

Introduction

CBH proposed that its draft Undertaking would apply only to port terminal services when they are not bundled with other CBH services. The ACCC's draft decision considered this scope to be inappropriate such that the services pursuant to the Undertaking should encompass all of the services provided by the port facilities.¹ This would mean that the terms of the Undertaking would apply to all port terminal services, regardless of whether they are bundled with other CBH services under Grain Express.

There is the potential for the scope of the services provided under the Undertaking to be expanded such that Direct to Port receivals could be co-mingled with grain parcels received at the Port via CBH's Grain Express system. The expansion of the scope of the services in this way would adversely affect the Western Australian grain industry as it would undermine CBH's capacity to manage and optimise wheat quality which is essential to maximise grower returns. Further, the future and value of the supply chain will be the capacity to protect the origin of grain (right back to the farm level) as buyers of grain strive to purchase grain with complete traceability.

The purpose of this note is to explain the importance of managing grain quality and to demonstrate the economic detriment associated with mandated co-mingling of Direct to Port and Grain Express sourced wheat.

In general, there is a distinction between hygiene factors and quality factors.

Hygiene

The quality of a grain parcel can be severely adversely affected by the presence of:

- insect infestations; and
- contaminants or chemical residues.

A key problem associated with the co-mingling of grain parcels delivered Direct to Port with parcels managed under Grain Express is the potential impact of undetected insect infestations.

The testing facilities at port terminals are only able to ascertain whether a parcel contains live insects. The facilities do not enable the detection of insect eggs. The scenario could therefore arise where a grain parcel that is delivered Direct to Port is co-mingled with stacks that have been managed under Grain Express, and causes an insect infestation in the co-mingled stack as a result of the insects becoming present after the co-mingling of the parcels. CBH's fumigation protocols preclude such an outcome occurring for wheat delivered to port under Grain Express.

CBH employs fumigation protocols from the time of grain receipt at the up-country sites through to its storage at the port terminals to ensure that insect infestation does not occur, including periodic re-fumigation to prevent infestations.

Any insect infestation caused by a Direct to Port shipper imposes costs on CBH's Grain Express customers as the infestation has an adverse impact on all grain in the co-mingled stack, not only the parcel that is delivered Direct to Port. If an infestation is detected, the entire co-mingled stack must be re-fumigated, meaning that growers must incur significant delay costs.

Moreover it is entirely possible under this scenario that the shipper who delivered grain Direct to Port may have exported a cargo from the co-mingled stack prior to detection so that the infestation adversely affects only Grain Express shippers.

The presence of chemical residues and contaminants also significantly reduce the quality of a grain parcel. These are far more difficult than an insect infestation to detect. The testing procedures for determining the presence of a residue or contaminant and then establishing what the chemical is can be lengthy, and may result in significant delays to the shipping of grain parcels. In some cases, a vessel may have already departed at the time that the contaminant is detected.

To reduce the possibility of growers delivering grain with chemical residues and contaminants into the CBH storage network the company has invested considerable resources in establishing the Better Farm IQ® program. This unique product provides confidence in the chemical residue status, general quality and traceability of the grain. Better Farm IQ® is an on-farm quality assurance program built to meet the internationally recognised SQF 1000 code and is fully Hazard Analysis Critical Control Point (HACCP) compliant. There are currently 2,037 Better Farm IQ® accredited growers in the state and they are estimated to produce around 60% of 2009/10 grain production. Better Farm IQ® gives CBH confidence that grain is received within standards allowing them to manage it then through their network.

CBH's system for identifying and managing chemical residues and contaminants is far more effective. As it has full knowledge of the treatment of the grain from the receipt

point through to distribution to the customer, CBH is provided with the opportunity to ensure that grain parcels managed under Grain Express do not contain any residues or contaminants. This cannot be guaranteed with parcels that are delivered Direct to Port.

Consequently, allowing or mandating the co-mingling of grain delivered Direct to Port together with Grain Express grain could have similar implications for Grain Express shippers as insect infestations. The detection of chemicals and or contaminants can effectively destroy total entry to some markets by Australia given the increasingly stricter residue regimes being implemented by food manufacturers and governments around the world.

Importance of wheat quality grading

There are several different quality grades that apply to wheat produced in Australia. The key determinants of the quality of a wheat parcel are:

- protein level;
- moisture content;
- physical traits such test weight and screenings;
- variety and grade;
- location of production; and
- age.

The quality that is attributed to a specific parcel of wheat is the key determinant of its market value. This is demonstrated in Table 1 which provides an indication of the price differentials that apply to some of the major quality grades for Australian wheat.

Table 1 Major quality grades of Australian wheat and the associated price differentials

Wheat grade	WESTERN POOL Estimated Pool Return 2008/09 AWB Pool (\$/t FOB, GST exclusive
Hard 11.5% protein	+10
Premium White	Base
Standard White	-15
General Purpose	-25
Feed	-90

Source: AWB Limited (2009).

In addition to those grades listed above there are also other specialty grades such as Standard Wheat Noodle (which is prominent in Western Australia), Soft Wheat and Durum Wheat.

CBH actively manages numerous grades each harvest and customers require those grades to be out-turned either as pure grades or as blends. One of the market related developments in recent years has been the growing sophistication of wheat buyers targeting particular attributes within a grade of wheat. This in turn creates the opportunity for significant value to be added through careful management of particular wheat characteristics for each grade that are more highly valued.

Another important development is the practice of blending wheat from several quality batches so as to optimise monetary arbitrage opportunities. In many cases, lower quality wheat is blended with another higher quality wheat so as to meet a minimum specification – thus creating arbitrage value between the cost of purchasing a quality versus the sale price. Blending requires careful management of grain segregations.

The correct grading of wheat parcels is therefore of high importance to growers and those selling that wheat and is therefore crucial to the efficient operation of the Western Australian grain industry. Grain located in our terminals has been accumulated in line with customer's quality specifications and Direct to Port grain deliveries will compromise our preparation in achieving those quality targets if we are forced to co-mingle Grain Express and Direct to Port grain.

Quality management under Grain Express

Under Grain Express, growers deliver grain parcels to CBH's up-country receival sites at which time CBH undertakes its quality assessment process for that load.² This process includes the sampling and inspection of grain parcels and the assignment of a specific quality grade to each parcel.

As CBH has complete knowledge of the treatment of the grain throughout the supply chain, the initial quality assessment that occurs at the receival site is crucial to enabling CBH to ensure the effective quality management of all grain parcels stored, transported and handled by CBH under Grain Express.

Co-mingling of grain parcels not managed under Grain Express

² In actual fact, CBH's quality management processes begin well before any grain is received with growers having the option of seeking quality accreditation with CBH.

Mandating the co-mingling of grain parcels delivered Directly to Port with those managed under Grain Express will undermine CBH's capacity to manage quality on behalf of all its Grain Express customers. In essence, the more limited ability of CBH to assess and manage grain quality at port will create an incentive for those with poorer quality grain to exploit the opportunity that presents.

This is attributable to the Direct to Port deliveries being significantly greater in terms of volume than the deliveries to up-country sites. This adds complexity to the task of assessing the quality of a given parcel of grain, particularly in relation to the sampling process. Moreover, at Kwinana, CBH's sampling facilities are not as extensive as those at up-country sites.

Consequently, the quality assessment task at the port terminal is likely to involve higher costs (on a per unit basis) than the current system at the receival sites and will be inherently less able to identify the variability in quality of each load presented to the Terminal (in some cases will require additional infrastructure). There is also a distinct possibility that delays will occur if every parcel of grain was assessed to the same level (number of samples taken etc) as occurs during harvest.

Moreover, CBH will have limited knowledge about the other relevant characteristics of the delivered wheat (age, location of production, presence of residues or other contaminants) or previous treatment of grain parcels that are delivered Direct to Port. There will not have been the same level of quality assessment as would have been undertaken at the up-country receival site under Grain Express. Consequently, CBH could not have the same level of confidence in the integrity of the results for Direct to Port receivals as under Grain Express.

Requiring the co-mingling of grain delivered Direct to Port with grain parcels managed under Grain Express will therefore compromise the quality of the "Grain Express" grain stored at the port terminals. It presents an "adverse selection" problem, as those growers with low-quality grain parcels will have an incentive to deliver their grain Direct to Port. Growers delivering poorer quality grain via Direct to Port can "hide" behind the CBH standard (and in so doing lower the outturn quality of grain possibly for a 3rd party who has only engaged with CBH in providing Grain Express quality). This in turn will enable growers with poorer quality grain to receive a higher return at the expense of those growers that use Grain Express. It may also compromise the credibility of the Western Australian grain industry. Further, co-mingling Direct to Port grain with that of Grain Express effectively destroys in the majority of cases one key reason for the Direct to Port arrangement whereby specific origin grain has been requested by the buyer. With increasing buyer choice of Australian grain, the ability to

separate unique parcels for buyers will be a significant advantage from the CBH network, provided co-mingling is not forced upon it.

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Conclusion

By requiring CBH to co-mingle grain parcels delivered by growers direct to port terminals, the ACCC will not only be requiring CBH to incur additional costs above the efficient level, but it will also be providing growers with low-quality grain with an opportunity to receive higher returns at the expense of those growers using CBH's Grain Express system.