PUBLIC

CT-2002-001

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34, as amended;

IN THE MATTER OF an Application by United Grain Growers Limited under section 106 of the *Competition Act*;

AND IN THE MATTER OF the acquisition by United Grain Growers Limited of Agricore Cooperative Ltd., a company engaged in the grain handling business.

B E T W E E N:

UNITED GRAIN GROWERS LIMITED

Applicant

-and-

THE COMMISSIONER OF COMPETITION

Respondent

-and-

THE CANADIAN WHEAT BOARD and MISSION TERMINAL INC.

Intervenors

Expert Rebuttal **AFFIDAVIT OF ALAN MARTYSZENKO**

I, Alan Martyszenko, of the City of Winnipeg, in the Province of Manitoba, make oath and say:

1. Attached to this affidavit and marked as Exhibit "A" is a true copy of my rebuttal report to the report of Dr. Ralph Winter dated January 27, 2006. The contents of Exhibit "A" represent my work, conclusions and opinions in this matter.

2. I swear this affidavit pursuant to Rule 47 of the *Competition Tribunal Rules.*

SWORN BEFORE ME at the City of Winnipeg, in the Province of Manitoba on February ______, 2006.

____
Alan Martyszenko

____
Commissioner for Oaths/Notary Public

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UNITED GRAIN GROWERS LIMITED (APPLICANT)

AND

THE COMMISSIONER OF COMPETITION (RESPONDENT)

REBUTTAL REPORT

FEBRUARY 24, 2006

MARTYSZENKO, CRAIG & ROSS
FINANCIAL GROUP

PUBLIC VERSION

February 24, 2006

Privileged and Confidential

Davies Ward Phillips & Vineberg LLP
44th Floor, 1 First Canadian Place
Toronto ON M5X 1B1

Attention: Mr. Kent Thomson and Ms. Sandra Forbes

Dear Sir and Madam:

United Grain Growers Limited (Applicant) and
The Commissioner of Competition (Respondent)

1.0 INTRODUCTION

This report is in response to certain findings and conclusions contained in the Report of Dr. Ralph Winter dated January 27, 2006 (the "Winter Report"). **This report contains information that was extracted from Confidential Level A documents.**

2.0 CONCLUSIONS

Based on our review and analysis of the Winter Report, we respectfully disagree with certain conclusions reached by Dr. Winter:

1. Firstly, in our view, the offers (expressions of interest) received by United Grain Growers Limited ("AU" or the "Applicant") in the past do not indicate that the potential buyers of the Agricore United Vancouver terminal (the "AUV Terminal") (formerly known as the United Grain Grower Vancouver terminal) were able to secure a sufficient volume of independent grain to "justify the investment" in the AUV Terminal. In fact, the offers (expressions of interest) support our understanding that the potential buyers (none of which ever indicated that they were ready to close) were not able to obtain a sufficient volume of independent grain to "justify an investment" in the AUV Terminal.

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2. Secondly, Dr. Winter alleges that it is realistic for a potential buyer of the AUV Terminal to gradually build its volume of independent grain over time and that the "cost of delay would be small". On the contrary, a potential buyer would, in our view, incur significant cash operating losses if it attempted to build volume over time; losses that may never be recovered. The cost of delay is not small; rather, in our view, it is significant.

3.0 OFFERS TO PURCHASE THE AUV TERMINAL

Paragraph 118 (page 47) of the Winter Report states as follows:

> "The question underlying Mr. Martyszenko's calculation of breakeven volumes is whether a new purchaser could be found even at zero cost. However, potential purchasers, with substantial purchase prices, have already identified themselves: **[CONFIDENTIAL].** We already have a market assessment of whether a new owner could find enough demand to justify investment in the plant. In such circumstances, the breakeven calculation in the Martyszenko Report becomes irrelevant in such circumstances. Given the choice between assessment of an outside expert, or the assessment by informed insiders (an assessment backed by offers of **[CONFIDENTIAL]**) I attach more credibility to the latter."

Further, paragraph 123 (page 48) of the Winter Report states as follows:

> "The most direct evidence of the viability is in expressions of interest and offers from market participants to purchase the UGG Terminal."

We disagree with these statements and conclusions. First, we note that no potential buyer offered to purchase the AUV Terminal for **[CONFIDENTIAL]**. While **[CONFIDENTIAL]** did refer to a purchase price of **[CONFIDENTIAL]** for the AUV Terminal, this was contained in a non-binding expression of interest, which falls short of being an offer. Second, as explained in more detail below, one only needs to analyze the "offers" to clearly see that the potential buyers were concerned about securing enough demand (grain) to justify an investment in the AUV Terminal.

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[CONFIDENTIAL]

[CONFIDENTIAL]. Despite this, **[CONFIDENTIAL]** required additional volumes of grain for the AUV Terminal.

In its April 22, 2002 non-binding expression of interest (Applicant's Disclosure Statement, Tab #121), **[CONFIDENTIAL]** stated that:

> "The Purchaser understands that the Terminal has an annual capacity of **[CONFIDENTIAL]** metric tonnes. The Purchaser can provide **[CONFIDENTIAL]** metric tonnes of product annually and the rest of the capacity will be provided by Vendor by way of a throughput agreement entered into between the Vendor and Purchaser as of the Closing Date on commercial terms."

Similarly, in its December 3, 2003 non-binding expression of interest letter (Applicant's Disclosure Statement, Tab #122), **[CONFIDENTIAL]** stated that:

> "**[CONFIDENTIAL]** may require obtaining a third party agreement for a volume commitment for a portion of the volume of the terminal and would be interested in discussing such an agreement with AU."

[CONFIDENTIAL] did not proceed with an offer to purchase the AUV Terminal.

[CONFIDENTIAL]

In order to ensure that it obtained the necessary volume of grain to justify its proposed purchase of the AUV Terminal, **[CONFIDENTIAL]** intended to enter into a handling agreement with the Canadian Wheat Board ("CWB"). Based on our discussions with representatives of AU, it is our understanding that, in the absence of such an agreement, **[CONFIDENTIAL]** would not have been able to secure sufficient grain to operate the AUV Terminal on a breakeven basis.

In addition, **[CONFIDENTIAL]** offer to purchase was subject to a number of conditions. For example, in its letters of April 14, May 14 and October 15, 2004 (Applicant's Disclosure Statement, Tabs #126, #129 and #131, respectively), **[CONFIDENTIAL]** indicated that its offer was conditional upon obtaining satisfactory financing arrangements. Similarly, in its letter of January 7, 2005 (Applicant's Disclosure Statement, Tab #135), **[CONFIDENTIAL]** indicated that: "What remains is for our organization to finalize financing of this transaction and to obtain final Board approval." Later, in its letter of February 11, 2005 (Applicant's Disclosure Statement, Tab #137), **[CONFIDENTIAL]** stated as follows:

> "At this time, the financing proposals we have received do not fully meet our expectations. Our issues are being discussed with the prospective lenders in the hope, and expectation, that a satisfactory financing package can be obtained."

While we understand that **[CONFIDENTIAL]** did eventually represent that it had obtained satisfactory financing, representatives of AU tell us that **[CONFIDENTIAL]** also advised that there remained certain outstanding issues. In addition, we understand that **[CONFIDENTIAL]** never advised AU that it was ready to close the deal.

<u>[CONFIDENTIAL]</u>

[CONFIDENTIAL] also intended to secure additional grain in order to justify a possible investment in the AUV Terminal. By letter dated October 27, 2004 (Applicant's Disclosure Statement, Tab #142), **[CONFIDENTIAL]** set out the principal terms and conditions of its proposed purchase of the AUV Terminal. Among other things, the letter **[CONFIDENTIAL].** Specifically, the letter stated that:

[CONFIDENTIAL]

Further, in its letter of December 2, 2004 (Applicant's Disclosure Statement, Tab #144), **[CONFIDENTIAL]** stated that: "As discussed at our last meeting, as a result of the very nature of the industry we must target third party shippers in whose tonnes AU would also have an interest."

[CONFIDENTIAL] never proceeded to close the deal.

Terminal One (representing five farmer-owned inland terminals)

In February 2005, a number of farmer-owned inland terminals (collectively, the "Producer Group"), which subsequently became known as Terminal One, expressed interest in acquiring the AUV Terminal. In a subsequent letter from Prairie West Terminal Ltd. dated March 16, 2005 (Applicant's Disclosure Statement, Tab #151), sent on behalf of the Producer Group, Prairie West advised that the Producer Group's offer was subject to the: "group being able to secure grain obligations to the Terminal of 1.6 million tonnes per annum (this is the basis of the financing pro-forma required as part of the business plan for financing purposes)." This condition was included in the Asset Purchase Agreement dated April 26, 2005 between United Grain Growers Limited and Terminal One Vancouver Ltd. (Applicant's Disclosure Statement, Tab #163). Specifically, clause 9.1 (i), which appears under the heading "Conditions of Closing in Favour of the Purchaser" reads as follows: "Grain Originations. The Purchaser shall have secured grain originations to the UGG Terminal of 1.6 million tonnes per annum on terms and conditions acceptable to the Purchaser, acting reasonably."

In an e-mail to Garth Gish of Terminal One dated July 28, 2005 (Applicant's Disclosure Statement, Tab #161), Chris Martin of Agricore United stated as follows: "We understand that T1 cannot originate the grain volume contemplated under the April 28th agreement and in fact total best estimates for the first year of a T1 operation are approximately **[CONFIDENTIAL]** p.a." We are advised by representatives of AU that Mr. Martin's understanding was never contradicted by Terminal One. In addition, in an article dated August 3, 2005, The Western Producer reported as follows: "The five original partners can generate about 500,000 tonnes a year in grain volume, but the goal is to move at least 1.6 million tonnes a year through the facility" (Applicant's Disclosure Statement, Tab #184).

Notwithstanding its efforts, Terminal One was unable to secure 1.6 million tonnes of grain and decided not to proceed with the proposed transaction.

[CONFIDENTIAL]

In a letter dated September 21, 2005 (Applicant's Disclosure Statement, Tab #393), **[CONFIDENTIAL]** outlined the principal terms and conditions of their proposed acquisition of the AUV Terminal.

We understand that Agricore United opted not to pursue a proposed transaction with **[CONFIDENTIAL]** because, among other things, the offer was highly conditional and provided a number of unacceptable "outs" in favour of the potential purchasers.

4.0 SUFFICIENT VOLUME FOR VIABILITY

Paragraph 52 (page 23) of the Winter Report states as follows:

> "Certainly, an indication of what would be sufficient volume for viability can be found simply in the volumes of demand that the current owner has been able to handle at the UGG Terminal, although these are likely to be greater than the minimum viable volumes...As long as a purchaser can attract the same volumes and operate at close to the same cost efficiency, the divestiture must be considered viable."

We disagree. AU uses the AUV Terminal as a canola and malt barley terminal; that is, all of the grain handled at the AUV Terminal is canola or malt barley. Canola and malt barley have much higher tariffs than wheat. The current tariffs are as follows:

	Canola	Malt Barley	Wheat
Elevation	$13.60	$ 10.800	$8.750
Cleaning	6.45	8.100	4.550
Storage	.12	.082	.075

Thus, the revenue is higher with canola and malt barley, resulting in higher profits. Based on our discussions with AU, we believe that no buyer would be able to secure the same volume of canola as is currently being handled by the AUV Terminal. A potential buyer who is handling primarily wheat and barley (such as would be the case with any purchaser who enters into an agreement with the CWB) would have a much lower revenue base. Consequently, its volumes would need to be much higher. Therefore, AU's current throughput of volumes of canola and malt barley are not, as Dr. Winter asserts, "an indication of what would be the sufficient volume for viability" for a new owner.

5.0 GRADUAL BUILDUP OF VOLUME

Paragraph 60 (pages 26-27) of the Winter Report states as follows:

> "A delay of two years, for example, while buyers steadily came off contracts to overcome the disadvantage of facing committed buyers, is approximately equivalent (in terms of present value) to a reduction in revenue from the outset of 3.5 percent for a firm that faced no delay. Given that grain volumes through individual Vancouver port terminals can fluctuate substantially from one year to the next, it is highly unlikely that a disadvantage of 3.5 percent would deter an otherwise viable purchase of the UGG Terminal. As a general matter, a disadvantage of 3.5% in revenue would not be considered a significant barrier to entry into the market. <u>In short, even if a purchaser had to wait two years for Non-integrated Graincos to come off contract before overcoming the disadvantage of buyer commitments – that is, even if the purchaser completely ignored the volume available from CWB directed shipments and the fact volumes would steadily be becoming available from Non-integrated Graincos – the cost of delay would be small.</u> Entrants face delays in building up demand in almost any market, and the cost of a delay in this market is small." (Emphasis added)

We disagree. In the absence of an agreement with the CWB, a buyer of the AUV Terminal would incur significant cash operating losses as it attempted to build the required volume over time, which would make a potential acquisition of the AUV Terminal prohibitively expensive and potentially non-economical. Further, there is no guarantee that a potential buyer would be able to secure a sufficient volume of grain as the handling agreements expire. In fact, on the basis of discussions with representatives of AU, we understand that certain potential buyers attempted to secure grain volumes by approaching grain companies to find out if they would be willing to ship their grain to the new owner of the AUV Terminal upon expiry of their existing handling agreements. In most cases, the grain companies refused to provide a commitment to do so. This reality is examined in more detail below.

5.1 AUV Terminal's Existing Operating Costs

The total operating costs of the AUV Terminal are about **[CONFIDENTIAL]** per annum. In its AUV Terminal revenue model, **[CONFIDENTIAL]** used total annual operating expenses of **[CONFIDENTIAL]** for **[CONFIDENTIAL]** tonnes (Commissioner Disclosure Statement, Tab #289). Similarly, in its AUV Terminal revenue model, **[CONFIDENTIAL]** used total annual operating expenses of **[CONFIDENTIAL]** for **[CONFIDENTIAL]** tonnes (Commissioner Disclosure Statement, Tab #290). Based on our analysis of the AUV Terminal's financial statements, we have classified AUV Terminal's annual normalized operating costs as follows:

Fixed costs	**CONFIDENTIAL**
Semi-variable (repairs and overtime)	**CONFIDENTIAL**
Variable (power and reg./cancellation)	**CONFIDENTIAL**
	CONFIDENTIAL

Between 1998 and 2004 (excluding 2003), the AUV Terminal's annual operating costs ranged from approximately **[CONFIDENTIAL]** to approximately **[CONFIDENTIAL]** with volumes of about **[CONFIDENTIAL]** to about **[CONFIDENTIAL]**. In 2003, the volume was about **[CONFIDENTIAL]** tonnes (due to strike/lockout) and operating costs were approximately **[CONFIDENTIAL]**. In 2005, the most recent fiscal year, volume was about **[CONFIDENTIAL]** tonnes and operating costs were approximately **[CONFIDENTIAL]**.

As noted above and explained below, any purchaser who buys the AUV Terminal with the objective of building the grain volume over a number of years would incur significant annual cash operating losses until the breakeven volumes are achieved.

5.2 A Prospective Purchaser's Cash Operating Losses

Using the model described in our report dated December 23, 2005, we have calculated the expected cash operating losses that would be suffered by a potential buyer that attempts to build grain volume over a number of years. In this regard, we have assumed that the potential buyer would secure 1,000,000 tonnes in year 3. This volume of grain is consistent with the level of grain that Dr. Winter believes would be available as existing handling agreements expire. We have also assumed that the potential buyer would increase its volume each year, securing 300,000 tonnes in year 1, 600,000 tonnes in year 2, and 1,000,000 tonnes in year 3. The grain mix is detailed in Schedule 1.

As noted previously, there is, however, no guarantee that a potential buyer of the AUV Terminal would be able to secure these volumes of grain from independent grain companies whose handling agreements were expiring. This is so for a variety of reasons. For example, the shipper of the grain may be very satisfied with its existing arrangements, its existing port terminal service provider would likely be motivated to offer competitive terms to retain the business, and the shipper may renew its handling agreement on expiration, or move to a terminal other than the AUV Terminal. Indeed, it is likely that the incumbent Port Terminal would be prepared to increase its diversion premium and/or offer other enticements in order to maintain the grain and enhance the relationship. This would be a likely scenario in the current era of excess capacity. Moreover, a shipper may be reluctant to enter into a handling agreement with any new owner of the AUV Terminal, unless the new owner offers a significantly better deal or there is some specific problem relating to the contractual relationship that causes the shipper to want a handling agreement with an alternative terminal. Even if Dr. Winter were correct and on the assumption that these volumes of grain could be obtained on the theoretical three-year timeline (which in reality is unlikely), the buyer of the AUV Terminal would incur the following cash operating losses excluding financing costs, as detailed in Schedule 1.

Diversion Premium	**Cash Operating Losses (CONFIDENTIAL)**			
	Year 1	Year 2	Year 3	Total
[CONFIDENTIAL]		**[CONFIDENTIAL]**		
[CONFIDENTIAL]		**[CONFIDENTIAL]**		

At a diversion premium of **[CONFIDENTIAL]** per tonne, the buyer of the AUV Terminal would be close to breakeven in year 3. Additional volumes in excess of **[CONFIDENTIAL]** tonnes would be required in order to recover the cash operating losses and the financing costs associated with those losses. It could be many years before the buyer would be able to recover its losses, if ever.

At a diversion premium of **[CONFIDENTIAL]** per tonne, the buyer of the AUV Terminal would still be incurring significant losses in year 3. Significant additional volume in excess of **[CONFIDENTIAL]** tonnes would be required simply to breakeven, let alone recover the losses of **[CONFIDENTIAL]** (before financing costs) suffered during the first three years of operation.

In our opinion, it would not be financially prudent to purchase the AUV Terminal on the assumption that the volume of grain required to breakeven could be secured over a number of years. Not only is there the certainty of significant cash operating losses, in addition to market risk factors there is no guarantee that, as handling agreements expired, the purchaser of the AUV Terminal would be able to secure available volumes of grain. As a result, there is no certainty that a buyer of the AUV Terminal could ever recover its losses.

5.3 Additional Factors

The analysis in Schedule 1 is predicated on a number of assumptions, in addition to those related to the ability to secure enough independent grain. The following additional factors, if they come into play, will increase the calculated losses:

1. A buyer of the AUV Terminal, given the low volume of grain, would need to layoff a number of union and non-union personnel. However, if such layoffs were to occur, the remaining union personnel would not be willing to work any overtime until such time as the union employees that had been laid-off are called back to work. Further, layoffs at the AUV Terminal may result in poor labour relations at the AUV Terminal (and other Vancouver Port Grain Terminals) with consequential reductions in productivity and efficiency. Also, as grain volumes build, it may be very difficult for the new owner to later recruit knowledgeable and experienced union and supervisory/management personnel. With respect to the issue of lay-offs, we note that the non-binding expression of interest that AU received from **[CONFIDENTIAL]** on September 21, 2005 provided that **[CONFIDENTIAL]**. If layoffs do not occur, the above cash operating losses would dramatically increase as a result of higher payroll costs.
2. Spotting a low number of rail cars at the AUV Terminal due to lower grain volumes may result in inefficiencies and logistical problems with the railways.
3. Any potential buyer would factor into its analysis of the AUV Terminal the loss of any diversion premiums that it currently receives. A potential buyer, who now ships grain to its own terminal (the AUV Terminal), would no longer receive the diversion premium, and hence its revenue would be lower.

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6.0 RESTRICTIONS

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We reserve the right (but will be under no obligation) to review and/or revise any and all assumptions and/or calculations and conclusions included or referred to in this report and, if we consider it necessary, to revise our conclusion in light of any information existing at the date of this report which becomes known to us after the issuance of this report.

Yours truly,

Martyszenko, Craig & Ross

Per Martyszenko Craig + Ross

Alan B. Martyszenko, CA CBV CFA

AGRICORE UNITED VANCOUVER TERMINAL
CASH OPERATING LOSSES

CONFIDENTIAL

AGRICORE UNITED VANCOUVER TERMINAL **SCHEDULE 1**
NOTES TO CALCULATIONS **Page 2**

(Except as noted, all assumptions are similar to the December 23, 2005 report)

Year 1 – 300,000 tonnes

1. **[CONFIDENTIAL]**.
2. The terminal would be operated with **[CONFIDENTIAL]** union and **[CONFIDENTIAL]** supervisory/management personnel.
3. In accordance with the collective agreement, sub benefits would be paid to the personnel that were laid off.
4. No overtime would be worked.
5. As a result of the low volume, no mixing/blending revenue would be earned.
6. Grain insurance costs would decline as a result of less grain being insured.
7. Repairs and Maintenance would decline as a result of lower volumes.

Year 2 – 600,000 tonnes

8. **[CONFIDENTIAL]**.
9. The terminal would be operated with **[CONFIDENTIAL]** union and **[CONFIDENTIAL]** supervisory/management personnel.
10. In anticipation of 1,000,000 tonnes in year 3, **[CONFIDENTIAL]** union personnel will be recalled in November in order to avoid the severance provisions of the collective agreement (if laid off for two years.)
11. The remaining **[CONFIDENTIAL]** union personnel will be severed in accordance with the collective agreement.
12. No overtime would be worked.
13. As a result of the low volume, no mixing/blending revenue would be earned.
14. Grain insurance costs would decline as a result of less grain being insured.
15. Repairs and Maintenance would decline as a result of lower volumes.

Year 3 – 1,000,000 tonnes

16. **[CONFIDENTIAL]**.
17. The terminal would be operated with **[CONFIDENTIAL]** union and **[CONFIDENTIAL]** supervisory/management personnel.
18. Some overtime will be incurred.