Submission in response to NCC Statement of Preliminary Views

Revocation of the declaration of the shipping channel service at the Port of Newcastle

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1 Executive Summary

On 19 December 2018, the National Competition Council (***NCC***) published its Statement of Preliminary Views in relation to the application by the Port of Newcastle Operations Pty Ltd (***PNO***) seeking revocation of the declaration of the shipping channel service at the Port of Newcastle (the ***NCC Statement***).

The NCC Statement indicates that the NCC's preliminary view is that it proposes to revoke the declaration on the basis of its preliminary finding that criterion (a) and (d) are not satisfied.

As would be evident from Yancoal's previous submissions, Yancoal is disappointed with that preliminary view, and considers that an appropriate consideration of the declaration criteria would result in a finding that each of the declaration criteria are satisfied such that the revocation application should be refused.

Yancoal's views are very similar to those expressed by the ACCC in their public response to the NCC Statement:[1]

> *The ACCC is extremely concerned about the potential removal of regulation of the shipping channel service at the Port of Newcastle …*
>
> *The port provides the only commercially viable means of export coal from the Hunter Valley region in New South Wales. …*
>
> *Should the declaration by revoked, the Port of Newcastle will be an unregulated monopolist that is able to determine the terms and conditions of its access with little constraint.*
>
> *It would be reasonable to expect that, without regulation, further price increases at the port would follow and this would be a bad outcome for users and the economy, particularly given the history here…*

However, Yancoal's objections are ultimately grounded in what it sees as flaws in the consideration of criterion (a).

In summary, Yancoal considers that:

(a) the NCC is correct in its assessment that criterion (b) (foreseeable demand at least cost) and (c) (national significance) are satisfied for the reasons set out in the NCC Statement – such that they are not further addressed in this submission;

(b) the NCC's interpretation of what criterion (a) legally requires is correct;

(c) the NCC's assessment than PNO has market power and in the absence of declaration would face no constraints from users or other contractual or regulatory arrangements is also clearly correct and reflects the market realities;

(d) the issues in relation to criterion (a), are in the application of that interpretation to the relevant circumstances – and particularly:

    (i) failing to take account of the full extent of likely future price rises that would be profit maximising for PNO in the absence of declaration; and

    (ii) substantially overestimating PNO's commercial incentives not to raise prices even if that causes a reduction in volume;

(e) following a reconsideration of those issues in respect of criterion (a) it will become evident that declaration has a material positive impact on the environment and opportunities for competition in the Port of Newcastle catchment coal tenements markets and promotes

[1] ACCC Concerned by NCC's Draft Recommendation on Port of Newcastle, 19 December 2018

investments in such coal tenements markets – such that both criterion (a) and (d) are satisfied; and

(f) accordingly, as all of the declaration criteria are satisfied, the NCC is bound to recommend against revocation.

Given everything turns effectively on part of the NCC's reasoning regarding the application of criterion (a), and particularly the NCC's analysis of PNO's incentives in the absence of declaration, this submission focuses principally on that reasoning.

2 Revocation – section 44J

(a) NCC is required to be positively satisfied a criterion is not satisfied

Yancoal agrees with the NCC's view that the NCC may only recommend revocation if it considers that one of more of the declaration criteria are not satisfied.[2] That is clearly consistent with the wording of section 44J(1) *Competition and Consumer Act 2010* (Cth) (***CCA***).

That conclusion is important as it requires that, in the context of a revocation application, the NCC must be positively satisfied that a criterion (most relevantly here, criterion (a)) is not satisfied.

Yancoal considers that is a difficult conclusion to reach given that, in order to be so positively satisfied, the NCC is required to make judgements about how PNO is likely set prices in the absence of declaration, and how that will impact on the environment for competition in dependent markets, out as far as 2031.

As the NCC acknowledges, there is considerable uncertainty about incentives and/or market conditions in the longer term.[3]

However, consistent with the NCC's own analysis, there is no evidence of any constraints on PNO's likely conduct in the absence of declaration, such that the NCC would need a high degree of certainty that it would not be profit maximising for PNO to raise prices in a way that impacted on volume and competition in dependent markets. For the reasons discussed in section 3 of this submission below, Yancoal considers such a finding is not reasonably open based on the evidence before the NCC.

(b) Residual discretion

It is not entirely clear to Yancoal from the NCC Statement whether Yancoal's interpretation (that section 44J CCA includes a discretion not to recommend revocation where the NCC is positively satisfied a criterion is not satisfied) has been rejected by the NCC or merely that the NCC does not consider it useful to analyse it as a two-step process.[4]

Yancoal continues to consider the clear use of discretionary wording (i.e. may) in the section suggests a discretion exists, and there is nothing in the NCC Statement (or the CCA) which explains why that discretionary wording should be given a mandatory interpretation.

Ultimately, Yancoal considers the declaration criteria are satisfied in any case, but to the extent the NCC finds otherwise, Yancoal considers that the circumstances of this application, the disparity revocation is likely to create between Glencore and other users, the object of Part IIIA, and the disruption to regulatory certainty caused by a revocation, all suggest any discretion should be used to not recommend revocation.

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[2] NCC Statement at [4.4]

[3] NCC Statement at [5.7]

[4] NCC Statement at [3.18]

3 Criterion (a) – Promotion of competition

3.1 Legal interpretation of criterion (a)

For the purposes of this submission, Yancoal proceeds on the basis of accepting the NCC's preliminary views that:

(a) The focus of criterion (a) (and d) is on the effect of declaration, rather than the effect of access;[5]

(b) Criterion (a) requires a comparison of two future scenarios: one in which the Service is declared and access to the Service is through declaration on reasonable terms and conditions, and one in which the Service is not declared and any access to the Service is in the absence of declaration;[6]

(c) When making judgements about likely future conditions and the environment for competition it is necessary to look beyond short-term static effects;[7]

(d) A promotion of a material increase in competition involves an improvement in the opportunities and environment for competition such that competitive outcomes are materially more likely to occur;[8]

(e) Criterion (a) is not satisfied by:

    (i) a mere change in the distribution of gains between supply chain participants;[9] or

    (ii) the mere existence of a bottleneck monopoly of market power;[10] and

(f) However, the market power of the service provider is relevant to the assessment of criterion (a) as part of the assessment of the service provider's ability and incentives to adversely affect competition in a dependent market.[11]

3.2 Application of criterion (a) – Market Power

Yancoal also agrees with the NCC's preliminary finding that PNO has a bottleneck monopoly position (i.e. market power).[12]

The channel is evidently natural monopoly infrastructure, and that finding is clearly consistent with the NCC's preliminary findings in relation to criterion (b), [13] and the issues raised in Yancoal's previous submissions (regarding the non-viability of duplication due to very high capital costs, and environmental and regulatory issues).

Applying the approach provided in the NCC Statement, the question then becomes whether, in the absence of declaration, PNO would have the ability and incentive to alter the future terms or provision of access in a manner such that, in comparison, the future terms or provision of access with declaration would involve an improvement in the opportunities and environment for competition in a dependent market.

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[5] NCC Statement at [5.4]

[6] NCC Statement at [5.4]

[7] NCC Statement at [5.7]

[8] NCC Statement at [6.51]

[9] NCC Statement at [6.54]-[6.55]

[10] NCC Statement at [6.55]

[11] NCC Statement at [6.56]

[12] NCC Statement at [6.26]

[13] NCC Statement at [7.7]-[7.8]

3.3 Identifying the appropriate dependent market(s) – Defining the Tenements Market

(a) NCC Approach

Yancoal agrees with the NCC's assessment of there being separate functional dependent markets for coal exports, coal tenements, and container port services.

Of those, Yancoal considers the coal tenements markets, is the most important to define appropriately.

Even if the coal tenements markets are considered a 'derivative' market of wider coal markets[14] – the environment for competition in the coal tenements market needs to be considered separately. That is the case because it clearly involves different participants and different substitution possibilities – creating the very real prospect that declaration could promote a material increase in competition in a Newcastle catchments coal tenements market while not doing so in coal markets which have a much wider export sales or global geographic dimension.

In relation to the coal tenements market, the NCC's Statement indicates that the NCC proceeded on the basis of defining the market as the 'market for the acquisition and disposal of exploration and/or mining authorities in relation to thermal coal in the Newcastle catchment area'.[15]

(b) Different markets for different types of tenements

Yancoal considers there are in fact separate markets for exploration and development tenements and mining tenements.

A similar coal tenements market definition was recently considered in the Queensland Competition Authority's (***QCA***) 18 December 2018 Draft Decision in relation to the Dalrymple Bay Coal Terminal coal handling service (the ***QCA Draft Decision***).[16] In the QCA Draft Decision, consistent with the advice of the QCA's independent consultant Balance Advisory,[17] the QCA found that tenements of different types have a different value and are in a different market.

Yancoal considers that finding is entirely consistent with market realties. In particular:

(i) exploration tenements are clearly not substitutable for mining/production tenements (for example, if the price of obtaining one type of tenement was to undergo a small but significant non-transitory increase, that would not cause a potential buyer to substitute to buying the other type of tenement);

(ii) the risks and speculative nature of exploration tenements make them markedly different (and markedly different to value, and of interest to a different class of purchasers);

(iii) as the NCC accepted, the investment profile of participants in the tenements market is likely to be characterised by higher costs and risks than may be present for investment in existing mines;[18] and

(iv) there are some companies that only participate in the market relating to exploration tenements (i.e. acquirers of tenements with a view to selling those tenements prior to development/operation – with this type of acquirer being

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[14] NCC Statement at [6.72]

[15] NCC Statement at [6.149]

[16] Queensland Competition Authority, Draft Recommendation, Part C: DBCT at [3.2.1]

[17] Balance Advisory, DBCTM Declaration Review Independent Opinion for Queensland Competition Authority, 31 August 2018

[18] NCC Statement at [6.152]

specifically referred to in the Australian Competition Tribunal's decision in the Pilbara access disputes in relation to the iron ore tenements market[19]).

(c) Geographic dimension of the market

Yancoal is willing to accept the 'Newcastle catchment area' as an appropriate market definition.

While the NCC Statement suggests that the geographic dimension of the market might be wider, Yancoal considers that is evidently not the case.

The fact that there are companies, like Yancoal, who hold coal tenements in multiple regions is not evidence that they are close substitutes of the type that are included within the same market. As discussed in *Re Arnotts Limited v Trade Practices Commission*[20]

> *the fact that, upon some occasions, some consumers select one product rather than another does not establish that the two products are substitutable, so as to be within a single market. No doubt there are many people who sometimes drink tea and, at other times, coffee. But if, for example, a particular company dominated the sale of tea within Australia, it would thwart the objectives of provisions such as ss.46 and 50 of the Trade Practices Act to deny their application because that company did not dominate the hot beverage market. The fact is that tea and coffee are distinct beverages, for each of which there is a distinct demand. To adopt the test applied in QCMA, a rise in the price of tea would probably cause few consumers to abandon tea for coffee. It is important to remember that the notion of substitutability adopted in s.4E is one which looks to the market itself, not to the habits of individual consumers. The section speaks of goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.*

The QCA Draft Decision provides a useful very recent analysis of the geographic boundaries of coal tenements markets. In particular, in the QCA Draft Decision it was determined there was a Hay Point catchment tenements market – as:

(i) infrastructure costs are sufficiently material to the cost profile of an existing or future mine that they will clearly impact on the valuation of relevant coal tenements; and

(ii) the difference in infrastructure costs in that coal supply chain was determined to be likely to result in the valuations being different for other regions, such that coal tenements in other parts of Queensland were not a close substitute.[21]

Similarly, in the Pilbara disputes it was considered by the Australian Competition Tribunal there was a Pilbara iron ore tenements market, due to issues likely differences in the scale and quality of resources, and different regulatory requirements and business environments.[22]

The reasoning from those previous regulatory decisions would equally apply to differentiate tenements in the Port of Newcastle coal supply chain – where infrastructure costs and coal quality varies materially from that in other coal basins (with the Newcastle catchment predominantly consisting of thermal coal, in contrast to the Bowen Basin in Queensland which predominantly consists of metallurgical coal), and regulatory arrangements which impact on prospects and timing of approvals varying materially between Queensland and New South Wales.

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[19] *In the matter of Fortescue Metals Group Ltd* [2010] ACompT 2 at [1117]

[20] [1990] FCA 473 at [64]

[21] QCA Draft Decision at [3.2.1]

[22] *In the matter of Fortescue Metals Group Ltd* [2010] ACompT 2 at [1119]

(d) Conclusions on appropriate market definitions

It follows from the above analysis that the most relevant dependent markets are:

(i) the market for thermal coal exploration authorities in the Newcastle catchment area; and

(ii) the market for thermal coal mining authorities in the Newcastle catchment area.

3.4 Ability and incentives of PNO to engage in price rises that materially impact on competition

(a) NCC Approach – Lack of constraints on PNO in the absence of declaration

As acknowledged by the NCC, port/channel charges could affect demand for tenements to the extent they influence costs and profitability of exporting coal.[23]

The NCC has also (correctly and consistently with Yancoal's previous submissions) determined that:

(i) current users of the channel services (or other port/channel providers) are not an effective constraint – because users have no effective alternative to using the Service, limited ability to pass on increases in Service access charges, and the demand for the shipping channel service is relatively price inelastic;[24] and

(ii) the very limited extent of constraints or influence arising from the Ports and Maritime Administration Act and Regulation prices oversight regime and the lease arrangement with the State of New South Wales do not provide effective regulatory or contractual restraints which would limit any effects on competition of PNO's conduct in the absence of declaration;[25] and

(iii) with declaration, the actuality and/or threat of arbitration by the ACCC has, and will continue to result in increased incentives and likelihood for PNO to provide 'reasonable terms and conditions' – which is likely to be more favourable for users than the terms which would exist in the absence of declaration.[26]

It follows from the conclusions on market power and constraints described above that PNO has the clear ability, in the absence of declaration, to raise prices to a point at which competition in the coal tenements markets would clearly be adversely impacted.

The NCC's assessment of criterion (a) therefore rests solely on the NCC's finding that PNO has incentives not to do so in pursuing a profit maximising strategy. That assessment is critically analysed below.

(b) NCC Approach – PNO's incentives in the absence of declaration

The NCC has, logically, concluded that as a commercial entity, PNO has an incentive to maximise profits.[27]

The key question is, in the absence of declaration, what would be PNO's likely profit maximising strategy.

[23] NCC Statement at [6.158]

[24] NCC Statement at [6.27]

[25] NCC Statement at [6.41]-[6.43]

[26] NCC Statement at [6.46] – [6.49]

[27] NCC Statement at [6.26]

The key reasoning in the NCC Statement about that question is the following (our emphasis added):[28]

> *If price rises imposed by PNO materially impaired the global competitiveness of coal leaving the Port or led to coal operations in the Hunter Valley ceasing to operate, it is likely the flow on effect would be a reduction in volumes shipped through the Port and less revenue realised by PNO.* ***The Council notes that it is possible that reducing coal volumes through the Port may not diminish PNO's profitability … However, considering PNO's ongoing reliance on coal export revenues, the Council does not consider this likely. The Council considers it more likely that PNO will have the incentive to maximise the volume of coal passing through the Port rather than set prices at a level that materially reduces coal throughput****. The Council considers that, with or without declaration of the Service, PNO's commercial motivation is to ensure that the Service supports the ongoing coal export market operation and its expansion, rather than setting prices at a level that leads to a reduction of coal production (and would impact competition in the coal export market).*
>
> *The Council considers that commercially realistic changes to Service charges (that is, charges set at a level that are not above the profit maximising level) which might arise in the future without declaration (even changes materially above those that have been imposed to date) would not have a material impact competition in the coal export market compared to the future with declaration.*

Accordingly, it appears from the NCC Statement that the NCC's preliminary view that the likely price rises without declaration are 'unlikely to be a significant cost component or driver of profitability in the coal export market' is based on a view that PNO would maximise its profit by not increasing its prices or only increasing prices to a relatively minimal extent (in dollar terms) so as to instead maximise channel throughput volume.

Yancoal considers that is an extremely dangerous assumption that is not likely in the absence of declaration and not a finding that is warranted in the circumstances.

In particular:

(i) the test required by criterion (a) is, as recognised by the NCC[29] a forward looking with and without test – such that the static price reference points the NCC has available (i.e. prices currently, the pricing that was put forward by PNO in the context of an arbitration or the pricing determined by the ACCC) are not of any real evidentiary value in determining the likely magnitude of the future price rises;

(ii) in addition those prices are prices which have been put forward by PNO in the context of the constraints imposed by an existing declaration and an ACCC arbitration, such that they are clearly not representative of the terms that are likely to apply in the future in the absence of any such constraint;

(iii) the NCC has concluded that reasonable terms and conditions as a result of declaration are likely to be more favourable to users than those set by PNO in the absence of declaration;[30]

(iv) the NCC has concluded that demand is relatively price inelastic[31] – such that the volume of usage of the channel service would be anticipated to change very little in response to material price increases; and

[28] NCC Statement at [6.98]-[6.99]

[29] NCC Statement at [5.4]-[5.7]

[30] NCC Statement at [6.49]

[31] NCC Statement at [6.27]

(v) the NCC (and for that matter PNO) has not provided any economic modelling which substantiates that maximising volume, rather than materially raising prices, would be a profit maximising strategy – which is surely necessary when all evidence suggests the contrary.

Consequently, Yancoal considers the preliminary views the NCC has expressed about PNO's profit maximising conduct in the absence of declaration need to be reconsidered, as the conclusion on criterion (a) (and, as discussed further in section 4 of this submission below, in fact the entire revocation recommendation) turns on whether that view is correct.

(c) PNO's likely profit maximising strategy is raising prices not maximising volume

To determine the profit maximising strategy for PNO in the absence of declaration, an economic analysis similar to that conducted in the Synergies Report (provided to the NCC by Glencore) needs to be conducted based on modelling PNO's revenue based on demand projections and how that demand would respond to price increases.

The Synergies Report provides evidence that a $3/tonne charge is clearly profit maximising at likely coal prices. What it does not show is that $3 / tonne is the maximum likely increase that would be profit maximising. Rather, the Synergies Report expressly provides that:[32]

> *Importantly, this analysis does not mean that the highest of the considered price increases is the profit maximising price. Given the relative insensitivity of volume from existing mines to changes in port charges, it is quite likely that further price increases beyond that shown in these scenarios would increase PNO's profits even further*

As the NCC recognises, users do not have an alternative to use of the channel – so this is not a circumstance where user's potential switch to a competing supplier imposes a constraint on PNO's ability to impose price rises.

There is also nothing which would require PNO to continue to use a 'building blocks' methodology for calculating revenue or pricing – such that any limitation that such a methodology is perceived to provide, is not credible.

Accordingly, the only likely constraint or incentive that exists for PNO in the absence of declaration is therefore that it has an incentive to ensure that demand does not drop below the point that further price increases per tonne are no longer revenue maximising for PNO.

This should, as a matter of economic principle, allow PNO to increase its charges to expropriate all profits of coal producers above their marginal costs (as coal producers would continue to operate provided they can meet their marginal costs – as they incur the fixed and sunk costs irrespective of operation).

Even allowing for the fact that the NCC considers that PNO may not be able to price discriminate, demand is highly inelastic, such that it would be anticipated that it would be profit maximising for PNO to engage in very significant price rises that expropriate most of the profits of the more profitable coal producers, even where that reduces the volume of throughput by removing more marginal producers from the market.

Why demand for existing producers is price inelastic

Demand for the channel is highly price inelastic such that demand would be anticipated to fall slowly relative to price increases.

That is the case for a few key reasons:

[32] Synergies Economic Consulting, Port of Newcastle – Assessment of Revocation Application by Port of Newcastle Operations, 8 August 2018 at 28

1) High sunk capital costs – high capital costs in the development of mines with the intention of earning a return over a long mine life characterise the coal industry. Yet those costs are sunk such that coal producers will continue operating provide they cover their marginal costs.

2) Coal supply chain take or pay charges - while the channel charges themselves are levied on an actual usage basis, coal producers are subject to long term take or pay arrangements at the coal terminals (PWCS and NCIG), ARTC's Hunter Valley rail network and rail haulage agreements. The take or pay arrangements for the coal terminals and rail access are actually subject to annual extensions – such that in assessing how a coal producer would respond to an increase in price, it is important to recognise that a decision by a producer to stop production will result in substantial economic losses through ten years of take or pay for below rail and port charges, and typically somewhere between 1-10 years of haulage charges.

The simple examples below seeks to demonstrate the magnitude of increases to the channel charges which are likely to be profit maximising:

Example 1 - $10 / tonne price increase

Current charges are stated by the NCC[33] to be $0.7553 per gross tonne for the navigation service and $0.746 per revenue tonne for the wharfage charge.

The combined volumes of coal exports through the channel for 2017 were approximately 161.4 million tonnes.[34]

PNO's costs are largely fixed and given the significant spare capacity that exists, it is likely the costs will remain similar irrespective of changes in volume.

A $10/tonne increase would, assuming volume remained the same, provide PNO with additional revenue of approximately $1.614 billion.

For revenue to be lower at the increased price, volume would have to fall dramatically (which is inconsistent with demand being price inelastic).

If it was simplistically assumed that gross tonnes and revenue tonnes would encounter corresponding changes, our estimate is that demand would need to fall to approximately 21.5 million tonnes before a price rise of $10/tonne would decrease revenue compared to the existing charges.

That sort of fall simply will not occur as many mines would remain profitable at that higher charging level – even though some marginal mines could clearly not.

Example 2 - $15 / tonne price increase

A $15/tonne increase would, assuming volume remained the same, provide PNO with additional revenue of approximately $2.421 billion.

Using the same assumptions as for example 1, our estimate is that demand would need to fall to approximately 15 million tonnes before a price rise of $15/tonne would decrease revenue compared to the existing charges.

Again, that sort of fall simply will not occur as many mines would remain profitable at that higher charging level – even though some marginal mines could clearly not.

This sort of goal-seeking analysis can be conducted for even higher increases, and indicates that very substantial drops in volume would be required in order for dramatic

[33] NCC Statement at [6.93]

[34] Port of Newcastle Operations Pty Limited, *Port of Newcastle 2017 Trade Report*, April 2018

price increases (well above those the NCC appears to have considered) would be profitable.

Against that backdrop, Yancoal has real difficulty in understanding how it can be simply concluded that it is profit maximising for PNO to maximise volume, rather than raise prices to a point where investment decisions are impacted for some (but not all) producers.

The only credible critique that Yancoal can see of the above analysis is that it could be argued that sizeable increases may over the longer term begin to more substantially impact future volumes. However, if PNO's submissions, as restated in the NCC Statement, are to be believed (that an average miner has profit margins of $45.39/tonne),[35] then substantial volumes will continue to be delivered, even at price rise well above $10-15/tonne, particularly taking into account:

(i) that is an average – such that mines with lower operating costs or higher quality coal will have higher profit margins; and

(ii) the take or pay commitments coal producers have will make it costly for producers to cease production.

Of course, some volume drop will occur – as the more marginal mines highest on the cost curve with lower margins will become economically unviable – but PNO is clearly incentivised to maximise profit at the cost of those marginal volumes.

In addition, PNO has the ability to reset prices annually to ensure that where the coal price decreases it reduces the charges so as to not lose too much volume, such that the potential for future changes in coal prices does not change their incentives to charge a profit maximising price.

Once it is properly appreciated that it is profit maximising for PNO to engage in substantial price rises that impact on investment decisions of some users and would make efficient but more marginal mines unviable, such that efficient investment into tenements which would underlie such mines in the future would obviously be hindered, that makes it absolutely clear that criterion (a) would be satisfied.

Having regard to the NCC's comments in the NCC Statement at [6.161], Yancoal confirms that the potential for prices rises of the nature discussed above will clearly influence its decision to participate in the tenements market in the Newcastle catchment – particularly as it relates to tenements which are more marginal in nature. It cannot see why that would not be the case for other coal explorers, developers and producers.

3.5 Given the greater price increases that can apply – uncertainty is far more important than the NCC has anticipated

The NCC's preliminary view was that uncertainty about charges at the Port of Newcastle 'is likely to be relatively small' related to other uncertainties facing coal producers, 'because the cost of access to the Service is itself a small component and the extent to which it might increase in the future is limited' such that it would not play a determinative role in investment decisions.[36]

However, as demonstrated above, the magnitude of potential future increases in charges is not anywhere near as limited as the NCC Statement appears to contemplate.

Consequently, the impact of the uncertainty of such future prices clearly needs to be reconsidered.

[35] NCC Statement at [6.94]

[36] NCC Statement at [6.103] and [6.105].

At a minimum, when potential buyers undertake a discounted cash flow analysis in seeking to value a tenement they will need to account for the potential for very significant increases (even the clearly profitable $10-15 price rise modelled above accounts for up to a third of PNO's estimate of the average margin of a coal producer, and therefore would be anticipated to make more marginal operators uneconomic) which will clearly prevent some efficient transactions and investments in the coal tenements market from occurring.

This is a major issue for an industry where there are high sunk costs to develop a coal mine, and long term take or pay contract liabilities assumed under rail and port arrangements, which are incurred with a view to earning a return over a long economic life, such that a coal producer is particularly exposed to subsequent prices rises after development costs have been incurred and take or pay contracts entered.

Consequently it is not the case that the investment decision for a coal tenement in the Newcastle catchment has to be on the 'knife's edge' relative to an alternative coal tenement in another market (as the NCC Statement suggests[37]) – rather the magnitude of the likely price rises in the absence of declaration will make tenements in the Newcastle catchment materially less attractive such that investment will instead occur in tenements in other coal regions.

Yancoal acknowledges that there are other uncertainties which face potential acquirers of such tenements. However, variables like coal prices and foreign exchange variations are issues set by the market on which coal industry players are both sophisticated in estimating and have other tools such as hedging and managing contract mix to manage. Whereas, the exposure to PNO's future price increases is completely unmanageable.

3.6 Glencore's advantage in the absence of declaration

It follows from the above analysis that Yancoal also disagrees with the NCC's preliminary findings that:

(a) any competitive advantage to Glencore in the absence of declaration will be minimal[38] - given the extent of likely price rises the advantage is likely to be highly material, placing Glencore in a competitive advantage over all other potential coal tenement buyers in the Newcastle catchment coal tenement markets; and

(b) whether Glencore has access on more favourable terms is not dependent on declaration[39] - when the issue is not really whether Glencore achieve the current outcome the ACCC has ordered or something less favourable, but that it will be immune from the price rises that PNO will be incentivised to impose in the absence of declaration.

The NCC Statement goes on to suggest that 'if the possibility of Glencore retaining such an advantage was a significant concern to market participants then they could have addressed this by seeking arbitration under section 44ZZCA of the Act'.[40]

However, that fails to appreciate that any attempt by a user to do so would be met with the same delays and challenges brought against Glencore by PNO, with a view of seeking to prevent there being an arbitrated outcome before a decision is made in relation to revocation. In other words, any attempt to seek an arbitration now would involve substantial expense and would be unlikely to achieve anything if there is a decision to revoke (which the NCC is currently proposing). For that reason, Yancoal, which has already sent a request to negotiate to PNO, has not yet sought

[37] NCC Statement at [6.154]

[38] NCC Statement at [6.115]

[39] NCC Statement at [6.113]-[6.114]

[40] NCC Statement at [6.115]

arbitration. The possibility of significant price rises is of a significant concern to Yancoal, but given the timelines for an arbitrated outcome (once all legal challenges PNO could bring are taken into account) relative to the timelines for a decision on revocation – Yancoal (and other users) have little option but to wait until either the revocation application is rejected or there is greater certainty that that will occur.

3.7 Economic Hold-up

The issue of economic hold-up was well described in the ACCC's second submission to the NCC:[41]

> *Absent declaration, any investments by customers also face the potential effects of a threat of hold-up. That is, customers will be reluctant to invest, or will make less desirable investments, due to the threat that once an investment is made, the monopoly service provider will seek to change the terms and conditions of use in its favour. This dampening effect on future investment can harm the competitive environment in the dependent markets.*

Yancoal considers that it is not necessary for PNO to be able to price discriminate between coal producers in order to impose economic hold-up (as the NCC Statement appears to suggest[42]).

Not all coal producers have the same level of profitability – so the hold up problem is best thought of in these circumstances as being that where PNO has the right to set new prices each year, the profit maximising price in a future year will be a price at or above the point at which a particular producer's mine is no longer profitable (even if numerous other mines remain profitable so that any reduction in PNO's revenue through loss of volume is more than offset by the additional charges based on the remaining throughput, i.e. the rise is profit maximising for PNO).

The risk of economic hold-up will have a strong chilling effect in the coal tenements market. Even through demand for the channel service from existing producers is highly price inelastic for the reasons noted above, for potential tenement purchasers who can simply decide not to invest in a tenement (without the asset stranding or take or pay liability tail an existing producer would experience), it would be anticipated there would be an immediate response and reduction in demand for and competition for tenements.

While Yancoal acknowledges that PNO will have some degree of incentive not to capriciously impose constant increases due to potential long term material reductions of throughput (as the NCC Statement suggests[43]), a single material increase shortly after revocation followed by a period of stable prices (i.e. maintaining a monopoly price which maximises profit, due to the high volume of long life existing mines which would continue to operate, despite producing an inefficient reduction in volume) will not produce the same long term deterioration – and is not disincentivised in the same way. However, that strategy would clearly have a chilling effect on investment and competition in the Port of Newcastle catchment tenements market.

3.8 Other commentary in the NCC Statement

(a) Alleged lack of submissions from 'small users'

The NCC notes that it has not received submissions from 'small users' that are said to be the parties which are most likely to be affected.[44]

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[41] ACCC, Submission to NCC – Possible NCC recommendation to revoke declaration at the Port of Newcastle – relevance of ACCC arbitration determination, 29 October 2018

[42] NCC Statement at [6.117]

[43] NCC Statement at [6.118]

[44] NCC Statement at [6.155]

There are a few obvious reasons for that, namely:

(i) smaller companies typically do not have the resources to make lengthy submissions;

(ii) smaller producers typically consider that the major producers and, in this process, the NSW Minerals Council or user owned coal terminals, will seek to protect the industry more generally; and

(iii) these smaller companies will, in the absence of declaration, have to deal with PNO in the future.

Accordingly it is a misunderstanding of the reasons submissions are not being made by small producers to somehow infer that means that the adverse impact on competition is less than is being stated by other coal industry participants.

In addition, producers like Yancoal have a range of tenements in their portfolio, such that while its incentives to make investments in tier one operations like Hunter Valley Operations, Mt Thorley Warkworth and Moolarben will not be materially affected, it has other tenements projects which have lower profit margins and may be affected. The issues arising from PNO's likely price rises in the absence of declaration impact on marginal operations, and the competition in respect of tenements that underlie future operations of that type, irrespective of whether they are owned by small or large participants.

(b) Container / cruise terminal markets

Yancoal does not consider it is well placed to be able to provided informed submissions on the container terminal and/or cruise terminal markets.

It is therefore reliant on participants in those indutsries and the NCC to consider whether criterion (a) is satisfied in respect of dependent markets relevant to those industries.

4 Criterion (d) – Promotion of the public interest

(a) NCC approach

Yancoal agrees with the NCC's summary of the legal requirements for considering whether criterion (d) is satisfied, including accepting for the purposes of that analysis the results of criterion (a).[45]

The NCC's preliminary view was expressed as being that while there are some benefits (and some detriments) that are likely to be realised from declaration, the NCC is not positively satisfied that declaration would promote the public interest.[46]

(b) Criterion (a) being satisfied will lead to criterion (d) also being satisfied

However, the NCC's analysis of criterion (d) was obviously conducted in the context of the NCC's preliminary findings in respect of criterion (a) that the likely changes in charges without declaration would not be of sufficient magnitude to impact investment decisions.[47]

Given criterion (d) should be assessed based on the outcome in respect of criterion (a), and criterion (a) should actually be satisfied for the reasons set out in section 3 of this submission above, Yancoal considers that it is clear on further analysis that, absent declaration, PNO has the ability and incentive to increase prices to (and past) the point that will materially impact investment decisions in the tenements markets.

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[45] NCC Statement at [9.32]-[9.37].

[46] NCC Statement at [9.63]-[9.64].

[47] NCC Statement at [9.41]

Yancoal submits that that will result in a completely different assessment of the effect of declaration on investment in dependent markets (being one of the mandatory considerations).[48]

Based on the reasoning in the NCC's analysis – the other public benefit and detriments are relatively balanced, such that it would be expected that once it is concluded that there are material impacts on investment in the coal tenements market, taking into account the economic growth and activity that drives, criterion (d) will clearly be satisfied.

5 Conclusion

For the reasons set out above, Yancoal considers it is clear that:

(a) PNO has the ability and incentive to, in the absence of declaration, substantially increase the prices for usage of the channel service;

(b) The existence or risk of such future price rises will adversely impact on investment in the Newcastle catchment coal tenements market;

(c) The adverse impact on investment in the Newcastle catchment coal tenements market without declaration will reduce and hinder efficient entry into the coal tenements market and the volume and supply of coal tenements in the market – such that declaration will promote a material increase in competition and criterion (a) will be satisfied; and

(d) The adverse impact on investment in the Newcastle catchment coal tenements market, shows a clear public benefit in terms of investment in dependent markets arising from declaration and criterion (d) will therefore be satisfied.

Accordingly, all the declaration criteria should be satisfied, and consequently Yancoal submits that the NCC is precluded from recommending revocation under section 44J (read with section 44F) CCA.

[48] Section 44CA(3)(a)(ii) *Competition and Consumer Act 2010* (Cth).