



PORT WARATAH COAL SERVICES

24 April 2019

Submissions – PNO Revocation
National Competition Council
GPO Box 250
MELBOURNE VIC 3001
Email: pon@ncc.gov.au

Dear Sir or Madam

POSSIBLE REVOCATION OF DECLARATION OF CHANNEL SERVICE AT THE PORT OF NEWCASTLE

Introduction

Port Waratah Coal Services Limited (**Port Waratah**) welcomes the opportunity to provide this submission commenting on NERA Economic Consulting's report dated 8 April 2019 (**NERA Report**).

PNO's incentives

The central argument made in the NERA Report is that 'in setting its price for the shipping channel service, [PNO] will have an eye on future investment in coal mines in the Newcastle catchment'. PNO will not want to develop a reputation for 'hold-up', as doing so would deter future investment in Hunter Valley coal mines. As the holder of a 98 year lease, PNO will not price in a way that would reduce the economic viability of new and prospective mining developments on which it depends.

In Port Waratah's submission this theoretical argument is commercially unrealistic. A party considering investing in the Hunter Valley coal chain (whether developing a new mine, expanding an existing mine or purchasing new rolling stock, etc) will know that PNO can charge whatever monopoly price it wishes at any point in time. Although PNO may have some regard to the impact of its pricing on its long term reputation for hold-up, it will also be very motivated to maximise its profits in the short term. A commercial party is most unlikely to make a major investment based solely on a hope that PNO's concerns about its long term reputation will outweigh its desire to maximise profits immediately. Furthermore (and as discussed further below), it is likely to be profit maximising for PNO to set a high monopoly price even though that may prevent **some** new coal mines being developed or existing coal mines being expanded. In summary, the presence of an unregulated monopolist

at the end of the supply chain will necessarily discourage and dampen investment in upstream markets, including the coal tenements market. This will in turn reduce dynamic efficiency and competition in those upstream markets, as well as being contrary to the public interest.

It is important to note that the NERA report acknowledges that because PNO has market power it will price at above competitive levels and that this will necessarily reduce the quantity of shipping channel services it provides. At paragraph 11 NERA states: Because PNO has market power in this market, maximising its profits may mean some restriction of total quantity compared to what would occur with a competitive price.

At paragraph 12 NERA, having noted that price discrimination is not possible, concludes that: 'It is therefore likely that increases in price above the competitive level would entail some volume reduction.'

These conclusions must be correct. It is a matter of basic economics that a profit maximising monopolist will price above the competitive level, with the inevitable result that there will be a reduction in the quantity of the service supplied by that monopolist.¹ An increase in price by a monopolist will necessarily result in a reduction in quantity (assuming a downward sloping demand curve).

What NERA refers to as 'some volume reduction' means, in this case, fewer vessels using the shipping channel and therefore lower volumes of coal being exported from the Hunter Valley. PNO's ability to monopoly price will necessarily lead to lower coal production and less investment in coal mines and related infrastructure and services. The 'volume reduction' should be seen as a material reduction in dynamic efficiency and competition in upstream markets. More obviously, it is clearly and fundamentally contrary to the public interest. PNO monopoly pricing will cost jobs in the coal industry and reduce profits and taxes.

Effect of declaration on competition in tenements market

Port Waratah does not agree that the tenements market is as least as wide as Australia and potentially as broad as the Asia Pacific. The fact that the thermal coal export market may be global does not mean the tenements market is also global. The Hunter Valley produces a particular type/quality of thermal coal and, to a lesser extent, a very specific type of coking coal (semi-soft). Tenements in other areas have significant geological differences and are not completely substitutable for Hunter Valley tenements. Coal in Australia's other very large coal producing basin, the Bowen Basin, is, for example, predominantly coking coal. There are also significant differences in the infrastructure and the cost of infrastructure services in other coal basins. Furthermore, parties interested in buying and selling tenements in the

¹ In the text book NERA cites in its report, *Carlton and Perloff, Modern Industrial Organisation (2005)*, the authors state at page 88:

A monopoly sets its price without fear it will be undercut by a rival firm. A monopoly faces a downward sloping demand curve and sets a price above marginal cost. As a result, less is sold than if the market were competitive (where price equals marginal cost) and society suffers a deadweight loss.



Hunter Valley are not necessarily the same as the buyers and sellers of tenements in other geographic regions. We note that not only did the Queensland Competition Authority conclude that the relevant tenements market was regional rather than global, the Australia Competition Tribunal has also reached the same view in relation to iron ore tenements (finding the relevant market was 'most likely Pilbara wide and not global').²

We also disagree with the statement that 'trading in tenements is rare'. In the mining sector tenements are traded not only directly but also, and more commonly, through corporate activity such as the acquisition of companies, farm-ins to tenements and other 'joint venture changes'. These types of transactions cannot be disregarded in assessing how the tenements market works.

For the reasons discussed above, PNO being an unregulated monopolist will dampen incentives to invest in tenements in the Hunter Valley, reducing dynamic efficiency and competition in that market.

Port Waratah again urges the NCC to reconsider its preliminary view that declaration should be revoked.

Please do not hesitate to contact me at _____ or _____ if you wish to discuss this submission further.

Yours sincerely

HENNIE DU PLOOY
CHIEF EXECUTIVE OFFICER

² In the matter of *Fortescue Metals Group Limited* [2010] ACompT 2.

