



Level 17, 2 Lonsdale Street
Melbourne Vic 3000

GPO Box 520
Melbourne Vic 3001

tel: (03) 9290 1800

www.accc.gov.au

Contact officer: Michael Eady
Contact phone:

6 February 2019

Linley Johnson
Executive Director
National Competition Council
GPO Box 250
MELBOURNE VIC 3001

By email: pon@ncc.gov.au

Dear Ms Johnson 

NCC preliminary view to recommend to revoke declaration at the Port of Newcastle

Thank you for the opportunity to submit to the National Competition Council's (NCC) consideration of whether to recommend that the designated Minister revoke the declaration of the shipping channel Service at the Port of Newcastle (Revocation Recommendation).

The attached submission considers the NCC's preliminary views and reasons for recommending the declaration be revoked, and provides additional information and analysis to help inform the NCC's final recommendation to the Minister. The ACCC believes that there are a number of points which, if approached differently, may result in a different outcome.

The response attached outlines what the ACCC considers are crucial elements to the assessment of criterion (a) and criterion (d). The ACCC considers sufficient attention has not been given to a future with declaration in order to assess whether criterion (a) has been satisfied. The ACCC considers that the public interest assessment should be conducted on the basis that all other criteria are satisfied, and give sufficient attention to a future both with and without declaration.

The ACCC further considers that the revocation of this declaration could lead to participants exiting and ceasing investments in related markets over the short and long term. In contrast, we think that declaration and the constraining of potential monopoly pricing will be more conducive to future investment.

If you would like to discuss this letter or any issues contained in the attached submission, please contact Michael Cosgrave, Executive General Manager, Infrastructure Regulation Division on _____ or Michael Eady on _____.

Yours sincerely

Rod Sims
Chair

Introduction

The ACCC has considered the National Competition Council's (NCC) preliminary view to recommend the revocation of the declaration of the shipping channel service at the Port of Newcastle. The ACCC has a number of comments to make on the findings reached by the NCC.

The ACCC notes that, in forming its preliminary view, the NCC was not satisfied that the service at the Port of Newcastle continues to satisfy the revised formulations of criteria (a) and (d). The ACCC notes that this is the first time that these revised criteria have been considered by the NCC. Accordingly, careful consideration of what does and does not satisfy this new criteria should be made before reaching a final recommendation.

The importance of the Part IIIA access regime means that a sound assessment framework which contains a logical interpretation and assessment of the new criteria is crucial to both this decision and future declaration applications.

The ACCC has discussed criteria (a) and (d). As previously stated, we consider that a proper consideration of whether declaration would promote competition in a dependent market within criterion (a) requires:

- a forward looking analysis
- assessment over the medium to long term
- consideration and comparison of the competitive conditions and environment likely to arise in the future with and without declaration, including considering the likely incentives of a monopoly service provider.

The ACCC considers that a longer term comparative analysis is crucial to properly considering the impacts of declaration in respect to both criteria (a) and (d).

This submission considers the NCC's preliminary views and reasons for recommending the declaration be revoked, and provides additional information and analysis to help inform the NCC's final recommendation to the Minister. The ACCC notes the guidelines to declaration which the NCC published in April 2018 and their application in this process. However, the ACCC believes that there are a number of points which, if approached differently, may result in a different outcome. We have outlined these below, as well as those points in which the ACCC agrees with the NCC's assessment.

The ACCC agrees with the NCC's assessment that the Port of Newcastle occupies a bottleneck position in the Hunter Valley export supply chain and may therefore have both the ability and incentive to earn monopoly profits by denying access to their service, significantly increasing charges for the service or cross-subsidising in a way that materially affects competition in a dependent market.¹ The ACCC also agrees with the assessment that there is no substantial constraint on Port of Newcastle Operations' (PNO) market power from other ports and there is no alternative to using the Service.

We also note the NCC's view that, while the NSW legislation and lease arrangements may allow for some influence over PNO by the State, the constraint falls well short of that which

¹ National Competition Council "Revocation of the declaration of the shipping channel service at the Port of Newcastle" – *Statement of Preliminary Views* (19 December 2018) (**NCC Preliminary Views**) at [6.26]

would result from an access regime capable of certification², and would not act to limit PNO's actions which may have competitive effects.³ The ACCC agrees with this conclusion. We have been vocal in noting the need for privatisations of State monopoly assets, including the Port of Newcastle, to subject the new operators to robust ex ante regulatory arrangements.

1. The NCC's assessment that PNO has the ability but not the incentive to use market power

The NCC firstly assessed whether PNO has the ability and incentive to use its market power to deny access to the Service or restrict output and charge monopoly prices.⁴ While the NCC accepted that PNO had market power, it considered it unlikely that PNO had any incentive to use this power to restrict access as PNO is not vertically integrated. The NCC therefore considered that it would be unlikely that PNO would have the incentive to use its position to set terms and conditions that discriminate in favour of any operation(s) in a dependent market in a way that may lead to reduced volumes.⁵

The ACCC disagrees with the NCC's assessment of PNO's incentive to use its market power. The NCC focuses on the incentives of vertical integration. However, the ACCC considers that there are incentives for PNO to use its market power beyond those contemplated by the NCC. In particular, the ACCC points to standard economic theory which suggests that monopolies can maximise profits by charging more, even if this reduces volumes. PNO's overriding incentive is to maximise profits, not volumes. Shortly after its privatisation, PNO imposed a price rise of around 40 per cent for coal ships entering the port. Over the long term PNO may increase prices to such an extent that the number of users of the Service falls. Monopoly profits could then be earned which might be shared between PNO and the fewer remaining users, after competition has been reduced.

2. The NCC's assessment of 'reasonable terms and conditions'

The NCC accepts that reasonable terms and conditions as a result of declaration are likely to be more favourable to users of the Service than those which would be set by PNO in the absence of declaration.⁶ However, the NCC has not considered the precise terms and conditions as provided in the ACCC arbitration determination – other than as an example of a potential outcome. The ACCC believes that this limits the NCC's ability to be able to assess whether a material increase in competition could occur with declaration.

The NCC refers to an extract from the Explanatory Memorandum to the Act which states that an assessment of reasonable terms and conditions:

“is an objective test that may involve consideration of market conditions. It does not require that the [NCC] or Minister come to a view on the outcomes of a Part IIIA negotiation or arbitration.”⁷

² NCC Preliminary Views at [6.42]

³ NCC Preliminary Views at [6.43]

⁴ NCC Preliminary Views at [6.28]

⁵ NCC Preliminary Views at [6.28], [6.98]

⁶ NCC Preliminary Views at [6.49]

⁷ The explanatory memorandum to the Competition and Consumer Amendment (Competition Policy Review) Bill 2017 at [12.21]; referred to by the NCC in the NCC Preliminary Views at [5.35] to [5.36]

The ACCC considers however that NCC's consideration of the arbitrated outcome in this case would not conflict with the EM. The revocation process presents a unique set of circumstances as the Service is currently declared and an actual arbitrated outcome is available as evidence. This contrasts with the more usual scenario, where the service is not yet declared and consideration of any arbitration outcome would be a hypothetical exercise.

In these circumstances, it is appropriate for the recent arbitration outcome to be used to inform what may occur with declaration, to properly assess the resulting competitive tensions and likely impact on longer term competition in the future scenario with declaration.

The NCC points to the fact that the arbitrated terms were specific to Glencore and PNO at a particular point in time.⁸ However, as the ACCC submitted to the NCC after the arbitration, these determined conditions are of broader relevance to the market more generally. The ACCC continues to consider that the arbitration outcome is the best and most recent independent assessment of what constitutes reasonable terms and conditions for the service as a result of declaration. The ACCC also repeats its position that, while the circumstances of a specific access seeker at a point in time are different from those for the broader market in the long run, the Determination as it stands provides the clearest picture of how the conditions or environment for competition may be promoted by declaration.

The ACCC notes that the terms and conditions which the parties both agreed to during negotiations, and those determined by arbitration, represent the first time that a user of the Service has been able to reach an agreement with PNO on the terms, conditions and fees, with these otherwise unilaterally imposed by PNO. The ACCC believes that correctly identifying and quantifying reasonable terms and conditions is crucial to determining the impact on dependent markets as a result of declaration. Not giving sufficient weight to the likely terms and conditions with declaration, as compared to those without, has meant that the NCC's analysis of the impact on dependent markets is incomplete.

3. The NCC's 'with and without declaration' assessment that declaration would not promote a material increase in competition in at least one market

The ACCC supports the NCC's finding that more favourable terms and conditions would be provided as a result of declaration compared with those without declaration.⁹ The ACCC however contends that these more favourable conditions as a result of declaration would have a favourable impact on related markets.

Approach to 'with and without declaration' assessment

The ACCC believes that in forming the view that there would be no promotion of competition as a result of declaration, the NCC has conducted a static analysis focused on what it considers are limited detrimental impacts on competition as a result of no declaration, rather than a proper examination of whether declaration could promote an increase in competition.

The ACCC therefore submits that the NCC did not properly conduct a 'with or without' test comparing the two future scenarios in each of the relevant markets in the appropriate way. Specifically, the NCC has not compared the two future outcomes in such a way as to identify and examine the long term and qualitative improvements in competition in related markets as a result of declaration.

⁸ NCC Preliminary Views at [5.32]

⁹ NCC Preliminary Views at [6.49]

The ACCC agrees that there are uncertainties which make it difficult for the NCC to assess long term impacts.¹⁰ However, the ACCC believes that in assessing criterion (a) the focus has continued to be too strongly on a future without declaration, and the subsequent finding that this would not impact volumes of coal production in the near term. The ACCC also considers that this is premised on the assumption that the Service charge will be an insignificant cost to users in a future without declaration. However, this assumption cannot be made where PNO has unfettered market power.

Promoting competition

The concept of “*promoting*” competition in the criterion does not correspond to measuring quantifiable increases in competition or the state of competition. Instead it expresses a more flexible concept of creating the conditions or environment for improving competition from what it would be otherwise. The ACCC again emphasises that the assessment of an increase in competition includes evaluative and qualitative judgements about the future conditions and environment for competition, and is not confined to quantitative effects. The ACCC notes that the NCC has outlined that it considers the approach outlined above as the correct one.¹¹

In support of this forward looking analysis of a future without declaration, the NCC has considered PNO’s submitted charge of \$1.36 per GT, and also Synergies’ submission that suggests it could rise as high as \$1.64 per GT under the same building block model.¹² The NCC uses these figures for the counterfactual of a future without declaration. The NCC does not however use the ACCC’s determination of \$0.6075 per GT for the factual future with declaration. The NCC also does not use the current PNO pricing.

The ACCC considers that, while the NCC has determined that even \$1.64 per GT is too small to impact on dependent markets and that PNO would remain incentivised to price rationally to maximise the volume of coal, the NCC has not adequately compared a future “with and without declaration” to be able to assess if a lower fee could in fact promote competition. The ACCC contends that the NCC should have compared a price of \$1.64 per GT and higher in a future without declaration with a price of \$0.6075 per GT in a future with declaration. Had this comparative analysis taken place, the conclusion may not have been that the fees are inconsequential in related markets in all circumstances. This analysis also fails to acknowledge the impact that a fee increase can have at the margins, particularly given PNO would be unconstrained in setting prices and those fees may continue to increase over time. It also fails to consider the resulting potential effect on the continuing participation of coal exporters in the coal export market, and on investment. The assumptions made about the size of the charge have led to an incorrect conclusion that fees for the Service are inconsequential to competition in all circumstances in related markets.

As noted above, we do not agree with the NCC’s view that PNO’s incentive to maximise the flow of coal through its facility would constrain it from increasing prices. The position of a monopolist is one of which the incentive is to maximise profit, even if this means reduced volumes at higher prices.

Further, the ACCC questions the assertion that PNO would be unable to obtain sufficient information to price discriminate between mines, either now or in the future. In addition to overall monopoly pricing and the resulting potential reduction in volumes, PNO could further

¹⁰ NCC Preliminary Views at [5.7]

¹¹ NCC Preliminary Views at [6.51]

¹² NCC Preliminary Views at [6.95]

increase the prices faced by some mines to capture additional profit. PNO's ability to do this in future will reduce those entities' incentive to invest and expand their operations, given any returns could be appropriated.

Uncertainty

The NCC's preliminary view considers that any uncertainty of PNO's Navigation Service Charge in the future is insubstantial, with or without declaration, in comparison to other uncertainties faced by coal producers.¹³ The NCC's argument assumes that the shipping channel costs will remain a relatively small proportion of overall costs. However, this assumption cannot be made in a scenario without declaration, where PNO has unfettered market power. Relevantly, and as noted by the NCC, the arbitration determination suggests that, if unconstrained, PNO's Navigation Service Charge still has potential for further increases.

The ACCC also considers that the fact that there are other uncertainties does not reduce the potential impact of an increasing shipping channel charge. The effect of these uncertainties can be cumulative, particularly over the long term. As noted above, greater consideration should be given to the effect of price increases than simply comparing the price of the shipping channel service to the current coal price. The ACCC considers that the threat of the continued future expropriation of profits of miners by PNO is likely to have a dampening or chilling effect on future investment in the Hunter Valley coal mines, which is in turn damaging to the conditions and environment for competition in dependent markets.

The ACCC notes that Glencore, as a result of the ACCC arbitration decision, has more pricing certainty than other coal producers without an arbitrated outcome (albeit the specific terms are subject to appeal). The NCC contends that, if Glencore had a material advantage by way of the terms gained through arbitration, then other participants would have sought rectification through arbitration themselves.¹⁴ However, given the Glencore arbitration was only finalised in late 2018, firms with existing long term contracts may not be able to seek arbitration until those contracts expire unless they contain a re-negotiation clause. The ACCC expects there would be financial consequences to firms breaching an existing contract to seek arbitration on a new one. Over the longer term it is likely most firms would seek to obtain similar terms, facilitating a level playing field. We note that there is some evidence from submissions that other firms are seeking to discuss access with PNO by reference to the terms obtained by Glencore.

Distribution

The NCC also states that in a vertical supply chain, there may be some differences in the distribution of gains but that this is not sufficient to warrant regulation.¹⁵ The ACCC accepts the NCC's argument that a mere redistribution of gains does not necessarily satisfy criterion (a).

However, the ACCC considers that investment will suffer if producers face an unregulated monopolist that can increase prices to extract all economic rents. The ACCC recommends that consideration be given to the impact of distribution issues, particularly by examining long terms impacts, in that repeated loss of gains to the monopolist is likely to contribute to the hold-up problem in other markets.

¹³ NCC Preliminary Views at [6.103]

¹⁴ NCC Preliminary Views at [6.115], [6.169]

¹⁵ NCC Preliminary Views at [6.54], [6.55]

4. The NCC's consideration of the public interest

The ACCC agrees with the NCC's view that criterion (d) is now a positive requirement that requires the NCC to be satisfied that access or increased access as a result of declaration of the Service would promote the public interest. The ACCC acknowledges that even if criterion (a) is found to be satisfied upon reassessment, it will not necessarily follow that criterion (d) is also then satisfied.

The ACCC agrees that criterion (d) "provides for the Minister to consider *any other matters* that are relevant to the public interest", as stated in the 2017 Explanatory Memorandum at [12.40].

The ACCC does not agree that criterion (d) allows the Minister to consider the "likely flow on effects that follow from its conclusions on criterion (a) – (c)", as referred to in [9.37] of the NCC Preliminary View.

Consideration of the "likely flow on effects that follow from its conclusions on criterion (a) – (c)", risks the result that criterion (d) will not be met whenever criterion (a) is not met. Such an approach tends either to make the content of statutory criteria redundant or generate double-counting and should be avoided if an alternative construction is available¹⁶.

The inquiry should be whether there is any matter *other than* those addressed in criterion (a) – (c) relevant to whether access, on reasonable terms, as a result of declaration, would promote the public interest. It is acknowledged that the mandatory matters in s 44CA(3) must be included in this assessment.

For the purposes of decision-making, an appropriate approach would be to assess criterion (d) on the basis that criterion (a) – (c) have been met.

This approach would be consistent with the 2017 Explanatory Memorandum at [12.39]:

"Subsection 44CA(1)(d) now constitutes an additional positive requirement which must be met before a service can be declared. However, it is only to be considered when subsections (a), (b) and (c) have been met, and it does not necessarily follow from this result that (d) will also be satisfied."

This approach would also be consistent with the NCC's prior approach to criterion (f) as set out in the Final Recommendation on declaration (2 November 2015) at [8.19] and [8.23]:

"The Council considers that it flows from Pilbara HCA that its role is to identify anything that is contrary to the public interest and that a detailed technical examination of the costs and benefits of access is inconsistent with the High Court's view of the judgment involved in considering declaration criterion (f). Furthermore, in circumstances where access would not promote competition, declaration would not be available simply because the criterion that addresses that issue (criterion (a)) would not have been satisfied. In the Council's view it is unnecessary and inappropriate to also find that criterion (f) is not satisfied, only because criterion (a) is unable to be satisfied.'

"NSW Treasury expresses a view that because criterion (a) is not satisfied, it is implied that declaration and regulation is not in the public interest. The Council

¹⁶ *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (14 September 2012) at [189]

reiterates its approach to assessing criterion (f) is not to seek to identify and weigh up all of the potential benefits (and costs) of access. Rather it is an assessment of the likelihood and consequences of matters which could mean that access is contrary to the public interest, assuming all other declaration criteria are met (see above).”

Assumptions

The ACCC considers the NCC relies on the following assumptions in its assessment of infrastructure investment (44CA(3)(a)(i)) which are subject to considerable uncertainty:

- that the Service charge will be set at a level which will facilitate efficient investment by PNO in infrastructure, in the future without declaration; and
- that the Service charge will remain an insignificant component of costs for users of the Service and therefore will not impact other investment which complements or relies on the Service, in the future without declaration.

The ACCC also considers the NCC’s finding that a future with declaration may result in charges that lead to underinvestment¹⁷ does not acknowledge that arbitrated outcomes take into account investment incentives and the impact on future investments. This finding ignores fundamental principles underlying economic regulation, and simply assumes that the risk of regulatory error in setting access terms and conditions will outweigh the benefits of more efficient pricing. Section 44X(a) of the CCA specifically requires the ACCC to consider the provider’s investment in the facility, and the pricing principles at 44ZZCA provide for a return on investment commensurate with the regulatory and commercial risks involved. A regulator-determined rate of return is more likely to lead to efficient investment outcomes than the return embedded in unconstrained monopoly prices. The ACCC questions what evidence underpins the NCC’s assumption that regulatory risk distorts investment outcomes in a negotiate-arbitrate regime.

The ACCC considers that the assumptions made about PNO’s incentives to charge at a level which facilitates efficient investment and does not impact dependent markets have led to the incorrect conclusion that declaration will not promote the public interest. These assumptions flow through from the conclusions on criterion (a).

The ACCC also considers that the NCC’s assessment of 44CA(3)(a)(ii), has been based on the finding from criterion (a) that the Service charge has little impact in dependent markets, which is a critical part of the NCC’s preliminary view that criterion (a) has not been met. The other matters considered by the NCC, such as improved efficiency and economic growth have also been assessed by the flow on effects from the findings of criterion (a).

The ACCC does not consider that this is the preferable approach in assessing criterion (d). The ACCC considers that the public interest test should be assessed on the basis that criterion (a) – (c) have been met and that care should be taken when having regard to the mandatory considerations in section 44CA(3)(a) that the assessment does not involve double counting by flowing through findings or assumptions that are determinative of the outcomes for criterion (a) – (c).

¹⁷ NCC Preliminary Views at [9.40]

‘With and without declaration’ assessment

Additional to the issue outlined above, the ACCC also considers that the NCC’s preliminary view that the declaration of the Service will not promote the public interest gives inadequate consideration to the consequences of a future without declaration.

The ACCC agrees with the NCC’s consideration that there are both some benefits and some detriments as a result of declaration.¹⁸ The ACCC considers the correct approach in assessing criterion (d) is to consider matters relevant to the public interest in a future with and without declaration, and then consider whether a future with declaration on balance promotes the public interest.

The NCC has outlined that its approach to assessing 44CA(3)(a)(i) is to ‘primarily consider whether declaration would undermine the viability of efficient investment decisions and hence risk deterring future investment in important infrastructure projects’.¹⁹ This consideration is focused on the potential detriments in a future with declaration. However, a with and without test also requires assessment of the detrimental impacts on public interest in a future without declaration, much like the NCC’s interpretation of criterion (a) which carries the same wording.²⁰

For example, NCC’s preliminary view is that declaration of the Service may lead to a reduction in the incentive of PNO to invest in improving the Port or the Service because of the limiting of returns which they may have otherwise accrued.²¹ As noted above, the return determined by the ACCC in an arbitrated outcome would incorporate incentives for efficient investment. However, the counterfactual of a future without declaration has not been fully considered in this regard. The ACCC considers that a future without declaration is likely to lead to monopoly pricing, which does not lead to efficient investment and may lead to long term over-investment.

In regard to the assessment of the impact of declaration on efficient investment other than that by PNO, the NCC has also only considered a future with declaration. The ACCC agrees with the NCC’s view that limiting the potential for PNO to set Service charges at an inefficiently high level may facilitate greater investment in infrastructure which complements or is reliant on the Service, but disagrees that this effect is likely to be limited.²² The ACCC considers that the NCC’s finding that declaration is unlikely to increase third party investment incentives because “the magnitude of the Service charge, with or without declaration, is unlikely to impact volumes in dependent markets”²³ relies on the assumption that significant monopoly rents will not be extracted without declaration. Given that PNO is a monopoly this is a questionable assumption. The ACCC considers that the Service charge in a future without declaration, which has no clear limits or constraints, will have a material impact on the incentives for investment and competition, regardless of the level of the charge in the past. The extent to which prices would actually differ in a future with and without declaration is unknown but the ACCC notes that an increase material enough to affect PNO’s own incentives is also likely to be significant enough to negatively impact incentives for complementary investments.

¹⁸ NCC Preliminary Views at [9.63]

¹⁹ NCC Preliminary Views at [9.39]

²⁰ NCC Preliminary Views at [9.40]

²¹ NCC Preliminary Views at [9.40]

²² NCC Preliminary Views at [9.41]

²³ NCC Preliminary Views at [9.41]

5. Impact of revoking the declaration

The ACCC has raised concerns more generally about the broader impacts of unregulated monopolists and the potential for unconstrained market power to be used to the detriment of users and to competition in related markets.

Should the declaration of the shipping channel service at the Port of Newcastle ultimately be revoked, the ACCC considers this would be a concerning outcome. It would leave PNO as an unregulated monopolist that is able to determine the terms and conditions of access to its services with little constraint. Ultimately, the revocation of this declaration could lead to participants exiting and ceasing investments in related markets over the short and long term.

The ACCC has noted in the past that, if the Part IIIA access regime does not apply to an unregulated monopolist, there may be an increased need for alternative industry-specific access regimes to address specific instances of market failure.²⁴ If regulation was removed from the Port of Newcastle, the ACCC notes that consideration may need to be given to the need for such a regime at the Port of Newcastle.

²⁴ See for example, ACCC, *ACCC submission to Exposure Draft Consultation on Consumer Law Amendments*, 5 October 2016, p. 7-8.