June 2015

NSW Treasury Submission to the National Competition Council

Glencore's application for Declaration of Shipping Channel Services at the Port of Newcastle

Introduction

NSW Treasury has prepared this submission to assist the National Competition Council (NCC) in its consideration of the application received from Glencore Coal Pty Ltd (Glencore) for declaration of channel access services at the Port of Newcastle (Port) under section 44F of Part IIIA of the *Competition and Consumer Act 2010* (Cth) (Application).

In its Application, Glencore indicates that it has sought access to the shipping channel services in response to the increases in prices for shipping channel services that came into place at the Port of Newcastle on 1 January 2015. Glencore incorrectly claims that there is no regulatory oversight by the NSW Government over pricing. The operation of the Port is subject to the price monitoring framework contained in Part 6 of *Ports and Maritime Administration Act 1995* (NSW) (PAMA).

This submission is in response to a series of questions related to the long-term lease of the Port of Newcastle which were sent by the NCC to NSW Treasury. The submission describes the:

- Port of Newcastle
- long-term lease of ports in NSW
- regulatory regime for ports in NSW

- long-term lease of the Port of Newcastle and
- impact of the transaction on the competitive dynamics related to the Port of Newcastle.

It also discusses the public interest test, the description of the service in Glencore's application, and the question of the designated Minister.

The Port of Newcastle

The Port of Newcastle (the Port) is the world's largest coal exporting port, and supports the Hunter coal industry which directly and indirectly contributes $12.2 billion to the NSW economy.[1] Until 30 May 2014 the Port was operated by the State most recently by the Newcastle Port Corporation, a State owned corporation (SOC) under the *State Owned Corporations Act 1989* (NSW) (SOC Act). On 1 July 2014, the residual functions of the Sydney Port Corporation and Port Kembla Port Corporation were amalgamated with the Newcastle Port Corporation, which now trades as the Port Authority of NSW.

In 2013, the NSW Government decided to proceed with the long-term lease of the Port following the receipt of a detailed Scoping Study and the successful completion of the long-term lease of Port Botany and Port Kembla.[2] Following the transaction, the Port has been operated by a privately owned entity Port of Newcastle Operations Pty Limited as trustee for the Port of Newcastle Unit Trust trading as "Port of Newcastle" (Port Operator).

In the long-term lease transaction, the land upon which the landside facilities comprising the Port are located was leased by Port of Newcastle Lessor Pty Limited (Port Lessor), a wholly NSW Government owned entity, to Port of Newcastle Investments (Property) Pty Limited as trustee of the Port of Newcastle (Property) Trust (Port Lessee) under a concurrent lease dated 31 May 2014. The land was subsequently subleased by the Port Lessee to the Port Operator under a concurrent sub-lease dated 31 May 2014.

The consequence of these leases and associated commercial arrangements as part of the long-term lease transaction was to place the Port Operator in substantially the same position vis a vis tenants as if it were landlord of the Port land. The Port Operator is responsible for the overall management of the Port. This includes vessel scheduling, property management, port development and pricing for navigation services charges relating to vessel movements, wharfage charges for cargo movements, security and utility charges and site occupancy charges.

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[1] UOW Research, *Economic Impact Assessment 2013/14: NSW Mining Industry*, Report prepared for the NSW Minerals Council, 2014.

[2] Media Release, NSW Treasurer Mike Baird and Minister for Roads and Ports Duncan Gay, 5 November 2013.

The State, through the Port Authority of NSW, is responsible for:

- pilotage services
- performance of the Harbour Master functions
- the Vessel Traffic Information Centre for the Port (the communications system)
- the Port Safety Operating Licence, including incident reporting, emergency responses and permit notifications
- coal framework arrangements
- induction for access to Newcastle Port Corporation sites
- maritime security functions for Newcastle Port Corporation activities and
- Nobbys Headland.

The Port Authority of NSW is required to perform these functions in a way that minimises any disruption to, or unreasonable interference with, the commercial operations of the Port of Newcastle.

The Harbour Master is appointed under the *Marine Safety Act 1998*, and has the authority to direct and control the:

- time and manner in which vessels can enter or leave the port
- navigation and other movements of any vessels in the port
- position and manner in which any vessel may anchor or be secured in the port
- time and manner in which any vessel in the port takes in or discharges cargo, stores, fuel, fresh water or water ballast and
- way in which any vessel is secured within or removed from the port.

The Harbour Master can also refuse a ship entry or exit into the Port if the Harbour Master has reasonable cause to believe the vessel is in imminent danger of sinking, causing an obstruction to navigation, or causing serious damage to the marine environment or property in the port.

A NSW Government agency, Roads and Maritime Services (RMS), is the registered proprietor of the submerged land above which are the areas of navigable waters which comprise the shipping channels and vessel berth areas referred to in Glencore's description of the Service and Facilities in its Application in sections 5.1 and 5.4.

The Port of Newcastle and RMS have entered into an agreement, the *Channel User Licence Deed*, under which the Port Operator has the right to use and dredge the channel and berth areas.

The long-term lease of the ports in NSW

On September 2011, the NSW Government decided to undertake the long-term lease of Port Botany with the policy objectives of:

- harnessing the benefits of private sector involvement in the operation of the port, such as access to capital to support the future growth and development of the port and specialist infrastructure expertise and
- providing and freeing up capital to help the Government fund investment in priority infrastructure projects in NSW.[3]

The Government also announced that a pre-transaction Scoping Study would be undertaken which would include an assessment of the best way to deal with Sydney Port Corporation's residual Sydney Harbour facilities.

On 12 June 2012, the Government announced its plans to undertake a long-term lease of Port Kembla, and indicated that Port Kembla would be included in the Scoping Study underway into the potential lease of Port Botany.[4]

As part of the Scoping Study process for both Port Botany and Port Kembla, the Government considered the competition and regulatory issues that the proposed transactions raised. The Government recognised the need to protect the community's interests in the economically efficient operation of the ports and competition in the markets which rely upon them. That included input into the separation analysis as to which assets, responsibilities, rights and obligations of the State owned port corporations should be transferred to the private sector, and which should be retained by the State, as well as the design of a competition and regulatory framework for the ports post transaction.

For example, responsibility for the operation of the Port Botany Landside Improvement Strategy, a regulatory regime administered by the Sydney Port Corporation at Port Botany to improve landside efficiency, was retained by the State because it was considered undesirable from a policy perspective to transfer responsibilities for a role which oversaw other private sector participants to the private sector.

The State considered that the long-term lease of the ports raised two main issues from a competition perspective:

- the adequacy and suitability of the existing statutory and regulatory framework if a port was controlled and operated by a private sector participant including one which has an interest in a participant in another link in the import-export supply chain and

[3] NSW Government announcement, Refinancing of Port Botany & Desal Plant to fund major infrastructure projects, 6 September 2011.

[4] NSW Government announcement, Refinancing of Port Kembla to boost funds for major infrastructure projects, 12 June 2012.

- whether the acquisition of the long-term lease by a particular entity might result in a substantial lessening of competition in any market in breach of section 50 of the *Competition and Consumer Act 2010* (Cth) (CCA).

These competition issues were of concern to the State because NSW seeks to facilitate effective competition in order to promote efficiency and economic growth in all markets, including the Government's commercial decisions in its day-to-day procurement activities and major transactions.

The ability of any of the port corporations to charge users monopoly prices was constrained by the:

- statutory charging regime under the PAMA which prescribed the type of charge which could be imposed and required that the Minister for Roads, Maritime and Freight approve the quantum of most of the charges imposed
- countervailing bargaining power of major port users such as the shipping lines and stevedores
- anti-competitive conduct provisions in Part IV of the CCA and
- statutory objectives of the port corporations under the PAMA specifically included promoting and facilitating trade and a competitive environment in port operations.

The State recognised that in the absence of any framework, a private port operator would run its operations to maximise profits and returns to shareholders. A private operator would not have obligations to foster competition in port operations or trade and would only do so if it was consistent with its objective to maximise profits.

Further, the State owned port corporations did not participate in any markets which were dependent on access to the port. To the extent that a potential operator of the port had ownership interests in other links in the supply chain, the transaction could give rise to what is commonly described as the essential facilities problem where the operator has not only the incentive to charge monopoly prices, but also to deny other businesses access to the port facilities as a means of protecting and exerting market power.

In considering how best to address these issues, including the potential to impose some form of economic regulation, the State had regard to the national policy environment including the Competition Principles Agreement 1995. NSW is also a party to the Competition and Infrastructure Reform Agreement (CIRA) which was signed in February 2006 as part of its participation in the Council of Australian Governments (COAG) National Reform Agenda. CIRA recognises that in the first instance, the terms and conditions of access to nationally significant infrastructure should be through commercial negotiation, and that economic regulation should only be used where it is warranted.

Parts 4.1 and 4.2 of CIRA establish a national framework for the regulation of nationally significant infrastructure. The major features of the framework with respect to ports are:

- Ports should only be subject to economic regulation where a clear need for it exists to promote competition in upstream or downstream markets or to prevent the misuse of market power.
- Where economic regulation of significant ports is warranted, it should conform to a consistent national approach based on the following principles:
    - wherever possible, third party access to services provided by means of ports and related infrastructure facilities should be on the basis of terms and conditions agreed between the operator of the facility and the party seeking access
    - where possible, commercial outcomes should be promoted by establishing competitive market frameworks that allow competition in and entry to port and related infrastructure services, including stevedoring, in preference to economic regulation
    - where regulatory oversight of prices is warranted, price monitoring for services provided by means of significant infrastructure facilities should be considered as a first step where price regulation may be required or when the regulator is scaling back from more intrusive regulation. Any regulatory oversight should be undertaken by an independent body which publishes relevant information and
    - where access regimes are required, and to maximise consistency, those regimes should be certified in accordance with the CCA and the Competition Principles Agreement.

While there is agreement between the Governments on the principles which should govern the economic regulation of ports, there is no uniform national approach in practice.

A number of regulatory models were considered to oversee the private port operator's operational and pricing decisions, ranging from a laissez faire approach, which is in operation at the Port of Brisbane, to full access and price regulation. The advantages and disadvantages of each model were carefully considered against the competitive dynamics operating at each of the ports in NSW.

The competitive dynamics after the transaction and existing legislative constraints were considered to ensure they would be sufficient to prevent market failure. These included:

- that the need for regulation may arise from the entry of a vertically integrated private port operator, rather than as a result of any specific conduct or market failure

- port charges were a very small share of overall transport costs for shippers at the ports, and as a consequence for most shippers a small increase in port charges is not considered to be a determinative or even significant factor in deciding whether or not to use the port
- the interdependence between any economic regulation imposed and the broader regulatory framework for the private port operator including statutory charging framework and any contractual obligations imposed upon them in the port lease
- the countervailing bargaining power of the shipping lines which used the port and
- the constraints imposed by the anti-competitive conduct provisions in the CCA and the potential for the State to impose intrusive regulation if the port operator did engage in anti-competitive conduct.

The State decided to implement the following competition and regulatory framework:

- bidders for the ports would have to obtain Australian Competition and Consumer Commission (ACCC) merger clearance or be able to state that there was no risk of ACCC intervention in their ownership of the port in order to lodge a final bid for a port
- the transaction documentation imposed an ongoing obligation on the Port Lessee to notify the State of any material changes in ownership or control
- contractual obligations were imposed on the Port lessee to operate the port in a manner which promotes the efficient operation of the port and associated facilities and
- a light-handed price monitoring regime was implemented to oversee pricing practices at the port in private operation.

The regulatory regime for ports in NSW

The PAMA regulates the operation of ports in NSW by Port Corporations and port operators of 'private ports' (Port Botany, Port Kembla and Port of Newcastle). The port operator of a private port is the private sector entity declared by the Minister for Roads, Maritime and Freight to be the port operator of that private port.

Statutory charges at ports in NSW

Part 5 of the PAMA sets out the statutory port charges that may be imposed at ports in NSW:

- **Navigation service charges** (sections 49-51 of the PAMA) may be imposed by the 'relevant port authority' for a port, which is either the relevant Port Corporation or, for Port Kembla and Port of Newcastle, the private port operator

or the 'appropriate public agency' (being the Minister or a Port Corporation designated by the Minister). These are charged against vessel owners for general use of a designated port and its infrastructure by a vessel, apart from the use of a pilot, land-based port facilities and staff and port access for cargo. The charge is based on the tonnage of the vessel.

- **Pilotage charges** (sections 52-54 of the PAMA) are imposed by the 'relevant port authority', which is the relevant Port Corporation at each NSW port. Pilotage charges are charged against the owners of vessels entering, moving within or leaving pilotage ports, and may be calculated by reference to gross tonnage of the vessel.
- **Port cargo access charges** (sections 55-57 and 69 of the PAMA) may be imposed by the Minister for Road, Maritime and Freight, however they are no longer imposed at any NSW ports.
- **Site occupation charges** (sections 58-63 of the PAMA and section 14 of the *Ports and Maritime Administration Regulation 2012*) are fixed by the relevant port authority for a port (that is, the relevant Port Corporation or, in respect of a private port, the port operator or the 'appropriate public agency'). They apply to vessels and their cargo, and passengers in designated ports in respect of sites owned or operated by, or leased to, the relevant port authority. The charge is payable by the occupier of the site and is calculated by reference to the time of occupation or reservation and/or the gross tonnage of the vessel.[5]
- **Wharfage charges** (sections 61-63 of the PAMA) are fixed by the relevant port authority for a port (that is, the relevant Port Corporation or, in respect of a private port, the port operator or the 'appropriate public agency'). Like site occupation charges, wharfage charges apply to vessels and their cargo, and passengers in designated ports, but only in respect of sites owned or operated by, or leased to, the 'relevant port authority'. The charge is payable in respect of availability of a site at which stevedoring operations may be carried out. The charge is calculated by reference to the quantity of cargo loaded or unloaded.
- **Port infrastructure charges** (sections 66A-66C of the PAMA) may be fixed by the relevant port authority for a port (that is, in respect of a private port, the port operator or the 'appropriate public agency' or, for any other port, the 'appropriate public agency'). These charges are payable by port users such as rail or road cargo transport services operators which are part of the port-related supply chain. The charges are used to fund the acquisition or development of land, or the provision of services and facilities by the relevant port authority (a 'port infrastructure project'), either at the port in connection with the operation of the port or outside the port in relation to transporting, distributing, storing and

[5] For passenger vessels, the charge is calculated by reference to the number of passengers arriving on the vessel, or by reference to both the number of passengers arriving on the vessel and the amount of time for which the site was reserved.

handling cargo to or from the port. Port infrastructure charges are not currently imposed at any of the ports in NSW.

- **Berthing charges** (sections 64-66 of the PAMA) apply to vessels in a designated port that are berthed at wharves, buoys or dolphins owned or operated by the Minister or RMS (as the relevant port authorities).

Under section 67 of the PAMA, port authorities may enter into an agreement with a person or party liable to pay any kind of charge. Such an agreement may relate to the amount of the charge, or the rights and privileges of the person or party liable to pay the charge.

Overview of the price monitoring scheme in Part 6

Part 6 of the PAMA implements a price monitoring scheme which has the statutory objective of promoting the economically efficient operation and use of, and investment in major port facilities in the State by monitoring the price port operators charge users of those facilities. The objective of the price monitoring scheme is to promote a competitive commercial environment in port operations.

The price monitoring scheme applies to all ports in NSW – that is, Port Botany, Sydney Harbour, Port Kembla, Port of Newcastle, Port of Eden and Port of Yamba – and to all port operators – that is, Port Corporations and declared private port operators (section 78 of the PAMA).

Port operators are required to give notices and provide information to the Minister for Roads, Maritime and Freight (Part 6 of the PAMA). The Minister, in turn, has relevant powers to require information and publish reports and statements based on that information. Transport for NSW (TfNSW) assists the Minister in assessing information submitted under the scheme.

Under the scheme port operators are required to publish information on charges, provide reports to the Minister, and publish notifications of price changes.

Publication of charges (section 79)

Section 79 of the PAMA requires that the port operator publishes a list of the port charges it imposes under Part 5 of the PAMA, and the standard rate of other charges charged for or in respect of use of port facilities on its website (together, the 'service charges').

Reporting (section 81)

Port operators are required to provide an annual report to the Minister every year before 1 October (under section 81 of the PAMA). The report must include the following information for the financial year ending on the previous 30 June:

- a list of the types of service charges charged by the port operator during that financial year

- the revenue received by the operator during the financial year from service charges (showing the amount of revenue for each separate charge)
- in the case of a service charge payable on the basis of the number of chargeable units (such as a unit of vessel cargo capacity or vessel gross tonnage) – the total number of units charged for or in respect of each separate charge and
- the amount of any variation in a charge during the financial year and the reason for the variation.

Under section 84 of the PAMA, the Minister has the power from time to time to publish reports and statements about the service charges at any one or more of the relevant ports (provided or obtained under Part 6 of the PAMA). Information from port operators' annual reports may be used in such a publication.

Notification of price changes (section 80)

The port operator must give advance notice of any proposed changes to services charges (including any new service charges) by notifying the Minister and publishing the proposed changes on its website before the proposed changes are made. In addition, the port operator must provide:

- the reason for any changes in existing service charges
- an explanation as to the purpose and function of any new charges (other than port infrastructure charges), the basis for calculating the charge and the port users required to pay the charge and
- the details of the port infrastructure project to which any new port infrastructure charges relates, the basis for calculating the charge, the port users required to pay the charge and the period of time the charge is proposed to be imposed.

A key benefit of the scheme is that it is transparent, and gives port users visibility and advance notice of any changes to port prices. The scheme also promotes commercial negotiation in preference to more onerous economic regulation. This enables the Government to identify pricing conduct which may be anti-competitive and deters port operators from engaging in such conduct.

Port users may approach the relevant port operator or the Minister for Roads, Maritime and Freight if they wish to make a complaint about pricing. Port users are generally large and sophisticated commercial entities, and have significant bargaining power in pricing negotiations and disputes.

The price monitoring scheme in Part 6 of the PAMA was specifically designed to work with the existing regime in the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW) (IPART Act) so that if the need arose:

- IPART could assist TfNSW and/or the Minister in undertaking the price monitoring under Part 6 and/or

- IPART could be directed to undertake a review of the effectiveness of the price monitoring regime and report to the Government.

Section 9(1)(b) of the IPART Act allows IPART to enter into arrangements to assist other agencies or persons on matters within its field of expertise and relevant to its functions. The IPART referral powers require the approval or involvement of the Minister responsible for IPART – currently the Premier of NSW. IPART is subject to the direction and control of the Premier, except in respect of the contents of any determination or recommendation it makes (section 7 of the IPART Act).

If necessary, the Premier could direct IPART to enter into arrangements with the Minister for Roads, Maritime and Freight or TfNSW pursuant to section 9 of the IPART Act to assist the Minister or TfNSW in carrying out annual reviews of the information provided by port operators, for example if the Government forms the view that more detailed technical economic review of pricing information is required. Alternatively, if the Government decides that it is necessary at any point in the future, a Ministerial or departmental review of the price monitoring regime could be undertaken.

Under section 12A of the IPART Act, the Premier can direct IPART to undertake its own investigation on any matter with respect to pricing, industry or competition. For example, this power may be used to require IPART to carry out a review of the price monitoring regime at a port if the Government considers it necessary.

Part 3 of the IPART Act establishes an investigatory framework that provides IPART with broad discretion on how investigations under this Part (including section 12A investigations) are conducted. The key features of that framework are as follows:

- the Premier may specify a period within which an IPART report must be submitted, and require IPART to consider specified matters when making its investigations. IPART must act in accordance with Part 3, Division 7 of the IPART Act in conducting such investigations
- generally IPART can conduct procedures informally without being bound by rules of evidence, inform itself including consulting with such persons as it thinks fit and compel persons to attend hearings or produce information or documents for the purposes of the investigation
- investigations are public, although IPART can receive documents and/or evidence in confidence if necessary. IPART must hold at least one public hearing for the investigation and any document (including any submissions) that it receives in connection with the investigation is subject to freedom of information requests under the *Government Information (Public Access) Act 2009* (NSW) and
- despite any issues of confidentiality, the Premier must make public the report prepared by IPART and submitted to the Premier at the conclusion of its investigation (section 19). On the recommendation of IPART, publication may be delayed (but not cancelled entirely) (section 19(2)).

TfNSW has undertaken a review of pricing at the Port of Newcastle following the increases which came into effect on 1 January 2015. The review concluded that referral to IPART was not warranted at this time.

In the event that the Government decides that the price monitoring scheme is insufficient to deter anti-competitive behaviour, it retains the ability to take steps that it considers appropriate in the circumstances. For example:

- the Premier may refer concerns regarding the level of prices for a review by an independent government agency, such as IPART
- the Government may amend Part 6 of the PAMA to include more stringent price controls or to introduce sanctions to compel compliance or
- the Government may, if it considers it appropriate, implement a State-based access and pricing regime. The State of NSW has experience in designing and implementing regimes targeting competition issues in particular industries. For example, the regime under the *Water Industry Competition Act 2006* (NSW) was developed for the purpose of encouraging competition in relation to the supply of water and the provision of sewerage services.

Both private and publicly owned port operators have strong incentives to comply with the price monitoring regime in the PAMA. The private port operators in particular are subject to port stewardship obligations in the relevant port leases the breach of which gives rise to a range of sanctions by the State.

The long-term lease of the Port of Newcastle

On 13 June 2013, the then NSW Treasurer Mike Baird announced the proposed long-term lease of the Port subject to the Scoping Study confirming value in the transaction.[6] The State's rationale for the long-term lease of the Port of Newcastle was substantially the same as that for Port Botany and Port Kembla. The Government committed to using part of the proceeds of the transaction to fund new infrastructure in Newcastle and surrounds.

Like Port Botany and Port Kembla, the Port is what is known as a 'landlord port' which is typified by ownership of the majority of port land and essential port civil infrastructure such as wharves and breakwaters as well as general utility connections, roads, bridges and sometimes rail infrastructure. Terminal land and the associated quay line are primarily leased to terminal operators who operate the terminals with their own equipment and are responsible for the exchange of cargo at the port. Other port land without a quay line is leased to businesses that benefit from immediate proximity to terminals.

A landlord port does not operate the terminals itself and the largest source of income for this business model is generally port charges. In the case of the Port of Newcastle,

[6] Media Release, NSW Treasurer Mike Baird, 13 June 2013.

navigation port charges are driven by the number of vessel visits and the gross tonnage of the vessels.

While the long-term lease structure adopted was similar to that which had been used for the Port Botany and Port Kembla transactions, the particular circumstances at the Port of Newcastle raised a number of competition and regulatory issues which were not relevant to the other two ports.

The Port is a key link in the Hunter Valley Coal Chain (HVCC), one of the largest coal supply chains in the world and of great significance to the NSW and Australian economies. The HVCC is spread over 450 kilometres between the Port, Gunnedah and Ulan. It is a concentrated network which produces very large volumes of coal transported through a single port. 1400 vessels visit the Port each year, but there is usually no more than two weeks' notice on how many vessels are arriving, the volumes required, and from which mines coal needs to be transported to meet requirements. At the Port, operations are constrained by coal handling terminal capacity, the time vessels take to load and the tides.

The main participants in the HVCC are:

- **Coal producers**: there are approximately 35 mines owned by 11 different coal producers.
- **Rail access providers**: the NSW Hunter Valley rail network which forms part of the HVCC is owned by TfNSW and is managed and operated by the Commonwealth Government-owned ARTC, pursuant to a Deed of Lease dated 4 June 2004 (ARTC Leased Network). There are a number of private sidings in and around the HVCC which are owned and operated by private entities, and which connect into the ARTC Leased Network. The Railcorp network connecting into the ARTC Leased Network at Islington Junction is owned by Railcorp and maintained by Sydney Trains.
- **Rail operators**: four operators provide rail haulage services to Hunter Valley coal producers: Aurizon, Pacific National, Freightliner, and Southern Shorthaul Railroad.
- **Coal terminal operators**: the two main terminal operators are Port Waratah Coal Services Pty Limited (PWCS) and the Newcastle Coal Infrastructure Group Pty Limited (NCIG) which own and operate coal terminal and loading facilities located at the Port on land leased from NPC. These operators are incorporated joint ventures between various participants in the HVCC.
- **Port operator**: the Port is operated by the Port Operator.
- **Shipping operators**: More than 1400 coal vessels per year are loaded from the coal terminals at the Port. Shipping operators that service the Port include Austral Asia Line, Gearbulk Shipping and Swire Shipping.

- **Coal customers**: coal is exported mainly to buyers in Japan (54 per cent), China (19 per cent) and Korea (13 per cent).

Note the Application does not discuss the two rail regulatory frameworks relevant to the HVCC. Further detail on this is provided at Attachment A.

The impact of the transaction on the competitive dynamics related to the Port of Newcastle

The Government undertook the same principled approach to analysing the potential competition issues that the long-term lease of the Port raised as it had with Port Botany and Port Kembla outlined above, and applied that analytical framework to the unique competitive dynamics applying to the Port which are described in detail below. That analysis included relevant matters from clause 4 of the Competition Principles Agreement regarding the potential separation of different elements of NPC's assets, rights and obligations, and the price and service obligations to be imposed on the port industry.

The regulatory framework governing the HVCC

The regulatory framework governing the operation of the HVCC is comprised of:

- a rail access undertaking the Australian Rail Track Corporation (ARTC) has given to the ACCC under Part IIIA of the CCA setting out the terms on which it will provide access to the ARTC-operated rail network used to transport coal from mines in the Hunter region to the Port
- the Hunter Valley Coal Chain Coordinator (HVCCC), which is responsible for day-to-day coordination and longer-term planning and capacity alignment of different elements of the HVCC and
- the Capacity Framework Arrangements (CFA) which underpin the commercial arrangements entered into between coal producers, coal terminal operators and the Port regarding the allocation amongst users of capacity at the coal handling terminals, the expansion of the existing coal handling terminals and the construction and funding of new coal terminal facilities.

These regulatory arrangements are in place because access to rail transport and port terminal services is a central part of the export supply chain for Hunter Valley coal producers. The capacity of the supply chain for each coal producer in terms of tonnes of coal exported is determined by the point in the chain which has the lowest capacity – for example, production and loading at the mine, access to train paths or port terminal services.

The regulatory framework in the Hunter Valley seeks to facilitate coordination between coal producers and the providers of rail transport, port terminal and port services in the supply chain to:

- minimise mismatches in the capacity of different elements of the supply chain both in terms of the overall capacity of the supply chain and access rights held by individual coal producers
- provide incentives for infrastructure owners to undertake investment, and provide for those investments to be partially funded by coal producers to ensure that the capacity of key infrastructure elements of the supply chain is sufficient to meet demand and
- allocate scarce capacity between competing users in a transparent manner which minimises the potential for disputes.

The commercial arrangements which comprise the CFA involve coal producers and service providers engaging in potentially anti-competitive conduct that is authorised under the CCA by the ACCC until 31 December 2024. Those arrangements include agreements between competing coal producers and competing coal terminal owners on:

- annual capacity nomination and allocation process
- procedures for reducing capacity allocations and
- an ability for coal terminal operators to refuse to supply services to coal producers that do not secure above and below rail access to match their coal terminal access rights.

The ACCC can only grant authorisation under the CCA if it is satisfied that the relevant conduct is likely to result in a public benefit that outweighs the likely public detriment that arises due to any lessening of competition. NPC did not engage in anti-competitive conduct under the CFA, but it is a party to the CFA and plays an important role in coordinating the coal terminal operators' conduct and advocating compliance with the CFA and its objectives.

Some aspects of the NPC's role were consistent with those of a traditional landlord, such as approving land development. However, other aspects of its role were semi-regulatory in nature and reflected the fact that participants in the coal chain saw the NPC as an independent and informed participant in the supply chain which supported the existence and operation of the CFA, and the importance of supply chain efficiency. For example, in some circumstances NPC potentially had, and continues to have the role of determining a dispute about the allocation of terminal capacity to specific coal producers.

During the Scoping Study stage, the State gave particularly careful consideration to NPC's rights and obligations under the CFA, and which of these should be transferred to the private sector operator. This task was complicated by the fact that many of these rights and obligations were embedded in the leases for land at the Port that the NPC had granted to the PWCS and NCIG terminal operators. From one perspective these were rights and obligations that a private port operator would expect to exercise as landlord under the terminal leases.

In designing the transaction, the following matters were taken into consideration:

- while a private port operator would have the same interest as NPC in the continued operation of the CFA and the HVCC, if it had related interests in the coal chain it may face incentives to use its CFA related rights for the benefit of its related entities rather than to achieve the purposes of the CFA
- the State had an ongoing interest in continued efficiency improvements in the HVCC and had been able to oversee developments in the HVCC through NPC
- NPC's role in the CFA included an enforcement aspect which was beyond that usually imposed on landlords
- the importance HVCC participants placed upon NPC's independence from any other participants in the supply chain and its Government ownership in performing its role under the CFA and
- the impact on the authorisation of the CFA of any transfer of the NPC's responsibilities under the CFA to a private port operator, including the need for the CFA to be varied or revoked and a new authorisation substituted in its place in accordance with the statutory procedure in the CCA.

The transaction preparations included a detailed analysis of the different incentives that a private port operator might face from NPC with respect to a number of different separation models for the NPC's role under the CFA.

Clearly, a private port operator with full economic control of the Port has a strong incentive to maximise coal supply chain efficiency and coal throughput, and that aligns with the continuation of the CFA which is essential for the continued growth and cooperative functioning of the coal supply chain. However, the State recognised it was not necessarily in the public interest for a private operator to perform NPC's role under the CFA.

Instead, the Government put arrangements in place as part of the long-term lease of the Port to enable the conduct the subject of the CFA to continue for the duration of the authorisation with as little disruption as possible to the CFA and its public benefits. The arrangements were designed to:

- put the NPC in a position to continue to perform its CFA role under the coal terminal leases and other CFA related agreements without any restriction on its discretion in those roles
- put the Port Operator in a position to perform its role as landlord under the terminal leases as far as possible and
- maintain the status quo in relation to the CFA as far as possible.

Other potential impacts of a private port operator on competitive dynamics

The Scoping Study considered whether the following would be sufficient to constrain the private port operator from raising prices, denying users access or engaging in discriminatory conduct:

- the existing price monitoring scheme under Part 6 of the PAMA
- the anti-competitive conduct provisions in the CCA
- the threat of further regulation and
- the countervailing bargaining power of shipping customers and other major port users, such as PWCS and NCIG, and the coal producers.

The main risk identified as part of this analysis was that a vertically integrated private port operator which had interests in upstream or downstream supply chain participants would have both the ability and the incentive to operate the Port so as to maximise its profits at the expense of other market participants. A range of potential responses to the competition issues were considered, including:

- cross-ownership restrictions
- contractual obligations and
- a more intrusive form of economic regulation than the existing price monitoring framework (for example a full access and pricing regime).

Given the central role that the Port plays in the HVCC and the historic challenges in introducing practices at each step of the supply chain to maximise its capacity and efficiency, the Government decided that it should proactively address the potential competition issues posed by the transaction. It did this by:

- imposing restrictions on the parties eligible to bid for the lease of the Port to exclude entities which held a controlling interest in a coal producer, coal developer or coal terminal
- requiring any bidder to disclose any non-controlling interest in a coal producer, coal developer or coal terminal unless the interest was less than 10 per cent of a publicly-listed entity as part of a broadly held share portfolio
- making it a condition of any final bid that the bidder had obtained merger clearance from the ACCC
- imposing provisions in the port lease and port sublease so that any change of control of the Port Lessee or the Port Manager would be taken to be a breach of the lease unless it was permitted under the lease or had been approved by Port Lessor

- imposing obligations in the port lease and port sublease that Port Lessee and Port Manager respectively must comply with any undertakings provided to the ACCC under the CCA and Part IV of the CCA with respect to matters at the Port. It also gives the Port Lessor the right to compel the Port Lessee or Port Manager to implement a competition cure plan in the event of non-compliance
- including port stewardship obligations regarding access in the port lease so that before any land at the port that is not currently used for coal storage, treatment or handling was to be used for that purpose, the Port Lessee or Port Manager is required to develop and implement an open access regime for that coal use and
- ensuring that the State, through the Port Authority of NSW, retains responsibility for the:
    - role the NPC performs under the CFA
    - Harbour Master role
    - provision of pilotage services and
    - Vessel Traffic Information Centre for the Port.

These measures were in addition to the constraints placed on the Port Operator provided by the:

- price monitoring regime in Part 6 of the PAMA
- significant countervailing power of the shipping lines which use the relevant ports
- threat of State Government intervention by way of more intrusive economic regulation
- anti-competitive conduct provisions in Part IV of the CCA and
- threat that a third party may initiate declaration of relevant port services under Part IIIA of the CCA.

Public interest test

The State undertook the long-term lease of the Port of Newcastle because it considered the transaction was in the public interest given it would:

- bring private sector expertise to the operation of the Port
- introduce private sector capital to fund the growth of the Port and
- free up capital to help the Government fund investment in priority infrastructure projects in NSW.

The Port Operator has brought private sector expertise to the Port and the transaction delivered significant proceeds, which resulted in more than $1.5 billion being invested in NSW's dedicated infrastructure fund Restart NSW.[7]

The potential for significant direct financial benefits to the people of NSW from the transaction proceeds was not the Government's only consideration in designing the transaction. The NSW Government considered it critical that the transaction was structured in such a way that facilitated effective competition in order to promote efficiency and economic growth. The Government is satisfied that all of the measures outlined above promote the public interest in that they are sufficient to address the potential competition issues the transaction raised without imposing intrusive and costly regulation.

It does not seem clear that imposing a more intrusive regulatory framework in the form of a Part IIIA access declaration would provide a public benefit greater than that provided by the status quo. Further, we would encourage the Council to carefully consider the risk that imposing a more intrusive regulatory framework in the form of a Part IIIA access declaration may in fact be contrary to the public interest. The introduction of an enforceable right to negotiate access could create risks to the efficient and effective operation of the HVCC. Risk factors that the NCC would need to carefully consider include regulatory uncertainty, risk of disrupting the CFA, risk of disrupting vessel scheduling and any implications of this on how the HVCCC functions.

We would encourage caution in considering whether the application meets the public interest test under criterion (f). In applying criterion (f), the potential risks to the public interest will obviously need to be weighed against the claimed benefits, this being the benefit of promoting competition in the identified dependent markets. The NCC may wish to consider the extent to which the application adequately identifies the benefits and their materiality, in the context of the risks, which are described a little further below.

The Port Operator has been subject to the price monitoring regime and other measures put in place as part of the transaction for just over a year. NSW Treasury and TfNSW are not aware of any suggestion that over this period the Port Operator has inappropriately denied any vessel access to the Port or engaged in discriminatory or anti-competitive conduct.

The Applicant now seeks declaration to address its concern that there is no certainty over the scale or nature of future cost increases. It claims that the lack of certainty creates risk for current and future coal producers in the Hunter Valley.[8] However, it is important to note that declaration of a service under Part IIIA does not guarantee port users price certainty.

[7] Media Release, Premier of NSW Mike Baird, 30 April 2014.

[8] Page 2 of the Application.

The State considers there is a public interest in having stable regulatory frameworks which are only changed in response to a demonstrated need. It is not in the public interest to replace or supersede a regulatory framework put in place by a Government after detailed and careful consideration of the competition issues and the most effective and proportionate way to address them, in the absence of a demonstrated inadequacy of the regulatory regime.

The Application is silent on the potential impact of an access declaration on the operation of the Port, such as the:

- need to align allocation of vessel access to the berthing boxes with allocation of terminal capacity to coal producers at the port
- allocation of vessel access between coal ships and non-coal ships and
- need to constantly review the allocation of vessel access taking into account changing demand, tidal movements and ship sizes.

Imposing a regulatory framework through an enforceable right to negotiate access may present risks to the CFA. For example, the extent to which an access dispute would include consideration of the terminal capacity allocation arrangements under the CFA is unknown, but any departure from those arrangements, or vessel access allocation which was inconsistent with those arrangements as part of a determination of an access dispute could amount to a material change of circumstances and hence risk the ACCC's authorisation of the CFA under section 91B(3) of the CCA. Given the CFA is critical for the efficient operation of the HVCC, the NCC needs to give careful consideration to the public benefits of declaring access and the extent to which this could put the CFA at risk.

In this respect, it is worth highlighting that the State went to considerable effort in the structure of the transaction to ensure that it supported the CFA continuing until its expiry in 2024 and did not create any risk that the CFA's authorisation would be revoked.

The State notes that the dependent upstream and downstream markets identified in the Application are all well established with multiple participants and no clear lack of competition. Indeed some of the markets identified, such as the market for global seaborne coal, are clearly effectively competitive. Given the state of competition in those markets, and the fact port charges at the Port comprise less than 1 per cent of the benchmark price of Newcastle coal delivered to Japan,[9] any additional competition benefit that may result from increased access is likely to be negligible particularly compared to the potential risks to the ongoing operation of the Port as a key part of the HVCC.

[9] Using the McColskey Contract for Insurance and Freight Japan Steam Coal Marker Price (US$/t)

Description of the Service

The NCC must form a view as to whether the Application concerns a 'service' within the meaning of that term in section 44B of Part IIIA of the CCA, which is defined as:

> *"service" means a service provided by means of a facility and includes:*
>
> *(a) the use of an infrastructure facility such as a road or railway line;*
> *(b) handling or transporting things such as goods or people;*
> *(c) a communications service or similar service;*
>
> *but does not include:*
>
> *(d) the supply of goods; or*
> *(e) the use of intellectual property; or*
> *(f) the use of a production process;*
>
> *except to the extent that it is an integral but subsidiary part of the service.*

Glencore describes the relevant service as comprising the provision of the right to access and use the shipping channels (including berths next to the wharves as part of the channels) at the Port, by virtue of which vessels may enter a port precinct and load and unload at relevant terminals within the precinct and then depart the port precinct (Channel Service) (section 5.1 of the Application).

The facilities used to provide the Service are identified as the shipping channels and vessel berth areas which are identified in a plan attached as Annexure C to the Application (Facilities), and are described as being integral to the infrastructure of the Port (section 5.4 of the Application).

The Application relies upon the certification of the Victorian Access Regime for Commercial Shipping Channels in 1997 in support of its argument that the Channel Service can be the subject of declaration under Part IIIA of the CCA (pages 1-2 of the Application). However, it is not apparent from the NCC's Reasons for Decision in that matter dated 12 May 1997 or the Treasurer's Statement of Reasons dated 1 August 1997 that the question of whether the use of a shipping channel was a relevant service under Part IIIA was ever directly considered.

The NCC will need to give careful consideration to the question of whether a service which comprises the use of navigable waters in a particular geographic location is a service for the purpose of Part IIIA of the CCA.

Designated Minister

The identity of the designated Minister depends on the application of section 44D of the CCA and the definition of 'provider' in section 44B:

- Section 44D states that the designated Minister is the Commonwealth Minister unless the "provider" of the service for which declaration is sought is a State or Territory body and the relevant State or Territory is a party to the Competition Principles Agreement, in which case the designated Minister is the Premier.

- The ‘provider’ is defined in section 44B to mean “*in relation to a service, means the entity that is the owner or operator of the facility that is used (or is to be used) to provide the service*.”

NSW Treasury sought legal advice on this issue, which indicated that the Commonwealth Treasurer is the designated Minister responsible for determining the application because the provider of the services which are the subject of the application is not a State or Territory body.

The legal advice indicated that the provider of a service under Part IIIA must be in a position to control whether a third party will be able to use the specific service and the terms and conditions of doing so, including price. A more limited interpretation of the term would not be consistent with its use in the arbitration provisions in Division 3, Subdivision C of Part IIIA, which are all based upon the assumption that the provider is the entity which has the ability to decide whether or not to grant access to a third party.

The following factors are relevant in determining the relevant provider for the Service:

- RMS owns the submerged land above which are the navigable waters which comprise the shipping channels and vessel berth areas identified in the Application
- RMS has granted the Port Operator a licence to access the navigable waters of the channels and berthing boxes for commercial shipping operations and a priority right to allocate vessels to, and to secure vessels in the berthing boxes
- RMS has also granted the Port Authority of NSW a licence to access the navigable waters of the channels and berthing boxes, however, that licence is limited to activities related to its functions which do not include commercial shipping operations
- RMS has no statutory charging powers under the PAMA
- the Harbour Master may refuse a ship entry or exit into the Port in certain circumstances, however, it generally cannot grant a coal ship access to the channels and berthing boxes, and cannot negotiate the terms and conditions of access including price
- the Port Operator has the role of scheduling vessel entry into the port, using the communication systems that are maintained by the Port Authority of NSW
- the Port Lessor cannot grant any vessel access to the channels or berthing boxes nor does it have any statutory charging rights under the PAMA and
- RMS does not have the ability to control the terms and conditions of access (including price) which the Port Operator may negotiate with a vessel for accessing the channels or berthing boxes.

As such, access seekers that wish to enter the Port of Newcastle for the purpose of loading and unloading cargo are required to enter into negotiations with the Port Operator for permission to do so.

The Port Operator determines whether or not access is granted and the terms and conditions of such access including price. The Harbour Master, the Port Authority, RMS and the Port Lessor are unable to perform this role in place of or on behalf of the Port Operator as long as the Port Operator is managing the Port in accordance with its contractual obligations.

Attachment B (confidential) includes more detailed information on the issues considered and rationale.