GLENCORE

4 November 2015

Mr David Crawford
Chairman
National Competition Council
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MELBOURNE VIC 3000

Mr Richard Home
Executive Director
National Competition Council
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Dear Mr Crawford and Mr Home

Port of Newcastle – Application for NCC recommendation for declaration under Part IIIA

Glencore is very concerned by the narrow approach taken by the NCC in its draft decision and believes this sets a dangerous precedent for similar matters which may come before the Council.

Australia's economic return from the resource sector is being challenged by falling revenues and rising costs. It is therefore critical that the vital infrastructure upon which this sector and the broader economy depends is operated at maximum efficiency and lowest cost.

The ability of Port of Newcastle to nearly double its profits by increasing the price it charges for exactly the same services, and with virtually no transparency or justification, is effectively imposing an arbitrary tax on the mining industry. The additional shipping cost, which is ultimately borne by the coal exporters through lower realised prices, is being imposed at precisely the time when the Hunter Valley mining industry can least afford it.

Port of Newcastle's behaviour is a clear example of a genuine monopoly exercising its price setting powers without fear of competition – prices were increased at a rate that is 19 times annual inflation. It is also clear the NSW Government that created the monopoly and benefited from the price paid by the new owners is not willing to intervene or provide genuine pricing oversight.

By narrowly interpreting criterion (a) of Section 44G(2)(a) of Part IIIA so as to endorse the actions of the privatised Port of Newcastle, the NCC is sending a signal to owners of monopoly assets that they can exercise monopoly power with little risk of intervention through regulation.

Australia, with a relatively small population and large land mass, is economically dependent on productive and cost efficient infrastructure. If we are to ensure future economic growth and investment in Australia, then it is vital that Part IIIA of the CCA is applied in a way that acts to protect the interests of critical industries that are dependent on access to that infrastructure, while recognising the legitimate need of monopoly infrastructure owners to generate a risk adjusted return to shareholders. This is particularly important where Governments privatise monopoly infrastructure assets at the end of multi-user export supply chains.

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In 2015 Glencore faces increased costs of approximately $6.5m for its customers' access to the channel at the Port of Newcastle where the level of service is exactly the same as that provided in 2014. We believe it likely Port of Newcastle will continue to pursue increased charges in future years that could cost Glencore up to a further $46m per year.

This is a material impost on our Hunter Valley business and a cost we cannot address as there is no other means for our customers to access Newcastle port other than through the channel. It will result in Glencore employing less people in the Hunter Valley than it would otherwise have employed, and it will be a material deterrent in our decisions as to whether to invest capital in the Hunter Valley in the future.

If a privatised ARTC were also to be allowed to adopt this pricing behaviour, then an even greater adverse impact on employment, investment and competition will follow.

We agree with the ACCC Chairman, Rod Sims that competition regulation should "…give the parties negotiating with the monopolist some strength to their arm." We also agree that the "…negotiate / arbitrate framework is true light handed regulation. It actually allows a commercial negotiation, where both parties have some negotiating leverage; without this there is no ability to negotiate commercially."

The NCC can play a role in achieving this outcome by recommending the declaration of the Port of Newcastle's facilities.

The shipping channel at the Port of Newcastle is exactly the kind of multi-user monopoly infrastructure which Part IIIA of the CCA is designed to regulate. If the negotiate/ arbitrate regime is not applied in this case, it is difficult to see when it would ever be relevant. For this reason we reject the legal arguments that have been made by the Port of Newcastle in its latest submissions as being inconsistent with both the purpose of Part IIIA and its previous application by the Federal Court.

A more detailed submission is attached.

Yours sincerely

Peter Freyberg
Head of Global Coal Assets
Glencore

GLENCORE COAL PTY LTD

Further Submission in relation to Glencore's application to the National Competition Council

4 November 2015

GLENCORE COAL PTY LTD

Applicant's reply to the submission of Port of Newcastle Operations Pty Ltd dated 2 October 2015

We refer to Glencore's previous submissions and to the submission by the Port of Newcastle dated 2 October 2015 that was recently made non confidential. Glencore remains concerned that the narrow interpretation of Part IIIA of the Competition & Consumer Act 2010 (Cth) ("**CCA**") adopted in the draft recommendation by the NCC, should it prevail into the final recommendation, will have a real and material adverse impact to undermine the effectiveness of the CCA, with far reaching and significant consequences for the Australian economy more generally.

1 Background

1.1 In relation to the Port of Newcastle:

(a) The NSW Government created a monopoly at the Port of Newcastle with absolute price setting power so as to maximise the sale price of the business. In the absence of transparent price setting processes or controls, the Government sought to reassure industry by explaining that the threat of regulation would limit the abuse of monopoly power. Clearly this provided no disincentive to the price setting behaviour of Port of Newcastle's new owners.

(b) At the first available opportunity, the Port of Newcastle's new owners increased navigation charges at the port by 60% for the most common vessel type, and by 40% on average. There was no consultation on this rate increase. They did this at the same time that every other regulated and industry owned infrastructure provider engaged in the resources industry is materially reducing their unit rates.

(c) The Port of Newcastle's new owners also unilaterally substantially revalued their assets without any consultation with industry or justification from the purchase price in April 2014 of approximately $1.75 billion to the amount of $2.4 billion by 31 December 2014.

(d) Despite concerns raised directly to the NSW Premier and Minister for Roads and Freight, the NSW Government saw no issue with the massive price increases, suggesting they were not unreasonable on the basis of inflation since 1995 (despite the fact that the revenue of the port has increased three fold in this period due to volume increases) and claimed that a regulator would likely approve the increases (and without providing any substantiation of this conclusion).

(e) It remains very clear that to generate a commercial return on the $1.75 billion purchase price paid by the Port of Newcastle (that was estimated to be at 27 times earnings), that prices charged to users of the channel will continue to increase at rates well above inflation into the future.

1.2 We emphasise that this matter is very different to the access to the integrated iron ore supply chains of miners in the Pilbara. This matter concerns privatised infrastructure at the end of a multi-user supply chain without adequate regulation.

2 Impact on mining industry

2.1 Glencore believes that increased access to the Port of Newcastle arising from the imposition of a regulated access regime would materially promote competition because of the increased investment certainty which would result from a regulated regime. This increased certainty would maintain and promote investment in coal production and associated markets in the Hunter Valley.

2.2 Glencore is one of the largest miners in the Hunter Valley and is prepared to speak out in relation to the concerns as to what has occurred with the Port of Newcastle in relation to a multi-user export infrastructure supply chain. However, Glencore is not alone in being subject to these cost increases. The Reserve Bank of Australia Financial Stability Review of October 2015 made

several statements which should sound warnings of the impact of the cost increases imposed by infrastructure owners to the resources sector[1]:

> *"Resource-related sector*
>
> *In contrast to the benign overall conditions in much of the business sector, risks appear to have increased further in the resource-related sector over the past six months. The sustained falls in coal, iron ore and oil prices are weighing heavily on the earnings and cash flow of producers of these commodities, particularly those higher up the cost curve. Most smaller producers are struggling to cover costs at current prices, with many already reporting losses. Where producers have been cutting costs to preserve profit margins, further cuts could prove progressively harder. The dwindling investment pipeline and ongoing cost-cutting by resource producers have in turn reduced the output and earnings of mining services companies.:"*

2.3 Glencore has previously noted that it believes that these cost increases by the Port of Newcastle will have a material impact on smaller coal miners as foreshadowed by the Reserve Bank.

3 Recent comments reflecting the Australian Competition and Consumer Commission's position on privatisation

3.1 Glencore notes the recent statements of the ACCC Chairman Rod Sims before the Port of Melbourne Select Committee on 30 September 2015 concerning the Port of Newcastle, as well as the significant parallels to be drawn from the Chairman's comments in relation to the Port of Melbourne and the privatisation of monopoly infrastructure generally.

3.2 We draw particular attention to the following comments of Mr Sims:

> *"We have often said that we are very comfortable with privatisation. We understand that the private sector will often operate assets more efficiently and if key assets are operated more efficiently, then that benefits the economy of Victoria—and of Australia, if I am speaking generally.*
>
> *The concern that we have been stating over the last couple of years is that the desire for a good sale price can come at the cost of poor competitive structures or outcomes or poor regulatory outcomes. The concern we have is that to, dare I say it, artificially boost the price, people selling private assets—and I emphasise again that I am speaking generally here to provide the context for our concern over the last couple of years—could sell assets with non-compete clauses or bundle potentially competitive assets together or they could put in place price regulation that really had no effective price regulation. These days, I am afraid, that is termed light-handed regulation. Personally I think light-handed regulation of a monopoly is a contradiction in terms.*
>
> *We have been advocating on this for some time. We do so because we believe that if there are artificial arrangements to boost a sale price, that can have the effect of imposing an effective tax on future users of whichever facility it is—whether it is an airport, a port, a railway or whatever—thereby damaging the competitiveness of the economy that the infrastructure facilities serve. So we have very real concerns. We have been expressing these concerns where there is a very clear monopoly—people have to use the asset—and I guess we simply would say to people who do not share our concerns, 'How do you think you would behave if you owned this asset, if you had paid a very high price for it and if you had shareholders who had very high expectations of a return?'. I think you would naturally be pricing as high as you could within the limits of any regime. That is why we think regulatory regimes need to be effective.*
>
> *I will just give one example, if I could. The port of Newcastle was privatised in May 2014, with a 98-year lease. It is the world's largest coal port, which is why I mention that. Pre privatisation, it was making around $23 million to $25 million a year, both profit or cash flow, whichever way you want to look at it. It was sold for $1.75 billion. The financial press universally welcomed the high price. As I say, that was in May 2014. On 1 January 2015 they increased the navigation charges by 40 per cent, which increased their profit or cash flow by about 20 million—that is, more or less doubled it. Then in April this year the*

[1] *Reserve Bank of Australia Financial Stability Review: October 2015 page 27*

people who owned the asset revalued the asset to about from 1.7 billion to 2.4 billion. I think it is fair to say that the coal industry and the ACCC have concerns about many more very large price increases to come, because there just does not seem to be much in the regulatory regime that can prevent that happening"[2]

3.3 Glencore notes that the ACCC Chairman shares its expectations of substantial future price increases at the Port of Newcastle. The speech given by ACCC Chairman Rod Sims on 29 October 2015 in relation to infrastructure also shares the same concerns as expressed by Glencore. This speech is linked below.

https://www.accc.gov.au/media-release/accc-believes-price-monitoring-for-monopoly-infrastructure-will-damage-australia%E2%80%99s-economy

4 Effect of declaration on prices

4.1 The recent Port of Newcastle submission argues that, in the event that the services were declared, arbitration by the ACCC in respect of the charges for the services would result in prices that are not necessarily lower than those under the prevailing regime. It goes further to suggest that prices for the services under declaration may, as a result of arbitration, be higher than the current prices under the existing framework.

4.2 Glencore notes that this approach does not accord with the case law in relation to criterion (a) of section 44G(2) of the CCA.

4.3 In the Sydney Airport decision, the Full Federal Court noted that considerations of the likely outcome of arbitration are not relevant to the inquiry of whether a promotion of competition would be achieved by declaration of the services. The Tribunal in the Sydney Airport matter specifically rejected that it should be required to surmise possible outcomes of arbitration and this approach was affirmed by the Federal Court. The Tribunal reasoned that it was the opportunity to arbitrate that was relevant to measuring the promotion of competition.

4.4 Any further analysis in relation to how a pricing dispute might be ultimately determined by the ACCC is therefore irrelevant and an erroneous reference point for considering whether criterion (a) may be satisfied.

4.5 Virgin Australia in their submission dated 31 August 2015 came to the same view. Accordingly, the analysis undertaken by the Port of Newcastle and the NCC is incorrect and not necessary. The relevant test in determining whether access (or increased access) would promote a material increase in competition is:

(a) the state of competition in the relevant dependent markets with a right or ability to use the shipping channel service at the Port of Newcastle; and

(b) the future state of competition in the dependent markets that any right or ability or with a restricted right or ability to use the service.

4.6 The Full Federal Court comprising French, Finn and Allsop JJ stated in Sydney Airport Corporation Ltd v Australia Competition Tribunal and Others (2006) FCAFC 146 at 83:

"...all s 44H(4(a)) requires is a comparison of the future state of competition in the dependent market with a right or ability to use the service and the future state of competition in the dependent market without any right or ability or with a restricted right or ability"

4.7 The Sydney Airport case also undertook the assessment of criterion (a) in this manner where an applicant (Virgin), already had access - an issue the same as in this matter in terms of the coal exporters having access to the channel. Given that the case law simply considers the right to access the service and the consequences if that were not the case in terms of impact on the dependent markets, Glencore believes that this application satisfies criterion (a) based on the test of the Full Federal Court in the Sydney Airport Case.

[2] *Transcript of Inquiry into the Proposed Lease of the Port of Melbourne – 30 September 2015 transcript page 2*

5 The Port of Newcastle's new arguments that the charges are a tax and therefore not arbitral by the ACCC

5.1 Glencore notes that the Port of Newcastle has now proffered a new argument that the port charges are in fact a tax and therefore not able to be arbitrated by the ACCC under an access regime should one be imposed. Interestingly, this is the first time that Port of Newcastle has asserted this significant characterisation of the charges since Glencore first submitted its application to the NCC in May 2015.

5.2 It is not possible for Glencore to fully comment on this argument because of the confidentiality claims by the Port of Newcastle. However it is highly concerning that private parties should be able to assume and exercise the statutory power to determine and levy taxes on infrastructure users at large. Such power should not simply be inherited or even acquired as part of a construct for a lease of state monopoly infrastructure – even if a very high price was paid.

5.3 It is important to also note that the Part IIIA access regime was in part created to deal with access to infrastructure of natural monopolies (that are more often than not controlled by government) and if Port of Newcastle's argument was accepted, it would (in theory) prevent the access regime from applying to many instances of essential infrastructure that are subject to statutory regimes for operating and charging for its use. Again Glencore fails to see how such an argument could possibly be sustained without calling into question existing regimes for nationally significant infrastructure across various states in Australia.

4 November 2015