



Level 17, 2 Lonsdale Street
Melbourne Vic 3000
GPO Box 520
Melbourne Vic 3001
tel: (03) 9290 1800
www.accc.gov.au

Contact officer: Justin Martyn
Contact phone: (08) 8456 3536
Contact email: justin.martyn@accc.gov.au

23 November 2020

Richard York
Executive Director
National Competition Council
GPO Box 250
MELBOURNE VIC 3001

Dear Mr York

Re: The National Competition Council's draft recommendation not to declare Services at the Port of Newcastle

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

The attached submission considers the Council's draft recommendation against declaring the shipping channel service (**the Service**) at the Port of Newcastle, and provides additional information and analysis to help inform the Council's final recommendation to the Minister. The ACCC believes that there are a number of points which, if approached differently, may result in a different outcome.

The submission outlines what the ACCC considers are crucial elements to the assessment of criterion (a) and criterion (d). The submission is supplementary to our previous submission in response to the application for declaration and builds on previous submissions the ACCC has made in relation to the revocation of declaration of the Service. If required, the ACCC can provide more detailed supporting information.

If you would like to discuss this letter or any issues contained in the attached submission, please contact Matthew Schroder, General Manager, Infrastructure and Transport – Access and Pricing, on (03) 9290 6924, or Justin Martyn, Director, Regulated Access – Rail, on (08) 8456 3536.

Yours sincerely

Rod Sims
Chair

Introduction

The ACCC has considered the National Competition Council's (**Council**) draft recommendation against declaration of the shipping channel service at the Port of Newcastle (**Port**). The ACCC has a number of comments about the Council's assessment.

If the Council's draft recommendation is adopted, it would reduce future threats of declaration of essential services, reducing constraints on non-vertically-integrated monopolists, thereby providing them with increased scope to charge monopoly prices to the detriment of the Australian economy. This is at odds with the objects of Part IIIA of the *Competition and Consumer Act 2010* (**Act**) regarding the promotion of the economically efficient operation of, use of and investment in infrastructure.

This submission touches on a number of issues including:

- objects of Part IIIA
- the Council's assessment of, with and without declaration
- the ability and incentive to deny access of charging monopoly prices
- materiality
- the impact on specific industries
- the public interest test.

This submission provides only a summary of our concerns. If the Council requires, the ACCC can provide more detailed supporting information.

This submission is supplementary to our previous submission to the Council (dated 20 August 2020) on this matter. Both submissions on this matter build on previous ACCC submissions relating to Port of Newcastle Operations' (**PNO**) application for revocation of declaration of the Service.

Objects

The Council states in its Draft Recommendation that it disagrees with the ACCC's submission that the objects of Part IIIA require that the assessment of whether criterion (a) is met focuses on whether declaration would promote the economically efficient operation of, use of, and investment in the infrastructure by which services are provided.¹ The Council contends that such an approach would be to control the language of criterion (a) or to seek to command a particular outcome based upon an assessment of efficiencies beyond the assessment of the effect of declaration on competition.

The ACCC disagrees with the Council's interpretation of our August 2020 submission. We do not contend that the objects of Part IIIA should replace the statutory language of the declaration criteria. Rather, we consider the declaration criteria should be interpreted in a manner which is consistent with the objects and, as such, an assessment of criterion (a) should give due weight to the increase in competition that economic efficiency in the pricing of the monopoly infrastructure can promote. Indeed, it appears the Council has not given due consideration to the potential benefits to competition in upstream or downstream

¹ NCC Draft Recommendation, paragraph 4.13, page 13.

markets from the efficient operation of the monopoly infrastructure when considering criterion (a).

One of the objects of Part IIIA is to promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting competition in upstream or downstream markets. Therefore, it is inherent in the language of Part IIIA that efficiency promotes competition.

Accordingly, we submit that the Council has not given sufficient weight to the potential benefits to competition in related markets that can arise from ensuring economic efficiency in bottleneck monopoly infrastructure.

Assessment of with and without declaration

The ACCC considers the Council's assessment of terms and conditions with and without declaration is based on an inappropriately limited time period and narrow considerations. The ACCC is concerned that undue weight has been placed on the immediate terms of PNO's Deed, an offer which includes terms and conditions with potentially problematic longer term implications for customers.

The ACCC understands that the development of the Deed has not included negotiations with customers, and that customers have indicated that parts of the agreement are not considered to be fair and reasonable.

Appropriate time horizon

The ACCC is concerned that, notwithstanding the Council's statement that it considered longer term issues, it appears that the Council has given considerable weight to 'discounted'² navigation service charges (**NSC**) in 2020, and has not considered the broader and longer term implications of the Deed:

While the Deed contains clauses that enable PNO to adjust the NSC in certain circumstances, the Council considers that the charges contained within the Deed represent a reasonable indication of the prices likely to be paid by users of the Port in a future without declaration of the Service.³

Critically, the assessment of the effect of declaration against the situation without declaration must have regard to the range of potential market conditions across the entire period in which declaration could apply. Where terms have been put forward by the provider they are required to be assessed over the potential period of declaration (for example 15-20 years). As the Australian Competition Tribunal (**the Tribunal**) makes clear, the assessment is required to take into account a broad range of issues over an appropriate period of time:

The understandable commercial incentive to maximise its profitability, and its revenue, may be served in different ways at different times, depending upon the strength of the coal export market.⁴

² Port of Newcastle, *Port User Pro Forma Long Term Pricing Deed*, page 1.

³ NCC Draft Recommendation, paragraph 1.13, page 2.

⁴ Australian Competition Tribunal, Application by Glencore Coal Pty Ltd [2016] ACompT 6, 31 May 2016, paragraph 166 page 36.

Terms and Conditions

It can be argued that certain terms of the Deed are illustrative of market power. For example, in other regulated industries customers are not compelled to pay twice for contributed assets.⁵ Contributed assets are excluded from the electricity industry and water industries. It is unclear why users would be required to agree to pay for contributed assets, already funded by third parties, to gain access to the Port.

The Full Federal Court recently stated:

Regard to the three aspects of economic efficiency described above reveals that there is the prospect of economic inefficiency if the provider of an essential facility can appropriate (and charge a price for access to) the value of capacity the cost of which has been borne by others.

The result will be that to the extent that the cost of the capacity is still being borne by others, they will make their economic decisions and price their products accordingly. Yet, in addition, the value of that capacity will have to be paid for and borne again by a third party who has to pay for access. By pricing twice the same value into the market, there is allocative inefficiency. The capacity is attributed with more value than it should be and market decisions are distorted in consequence. The cost of access to the capacity to the market as a whole is doubled, thereby distorting economic decisions leading to economic inefficiency.

In addition, there will also be productive inefficiency if the double burden is imposed on parties who have already borne the cost of the extension and must now pay again for access to that capacity. However, there is inefficiency even if that is not the case.⁶

The Federal Court recognises the allocative and productive inefficiencies that arise when user contributions are charged twice and the associated monopoly rents are allowed.

Additionally, the Council appears to have placed considerable weight on the 'discounted' price (\$0.81 per gross Tonne (**GT**)) offered to customers, compared to the higher price offered via PNO's open access price (\$1.04 per GT)⁷. This discounted price appears to provide a short term incentive for customers to sign, notwithstanding the longer term implications. In the current low-inflation, low cost of debt and low labour cost pressure environment, it is not clear that it should be accepted that customers should agree to a 4 per cent per annum price increase over the next 10 years (for NSC or wharfage charges).

The Council also places some merit on the Deed having a dispute resolution process (Clause 9 of the Deed) but it should be noted that the Deed explicitly excludes disputes relating to certain prices (i.e. the NSC or wharfage charges, (as set in the Deed))⁸. This exclusion seems to diminish the benefits of the dispute resolution process.

By the Council concentrating on prices in 2020 and stating there is no material difference between an outcome with declaration and an outcome without declaration the Council appears to agree with PNO's premise that PNO's offer is reasonable without giving consideration to these longer term factors.

Additionally, there is a risk that the Deed offered by PNO has vague or open ended clauses. Therefore, the Council could also consider issues around incomplete contracting. Incomplete

⁵ Port of Newcastle, *Port User Pro Forma Long Term Pricing Deed*, page 13 (Initial Capital Base).

⁶ Federal Court of Australia, *Glencore Coal Assets Australia Pty Ltd v Australian Competition Tribunal* [2020] FCAFC 145, 24 August 2020, paragraph 63, page 17.

⁷ NCC Draft Recommendation, paragraph 1.14, page 3.

⁸ Port of Newcastle, *Producer Pro Forma Long Term Pricing Deed*, Schedule 3, Clause 6, Definitions (Excluded Dispute).

contracts allow for the possibility of opportunistic behaviour and hold up through a failure to define terms, reveal costs, specify contingencies, and limit the ability of a party to monitor and enforce contract terms, diminishing the benefits of the agreement to customers. For example, an upfront discounted value may simply result in higher 'catch-up' charges down the track.

In summary, the ACCC believes that the Council's assessment of the Deed's terms and conditions with and without declaration does not fully consider the implications of declaring or not declaring the Service.

It is important to consider pricing, and terms and conditions in periods beyond 2020 and how PNO may act following the expiry of the Deed, given the reduced threat of declaration if the Minister decides not to declare the Service.

Ability and incentive to deny access of charging monopoly prices

The ACCC does not agree with the Council's assessment of potential constraints on PNO's monopoly power by state government intervention, reputational harm, the length of the lease or the current level of capacity at the Port.

Government intervention and reputational harm

The Council indicated that the potential for the NSW Government to intervene in the market presents some level of constraint on PNO's pricing.⁹ However the NSW Government has not intervened to date and as noted by the Council, taking steps to obtain redress for PNO's potential future behaviour would entail a significant time and cost commitment.

The Tribunal has previously noted:

Nor does the PMAA [Ports and Maritime Administration Act 1995 (NSW)] provide Glencore, or any access seeker in relation to the Service, with any right to negotiate the terms and conditions of access or to provide for any enforcement process if agreement as to the terms of access cannot be reached.¹⁰

The ACCC does not consider a price monitoring framework of itself to be an effective constraint on market power unless there is an associated credible threat of regulation.

Further, the Council states:

harm to PNO's reputation as the operator of the Port can be expected to impact on its commercial returns¹¹

It is suggested that this will place some constrain on its behaviour. However there seems to be limited evidence that this would be a constraint on PNO's future behaviour.

Lease

The Council also discusses PNO's incentive to maintain its profits over the remaining 92 years of its lease¹². It is unlikely that the current revenue base for PNO will remain static over

⁹ NCC Draft Recommendation, paragraph 7.37, page 43.

¹⁰ Australian Competition Tribunal, *Application by Glencore Coal Pty Ltd [2016] ACompT 6*, 31 May 2016, paragraph 15 page 3.

¹¹ NCC Draft Recommendation, paragraph 7.38, page 44.

¹² NCC Draft Recommendation, paragraph 7.40, page 44.

the next 92 years. Further, it is difficult for third parties to assume the strategic and financial goals applicable to a private business, especially many decades into the future.

As it is likely that PNO's focus and incentives will change over time, the Council should consider whether any weight should be placed on the length of the lease.

Capacity

The Council also points out that the Port is not currently operating at capacity¹³ concluding this will provide some *'level of constraint on PON's future pricing'*¹⁴. Following this reasoning, PNO should be reducing prices to encourage increased volumes to utilise more of its capacity. However, since establishment of the current pricing structure in 2015 PNO has not reduced the NSC. Further, the Deed sets out PNO's plans to increase prices for the NSC and wharfage charge, in real terms, over the next 10 years.

Monopolists have an incentive to increase profits and these profits are derived from a combination of the price charged and the volume of services. By its nature, a monopolist is able to increase profits and revenue via price increases, which more than offset any reduction in revenue from a reduction in volumes. The precise point where increases in prices result in a net loss of revenue is subject to the specifics of the situation, but this point would always be higher than the efficient price determined by a regulator.

One of the reasons for regulating is that the inelasticity of demand gives rise to market power and the ability and incentive to raise prices significantly above cost to the detriment of efficiency.

In summary, there does not appear to be sufficient basis upon which to determine that state government intervention, reputational harm, the length of the lease, or capacity will be likely to provide sufficient constraints on PNO's behaviour absent regulation.

Materiality

The Council references PNO's previous study of the costs and impacts of the NSC on total revenue / expenditure for the mining industry, setting out that the NSC is a fraction of the total cost¹⁵. This analysis relies upon PNO's 2018 submission.

The Council then concludes that because the NSC charge is a small fraction of the total cost of coal it is therefore immaterial. The ACCC has concerns with this analysis of materiality. The Council's consideration of materiality would be more comprehensive if it also considered the drivers of investment and business decisions.

Profit focus

The ACCC believes materiality should be assessed based on the profit margin of the business rather than the percentage of total revenue or total cost of the business. Future investment decisions and decisions regarding whether to operate a business or not are not based on revenue or expenditure outcomes but on the resulting profits. For marginal investments, any increase (or threat of future increases) in costs will have a significant and material impact on a business' decisions.

Additionally, while changes in profits impact the annual outcome, these annual impacts are compounded over the life of the investment (i.e. 20 to 30 years). What might initially seem

¹³ NCC Draft Recommendation, paragraph 7.45, page 45.

¹⁴ NCC Draft Recommendation, paragraph 7.59, page 48.

¹⁵ NCC Draft Recommendation, paragraph 7.99, page 58.

small, when compounded over the life of the project may become a material risk and decision point for future investments.

Noting how vigorously the declaration, revocation and arbitration processes have been argued by users of the Port, it would appear that the businesses making the investment decisions consider the charges at the Port to be material.

As an indication of magnitude, the total amount of revenue earned by PNO for NSC was \$86 million in 2019¹⁶ based on a price of \$0.7809 per GT. The ACCC acknowledges that some of the NSC revenue is derived from other sources, however, the vast majority is from coal.

As a simplified example, changing the price to \$0.63 or \$1.04¹⁷ results in a revenue outcome ranging from around \$66 million per annum to \$108 million per annum. A variation of some \$40 million per annum (based on 2019 volumes). The difference in price is linked to the value of contributed assets identified by the ACCC during the Glencore arbitration process. The value of contributed assets of over \$900 million represents the future value of lost profits from PNO's customers.

Fluctuations in prices over time

The above example is based on a pricing range set out by the Council. It should be noted that prices set by a monopolist (without constraint) will fluctuate over time due to external factors. For example coal from Newcastle has fluctuated in price from a high of \$161 to a recent low of \$70¹⁸ per tonne.

Under current conditions, it is likely the monopoly price is relatively low but any recovery in coal prices into the future may increase PNO's ability to increase the NSC charge. This is likely to result in a large range of possible pricing outcomes over time.

In summary, the ACCC submits that the impact on the industry without declaration should be assessed against users' profits and in the longer term there is the possibility of a broad range of pricing outcomes.

Impact on specific industries

The ACCC has some concerns regarding the Council's discussion on the impact on the users from uncertainty in terms of scope and timeframe, and the Council's discussion on price discrimination.

The Council has dismissed producers' concerns that not declaring the service increases the uncertainty for users, indicating that this uncertainty is immaterial compared to the other uncertainties faced by users.¹⁹

Normally businesses will seek to understand all of their risks and find ways to efficiently mitigate these risk (or the potential impacts). Where there are multiple risks faced by a

¹⁶ <https://www.portofnewcastle.com.au/about-our-port/#facts-and-figures>

¹⁷ NCC Draft Recommendation, paragraph 1.14, page 3.

¹⁸ Australian Dollars, as per <https://www.indexmundi.com/commodities/?commodity=coal-australian&months=60¤cy=aud>. Coal (Australia), thermal GAR, f.o.b. piers, Newcastle/Port Kembla from 2002 onwards, 6,300 kcal/kg (11,340 btu/lb), less than 0.8% sulfur, 13% ash; previously 6,667 kcal/kg (12,000 btu/lb), less than 1.0% sulfur, 14% ash

¹⁹ NCC Draft Recommendation, paragraph 7.103, page 59.

business, these will compound the overall risk of a decision, especially where those risks cannot be mitigated.

It appears that users have identified uncertainty of access to the Port as a significant risk to their business (and future investment decisions) and they have entered into this process as a mitigation strategy.

The ACCC notes that many of the other risks identified in the Council's discussion, while large, can to some extent be mitigated by businesses through contractual opportunities reducing the overall impact of these risks. For example, fluctuations in world coal prices can be reduced by contracting/hedging arrangements. If this service is not declared, then it is unclear how users can hedge or avoid the uncertainty regarding access to the Port.

Additionally, the industry makes investment decisions over a 20 to 30-year time horizon. Having certainty for the next 10 years, via the Deed is unlikely to be sufficient to remove the risks associated with such long-term investments. The NSWMC requested 20 years for declaration²⁰ as this is presumably their assessment of the minimum time period required to ameliorate Port access risks for users.

Price Discrimination

The Council has dismissed user concerns regarding PNO's ability to price discriminate between users in the future.²¹ While the Deed allows for "multi-part pricing and price discrimination when it aids efficiency"²², consistent with the language contained in the section 44ZZCA pricing principles, the language in the Deed may not necessarily be interpreted and applied in the same way. For example, the term 'efficiency' is not defined in the Deed and therefore its meaning may be subject to PNO's own interpretation. That is, any price discrimination that PNO could engage in under the Deed is not necessarily consistent with that which would occur with regulated prices in accordance with the section 44ZZCA pricing principles.

The ACCC believes that price discrimination provides additional opportunities for PNO to increase its profits beyond efficient levels and may distort associated markets reducing competition. It is noted that the mining industry relies upon profitable mines to fund exploration costs and expenditures and fund investment to improve and maintain the current conditions in the existing mines. Therefore, allowing price discrimination against the most productive mines is likely to result in less exploration, development and investment in the long run.

In summary the ACCC believes that some weight should be placed on the increased uncertainty to the industry from not declaring and that there is the possibility that detrimental price discrimination may occur in the future (without declaration).

Public Interest Test

The ACCC has some concerns regarding the Council's discussion on the cost of declaration, specifically regarding regulatory administration and the possibilities of bilateral disputes.

²⁰ NCC Draft Recommendation, paragraph 8.2 page 68.

²¹ NCC Draft Recommendation, paragraph 7.52, page 46

²² Port of Newcastle, *Producer Pro Forma Long Term Pricing Deed*, Schedule 3, clause 4.2(k).

Regulatory administration

The Council states that:

*declaration of any service (and any consequent access regulation achieved via a negotiate-arbitrate regulatory model under Part IIIA) has the potential to alter a service provider's incentive to efficiently invest in maintaining or improving infrastructure necessary to provide the service; and/or inefficiently distort the timing of those investments.*²³

However the Tribunal has previously found:

*Given the terms under which any arbitration by the ACCC under Div 3 of Pt IIIA would be applied, and the applicable pricing principles require that regulated access prices be set to meet the efficient cost of providing access and include a return on investment commensurate with the regulatory and commercial risk, the Tribunal is not satisfied that the declaration would cause any adverse effect on incentives or obligations to invest or discourage efficient investment and costs to PNO as the provider of the Service. It has taken into account the fact that declaration would expose PNO to the processes available under Div 3 of Pt IIIA and the costs associated with that. There is no evidence that those costs would be of particular overall significance.*²⁴

Further, the Council references the use of commercial arbitration as set out in the Deed.²⁵ However, this commercial arbitration specifically excludes arbitration on certain prices, possibly limiting the value of a comparison against the ACCC arbitration under Part IIIA.

Bilateral disputes

The Council states:

*It can be expected that a series of bilateral access disputes would add to the administrative and compliance cost associated with declaration of the Service, on balance these costs have the potential to be significant.*²⁶

PNO's submission that declaration would result in bilateral access disputes is only one of a number of possible outcomes.

While declaration gives users recourse to arbitration in the event that negotiations result in an access dispute, such access disputes can be avoided altogether through genuine negotiation that takes into consideration the likely arbitrated outcome. Further, it is not clear that ongoing bilateral access disputes is a likely outcome given the possibility of collective bargaining.

In summary, the ACCC believes the Council is placing too much weight on the impact of regulation on PNO's future investment decisions and not enough on the benefits of regulation (such as the promotion of efficient investment). Further, the Council should consider a broad range of possible outcomes regarding future agreements between PNO and its users, as access disputes can be avoided altogether through genuine negotiation that takes into consideration the likely arbitrated outcome.

²³ NCC Draft Recommendation, paragraph 10.23, page 73.

²⁴ Australian Competition Tribunal, *Application by Glencore Coal Pty Ltd [2016] ACompT 6*, 31 May 2016, paragraph 167, page. 36-37.

²⁵ NCC Draft Recommendation, paragraph 10.27, page 74.

²⁶ NCC Draft Recommendation, paragraph 10.42, page 77.