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Dear Sarah

## **CBH Access Undertaking: Further submissions on capacity allocation**

This further submission explains and addresses some particular issues raised by the ACCC in relation to the CBH port capacity auction process (**PCAP**), which is embodied in the Port Terminal Rules submitted to the ACCC on 31 July 2009.

### **1 Overview of PCAP**

- 1.1 In 2009, CBH proposes to introduce a new system for allocating the available capacity of its Port Terminal Facilities (**Port Capacity**). Allocation will operate over two periods throughout the year:-
  - (i) 1 November to 15 January (**Harvest Shipping Period**) where capacity will be allocated on the basis of expressions of interest; and
  - (ii) 16 January to 31 October (**Annual Shipping Period**) where capacity will be allocated on the basis of a price/volume based auction.
- 1.2 In the Harvest Shipping Period, when demand may be low, Port Capacity will be available to exporters by expression of interest, with CBH exercising no discretion in relation to the allocation of capacity. In the Annual Shipping Period, when demand will be higher, Port Capacity will be allocated to exporters in a three phase auction process.
- 1.3 The PCAP does not discriminate between exporters. Grain Express customers and customers who make their own up-country supply chain arrangements will have the same opportunity and ability to access Port Capacity.
- 1.4 The PCAP will allow exporters to establish an operational commitment for the accumulation of their grain within agreed ship loading windows at the Port Terminal Facility.

## 2 Different systems for Harvest Shipping Period and Annual Shipping Period

- 2.1 In 2009, capacity allocation during the Harvest Shipping Period is proposed to be allocated via an Expression of Interest (**EOI**) process as follows:-
- (i) EOI will be called for no later than 15 September 2009;
  - (ii) Allocations will be made no later than 1 October 2009;
  - (iii) EOI's offered will be in full month shipping windows;
  - (iv) EOI's can be submitted without grain entitlement by any customer holding a Grain Services Agreement (**Grain Express**) or PTS Agreement;
  - (v) Submissions must include the maximum lift-by window/port/zone/commodity/grade and include multi port requirements;
  - (vi) Confirmation of shipping slots will be provided with a summarised statement of slots gained including all particulars for each slot;
  - (vii) Exporters will be required to pay an Up Front Marketer Fee as a pre-payment to secure the capacity within 5 working days from date of invoicing;
  - (viii) Exporters may trade their Harvest Shipping slots in part or in full in increments of 1,000mt with another eligible exporter and in line with the secondary market business rules in the Port Terminal Rules.
- 2.2 Demand for Port Capacity during the Harvest Shipping Period is unlikely to exceed supply. The nomination of grain to exporters and the pace of harvest constrains the ability to ship during this period – marketers cannot ship grain that they have not acquired or accumulated for shipping. Past experience, including the 2008/2009 Harvest Shipping Period confirms this.
- 2.3 Port Capacity during the Harvest Period (**Harvest Capacity**) is therefore not expected to be a scarce resource and will be simply allocated to qualified exporters on application. This mechanism was successfully employed in 2008/9.
- 2.4 The ACCC has suggested that making capacity year-round subject to the auction system would have the benefit of simplicity by having a single system. This proposal has merit. For the 2010/2011 harvest, CBH may seek to amend the Port Terminal Rules to auction the entire year's Capacity. However, there are several reasons why CBH has chosen not to do so this year:
- (i) there is insufficient time to introduce the auction system and conduct auctions sufficiently in advance of the harvest;
  - (ii) auctions cost approximately \$ 20,000 per auction;
  - (iii) if capacity is not scarce, CBH believes that the benefit of having one single system may not justify the additional cost of holding auctions during the Harvest Shipping Period.

### **3 PCAP fees are non-discriminatory**

- 3.1 CBH's published prices for Port Terminal Services will be the same whether or not exporters have acquired, or agreed to acquire services through Grain Express. PCAP provides an inherently non-discriminatory market-based means of allocating a valuable resource.

### **4 CBH's incentives**

- 4.1 CBH is also a grower owned organisation with the express mandate to maximise farm-gate returns. With regard to Port Capacity, its objectives are:
- (i) to ensure the grain supply chain is efficient and has the flexibility to deal with the increasing variability of crop size and the capability to deal with significantly large harvest volumes, and
  - (ii) to ensure that Port Capacity is allocated on a fair, equitable and transparent basis in such a way as to ensure that exporters who have grain to export, can do so within a practicable window..
- 4.2 These objectives have guided the development of Grain Express and the PCAP.
- 4.3 CBH has neither commercial nor operational incentives to restrict the supply of Port Capacity because:
- (i) CBH would not profit from limiting capacity. Under PCAP, encouraging the scarcity of Port Capacity at peak periods would not extract monopoly profit or raise barriers to entry because CBH does not retain the auction premium. Restricting capacity would reduce CBH's revenue and lower profit margins as scale economies are eroded. It may also lead to pressure for CBH to prematurely expand terminal capacity.
  - (ii) CBH is constrained by the threat of new entry. If CBH artificially limited export capacity at times when exporters wish to ship, the reduction in farm gate returns for growers would encourage competitors to build competitive country storage facilities. Because CBH relies on volume for its scale efficiencies, it would make no sense for CBH to restrict capacity.
  - (iii) Whether port export volume comes from the CBH Supply Chain or direct from farm storage, CBH has a commercial incentive to attract volume through its Ports. CBH does not earn margins on the provision of freight services within its supply chain. The bundling of freight with storage and handling is a means of achieving supply chain efficiency. It is not a means of leveraging increased margins.

### **5 Calculating capacity**

- 5.1 Port Capacity is a function of the following factors:
- (i) port intake capacity;
  - (ii) intra-port transport capacity;
  - (iii) labour deployment;

- (iv) fumigation demands;
  - (v) port terminal storage;
  - (vi) outloading speed; and
  - (vii) berth capacity.
- 5.2 In order to allocate Port Capacity, CBH begins with its assessment of the theoretical maximum capability of a Port Terminal to load vessels in any given half month operating at peak operating levels.
- 5.3 The theoretical maximum capacity of the CBH Port Terminals in any given half month, ignoring prevailing circumstances is as follows:
- (i) Geraldton – 150,000
  - (ii) Kwinana – 315,000
  - (iii) Albany – 175,000
  - (iv) Esperance – 130,000
  - (v) Monthly total – 1,540,000
  - (vi) Annual total – 18,480,000
- 5.4 However:
- (i) harvest size and characteristics vary between years and between zones; and
  - (ii) Port Terminal Facilities are connected to supply chains which bring grain to port (either the CBH Grain Express supply chain or third party supply chains);
  - (iii) depending on the harvest, and other factors that are difficult to predict and often beyond the control of transporters, storage & handling operators or individual supply chain participants, those supply chains may not deliver grain at a speed or in a form that allows the Port Terminal to achieve the maximum Port Capacity.
- 5.5 For these reasons, the ability of a Port Terminal to achieve its theoretical capability is inherently uncertain.
- 5.6 The theoretical maxima referred to above are a targets that CBH aims for but any system for allocating Port Capacity must take account of the potential limitations of the connected supply chains and the potential for unforeseen events to reduce number of vessels that will actually be able to be loaded. Otherwise, CBH would be allocating capacity that may, in reality, be unachievable.
- 5.7 For this reason, before allocating capacity, CBH must consider factors including the harvest size and characteristics as well as the likely performance of the supply chain to port.
- 5.8 With its theoretical, maximum monthly objective in mind, CBH considers what capacity it can realistically offer given the likely performance of supply chains.

The performance of these supply chains may itself be influenced by the pricing behaviour of suppliers on supply chain component services. For example, CBH charges additional storage, handling and transport fees for increasing the performance of its non-port services at peak time. That service component is called “surge” and is referred to in the Port Terminal Rules because it has an effect on the speed at which grain may be delivered to port and made available for shipping.

5.9 The deployment of “surge” resources by CBH has a significant effect at port. For this reason, CBH will offer some lots of Capacity which are described as “surge lots”. These are the additional tranches of Capacity that CBH considers that it will be able to make available by deploying surge resources up-country. This raises an issue for the auction system, because prices paid for Port Terminal Services are not to be used to finance CBH’s up-country network. For this reason, exporters who acquire surge lots will not be charged surge fees. Surge Fees will be charged only to customers who acquire surge lots and nominate Grain Express as their chosen supply chain solution.

5.10 Capacity is highly variable, very difficult to model and dependent upon a significant number of considerations:

- (i) The number of segregations that may be required. This will depend upon customer requirements and harvest characteristics.
- (ii) The grade mix required within the Port Terminal.
- (iii) The speed of delivery into the Port Terminal. One objective of the Grain Express supply chain is to maximise the efficient use rail transport. It is a critical KPI for Grain Express and a function of campaign clearance. One Standard Gauge train set represents the equivalent carrying capacity of sixty six road trains. In the Kwinana Grain Terminal for example, it will take an average of 3 hours to discharge the train. The equivalent volume in road transport would take up to 11 hours to discharge due to the relatively inefficient process of cycling and tipping trucks. CBH anticipate that the majority of volume that will come from an alternate supply chain will be delivered to port via road based facilities. Therefore where trucks replace trains at the Kwinana in-take grids, the rated in-take capacity of the Port is estimated less than 30% of its rail equivalent. Whilst the impact of road compared to rail is profound at Kwinana, the relative congestion and poor cycle speeds of trucks as compared to rail mean that road transport acts to reduce the in-take speed of the Port Terminals. Therefore relative share of rail verse road deliveries to a port in any given month will impact Port Capacity and must be known before Port Capacity can be accurately predicted<sup>1</sup>.

<sup>1</sup> This is likely to be one of the unintended negative consequences of section 24 of the WEMA. As an alternative to building rail loading storage infrastructure, exporters wishing to make their own supply chain arrangements may acquire grain from growers with on-farm storage and have growers deliver that stock direct to the port by road on the exporters’ behalf. This would have a serious adverse effect on efficiency, while simultaneously threatening the viability of the rail network by bleeding it of volume.

- (iv) Grower deliveries to Port during Harvest. During harvest CBH rely heavily on rail transport to cycle grain into the Port Terminals. This is because the congestion created in the vicinity of the Ports during harvest means that the cycle efficiency of road transport to accumulate for cargos at the ports is impacted. Therefore the point (iii) above is exacerbated during harvest.

## **6 The Process to Determine Capacity for to be offered in Auction Phases**

6.1 The concepts described above demonstrate that the way grain gets to a Port Terminal will have a significant impact upon the likely ability of that Terminal to load vessels in any given period. It is for this reason that CBH is conducting phased auctions, beginning with a proportion of the theoretical maximum capacity of each Port Terminal. Subsequent phases will provide additional capacity, with the benefit of greater information about harvest characteristics and supply chain performance. Capacity will be offered in three stages:

- (i) Phase 1 Auction,
- (ii) Phase 2 Auction (rolling monthly)
- (iii) Phase 3 Spare capacity allocation.

### 6.2 Phase 1 Auction (October)

- (i) In the first phase auction, CBH will offer capacity for the period January 15 to October 31. In determining the quantum of capacity offered, CBH will make reference to the following considerations:
  - (A) Anticipated harvest volume,
  - (B) The geographic spread of the crop,
  - (C) The potential size of the domestic market,
  - (D) Prevailing weather conditions.
- (ii) In any given season, it is efficient to match CBH Port Capacity with the quantity of the harvest at hand. CBH will assume carry in equals carry out and the export task will match the harvest volume. Providing terminal capacity either above or below this figure makes little economic sense.
- (iii) Uncertainty regarding harvest volume is still significant in the final quarter of the growing season. Late rains or frosts can have a significant impact upon final yields. Whilst CBH has developed expertise in predicting crop volume over many years, accuracy is never assured. Through the intersection of feed-back from growers specifying the number of hectares sown on farm, combined with CBH views regarding farm yield by Area, it is possible to build a prediction of likely harvest volumes by port zone; but this remains a prediction only. Despite all the science available, CBH crop forecasts have generally proven to be within +/- 20% of the final mark with further fluctuations across port zones. It is for this reason that

CBH will be conservative in its crop forecast and initial allocation of capacity.

- (iv) Therefore, in the first phase auction and harvest EOI, CBH will allocate capacity on the basis of a full year crop clearance at 75% of the forecast crop. On the basis of a 2009/10 harvest size of 13.3 million tonnes (less one million of domestic consumption, less approximately 1 million tonnes that is likely to be shipped during the Harvest Period), CBH will offer 8.5 million tonnes of capacity for the period 15 Jan – 31 October.
- (v) After the first phase auction is complete, winning bidders of Capacity in the first auction will need to nominate the means by which grain will be delivered to port (ie, whether the exporter will be using Grain Express or another supply chain solution) so that CBH can:
  - (A) in the case of Grain Express customers, deploy sufficient resources to ensure appropriate stocks of grain are at port<sup>2</sup>;
  - (B) in the case of other customers, deploy sufficient resources to receive grain at port from the external supply chain..

6.3 Phase 2 Auction. The phase 2 auction will commence on 15 November. At this stage the final harvest volume remains a prediction but better information is available. At this stage CBH Operations will consider the outcomes of the first auction and the likely proportion of grain that will come to port from within and without the CBH system. It will make an assessment of the impact of the integration of each of these (considering the issues raised in point 5 above) and offer a further tranche of capacity in this second phase.

6.4 Phase 3 Spare Capacity Allocation. Once the first and second phase auctions are complete, CBH will have a clear understanding of the performance of the supply chains. After consideration of the relative complexity of the port accumulation plans contemplated for each port zone, CBH will then make a final determination of Port Capacity by zone. This capacity will be offered as spare capacity and will be notified on the CBH shipping stem. This capacity will be offered on a first come, first served basis.

6.5 After the completion of each phase, CBH will ask the exporter to nominate the means by which grain will be delivered to port (ie, whether the exporter will be using Grain Express or another supply chain solution) Once this nomination is made, :

- (i) customers who have nominated to use non-CBH supply chain to service their acquired Capacity may trade that Capacity with each other; and
- (ii) customers who have nominated to use Grain Express to service their acquired Capacity may trade that Capacity with each other;

but

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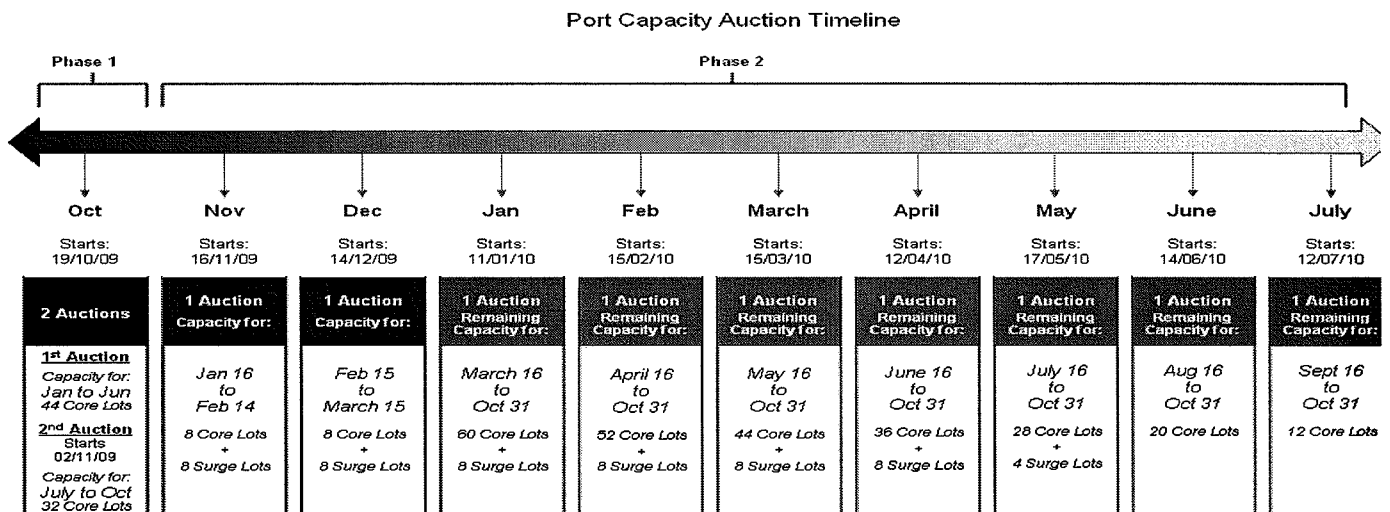
<sup>2</sup> This may involve CBH charging Grain Express customers "surge" fees, which are required to cover the cost of additional resources such as increased labour and road transport charges to provide an enhanced service up-country at peak times.

(iii) customers who have nominated to use non-CBH supply chain to service their acquired Capacity may not trade that Capacity for Capacity that another customer has nominated to be serviced by Grain Express and vice versa.

6.6 This restriction is not a form of discrimination. The up-country supply chains will be under considerable pressure to get grain to port in a timely manner. Capacity nominations tell supply chain managers the magnitude and complexity of that task, as well as the effect of the supply chain mix on Port Storage Capacity (eg, the number of segregations required). Supply chain managers will rely upon this information to allocate resources to meet the demand represented by the nominated Capacity. Many of these resources may be acquired on a take or pay basis. If Port Capacity nominated to Grain Express were to be traded for capacity assigned to an alternative supply chain, CBH will have acquired resources unnecessarily and these resources would lay idle (and vice versa).

6.7 Finally, CBH will make available any additional Capacity that becomes available following the auctions and prior to the last available nomination date for a shipping window. This additional Capacity may become available as a result of any number of factors including changes in shipping schedules, efficient intake of grain due to higher than expected levels of more efficient unit train deliveries to port or good weather conditions (CBH cannot load ships in the rain for obvious reasons). It is difficult to predict if and when such additional Capacity may become available but in the peak of the post-harvest period, CBH is doing everything possible to allow the maximum flow of capacity to the market in an effective and transparent process without over selling capacity or over committing resources.

6.8 The following timeline sets out the proposed auction schedule for 2009 and 2010.



*Note: Capacity remaining within lots will be re-auctioned in subsequent auctions.*

Lot = ½ month capacity by Port.

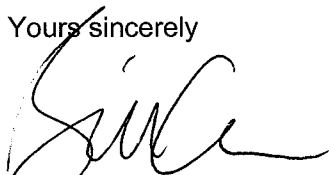


## 7 Conclusion

7.1 CBH submits that the current form of the PCAP is appropriate because:

- (i) the allocation system used by CBH in that previous harvest did not sufficiently encourage exporters to ship outside the peak shipping period of 15 January to 30 March and required CBH to exercise discretion in allocation decisions;
- (ii) auctions are an efficient, non-discriminatory means of allocating capacity that reduce the need for discretionary decision-making by CBH;
- (iii) PCAP is the best alternative to the status-quo that could have been achieved in time for the 2009/2010 harvest;
- (iv) because net auction proceeds (and any interest earned on them<sup>3</sup>) are returned to exporters in full, CBH has no opportunity or incentive to discriminate; and
- (v) PCAP is subject to the Non-discrimination and No Hindering Access provisions in the Undertaking.

Yours sincerely



**Bill Keane**  
Partner

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<sup>3</sup> We are instructed to confirm that the interest earned on auction proceeds will be added to the pool of returns and distributed with returns to exporters.