port Service Fee and $0.60 per tonne due to not receiving the Export Select rebate.

[332] Viterra charges a monthly storage fee for bulk wheat on-hand at the first of each month, with no additional storage costs charged during the first calendar month. The equivalent Viterra storage fee for three months would be $3.61 per tonne.

[333] From notes of a meeting between Commission and Viterra staff on 6 February 2018.

F2 Viterra grower delivery zones

Figure F.1 Viterra Inner Harbour (Port Adelaide) grower delivery zone[334]

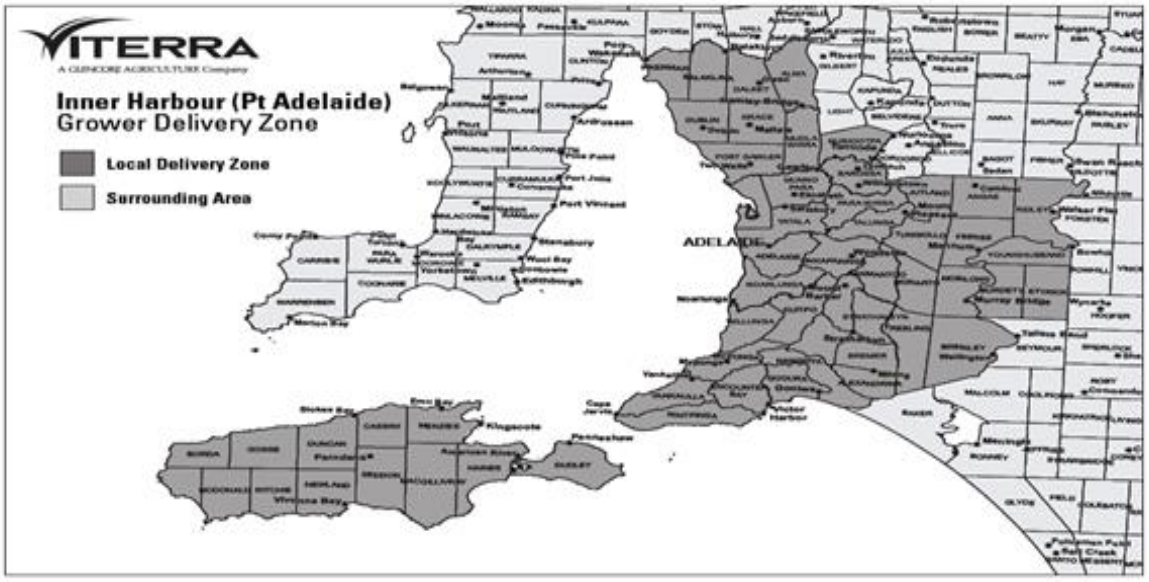

Figure F.2 Viterra Port Lincoln and Wallaroo grower delivery zones

Source: Viterra.

[334] Originals of these maps are available from: Port Adelaide (http://www.viterra.com.au/wp-content/uploads/2017/07/Inner-Harbour_Delivery-Map-2017_A4.pdf), Port Lincoln (http://www.viterra.com.au/wp-content/uploads/2017/07/Pt-Lincoln_Delivery-Map-2017_A4.pdf) and Wallaroo (http://www.viterra.com.au/wp-content/uploads/2017/07/Wallaroo_Delivery-Map-2017_A4.pdf).

Appendix G-Issues considered following release of Draft Report

Table G.1 lists issues raised during consultation and arising from the release of new reports, with a summary of the Commission's response. The new reports are:

- AEGIC, *Australia's grain supply chains: costs, risks and opportunities*, October 2018[335]
- Department of Agriculture and Water Resources (DAWR), *Review of the wheat port access code of conduct*, October 2018 (Final Report), and submissions to the Department's interim report.

The introduction to the response for each item summarises whether a change has been made to the Draft Report Findings and/or body of the Final Report, or not. In summary:

- A change to a Finding has required both a change to the text of the Finding and the supporting text.
- In some instances, new information has been received or additional analysis has been undertaken which has not required a change to a Finding. In these instances only the supporting text has been amended.
- Where an issue has been raised and it has not been necessary to change a Finding or supporting text, we have explained why we believe this to be appropriate. For example, it may be the case that it is considered that the issue is adequately addressed by the existing text, with the response explaining why we believe a change is not required. In other cases, the issue raised does not fall within the remit of the Inquiry Terms of Reference.

The column titled 'Section' (Table G.1) identifies the relevant section of the Final Report. Unless otherwise specified, references in the 'Response' to Figures and Sections are to the Final Report. Issues have only been attributed to an organisation or individual where there is a written submission or report. Where an issue was raised with the Commission during presentations or meetings, the identity of the individual(s) is not disclosed, noting that transcripts were not taken at these sessions. Submissions to the Draft Report are available from Grain Inquiry

[335] Noting the Commission was privy to advanced drafts of this report, with some draft material from this report included in the Commission's Draft Report.

Table G.1: Issues raised in consultation and third party reports and Commission response

No.	Section[336]	Issue	Response
Chapter 3: Overview of the Supply Chain **South Australia's place in the bulk grain export market**			
1	3.1	Additional evidence presented confirmed that a key advantage for South Australian grain is that it is high quality, sustainable, traceable and clean. Evidence was also presented showing the importance of the grains industry remaining alert to new customer demands. Viterra submitted that value is captured for growers and exporters from having a supply chain designed to handle peak volumes, to support customers requiring timely shipments when overseas demand is highest.	**Have the draft findings been amended to reflect this issue(s)?** Yes, Finding 3.1 has been revised to state the importance of the South Australian grains industry being responsive to potentially greater customer demands for safe and traceable grain, noting quality specifications should reflect customer demands and not be used by incumbent operators to impose barriers to new competition. **Has the report been amended to reflect this issue(s)?** Yes, the Final Report emphasises the importance of the grains industry being responsive to potentially greater customer demands for safe and traceable grain. However, noting that quality specifications should reflect customer demands and not be used by incumbent operators to impose barriers to new competition. Additional context has been included that Australian supply chain costs are higher than for most of its competitors, which underpins the increased market share being achieved by overseas low cost producers. **Commentary** Australian growers cannot compete in the world market on price alone. High quality product is necessary to maintain existing markets and potentially open the door to new markets. If any particular supply chain cannot be trusted to provide the right quality consistently it will not be used. Arguably there are also possible effects for adjacent supply chains, with the potential for whole ports or regions to be blacklisted. On value capture and growers product reaching the market at peak harvest, the APW1 (wheat) price varied by $36 from a high wheat price in November 2016 trending down to a low in April 2017.[337] This also demonstrates that a few dollars variation in supply chain costs can, at times, be dwarfed by movements in grain prices over a relatively short period. Australian supply chain costs are higher than most of its competitors, except for Canada, which underpins the increased market share being achieved by overseas low cost producers. For example,

[336] Refers to section in Grains Inquiry Draft Report.
[337] Viterra response to request for information.

No.	Section[336]	Issue	Response
			AEGIC estimates that total Australian wheat supply chain costs are 49 percent higher than Ukraine (2015-16), 52 percent higher than Russia (2016), and 14 percent higher than Argentina (2017).[338]
South Australian harvest trends			
2	3.2	The 2018-19 season is forecast to be well-below an average South Australian grain harvest, with South Australian grain being diverted to eastern States due to the drought (rather than exported through South Australian ports). The 2018-19 season is testing the notion that the South Australian grain region is made up of two or three separate markets.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes. Figure 3.3 has been updated to include a final harvest figure for 2017-18 (6,931,400 tonnes) and a forecast for 2018-19 (4,893,500).[339] The text in section 4.3.2 has also been amended to clarify that grain movements are not geographically constrained between South Australia and the eastern States, but respond to price spreads and the extent to which these signal profitable opportunities. **Commentary** It was only 2016-17 when the export supply chain was being asked to cope with a record harvest. As such, the 2018-19 season represents a good case study of supply chain dynamics and associated price spreads in a low harvest season, with grain not captured to export as a result of the extended eastern States' drought. The Inquiry has defined the (local) market for supply chain services as the area bounded by the South Australian borders and within that area, two separate geographic markets being Eyre Peninsula and eastern South Australia (section 4.3.2). This reflects the general pattern of grain movement when the focus is on export. However, there is no physical constraint preventing Eyre Peninsula grain moving to domestic markets located to the east and the evidence is that grain will move to these markets when the price spread is sufficient to offset additional costs. What the 2018 eastern Australian drought has shown is that grain price spreads can be such as to draw grain from South Australia to meet NSW and Queensland domestic needs. South Australian grain can and is being shipped to ports such as Newcastle and Brisbane.[340] There are media reports of grain being

338 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities*, October 2018, p.87.

339 PIRSA, *Crop and Pasture Report South Australia, 2018-19 Spring Crop Performance*, November 2018, p. 9, available at http://www.pir.sa.gov.au/__data/assets/pdf_file/0008/335960/PIRSA_Crop_and_Pasture_Report_Nov_2018-19.pdf.

340 The Singleton Argus, *Desperately Needed Grain is Heading East by Ship, Train and Truck*, 9 August 2018, available at https://www.singletonargus.com.au/story/5577527/interstate-grain-to-the-rescue/. Also, The Sydney Morning Herald, *WA grain ships east as drought resets industry*, 1 October 2018, available at https://www.smh.com.au/business/the-economy/wa-grain-ships-east-as-drought-

No.	Section[336]	Issue	Response
			shipped from Port Lincoln into Brisbane.[341] Also, grain accumulated in one port zone can be swapped for grain in another port zone, to allow grain in favourable positions to be shifted east. So, Eyre Peninsula grain does not have to be physically shipped out of Port Lincoln to be headed for eastern States domestic markets.[342] This is an example of the benefits in having an integrated supply chain network operating in South Australia. Consequently, the South Australian grain industry is dynamic and interlinked across geographic areas and responsive to grain price spreads. South Australia, or sub-regions within South Australia, are not separate in the market context. The last time the price differential was sufficient to attract grain from South Australia to eastern Australia was during the Millennium Drought, in particular 2005-06 to 2007-08.[343] In this instance there was little South Australian supply to transport given the impact of the drought on South Australian grain harvests.[344] We note the Eyre Peninsula and Yorke Peninsula growers who attended the Commission's presentations generally view themselves as operating in separate regional markets, due to them usually receiving the best farm gate price from their grain being exported through Viterra port facilities located close by (and in that sense consider themselves generally captured to the Viterra export supply chain). However, based on the above, this should not preclude them selling their product within Australia when commercial circumstances and pricing signals provide incentives to do so.
3	3.2	SAFC submitted that in respect of Draft Finding 3.3, the Commission should make explicit that it is Viterra who bears the risk of supply chain variability. GPSA submitted:	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No

resets-industry-20180928-p506n5.html. The Land, *Grain Likely to go North by Boat as Queensland, NSW Crop Dries Up*, 11 September 2017, available at https://www.theland.com.au/story/4916104/intra-country-grain-shipments-imminent/.

341 ABC Rural, *Drought Drives Demand for Feed Grain, Forcing Up Prices and Creating New Transport Routes*, 8 August 2018, available at https://www.abc.net.au/news/rural/2018-08-08/drought-drives-feed-market-into-uncharted-waters/10083910.

342 Malcolm Bartholomaeus, farmonline National, *SA Grain Price Sets Market*, 6 August 2018, available https://www.farmonline.com.au/story/5567931/sa-grain-price-sets-market/.

343 ABARES Insights, *Analysis of 2018 Drought*, 26 October 2018, p. 4, available at http://www.agriculture.gov.au/abares/Documents/abares-insights-analysis-2018-drought.pdf .

344 Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, Figure 2.6, p. 57.

No.	Section[336]	Issue	Response
		▶ It was important for investment to cope with peak demand while ensuring the capability provided will be well-utilised and idle capacity reduced to a minimum ▶ That comparing Draft Report Figure 3.2 and Figure 4.6 did not support the Draft Report finding that high returns in a good year may be needed to offset poor returns from a bad harvest.	Commentary Regarding SAFC's comment, Viterra bears the risk of holding assets structured to meet peak harvests. The Commission's assessment already recognises this through finding that returns in good years are needed to offset those in bad years. With respect to the GPSA's comments regarding its interpretation of Figures 3.2 and 4.6 in the Draft Report, GPSA is comparing the operating surplus results for 2016-17 (good year) with the results for 2014-15 (average year), which need not reflect a bad harvest year. Further, the comparison does not relate to returns and, therefore, does consider the value of assets Viterra operates. In relation to the remaining points made by GPSA: ▶ The Commission agrees idle capacity should be reduced to a minimum whenever practicable. The Commission considers a logical extension of this is potentially further site closures if such closures result in logistical/operational efficiencies. As such, there is a tension between capacity utilisation and any grower preference to have more choice regarding sites they can deliver to. ▶ The Commission has focused on trend analysis rather than seeking to compare the performance of individual years. The supply chain is characterised by a high proportion of fixed costs. During poor seasons, this results in Viterra incurring high operating expenses per tonne. However, fees are not increased to reflect this, as Viterra maintains steady fees over time (which the Commission understands is the preference of growers, compared to fees that vary markedly from year to year to achieve a constant return for the operator). This results in Viterra achieving poor returns in poor seasons, with the operator bearing the risk of assets structured to meet peak harvests.
South Australia's bulk export supply chain			
4	3.3.1	Concerns were expressed that the export trader market is not efficient and that the number of traders operating is reducing over time. GPSA submitted that knowing the total number of traders does not mean that	**Have the draft findings been amended to reflect this issue(s)?** Yes, to include new evidence that 12 traders booked shipping slot capacity with Viterra to export the 2017-18 grain harvest. Also to note that given low grain trading margins per tonne traded, traders rely on an efficient supply chain that can respond to variability. **Has the report been amended to reflect this issue(s)?** Yes, to clarify traders' relevance to the Inquiry Terms of Reference and to report further analysis undertaken on the number of grain traders by grain type by South Australian port and port operation. Also, the text has been updated to report on the number of

No.	Section[336]	Issue	Response
		there is an efficient trader market for individual grades-segregations. Some stakeholders considered port price spread trends was evidence of Glencore-Viterra price manipulation. GPSA submitted a range of additional analysis it considered should be undertaken by the Commission and concern that evidently no competitor or potential competitor has taken the opportunity to contribute and make a submission.	traders that booked with Viterra for the 2017-18 harvest and, given low trading margins per tonne traded, the traders' reliance on an efficient supply chain that can respond to variability. Commentary The Inquiry Terms of Reference cover supply chain costs, from farm gate to export vessel, including vessel loading charges (Appendix A). Traders' relevance to the Terms of Reference relates to: ▶ traders being involved in the financial flows associated with the supply chain (Figure 3.4) ▶ traders' role as an intermediary and the extent to which traders act as a countervailing force to reduce supply chain fees ▶ traders' potential to provide relevant evidence on the market behaviour of Viterra ▶ the extent to which traders operating in the global context can place competitive pressure on Viterra to operate efficiently (section 4.3.1). The Terms of Reference do not cover the price growers receive for their grain or the extent to which the trader market reflects the world price through to the grower. The recently released Wheat Port Code Review Taskforce notes that grain trading margins are low (averaging $1 to $2 per tonne traded, over the past five years for some Australian trading houses).[345] So trading is a volume rather than a margin business, and hence relies on an efficient supply chain that can turn around high volumes quickly and respond to variability – otherwise it would be difficult for traders to make a profit. Given the scope of the Terms of Reference, the Commission only undertook limited additional analysis in this area, intended to inform any future investigation of the competitiveness of the trader market. This was confined to interrogating the Australian Crop Forecasters data further to identify the number of traders by grain type by port by export terminal operator. The results are presented in section 3.3.1. This shows there are multiple traders for the main grains of wheat and barley, but only small numbers of

[345] Department of Agriculture and Water Resources, *Review of the Wheat Port Access Code of Conduct,* 2018, p. 58.

No.	Section[336]	Issue	Response
			traders active in the export of other grains. It might be expected that the small tonnages involved with the other grains would only attract a small number of traders. It is also noted that the ACCC's bulk wheat ports monitoring report provides a source of public information, such as the market concentration of export traders at each major grain port. These may assist any party with identifying whether, based on market share analysis alone, there is a competition concern they may wish to raise with the ACCC as the relevant authority. [346] However, market structure on its own does not provide conclusive evidence that a firm is exercising market power to the detriment of competition (section 2.2.2). Further, there was no evidence provided through consultation which rebutted the Commission's draft finding that the grain trading market in South Australia appears to be competitive (Draft Finding 3.4). Notwithstanding the above, the key drivers of the export price of wheat are:[347] ▶ the global demand for, and supply and stocks, of wheat ▶ the exchange rate, and ▶ relative transport costs from port to export markets. Wheat price cycles over time are common and there is no reason to believe the global wheat market is other than highly competitive.[348] Other factors influencing the price a specific trader offers may include the trader's preferences, its ability to source sufficient quantities of grain to load a booked vessel and access to shipping slots. Against this background, vertically integrated supply chain operator and traders, such as Glencore-Viterra, are not uncommon in the global context.[349]

346 For example, ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*.

347 Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 27.

348 Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, pp. 89 and 202.

349 Large grain companies own most of the port terminal capacity in Canada, with Viterra, Richardsons and Cargill accounting for about 75 percent of the annual Canadian export grain movements. Canada is considered to provide a useful comparison given Canada and Australia have significant similarities in their grain production systems. They produce similar sorts of grains, export large proportions of these grains and compete in similar markets. Source: AEGIC, *The Puck Stops Here! Canada Challenges Australia's Grain Supply Chains,* May 2015, available at https://www.aegic.org.au/wp-content/uploads/2016/04/Canadian-Supply-Chain-Full-Report.pdf. Also, the Productivity Commission considers that as most of Australia's overseas competitors are also vertically integrated, to deny such benefits in the Australian context could place domestic traders at a competitive disadvantage - Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 248.

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			Moreover, in response to concerns from some growers that traders all seem to be offering similar prices - in competitive markets for a homogeneous commodity, like a specific grade of wheat, the 'law of one price' often prevails.[350] This is an outcome of competitive pressures and the ability to arbitrage any differences. Specifically in relation to Western Australia, some growers expressed concern that grain prices received at Western Australian ports are higher than at South Australian ports. To some extent this would be expected, given that the location of most overseas grain customers means that Western Australia has relatively favourable sea transport costs.[351] Additionally, section 4.4.4.3 provides a reconciliation of CBH (WA) and Viterra supply chain fees, showing that differences can be explained in terms of differing corporate structures and operational factors.[352] Submissions have not provided evidence which demonstrates that such factors do not legitimately contribute to any fee differentials between Western and South Australia. Regarding trader numbers, Viterra submitted that it actively seeks to maximise the number of traders in order to diversify the risk of one or more traders ceasing to use Viterra. This would seem appropriate behaviour for a firm such as Viterra, which has high fixed costs. Viterra submitted that 11 grain traders booked shipping slot capacity with it to export the 2016-17 grain harvest, with 12 for the 2017-18 harvest. Further, no individual trader had more than 50 percent of Viterra's business for 2016-17. Finally, although the Commission has not received a submission from a trader, Commission staff have met or had telephone conversations with some traders and new port proponents during consultation on the Draft Report. The view of one trader was that growers lack transparency in grain prices.
5	3.3.2	Growers indicated that they are investing more in on-farm storage, but the Draft Report stated that Commission had not received evidence of a material increase in the last decade.	**Have the draft findings been amended to reflect this issue(s)?** Yes, Finding 3.5 has been amended to note that, on balance, the evidence suggests there has been a material increase in on-farm storage in South Australia. **Has the report been amended to reflect this issue(s)?** Yes, to reflect the above finding and to add emphasis on the fact such an increase is likely reflective of market development within the supply chain over recent years.

[350] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 117.
[351] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 60.
[352] See also Inquiry consultation briefing pack, August 2018, slide 17, available at https://www.escosa.sa.gov.au/ArticleDocuments/11249/20180829-Inquiry-BulkGrainExportSupplyChainCostsDraft-Part1-BriefingPack.pdf.aspx?Embed=Y.

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			Commentary No authoritative data source has been found for the current total capacity of South Australian on-farm storage. The Grains Research & Development Corporation's (GRDC) annual grower survey 2017 shows the number of South Australian growers storing grain at 84 percent, which is a statistically significant increase in the number of growers storing grain since 2013.[353] However, average storage capacity does not show a statistically significant increase since 2013, which suggests that more growers are storing on farm but only relatively small amounts (compared to eastern States' counterparts).[354] Meanwhile, the AEGIC report notes the level of on-farm storage in South Australia remains much lower than in the eastern States, reflecting the smaller local domestic market.[355] Overall, based on the advice received during consultation, the Commission finds that there has been an increase in the amount of on-farm storage in South Australia in recent years. This is likely to be mainly occurring in eastern South Australia but, from an absolute perspective, still remains relatively low in comparison to eastern States. Given this, Finding 3.5 and the supporting text have been revised. AEGIC considers that on-farm storage is usually more expensive than the commercial equivalent (on a $/tonne basis).[356] Given this, a grower is essentially determining whether the value arising from increased flexibility provided by on farm storage offsets (in the grower's estimation) the additional cost. Overall, the Commission is of the view an increase in on-farm storage would be indicative of the market responding in the manner expected to the events of recent years. In recent years, Viterra has been earning returns towards the upper end of what might be expected for a firm with Viterra's level of risk and, from the perspective of the industry, it has not sufficiently passed on gains to growers. This has created profitable opportunities for alternate supply chains using differing technologies, but handling relatively small tonnages. Such conditions are conducive to on-farm storage.

353 GRDC's Grower Survey questionnaire includes both annual and cyclical metrics and so why the 2017 survey result is compared with the 2013 result in this instance.

354 GRDC, *2017 GRDC Grower Surveys*, p.67, available at https://grdc.com.au/about/corporate-governance/grower-and-researcher-surveys,

355 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p.38. As noted by AEGIC (p.26), WA and SA have a relatively small domestic market with a large part of their total production exported: 88 percent and 72 percent for Western Australia and South Australia respectively from 2006-16. This contrasts with New South Wales, Queensland and Victoria where domestic consumption can often take more than 50 percent of total production.

356 AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p. 40.

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6	3.3.2.1	It was suggested by one stakeholder that Glencore is a 'subsidiary' of Viterra, not an 'affiliate' as termed in the Draft Report.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, References to 'affiliated with' are replaced with "related party" in the final Report. **Commentary** In response to a request for information, Viterra advised Glencore Agriculture (trading as Glencore Agriculture Pty Ltd in Australia) is a related entity to Viterra Holdings Pty Ltd and its related body corporate (referred to as Viterra in the Report), via common ownership by the ultimate parent entity in the global group of Glencore Agriculture Limited.
7	3.3.2.1	GPSA submitted the concerns of some grain growers with Viterra's post-harvest delivery policies, such as Viterra allegedly rejecting grain stored on farms for extended periods, resulting in these growers believing they have no choice but to sell grain at harvest or soon after when prices may be profitable or may not	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** In a response to a request for information, Viterra advised that it does not have a policy of rejecting grain stored on-farm for extended periods. For example, grain delivered from 1 March 2018 to Viterra sites was received under the standard Late Season Delivery Procedure. This required the completion of a late season delivery declaration form. This declaration requires the grower to list the protection chemicals/fumigants that have been applied. Viterra states on its website that the procedure is adopted to ensure that grain is fit for purpose and that Viterra is able to meet the needs of customers and export markets. Given the importance for the industry to maintain a clean product (refer item 1), the information being sought by Viterra does not appear unreasonable.
8	3.3.2.1	Viterra submitted that in relation to upcountry bulk grain storage it faces more competition than suggested in the Draft Report, including:	**Have the draft findings been amended to reflect this issue(s)?** Yes, Finding 3.5 has been revised to state Viterra has a substantial market share of commercial bulk grain storage sites in South Australia. **Has the report been amended to reflect this issue(s)?** Yes, to reflect the above finding. The text has also been updated to provide Viterra's adjusted number for upcountry sites operating in 2016-17 (section 3.3.2.1) and a revised list of competing bulk handlers (section 3.3.2.3).

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		▶ Viterra operated 78 sites (not 103) in 2016-17, which impacts on the precise figure for Viterra's market share of throughput ▶ At one million tonnes, on-farm storage represents 9-22% of total production.	**Commentary** The Final Report has been adjusted to adopt Viterra's submitted number of 78 upcountry sites operating in 2016-17 which, with five sites at port, results in total Viterra storage sites of 83.[357] In its submission to the PTAC review, Viterra listed 10 competing providers of upcountry storage facilities, many of which are involved in the export of bulk grain.[358] Most of these alternative providers had already been recognised in section 3.3.2.3. The findings and supporting text have been revised to state that Viterra has a substantial market share of commercial bulk grain storage sites in South Australia. Refer item 5 for discussion of on-farm storage.
9	3.3.2.2	Viterra submitted that, in relation to bulk grain port loading services, it faces more competition than suggested in the Draft Report, including: ▶ expressing concern with Draft Finding 3.7 that Viterra has a high market share, with 91% in 2016-17 ▶ Cargill and SCS exports similar volumes to Viterra's Port Adelaide's Inner Harbour terminal - providing significant competition, along with container and domestic demand	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** Regarding Viterra's comments, the Commission: ▶ Considers Figure 3.8 and accompanying text adequately reflects the impact of competition on Viterra's bulk grain port loading market share, being based on independent data provided by Australian Crop Forecasters. ▶ Notes that Viterra only faces actual competition at Port Adelaide-Inner Harbour at this moment. Table 4.1 (updated) identifies some examples of where future competition may come, most of which is designed to service Eyre Peninsula. Further, if Viterra considers it faces material competition at Port Adelaide then it could seek exempt status to the PTAC for this port. ▶ Agrees that share of tonnage is an incomplete measure of market competition and it is for this reason it has undertaken the analysis of market behaviour presented in Chapter 4. Regarding GPSA's comments that new entrants tend to be opportunistic or dependent on their ability to access specific supply chain infrastructure. The Commission is not of the view that this is an issue. A

[357] Although it is noted that AEGIC has retained a figure of 103 Viterra sites for 2017 – source: AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p.33.

[358] Viterra, *Review of the Port Terminal Access (Bulk Wheat) Code – Response to Interim Report,* August 2018, pp.11-12, available at https://s3-ap-southeast-2.amazonaws.com/ehq-production-australia/32c09de7e6c227cbb42514d0ef8257180ada522f/documents/attachments/000/090/153/original/wpcr-rd2-09-viterra.pdf?1539730519.

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		▶ share of tonnage is an incomplete measure of market competition, which suggests that competition may be better assessed by considering ongoing existence of actual, planned and potential competition in the SA grain market. GPSA submitted that: ▶ citing the ACCC 2016-17 ports monitoring report, new entrants tend to be opportunistic or dependent on their ability to access specific supply chain infrastructure. SAFC submitted that Draft Finding 3.7 should be amended to state that Viterra has a declining market share. John Hill submitted that Viterra has a significant advantage with its access to deep sea ports.	competitive market relies on the innovation of new entrants, which may include the ability to use the existing supply chain to their best advantage. Regarding Viterra's market share of bulk grain exports, time will tell whether this continues to fall, so the Commission is not confident at this time to find that Viterra has a declining market share. Figure 3.8 simply presents actual results to date. Regarding the comments with respect to deep-sea port access, the PTAC and the Ports Access regime are a regulatory response to the advantage Viterra enjoys through its ownership of assets at the State's deep sea ports.
10	3.3.4	Viterra submitted that Figure 3.7 does not adequately portray the complexities of Port Adelaide's four supply chains and, as a result, overstates the port's throughput.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, to emphasise that the average grain throughput for Port Adelaide in Figure 3.7 covers multiple operators from 2015-16. **Commentary** Figure 3.7 is included to show the relatively small throughput of Port Adelaide compared with Kwinana (WA), to support the CBH–Viterra fee comparison explanation. The fact that Port Adelaide has multiple service providers is drawn out in Figures 3.8 to 3.10. The footnote accompanying Figure 3.7 now emphasises that Port Adelaide has multiple service providers from 2015-16.

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11	3.3.4	It was suggested that the Draft Report's reference to six ports is not correct, given Port Adelaide Inner Harbour and Outer Harbor are both located at Port Adelaide.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, to reflect differences in stakeholder perceptions regarding treatment of these facilities. **Commentary** The Commission has chosen to treat Inner Harbour and Outer Harbor as separate ports to emphasis some operational differences, such as Outer Harbor being a deep-sea port, with Inner Harbour a shallow port. However, the accompanying footnote has been amended to recognise that some stakeholders treat Port Adelaide as a single port comprising Outer Harbor and Inner Harbor, resulting in them recognising five South Australian grain ports.
Chapter 4: Whether the supply chain is efficient **Segments of the supply chain**			
12	4.1	SAFC submitted that GWA does not have the potential to exercise market power and that the relevant statement (Draft Report p.30, paragraph 3) should be amended accordingly.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The Commission remains of the view that GWA does have the *potential* to exercise market power to the detriment of competition. The Report explains why the Commission believes GWA has not exercised this potential (section 4.2.1).
Segments of the supply chain that warrant review			
13	4.2	SAFC submitted that the wording of Draft Finding 4.1 (which deals with the state of competition in the supply chain) be amended to remove the line: *A possible exception are the fees for port receival and outturn from storage services*	**Have the draft findings been amended to reflect this issue(s)?** Yes, the phrase 'a possible exception are the fees for port receival and outturn from storage services' has been removed from Finding 4.1. **Has the report been amended to reflect this issue(s)?** Yes, to reflect the above revision. **Commentary** On further review, a 'port terminal service' is defined under PTAC to be a service provided by means of a 'port terminal facility'. This includes the use of a 'port terminal facility'. Further, a 'port terminal facility'

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			means a vessel loader capable of handling bulk wheat. This includes any of the following facilities situated at port: an intake/receival facility; grain storage facility; a weighing facility and a shipping belt.[359] Thus, it is evident from the definition of 'port terminal facility' that port receival and outturn from storage services are covered under the PTAC. Further, in the case of non-exempt ports (includes all of Viterra's ports), PTAC provides for binding independent arbitration where exporters and the terminal operator (Viterra) are unable to agree on prices and terms of access.[360] As the PTAC has been found to be an effective access regime[361] and it covers agreement on prices (fees) and terms of access, the statement 'a possible exception are the fees for port receival and outturn from storage services' does not apply. Finding 4.1 and the supporting text have been revised to reflect this.
14	4.2.1	In relation to the trend in rail's share of the freight task, Draft Report (p.32) presented evidence from two sources which were read to be in conflict. One source (SAFC) suggested that rail's share has fallen over the past 10 years, whereas the other (Viterra) noted that its rail share had not declined. SAFC submitted that there was no conflict, that while the modal share of tonnage to port may not have changed materially (Viterra's evidence), there has been a decline in the rail task as measured by net tonne kilometres (distance multiplied by tonnage) given the cessation of rail services, such as in the Murray Mallee (SAFC evidence). This point was raised in	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the text in section 4.2.1 dealing with rail's share of the grain freight task has been revised to reflect SAFC's comments and new information from AEGIC. **Commentary** The Commission accepted SAFC's clarification of the basis for its earlier submission. Further, AEGIC concludes that while the closure of two rail services in South Australia's Mallee saw around 180,000 tonnes of grain shift to road, operational efficiencies elsewhere saw a slight increase in the proportion of grain transported by rail – the net effect being an overall modal share of 50 percent rail and 50 percent road.[362] In relation to the concern raised on the level of road cartage in specific locations, how much of the freight task travels on rail compared with road should be a commercial decision, based on moving grain in the most cost-effective manner. This can be influenced by Government policy direction. The Government has the option to regulate or make investments to deal with any identified social concerns (for example, in response to community concerns from any identified impact of additional road cartage on road safety).

[359] Competition and Consumer (Industry Code-Port Terminal Access (Bulk Wheat)) Regulation 2014, 18 September 2014, Schedule 1-Port Terminal Access (Bulk Wheat) Code of Conduct, Part 1, Clause 3 definitions, available at https://www.legislation.gov.au/Details/F2014L01250.

[360] ACCC, *Bulk Wheat Ports Monitoring Report 2016-17*, p. 16.

[361] On the basis of the PTAC having recently been reviewed by the PTAC Taskforce with a recommendation that it be retained, with export traders supporting its continuation. Source: Department of Agriculture and Water Resources, *Review of the Wheat Port Access Code of Conduct*, October 2018, pp. vi-vii, available at https://haveyoursay.agriculture.gov.au/review-of-the-wheat-port-code

[362] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p.50.

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		the context of SAFC's submission that the Inquiry should look for options to increase rail's share. Another stakeholder raised concern that large volumes of grain from the Murray Mallee are being transported by road to Port Adelaide, rather than via rail from Tailem Bend.	The Productivity Commission notes the level and allocation of any investment by governments in road and rail infrastructure (or regulatory response) should be based on rigorous cost-benefit analysis, with a focus on achieving economically and socially efficient logistics chains.[363] In relation to SAFC's submission to look for options to increase rail's share, [364] the rationalisation of rail branch lines is an interstate and global trend, particularly low volume lines linking small and/or remote receival sites.[365] The relative closeness of South Australian grain producing areas to port places added pressure on rail's ability to compete with road. Consolidating grain onto major rail corridors enables larger tonnages to be assembled on those lines, increasing the commercial viability of rail (and lowering costs to users).[366]
15	4.2.2	Some concerns were raised for the price competitiveness of road transport, including: ▶ For some regions, one operator may have a large share of the freight task ▶ It may be difficult for road transport to cover a sudden closure of a rail service, leading to high freight rates ▶ A looming shortage of heavy vehicle drivers.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No The Commission considers that none of the issues raised contradict the finding that the road transport market is competitive, noting that: ▶ If a road transport operator does not perform to requirements, then Viterra (or any purchaser of road freight services) has a potential pool of other road transport operators to draw from. ▶ Any short-term shocks (for example, sudden closure of a rail service or shortage of drivers) are expected to only be transitory. A short-term road freight rate increase, if it occurred, is likely to attract other operators (or more drivers into the industry) and be eroded, given the market is competitive.
Market structure for services Viterra provides			
16	4.3	GPSA submitted that some growers regret the deregulation of the bulk wheat export market and the demutualisation of the former cooperative, arguing that the market	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, a new table (Table 3.2) has been included in the report that compares risk allocated to growers pre and post-deregulation. The text is also amended to

[363] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 2.
[364] SAFC, *Submission to the Inquiry into the South Australian Bulk Export Supply Chain Cost*, 12 May 2017, p.2.
[365] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 19.
[366] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 266.

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		has evolved into one where big commodity traders have thrived.	include the GPSA's submission on some grower's reflections concerning the outcome of deregulation and demutualisation. **Commentary** The competitiveness of the trader market is addressed in the response to item 4. Regarding deregulation, Australia is not unique in removing the single-desk marketing arrangements, with the exclusive right of the Canadian Wheat Board to sell wheat and barley from Canadian western provinces removed in 2012-13.[367] It is also acknowledged that deregulation may have changed a grower's risk profile, with the potential for a grower to face an increased level of risk, albeit with the potential to achieve higher returns (new Table 3.2). This position may or may not be preferred by any given grower. On the issue of growers regretting the demutualisation of the former cooperative: ▶ With the sale that followed the demutualisation, South Australian growers at that time effectively chose to take short-term gains through the sale, thereby not valuing the medium to longer-term benefits of the cooperative as highly as cash from selling. A potential benefit foregone was greater integration and influence. ▶ Further, while growers may feel that, in hindsight, they have lost buying power as a result, going forward there does not appear to be any impediment to growers developing pools or cooperatives, provided growers are willing to put in the necessary capital to sustain this. Grower representative bodies (for example, GPSA) might be able to perform a useful research and coordination role in examining the merits and feasibility of pursuing such options.
17	4.3.3	Not all stakeholders consider the existence of new entrants as a positive sign of supply chain efficiency:	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** In relation to the submission that new entrants are symptomatic of an inefficient supply chain, competition in a well-functioning market can result in what might appear to be excessive or inefficient costs at some stages of its development, such as through the duplication of facilities. But it is important to have regard to the competitive process and not compare static outcomes. For markets characterised

[367] AEGIC, *The Puck Stops Here! Canada Challenges Australia's Grain Supply Chains,* May 2015, p. 7.

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		▶ Some stakeholders see the existence of new entrants as symptomatic of an inefficient supply chain, particularly when these new entrants operate less sophisticated machinery than Viterra. ▶ That with the unlikelihood that the average crop size could be materially increased in coming years, new entrants through fragmenting throughput will inevitably result in higher costs for the South Australian grain industry. GPSA submitted concern that new entrants emerging at Port Adelaide could be an indication of an inefficient supply chain, driven by lack of ability to negotiate favourable terms with Viterra. Viterra submitted exception to: ▶ The statement in Draft Report (p.39) that, in the long term, it is possible that new entrant competition could result in *lower supply chain costs if it is efficient*.	by material economies of scale, invariably there is a trade-off between competition potentially delivering innovation and driving down costs over time (dynamic efficiency), against the loss of economies of scale for an incumbent. Table 4.1 has been updated to show the current known list of potential new port developments. In relation to the submission that new entrants will fragment the supply chain, any fragmentation of the supply chain is most likely to occur at port: ▶ Upcountry storage facilities do not exhibit material economies of scale that make it uneconomic to duplicate.[368] ▶ Most of the supply chain asset value is located at the ports.[369] The impact of any fragmentation costs should not be overstated: ▶ Where it occurs, fragmentation generally occurs over time allowing affected parties time to adjust, including the potential for the facilities to be relocated or put to alternative uses (for example, port loading belts handling commodities other than grain). ▶ Other than Viterra's Outer Harbor facilities, most of Viterra's port facilities are ageing assets (while acknowledging Viterra is undertaking sustaining investment, such as upgrading electricals etc.). In relation to Viterra's submitted exception to the Commission's statement that new entrant competition could result in *lower supply chain costs if it is efficient.* All things considered, the Commission views as positive the fact that competition exists at the margins for a supply chain characterised by economies of scale, at least for a key segment of the chain. Further, the Commission maintains its view that it is *possible* that new entrant competition could result in lower supply chain costs *if it is efficient*. Finally, in relation to Viterra's submitted exception to the Commission's statement on the effectiveness of local competition to discipline Viterra's behaviour, as stated in Finding 4.2 it remains unclear to the Commission the extent to which local competition may have this impact, notwithstanding Viterra submitted that it does. However, that should not be interpreted as the Commission concluding that local competition (rather than global) does not impact Viterra, given the financial viability of its operation relies

[368] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 31 and pp. 268-269.
[369] Viterra response to request for information.

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		▶ An aspect of Draft Finding 4.2, interpreting the statement that: *the extent to which competition places effective and credible discipline on Viterra's behaviour is not clear* as the Commission saying that current and potential competition is not an effective and credible discipline on Viterra's behaviour.	on maximising throughput. Which, picking up on GPSA's point, should in turn provide some encouragement for Viterra to negotiate favourable terms with traders.
Investigating Viterra's market behaviour			
18	4.4.1.1	Viterra submitted more evidence of its approach to tailoring services to meet customer needs, including: ▶ recognising the importance of flexibility to growers ▶ providing access to a range of buyers and warehousing services ▶ introduction of improved classification accuracy with Dynamic Binning ▶ regularly seeking customer feedback.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report makes reference to dynamic binning. **Commentary** Table 4.2 and section 5.4 has been updated to incorporate the introduction of dynamic binning for wheat for the 2018-19 harvest.[370]
19	4.4.2.3	One stakeholder contended that Viterra is spending less on capital expenditure and maintenance than its predecessor cooperative.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** This view is not supported by the evidence available to the Commission. The Commission has examined the maintenance and sustaining capital expenditure figures provided by Viterra for the period since

[370] Viterra, Dynamic binning, available at http://viterra.com.au/index.php/dynamic-binning/.

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			2006-07, adjusted for inflation. Comparing expenditures under ABB ownership (2006-07 to 2008-09) with Viterra-Glencore expenditures, shows average post-ABB real expenditures are 60 percent higher. While it is noted that the only ABB data available to the Commission covered the period of extended drought, it is also noted Viterra (in response to a request for information) is intending to maintain sustaining capital expenditures during 2018-19, which is also a period of low export outturn.
20	4.4.2.3	GPSA submitted Figure 4.1 [Movement in operating expense, Viterra, 2007-2017] shows that Viterra's indexed real $ per tonne has reduced from about $100 per tonne to less than $50 per tonne.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, to improve clarity by using the term 'indexed real cost per tonne'. **Commentary** As noted in section 4.4.2.3, the real dollar per tonne financial figures provided by Viterra have been indexed in a manner that shows trend but does not identify the absolute values – now termed 'indexed real cost per tonne'. It is not possible to use the figures for comparison with actual fees, given the process adopted to maintain the confidentiality of the data.
21	4.4.3.1	Some stakeholders are concerned that Viterra is achieving efficiency at the expense of growers, through cost shifting to growers. In particular, the closure of sites leading to additional freight costs through having to transport grain to a site further away.	**Have the draft findings been amended to reflect this issue(s)?** Yes, a new Finding 5.5 – that based on a case study undertaken by the Commission, it cannot be concluded that site closures result in Viterra shifting costs to growers. **Has the report been amended to reflect this issue(s)?** Yes, the results of a case study of changes in grower costs arising from a closure of sites are provided as a new section 5.5. Text has been included in the report to reflect that, from a total fees perspective, a grower may achieve a net reduction in their overall supply chain costs, despite sites closer to them being closed and having to transport their product to a site further away. **Commentary** The Commission undertook analysis to gain an understanding of the additional costs some growers might face from site closures. A case study approach, based on actual events, was adopted. This assessed the impact resulting from the closure of Yongala and Caltowie, and the retention of Gulnare and Jamestown, with Gladstone the main centre for the area. The case study assesses the impact on grower costs of changes (or not) to supply chain routes from farm to Viterra's upcountry sites, estimating the

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			incremental rise in trucking costs.[371] The case study also took account of any potential fee changes, such as those resulting from tier 1 sites having lower receival fees and lower Export Select rates than the tier 2 sites closed (or considered for closure). The methodology and results are presented in section 5.5. Based on the case study results, it cannot be concluded that Viterra is improving its efficiency by simply shifting costs to growers. In the case study, savings in freight rates to port and handling fees are shown to more than offset the additional freight costs incurred by growers in getting grain from farm to the nearest remaining open site. In this case study, the approach to site rationalisation benefited all parties, and improved the overall efficiency of the industry. The Commission acknowledges this result is specific to the case study in question. Should, however, there be specific instances where growers believe that a site closure would result in additional net costs to them, then there is sufficient transparency in fees for growers to undertake the type of analysis used in the case study, to mount a case to Viterra. The important point is that such analysis must incorporate all relevant costs. Overall, rationalisation of upcountry sites is a common practice interstate and overseas.[372] The closure of sites will inevitably result in some growers incurring additional freight costs as a result of having to travel further to the next open site. These need not, however, result in cost shifting to growers. Further, it is important that Viterra continues to pursue efficiencies, so that the South Australian grain export supply chain is as efficient as possible.
22	4.4.3.1	Some stakeholders are concerned that Viterra by bundling its charges hides any excessive charge components. John Hill submitted that it is important to compare the unbundled charges for the specific monopoly services. Further, that the lack of transparency due to Viterra's	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The Commission has investigated Viterra's Export Select, which is a bundled service (section 4.4.3.1). Even though it is a bundled service, Viterra transparently disaggregates the fees for each component in its published Export Select fee schedules.[373] Also, it is not necessary when products are bundled for the price

[371] This additional trucking cost has used freight rates received from AEGIC (supporting AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018), which the Commission has verified against published Viterra freight rates.

[372] For example, receival site numbers in Western Canada have declined by more than 60 percent since 1999-2000 – source: AEGIC, *The Puck Stops Here! Canada Challenges Australia's Grain Supply Chains,* May 2015, p. 26. Receival sites for major providers in Australia declined from 925 (1998) to 536 (2017) - AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p. 42.

[373] Viterra, *Current Export Select Rates,* viewed 28 November 2018, available at http://viterra.com.au/index.php/export-select-freight-rates/.

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		bundling of charges, many of which relate to passing on charges of other service providers, disguises its handling charges.	for individual components (where identifiable) to be cost reflective. Bundling can allow for cross subsidisation via the component pricing within the bundle of products, providing the overall bundled price does not result in excessive returns (reviewed in section 4.4.4). Further, Viterra pricing to maximise network throughput is not an unreasonable method for setting fees, providing the pricing is not conducted in a way that is anti-competitive (market behaviour reviewed in section 4.4.5.1). In relation to John Hill's point that Viterra's approach clouds the cost of other service providers' charges, the Inquiry has determined that road and rail freight prices are set on a competitive basis. Further, based on available evidence, Viterra appears to be earning returns towards the upper end of, but not in excess of, what might be expected for a firm with Viterra's level of risk (on average across harvest years, but subject to significant year-on-year variations depending on harvest yields). Consequently, it is not considered necessary within the context of this Inquiry to compare Export Select freight rates against the relevant underlying contract prices for other service provider charges.
23	4.4.3.1	One stakeholder was concerned that Viterra does not peak price its upcountry facilities, which they expected would enable better utilisation of Viterra's facilities and possibly encourage on-farm storage.	**Have the draft findings been amendedto reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** Peak pricing can be an effective mechanism to reduce (ration) the level of assets required to provide a given service, by requiring customers to pay an additional fee during periods of high demand. Those customers who do not value the service sufficiently to pay the additional fee can move their demand to the 'shoulders', thereby achieving a more uniform (less peaky) asset use over time (resulting in less assets needed to service a given demand). Viterra adopts peak pricing at ports that are subject to potential congestion. For example, for Port Adelaide Inner Harbour, the 2018-19 Port Handling & Shipping Fee is $16.84 per tonne for January through to May, but progressively dropping down to $15.99 (December and June) and then $14.20 (October, November and July to September) per tonne in the shoulders.[374] By way of contrast, Viterra does not adopt peak pricing with respect to receival capacity (upcountry storage). Rather, it employs pricing to encourage growers to use the more efficient tier 1 sites, with a saving on upcountry receival fees of $0.75 per tonne (major wheat).

[374] Viterra, *Pricing, Procedures & Protocols Manual 2018/19,* p. 6.

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			Viterra submitted that sufficient receival capacity (to cope with a peak harvest) maximises efficiency for Viterra and growers and avoids value leakage. In 2016-17, the record harvest year, Viterra did not apply peak pricing at upcountry receival sites; rather, it undertook additional investment in bunker storage. This may be a reasonable response given the movement of grain in Australia is characterised by peak load movement during harvest and the following two to three months,[375] when prices are generally most favourable (refer response to item 1). This contrasts to competitors such as Canada, where deliveries to receival sites usually occur at an even pace after harvest.[376] Given the above, the Commission is of the view that there is not a clear causal relationship between peak pricing and the incidence of on-farm storage (refer response to item 5). The level of Viterra's upcountry receival fees is only one factor in any grower decision to invest in on-farm storage, noting that the cost per tonne of on-farm storage is generally higher than the commercial equivalent.
24	4.4.3.2	GPSA submitted that some growers compare Chart 1 (fee movements) of GPSA's May 2017 submission with Viterra's efficiencies achieved and suggest that efficiencies have not flowed through to growers in lower fees. Some stakeholders asked why the Commission's fee analysis was confined to a five year period (2013-14 to 2017-18) and not the 10 year period covered by the Inquiry. John Hill submitted that there are good grounds for contending that charges in South Australia should not have increased with Viterra's acquisition of the system. That at one time, South Australian charges were consistently the lowest.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report includes the GPSA's Chart 1 from its May 2017 submission and the Commission's accompanying analysis. **Commentary** The Commission considers the GPSA's submission that Viterra has chosen not to share efficiencies with growers through lower fees is consistent with Inquiry Finding 4.6. Further, the Final Report includes the GPSA's submission Chart 1, updated to include Viterra 2017-18 fees, as new Figure 4.2. This provides a continuous set of annual fee data from 2006-07 (albeit based on different assumptions to those used in deriving the fees presented in Table 4.5), therefore covering the 10 year period of the Inquiry. The Draft Report concentrated on fee analysis from 2013-14, as this covered the period of operation for the current owner (Glencore), which is considered most pertinent for analysing market behaviour. New Figure 4.2 covers the period of Glencore ownership, as well as Viterra's and the start of period under consideration relates to ABB ownership.

[375] Grain Growers, State of the Industry Report 2016, p. 41.
[376] AEGIC, *The Puck Stops Here! Canada Challenges Australia's Grain Supply Chains,* May 2015, p.21.

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			Figure 4.2 shows a significant increase in fees occurred in the lead up to the sale of the co-operative (ABB) to Viterra in 2009 (as shown by the light blue line in new Figure 4.2). In relation to John Hill's point, since the change in ownership from ABB, fee increases have been relatively flat relative to those ABB put in place prior to the 2009 sale to Viterra. It is difficult to see why growers would have expected fees to have gone down immediately following the sale.
25	4.4.3.2	Some Eyre Peninsula growers considered it important for the Commission to undertake additional port zone supply chain fee analysis to see if one port zone was paying higher fees than another and so, in that sense, was relatively disadvantaged. One stakeholder requested an additional supply chain comparison comparing Western Australian with South Australian fees at 100kms and 300kms.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** Regarding fee levels in South Australian and Western Australia, the Commission acknowledges South Australian supply chain fees are higher than their Western Australian equivalents, as demonstrated in Figure 4.5 of the Final Report. Reasons why this might be the case, which include CBH's (WA) corporate structure and operational factors, are provided in section 4.4.3.3. The Commission has no evidence that Eyre Peninsula growers are being disadvantaged: ▶ Viterra submitted that its fees are relatively consistent throughout its network across South Australia and that, where fee differentiation exists, it is based on network efficiency. This is consistent with the Commission's fee analysis reported in Table 4.5, which shows a similar trend in fee increases across Eyre Peninsula and eastern South Australia. ▶ AEGIC reports that road transport rates are up to 35 percent lower on Eyre Peninsula (AEGIC's western region) than in AEGIC's eastern region (east portion of eastern South Australia), for an equivalent 150 kilometre journey.[377] On this basis, Eyre Peninsula growers should be on par with their eastern South Australian counterparts, or potentially better off. In the absence of receiving specific evidence to support the concerns raised by the growers, the Commission has not undertaken further analysis. Viterra publishes all its fees and it is open to growers or representatives on their behalf, such as the GPSA, to assess this on a systematic and regular basis, seeking explanation from Viterra for any identified concerns.

[377] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018, p.56.

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26	4.4.3.3	John Hill submitted that the most important fee comparison was between Viterra and CBH (WA), due to the much larger eastern states' domestic market and the differences in climate zones. That there are good grounds for contending that Viterra's charges should be lower those of CBH.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report includes the analysis summarised below. **Commentary** The fee comparison analysis undertaken for the Inquiry draws on the results of AEGIC's fee comparison investigation, which includes CBH (WA).[378] Figure 4.5 shows CBH to have materially lower charges, with section 4.4.3.3 arguing that corporate structure and operational advantages drive the difference. The Commission also compares Viterra with its eastern Australian counterparts, given their similar corporate structures, and for completeness. The comparison suggests Viterra's fees are not materially out of line with its eastern State peers. Figures 4.3 to 4.5[379] provide a comparison of Viterra's upcountry and port fees with its interstate counterparts for 2013-14 (adjusted to 2017-18 equivalent prices) and 2017-18. These are based on AEGIC's published report. There is no material change in these figures to that provided in the Inquiry Draft Report based on draft AEGIC data, with the Final Report figures updated to incorporate the final AEGIC fee comparison data. It should be noted the interstate fee comparison analysis presented in Figures 4.3 to 4.5 does not include freight costs (upcountry to port) because of the: ▶ lack of publicly reported freight rates for New South Wales, Victoria and Queensland, and ▶ varying pathways and grain haulage distances across different Australian states. However, in the process of finalising its report, AEGIC received GrainCorp execution freight rates, with freight rates also available for CBH. It is not possible to simply derive a freight cost using these freight rates to add to the combined upcountry and receival fees and port fees for major bulk grain handlers (Figure 4.5). This is because

[378] AEGIC, *Australia's Grain Supply Chains: Costs, Risks and Opportunities,* October 2018.

[379] Note that with the inclusion of new Figure 4.2, the citation numbering for the subsequent chapter 4 Figures has progressed by 'one' compared to their Draft Report numbering (e.g., Draft Report Figure 4.3 converts to Final Report Figure 4.4).

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			upcountry locations have not been identified by AEGIC for each State, for its upcountry and receival charges comparison. Given this, the approach adopted by the Commission has been to derive indicative freight cost differentials between Viterra and, in turn, GrainCorp (NSW) and CBH (WA), using typical South Australian supply chain distances. This is designed to focus the comparison on what a South Australian grower might be charged were the freight rate to be set at either the CBH or GrainCorp freight rate. The aim of the exercise being to see if the resulting freight cost differentials were sufficient to overturn the Commission's finding that Viterra's fees are not materially out of line with its eastern State peers – that finding based on a comparison of upcountry and port fees (Figure 4.5). Two South Australian road distances have been adopted for the analysis, the average road distance from upcountry grain site to port for South Australia of 144 kilometres and the third quartile distance of 200 kilometres (Figure 3.6). Feeding these distances into AEGIC's 'best fit cost lines' for 2017-18 freight rates shows CBH freight charges to be around $5.00 per tonne lower than Viterra, with GrainCorp around $1.00 per tonne higher. The difference narrows to around $3.00 per tonne when freight rates for Viterra's top 22 sites are compared with those for CBH's primary receival sites. The result is that a $3 to $5 per tonne difference between CBH and Viterra's freight rates when combined with the upcountry and port fee differential produces a total differential that is still within the bounds of the analysis explaining why CBH's other supply chain fees are significantly lower than Viterra's (being differences in corporate structure and operational advantages). Comparing freight differentials for Viterra and GrainCorp does not present an issue, given the result is to reduce the size of the differential based only on upcountry and port fees.
27	4.4.3.3	In responding to differences between Viterra and CBH, some stakeholders suggested that CBH pays tax, but Glencore does not	**Have the draft findings been amendedto reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** CBH's Storage and Handling Division accounts for three-quarters of its pre-tax profit, but due to CBH's cooperative structure this division is tax-exempt, with all other divisions subject to company taxation.[380] But in any event, even if Glencore could reduce its effective tax rate to zero, this is not relevant because

[380] AEGIC, *Australia's grain supply chains: costs, risks and opportunities,* October 2018, p.12.

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			this does not mean Glencore is exempt from paying tax, it simply means its treasury functions with regard to tax liability have developed a strategy to minimise the tax burden.
28	4.4.4	The Draft Report states that, given the lack of financial information publicly available on Viterra's performance (section 4.4.4.1), it is unclear whether a competitor of Viterra has sufficient information available to assess viable proposals. Viterra submitted that Viterra Holdings Pty Ltd, the ultimate Australian parent entity in the Australian group, files audited financial statements with ASIC that can be obtained for a nominal fee.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The Commission acknowledges that the annual accounts of Viterra Holdings Pty Ltd can be obtained from the Australian Securities and Investment Commission (ASIC) for a nominal fee. However, having reviewed this material, the Commission finds these accounts of limited use for identifying the reasonableness of Viterra's supply chain fees and returns for a number of reasons. These reasons being that the accounts: ▶ Are based on calendar year results, rather than harvest years. Consequently, the results of any particular harvest, either good or poor, will be split into two reporting years ▶ Provide little commentary on the operational performance of the business. In contrast, the published Annual Reports of both CBH and GrainCorp provide a good deal of such information in a format suitable for the general reader ▶ Contain significant related party transactions for some years, which make comparisons of the underlying business performance difficult ▶ Are for a consolidated group of (currently) seven subsidiary businesses (albeit four of those businesses were non-operating in 2017). Further, prior years' results also included those of a New Zealand business (Glencore Grain NZ Ltd), which was disposed of in August 2016 ▶ Contain no segmental information, which would allow analysis of the core South Australian grain storage and handling business separately to the other group activities. ▶ Are in a format designed for use by accountants and business analysts, rather than growers or traders.

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29	4.4.4	Why has the Commission not examined the financial performance of Cargill's sites, why concentrate only on Viterra?	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report clarifies why it concentrates on Viterra with respect to this issue. **Commentary** There is no reason to assess the behaviour or financial performance of Cargill or any other new entrant given their position in the market. That is, there is no reason to believe that a new entrant has any market power to exercise to the detriment of competition and the efficiency of supply chain cost. The text in section 4.3.3 has been updated to make this point.
30	4.4.4.3	Both Viterra and SAFC submitted concern with the Commission's statement that Viterra has chosen not to share efficiencies with growers through lower fees: ▶ Viterra submitted that it has shared efficiencies through the service improvements it lists in its submission. ▶ SAFC submitted that it is normal business practice for a company increasing its profits by reducing internal costs for the benefits to go to shareholders, not customers (in the absence of exercising market power).	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report includes overseas examples of firms sharing efficiency benefits with growers, while emphasising that this is Viterra's business choice. **Commentary** The Commission accepts that there are two components to a product – price and service. While providing a list of service improvements, Viterra's submission does not provide evidence to counter the statement that it has not shared efficiencies through lower fees. Moreover, Viterra's submission suggests that incremental costs associated with service improvements have, to some extent, been passed through to customers by stating that its prices are reflective of the quality of the services it provides to its customers. In response to SAFC's submission, given recent developments with new market entrants, the extent to which Viterra shares efficiency gains may or may not change in the future. In order to reduce potential impacts on growers, there are overseas examples where firms rationalising sites have shared some of the resulting efficiency benefits with growers through lower fees (offsetting any cost increase faced by growers).
31	4.4.4.3	There were some issues raised with the Commission's analysis of Viterra financial returns (section 4.4.4):	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report and relevant appendices have been updated to account for the further analysis undertaken.

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		▶ Viterra submitted concern with the: – result of the analysis showing Viterra earning returns towards the upper level of what may be considered reasonable – lack of transparency in how the Commission arrived at this position – comparability of the firms against which Viterra's return were assessed. ▶ SAFC submitted that Viterra had had nine good seasons in a row and Viterra bears the risk of a poor season. ▶ GPSA submission asked whether Viterra's earnings returns analysis would produce a different result if a weighted average cost of capital was calculated using the business' actual financial statements on the cost of capital and represent the future returns for an efficiently managed vertically integrated business. ▶ Other issues raised by some stakeholders were: – whether Viterra should be permitted to earn a return on redundant assets	Commentary While there are a number of stakeholder comments on this issue, these have not resulted in the Commission changing its Finding 4.6 that Viterra is earning returns, on average, towards the upper end of, but not in excess of, what might be expected for a firm with Viterra's level of risk. Regarding Viterra's points with respect to the Commission's financial returns analysis: ▶ The conclusion that Viterra is earning towards the upper end of what might be expected for a firm with Viterra's risk profile, on average, is a product of the analysis. This analysis utilises information received from Viterra over which confidentiality has been claimed. Consequently, it is not possible for the Commission to be more transparent in its approach to the benefit of all interested parties without disclosing information received from Viterra. ▶ The financial returns of comparison firms have been used as a guide to inform the assessment. Regard has also been had to the fact that Viterra has to compete for capital in a highly commercial setting, as well as the volatility of harvests through time. Further, the analytical approach adopted considers ranges, through adopting the 50th and 75th percentiles, rather than single point averaging. This mitigates the impact of extremes influencing the assessment. SAFC's point relates to the volatility of harvests over time and the impact of poor seasons. In this regard the Commission requested and received updated financial data from Viterra for 2017-18, and a forecast for 2018-19. This has enabled the Commission to update the analysis presented in the Draft Report to include Viterra's financial performance for the most recent two years. These most recent two years follow the excellent 2016-17 season, with the forecast for 2018-19 illustrative of the very poor returns Viterra faces when low harvest levels and droughts can radically reduce the throughput in Viterra's export supply chain. Growers will look for options to maximise their return in 2018-19, which may include direct deliveries to the eastern States (in response to supporting price spreads). They will also expect Viterra to cover the losses for 2018-19 and still be available to handle future harvests. The Commission also made these points in response to items 2 and 3. It is, however, also important to recognise that this illustrates volatility, which is an expected outcome of participating within the grains industry. Such volatility, in and of itself, does not alter the conclusion that, on average, Viterra's financial returns over time remain at the upper end of what might be expected for a

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		– what level of return would the Commission consider to be unreasonable.	firm with Viterra's risk profile. Rather, it illustrates the point that high returns in good years offset poor returns in the bad years. Noting the above, the Commission considers the GPSA's question regarding an appropriate level of return in the future based on the weighted average cost of capital as not strictly relevant. The purpose of the Inquiry is to consider the evolution of supply chain costs in the recent past, and consider their appropriateness or otherwise at this point in time. The Inquiry has not sought to prescribe what future returns should be, that is not its purpose. Nor is its purpose to overlay regulatory methodologies that may or may not operate well in an environment of such volatility. Indeed, as evidenced by the current year (2018-19), trade flow dynamics, and harvest volatility make it difficult to identify what level of return might be reasonable at any given point in the future. Finally, the Commission has considered various additional adjustments to the financial analysis including adjusting Viterra's asset base to (details provided in updated Appendix D): ▶ remove value associated with redundant assets, and ▶ account for the amount of non-grain volume through Thevenard, given it is also used to export gypsum, salt and mineral sands. These adjustments and the financial data for 2017-18 and 2018-19 forecast have opposing impacts. Accounting for 2017-18 and 2018-19 has the effect of reducing returns. This is because the lowering of throughput through Viterra's system reduces operating surplus. By contrast adjusting for redundant upcountry assets and accounting for non-grain movement increases assessed returns, through reducing the value of assets attributable to grain transportation. The net impact on the average return over the five-year period of the analysis is relatively insignificant. Overall, based on the factors outlined above and having regard to normal estimation errors, the Commission remains of the view that Viterra is earning returns, on average, towards the upper level of, but not in excess of, what might be expected for a firm with Viterra's level of risk.
32	4.4.5.1 Export Select	Some further evidence and issues were raised in relation to the Commission's investigation of the potential for Export Select to be used as a foreclosure instrument:	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the relevant aspects of the Wheat Port Code Review are considered in section 4.4.5.1 of the report.

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		▶ The PTAC review has identified: – the potential for site swaps to discourage a trader from organising its own transport, potentially capturing them to Export Select – some stakeholders expressing concern that, where they have chosen not to use an operator's bundled service (such as Export Select), they have received access to upcountry sites with fewer quality segregations, which resulted in either increased quality risk or prevented access to grain of similar quality to that purchased. ▶ Some stakeholders are concerned that Viterra is earning an excessive return on its (Export Select) road and rail contracts.	Commentary The report on the Wheat Port Code Review Taskforce (**PTAC Taskforce**) review of the Port Terminal Access Code (**PTAC**) has recently been published.[381] An aspect of that review which is of direct relevance to this Inquiry is the effect of upcountry site swaps on transport costs. The PTAC Taskforce highlighted this as an issue for South Australia. Site swaps provide operators with the ability to require traders to outturn grain from a site other than the site at which the trader took ownership of the grain. Viterra's storage and handling agreement provides for site swaps for various reasons, the most general being when *Viterra determines (in its reasonable opinion) that it is operationally efficient to move the Grain*.[382] Another related issue raised by the PTAC Taskforce is the possibility of traders facing reduced grain quality from being site swapped. However, aside from canola, which does not have an established minimum receival standard, this would not appear to be a significant issue with contractual remedies generally available. For example, Grain Trade Australia has contract dispute procedures in place that help to redress any problems arising from quality outturn contractual specification not being met (which provide recourse where minimum receival standards have been established). Accordingly, the impact of site swaps on transport costs was subject to further consideration, noting the Commission is of the view that it need not amend its Findings regarding Export Select as a result of the Wheat Port Code Review. PTAC Taskforce review findings of note for the South Australian supply chain with respect to site swaps on transport costs include:[383] ▶ Site swaps can result in grain being outturned at a site that is further away or closer to port than the site at which the interest or entitlement to grain was originally purchased. The resulting differences in freight costs have to be reconciled. Some stakeholders expressed concern about Viterra's lack of willingness to negotiate reconciliation of negative freight differentials or to swap traders to freight neutral alternative sites, although the PTAC Taskforce was advised that the situation had improved recently.

[381] Department of Agriculture and Water Resources, *Review of the Wheat Port Access Code of Conduct*, October 2018, available at https://haveyoursay.agriculture.gov.au/review-of-the-wheat-port-code.
[382] Viterra, *2017/18 Season Storage and Handling Agreement*, clause 6.6 (a)(iii), available at http://viterra.com.au/wp-content/uploads/Storage-and-Handling-Agreement-2017_2018.pdf.
[383] Department of Agriculture and Water Resources, *Review of the Wheat Port Access Code of Conduct*, October 2018, pp. 56-65.

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			▶ In addition to the direct costs associated with site differentials, site swaps could cause logistical issues and other additional costs. For example, when the exporter has arranged transport from specific upcountry site to port, only then to be required to re-organise transport from an alternative site. The PTAC Taskforce notes that grain trading margins are low (averaging $1 to $2 per tonne traded, over the past five years for some Australian trading houses). This suggests that, in the absence of compensation for freight differential costs, many traders may simply opt for Export Select to mitigate contractual risk associated with using an alternative transport operator. This might explain the high take up of Export Select by traders. As with other aspects of the investigation into the use of Export Select as a potential foreclosure tool (refer section 4.4.5.1), when considering the implications of site swaps, it is a matter of balancing potential operational considerations against the potential for it to represent an exercise of market power to the detriment of competition. Overall, In the absence of a trader providing evidence probative of Viterra exercising market power to the detriment of competition, the Commission considers the PTAC Taskforce Recommendation 12 relevant to this Inquiry, which is as follows: *That Grain Trade Australia should take the lead in engaging with open-access up country storage operators and third party exporters to establish and/or confirm industry standards and expectations in relation to the reconciliation of freight differentials and other costs arising from site swaps.* *If, despite action by industry, new evidence emerges of a non-exempt PTSP using its market power to intentionally and unreasonably resist fair and transparent access to grain export through operation of its up-country storage and handling network, the need for intervention, including regulation, should be considered.* Given this recommendation, the Commission does not consider it necessary to amend its Finding 4.7 regarding Export Select to account for the role of site swaps. Finally, the evidence presented by the growers who raised concerns that Viterra was earning excessive returns from its freight contracts appears limited, in that it simply notes that individual truck drivers reported earning less than what would be implied by Viterra's published Export Select freight rate. As noted in item 22, bundling individual fees within a bundled service need not be cost reflective for the service to still be considered efficient. Given this, the Inquiry has not sought to discover whether individual fees are cost reflective, nor the level of return achieved from each fee. The Inquiry has been focussed on

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			determining whether Viterra's overall level of returns are, or are not, demonstrably above that expected in a competitive market for a firm with Viterra's risk profile (see item 31). In any event, there could be a range of factors that explain the growers' observation regarding individual truck driver earnings relative to the Export Select freight rate. In particular, the Export Select freight rate will include elements additional to costs associated with individual truck drivers. Given Viterra contracts with trucking firms rather than individual drivers, some of the difference might be explained by the need to service the operation of the truck and a financial return to the trucking firm. Viterra would also be entitled to some level of return and/or administrative fee for organising the transport. As with site swaps, this concern revolves back to whether Export Select is being used to impede competition, and to whether there are excessive returns overall. On both counts, the Commission has found no evidence that Viterra is using Export Select to exercise market power to the detriment of competition.
33	4.4.5.2 Grower direct deliveries to port	During consultation growers, particularly on Eyre Peninsula, raised concerns with restrictions on being able to deliver direct to port, with some arguing they faced additional costs as a result. GPSA submitted that a constant frustration of many growers is the existence of Viterra's local delivery zones, arguing that the trader bears no freight cost risk as the Viterra Export Select value or Locational Differential charge has been passed back to the grower at point of sale.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The Draft Report covered this issue in some detail in section 4.4.5.2, noting there are clear operational reasons for requiring some restrictions to direct delivery to certain ports (refer Appendix F, section F2, for delivery zone maps covering Port Adelaide, Port Lincoln and Wallaroo). Ports are generally not used as long-term storage facilities, rather their primary function is for assembling shipments for export. Wheat stored up country is held for a much longer time, and might be carried over to the next harvest.[384] Further advice was sought from Vittera on this matter. Viterra provided examples of occasions when growers located outside the Port Lincoln and Port Adelaide delivery zones had been permitted to deliver direct to these ports. It is understood that this is most likely to occur where the grain can be tested upcountry and the particular grain types are required for immediate shipping.

[384] Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 253.

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			Viterra further advised that it is difficult to predict when deliveries from outside the zone may be possible, as each season presents different challenges –the grade, commodity or shipping profile will differ, as will the service demand with regard to segregation availability. If it is accepted, as the Commission has, that there are sound operational reasons for Viterra adopting grower delivery zones, then it is not a case that growers located outside the zone face additional costs; rather, they might be considered to receive a discount when permitted to deliver direct to port. In relation to the points submitted by GPSA, as is the case for most products, transport costs are generally passed back to the customer, with the price charged incorporating a valuation of associated risks. The actual price for transportation is only a concern if it leads to sustained excessive returns, or can be used to foreclose the market to potential competitors. As noted elsewhere (item 31), the Commission's view is that overall returns, on average, have been towards the upper end of, but not in excess of, what might be expected for a firm with Viterra's level of risk. It is open to the grower to take this freight risk on themselves and/or engage and promote alternative transport operators.
34	4.4.5.3 Competitor direct deliveries to port.	Draft Finding 4.7 identified Viterra's Receival at Port Service Fee (from Approved Third Party Storage) as possible evidence of a pricing structure that potentially serves as a barrier to new competition or expansion by existing competitors. Viterra submitted concern with this finding, seeking to provide further evidence in support of its position.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** Viterra's submission reiterates its rationale for the Receival at Port Service Fee (from Approved Third Party Storage), based on the cost and risk that receival from third party storage introduces to its operations. The reasons for the Commission's concern with this fee are presented in section 4.4.5.3. As noted in the response to item 1, the maintenance of a high quality safe product is necessary to maintain existing markets and potentially open the door to new markets. The Commission accepts that Viterra has a focus on maintaining a high quality safe product and so Viterra may consider that it has legitimate operational reasons for imposing such a fee. It is also the case that quality specifications should relate to genuine customer needs and not impose undue barriers to new competition. However, the Commission also notes that Viterra is the only major Australian operator to charge this fee to approved third party operators. The ACCC monitors this fee as part of its annual bulk wheat ports

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			monitoring, for any potential anticompetitive use. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power (Finding 4.7). It is understood that technology improvements are reducing the cost of testing samples. However, as noted in section 4.4.5.3(b), according to Viterra's published wheat reference prices schedule the fee also covers other services such as reviewing grain treatment histories, potential segregation and storage for risk mitigation, and potential fumigation. Were it be the case that the fee includes a risk premium (for example, to cover cost of spoilage of a grain shipment or loss of reputation), then one option might be to consider if there are any potential avenues for a less costly approach, such as through industry codes of practice or commercial arrangements (that might enable the offending party to bear more of the risk).
35	4.4.5.5 Lost capacity fee	Some stakeholders are expecting a combination of Long Term Agreements for port capacity and a poor export season will lead to many exporters being liable for large lost capacity fee payments.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The arrangements exporters put in place to diversify the risks they face when entering into a Long Term Capacity Agreement are dependent on each exporter's risk appetite. Viterra has submitted to the Commission that it is fully aware of the implications and is working with exporters. Further, the ACCC, as administrator of the PTAC, has the option to assess the performance of the code during 2018-19 as part of its routine monitoring function.
36	4.4.5.6 Shrinkage and dust rates	Clarification was sought on whether the shrinkage rate was based on grain price or tonnage.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, to ensure clarity of the charging basis. **Commentary** Viterra (in response to a request for information) submits that shrinkage is charged on a tonnage basis.
37	4.4.5.7	Some growers are concerned that Glencore dominates the trader market and that Glencore-Viterra behave in a way that	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No

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	Impact of vertical integration	constrains the ability for other traders to be able to offer better (than Glencore) prices.	**Commentary** Stakeholders were requested to provide evidence of any poor behaviour on a confidential basis if deemed necessary. No such evidence has been received. Reference is made to the responses made to item 4.
38	4.4.6 Market transparency	Viterra submitted: ▶ concern with Draft Finding 4.8 - that the Commission found evidence that the market is not sufficiently informed, in the case of both growers and traders, and potential competitors ▶ a list of the approaches it adopts in an effort to make fee information transparent to growers ▶ a sample of invoices from Viterra that are issued to traders ▶ that further communication and transparency of supply chain fees as part of the grain price shown to growers is at the discretion of the buyer [trader]. GPSA submitted:	**Have the draft findings been amended to reflect this issue(s)?** Yes, to reflect additional evidence received. In relation to fees: there is a considerable amount of fee information available to growers to enable them to approximate the total supply chain costs that have been passed back to them. The nature of a commingled grain system means it is not possible to provide growers with individualised statements providing detailed reconciliations. In relation to financial information: going forward, it should be possible to gain some understanding of Viterra's future performance through monitoring trends in supply chain fees (publicly available) and service levels (publicly observable). The absence of suitable published financial information places an onus on Viterra to publicly justify to its customers any future fee increases, particularly if service levels remain constant or decline. Failure to do so would result in Viterra risking customer disquiet, increasing the likelihood of future investigations or inquiries being undertaken and subsequent consideration of remedial measures. The fact that there are new entrants indicates that competitors to Viterra who seek to compete generally in the market for grains, rather than serve a particular customer, have sufficient information available for them to be able to assess the viability of proposals - whether or not they can match or better the Viterra fees for a particular service offering. This suggests that there is sufficient information for the market to work effectively from a signalling perspective. However, it is too early to assess the extent to which new and prospective entrants place a competitively significant constraint on Viterra's behaviour. Ultimately, the ACCC is responsible for undertaking any investigation into possible misuse of market power that may undermine the potential for new and prospective entrants to provide a competitively significant constraint. **Has the report been amended to reflect this issue(s)?** Yes, to reflect the above revision. **Commentary**

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		▶ that a potential improvement to the transparency and ability to negotiate supply chain fees would go some way to redress the imbalance between market participants and grain producers – there is evidence to show that insignificant steps have been taken to improve total on-farm storage capacity. With the assistance of GPSA, the Commission received a small sample of statements growers receive from traders.	<u>Fees</u> As noted in section 3.3.1, general practice is for growers to sell to traders from within Viterra's storage, with the trader accepting responsibility for the payment of supply chain fees to Viterra, ultimately to be passed through to the grower. This involves Viterra invoicing the trader and then the trader providing a statement to the grower. From the small sample of trader transaction statements to growers that the Commission received, it appears a significant amount of information is provided by traders to growers, typically including: ▶ for each delivery: – ticket number – grain type/grade – delivery site – delivered weight – site price (upcountry) – protein value – moisture value – screenings value – freight fee per metric tonne – storage per metric tonne – load value ▶ separately itemised end point royalty payments (eg, Australian Grain Technologies) ▶ total settlement amount. The Commission understands that the issue some growers have is in being able to reconcile the upcountry 'site price' (accepted by the grower and presented in the trader's transaction statement to the grower) with the equivalent publicly available 'at port price' (which the grower monitors, given the grower's expectation that their grain is destined for port). This is because a number of supply chain fees are not included in the statements to growers, such as receival, outturn, port inload, port handling and booking fee and dust and shrinkage. In deriving the site price offer, the trader has implicitly deducted Viterra charges that are not directly recouped from the grower by the trader. This results in the site price being lower than the at port price.

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			However, Viterra publishes all fees on its website, including those not explicitly on-charged to the grower by the trader (that is, including those not explicitly listed in the trader's transaction statement to the grower). Therefore, it should be possible for growers to approximate the balance of fees, to the extent of being in a position to query the trader were the grower to believe a material discrepancy exists. Indeed, the Commission understands the GPSA chart reproduced as new Figure 4.2 is an attempt by GPSA to assist growers in estimating total supply chain costs for a particular year. The GPSA chart, as for the fee estimates provided by the Commission in Table 4.5 and Appendix E, is necessarily based on simplifying assumptions (given the myriad of actual supply chain paths), covering variables such as: location of upcountry site; time of year transferring grain to port; and number of months stored. Viterra provided the Commission with a sample of invoices and related data tables that it provides to traders. This would appear to provide traders with a sufficient level of transparency for the fees charged by Viterra. It is not, however, possible from this information for traders to provide growers with individualised statements itemising actual fees incurred in the handling of the grower's grain, if indeed this is what growers need. In fact, any requirement to provide growers with a fully itemised list of charges attributed to a grower's delivery would not be possible without a fundamental change in the operations of the industry. Given the nature of a commingled grain system, Viterra is only able to bill the trader for specific services it provides in handling the trader's commingled grain. For example, an individual grower delivery might be commingled with grain that may in part be outturned to a domestic customer and in part be outturned for export. It is not relevant to say a particular delivery is exported and should therefore incur specific port and shipping fees. The trader, having regard to the aggregate supply chain costs expected to be incurred, sets the site price, which incorporates a margin to provide a return to the trader. Therefore, it is this margin that a trader adds to Viterra's fees that is not transparent. The grower is therefore reliant on an efficient trader market (see item 4) for such margins to be kept in check, noting the PTAC taskforce's observation that trader margins are very low (see item 32). <u>Financial information</u> The publicly available financial information[385] on Viterra's performance is for a consolidated group of seven businesses, reports calendar years (not harvest years), and provides little commentary on the operational performance of the business (section 4.4.4.1). By contrast, stakeholders in Western Australia

[385] Available from ASIC for a nominal fee.

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			and eastern Australia have access to the published annual report and accounts of CBH and GrainCorp respectively that are more reflective of their grain storage and handling business operations in the relevant States. However, Viterra does publish a comprehensive list of its fees. It should, therefore, be possible for consumers to gain an understanding of Viterra's future performance through monitoring trends in supply chain fees (publicly available) and service levels (publicly observable). It would be a potential concern to see fees increasing materially above inflation and/or service levels deteriorating. Such circumstances, if they occurred, would place an onus on Viterra to publicly justify to its customers the fee increases. Failure to do so would result in Viterra risking customer disquiet, increasing the likelihood of future investigations or inquiries being undertaken and subsequent consideration of remedial measures. Further, based on the fact that there have been new entrants, a potential competitor of Viterra has sufficient information available regarding fees and service levels for them to be able to assess the viability of proposals by considering whether its proposal can match or better the Viterra fees for a particular service offering. That being said, it is too early to assess the extent to which recent and prospective entrants will place a competitively significant constraint on Viterra's behaviour. Indeed, in the case of new and prospective entrants, the central concern is their chances of success should not be adversely impacted by any misuse of market power (with the success or entry being based instead on the product offering and customer's willingness to support the venture). Ultimately, it is the role of the ACCC to undertake any investigation into possible misuse of market power under section 46 of the Competition and Consumer Act 2010.
Chapter 5: Other issues			
39	5.2 Grain stock information	Viterra submitted that the current level of stock information strikes the right balance. GPSA submitted that: ▶ calls for the Australian government to import grain from overseas to assist drought-stricken NSW farmers raises the question as to how much grain is held in storage in Australia	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The Commission does not consider that the available evidence supports or requires a change to the Commission's finding that the level of stock information available is an issue that industry should be able to manage (Finding 5.2). Further, assessing the merits of routine availability of stock information at a

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		▶ self-regulation has been advocated ▶ the Wheat Industry Advisory Taskforce recommended an open, transparent grain stock reporting system.	defined level of disaggregation should ideally be distinguished from a country-wide security of supply issue, as might occur during an extended drought.
40	5.3 The basis of road and rail cost recovery	GPSA submitted: ▶ Support for greater access for heavy vehicles on less restrictive terms to the South Australian road network ▶ First and last mile issues continue to be a problem for the industry. Other issues raised by stakeholders include: ▶ Instances that could suggest the application of excessive regulation (for example, a road train being required to gain permission to access a specific rail crossing and to advise the rail authority when the manoeuvre is completed - when there may only be one such crossing on the Perth to Sydney route) ▶ Concern the Commission was not intending to analyse global road freight rates. Viterra submitted support for Draft Finding 5.3.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** The Terms of Reference do not extend to global freight rates. The Terms of Reference require the Commission to have regard to the basis upon which road and rail components of the South Australian supply chain grain export supply costs are recovered. This is addressed in section 5.3. As noted in section 5.3, the Government has initiatives in place pending the development of a national integrated efficient pricing, funding and infrastructure investment system. The Commission acknowledges the current basis of road cost recovery may impact on issues such as first and last mile (where the first and last legs of a trip are over local roads). For example, it is likely local councils would more readily permit higher capacity vehicles if there was a clearer mechanism for obtaining any necessary road upgrade funding. The Commission, however, considers that such concerns should be dealt with via the relevant Government channels and initiatives.

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41	5.4 Quality arbitrage	Some growers are concerned that the grain they deliver is outturned on a different basis. GPSA submitted that some growers are concerned with: ▶ selling grain at a quality level above the grade-segregation offered and not benefiting from arbitrage ▶ being required to travel further to where their preferred segregation was available and finding that it was not commercial to do so ▶ the arbitrage benefit going to the grain trader and not the grower. Viterra submitted support for Draft Finding 5.4.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** No **Commentary** Overall, no further evidence was presented that would lead the Commission to revise the central tenet of Draft Finding 5.4 - that traders should have the right to benefit from the new product they produce through blending the grain specifications they have purchased. Regarding quality arbitrage and the sharing of any associated benefits, the grower delivers according to industry specifications, but then the trader needs to blend to what the customer demands. While standard practice, this appears to present a disconnect for some growers. Traders use quality arbitrage to extract the maximum value from their grain purchases (refer section 5.4). With the sale of ABB to Viterra, growers effectively exchanged the opportunity to share in such value creation over the longer term for the near term cash flow gains achieved through the sale of ABB at the time (see item 24). Regarding the Glencore-Viterra relationship and its relationship with quality arbitrage, the Commission supports an earlier observation from the Productivity Commission that it is not necessarily inappropriate for such vertically integrated entities to have a level of competitive advantage as a consequence of information asymmetry in relation to stocks information.[386] Sharing information between marketing and operational arms might be necessary to capitalise on potential synergies and efficiencies, in order to obtain a return on the firm's investment in the supply chain (see item 4 for further discussion of the trader market). Regarding segregation and travel distance, Viterra provides a large number of segregations across its network, which it does in consultation with local silo committees. There is a limit to which Viterra can satisfy the needs of all growers in the number of segregations it makes available, and deliver an efficient service.[387] Further, as discussed in item 21, the extent to which additional travel may or may not be commercial is not necessarily clear cut and requires the full costs of the specific transaction to be considered, not just changes distance travelled.

386 Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 328.
387 Productivity Commission, *Wheat Export Marketing Arrangements*, 2010, p. 351.

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42	5.5 Statewide regulation	Viterra submitted reasons against extending PTAC upcountry, including its view that such regulation would be unnecessary and risk undermining the efficiency of the supply chain. SAFC submitted: ▶ that it supports further investigation of the merits of merging the port and rail access regimes, but has at no stage suggested the concept should go beyond rail and port infrastructure, such as being expanded to include silos and grain storage. ▶ any merged access regime should be no more onerous than the current regime. ▶ SAFC has under review whether the rail and port access regimes are required at all.	**Have the draft findings been amended to reflect this issue(s)?** The interim finding that the Commission would consider any position reached by the DAWR in its PTAC review final report has been removed. The implications of the final PTAC review have been considered here, and in the response to item 32. **Has the report been amended to reflect this issue(s)?** Yes, Draft Report section 5.5 has been removed for the Final Report. **Commentary** The submissions in this area reflect discussion arising from an ACCC submission to the PTAC review interim report calling for some provisions of the PTAC to be applied to upcountry storage services. The PTAC Taskforce did not support the ACCC on this matter in its final report.[388] As noted at item 32, the Commission considers PTAC Taskforce Recommendation 12 of relevance, being that to the extent an issue is identified upcountry, an industry-based solution should be pursued in the first instance. Consequently, Draft Report section 5.5, regarding a statewide transport access regime covering grain storage and handling, has been removed for the Final Report.
43	5.6 20-foot containers	Role of containers	**Have the draft findings been amended to reflect this issue(s)?** No (there being no draft finding) **Has the report been amended to reflect this issue(s)?** Yes, Draft Report section 5.6 has been removed for the Final Report. **Commentary** As noted in the Draft Report, containerised grain exports are outside the Inquiry's Terms of Reference. The inclusion of section 5.6 in the Draft Report did not generate discussion, other than the potential for containerised grain to provide competition to bulk grain exports, and that the South Australian economy

[388] Department of Agriculture and Water Resources (DAWR), *Review of the Wheat Port Access Code Of Conduct*, Final Report, 18 October 2018, p. xii, available at https://haveyoursay.agriculture.gov.au/review-of-the-wheat-port-code

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			dictates the number of food grade containers that may be available for the use of grain exports. Consequently, Draft Report section 5.6 has been removed for the Final Report. However, an additional paragraph has been included in section 4.3.3 to recognise that containers provide potential competition and an avenue for growers to potentially earn a higher return from on-farm storage in the case of high quality grains.
Appendices			
44	Appendix F, Table F.1. Table 4.5. Table E.2.	Viterra submitted concern with the Outer Harbor fee comparison, arguing that use of two completely different supply chain modes in the Draft Report distorted the findings, as the upcountry outturn and port receival tasks are fundamentally different for road and rail. Concerns were expressed that the Waramboo (Eyre Peninsula) to Thevenard route is not used in practice, casting doubt on the relevance of the findings for this specific path.	**Have the draft findings been amended to reflect this issue(s)?** No **Has the report been amended to reflect this issue(s)?** Yes, the report has been amended, where necessary, to reflect the results of the revised supply chain pathways used in the Final Report. **Commentary** Regarding the comparison using two different supply chain modes. The new entrant example in Table F.1 in the Draft Report compared the following supply chain pathways: ▶ Tailem Bend to Port Adelaide Outer Harbor, Rail Export Select ▶ Tailem Bend to Port Adelaide Inner Harbor, Road Third Party. These have been replaced with the following supply chain pathways in the Final Report: ▶ Pinnaroo to Port Adelaide Outer Harbor, Road Export Select ▶ Pinnaroo to Port Adelaide Outer Harbor, Road Third Party. The reasons for these changes are: ▶ Viterra confirmed that it was possible for a third party operator to deliver grain direct to Outer Harbor using the third party operator's own rail or road transport ▶ the use of Road to Outer Harbor, given road is the more likely mode used by a new entrant[389]

[389] It is easier for a third party operator to contract road transport as more flexible than seeking to contract with a rail operator. This is supported by evidence provided by Viterra providing examples of recent third party operators that have organised their own road transport to Outer Harbor, whereas an independent use of rail has not occurred in recent years.

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			▶ the use of Pinnaroo (rather than Tailem Bend) is consistent with an actual example of a third party operator having a site outside Viterra's Port Adelaide grower delivery zone (GrainFlow, a wholly owned subsidiary of Cargill Australia Ltd, operates a site at Pinnaroo, as does Viterra). The result of the revised analysis is that, rather than the third party operator facing additional charges of $6.86 per tonne in fees relative to Export Select, it would face an additional charge of $3.30 per tonne (noting Table F.1 does not include freight rates). The revised difference comprises $2.70 per tonne Receival at Port Service Fee and $0.60 per tonne due to not receiving the Export Select rebate. This matches the difference cited by Viterra in its submission. The implications of this change are: ▶ a reduction in the assessed additional charges that might be faced by a third party operator ▶ that the primary component of the additional cost is the Receival at Port Service fee discussed at item 34. Some stakeholders noted that Waramboo to Thevenard was not a recognised grain path. Regarding alternative routes to the Waramboo (EP) to Thevenard pathway example used in the Draft Report, Viterra provided a sample of potential sites that might be used to replace Waramboo. The Commission has selected Poochera to Thevenard, which also is a Tier 1 site. The implications of this change are: ▶ no impact on Table F.1, other than to replace Waramboo with Poochera (as Table F.1 does not include freight rates) ▶ revised fee numbers for Table 4.5 and Table E.2 for this particular path, but with no material change to the price trend line results, given that the only difference is a reduction in the freight rate as a result of Poochera being closer to Thevenard than Waramboo.

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