

NON-CONFIDENTIAL VERSION

2 October 2015

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Dear Mr Crawford

Application for declaration of shipping channel services at the Port of Newcastle

We refer to the above matter (the **Application**), and to your letter to Port of Newcastle Operations Pty Ltd (**PNO**), dated 18 September 2015, and the attached notice issued to PNO under section 44FA of the *Competition and Consumer Act 2010* (Cth) (**CCA**) (**Notice**).

Please find attached to this letter:

- PNO's response to the Notice (**Response, Attachment A**);
- a report prepared by HoustonKemp Economists which addresses certain economic aspects of the Application and associated submissions (**HoustonKemp Report, Attachment B**);
- a report prepared by Castalia Strategic advisors (**Castalia Report, Attachment C**) commenting on the report prepared by Synergies Economic Consulting and which was attached to Glencore's response dated 9 September 2015 to the Council's draft recommendation;
- a submission by PNO regarding the correct approach to the assessment of criterion (a) (**Attachment D**); and

- a submission by PNO regarding the proper characterisation of the charges made by PNO under the *Ports and Maritime Administration Act (1996)* (**Attachment E**).

Confidentiality

PNO has identified information in this letter and its attachments that is confidential. Where PNO has identified that information in this letter is confidential, such information has been provided to the Council on a confidential basis and PNO claims confidentiality over this information.

Pursuant to section 44GB of the CCA, PNO asks that the Council:

- not make any confidential information publicly available, whether under section 44GB(4) of the CCA or otherwise; and
- not publish or make available any confidential information, whether under section 44GC of the CCA or otherwise because the confidential information is confidential commercial information within the meaning of section 44GB(5).

Should the Council refuse this request, PNO requires the Council to return the confidential information to PNO, under section 44GB(6)(a).

Where returned, as required, because the Council refuses this request for confidentiality, PNO understands that, pursuant to section 44GB, the Council must not:

- make the confidential information available under subsection (4);
- publish or make available the confidential information under 44GC; or
- have regard to the confidential information in making its recommendation on the Application.

PNO understands that the Council will not disclose the confidential information to any third parties without first obtaining PNO's written consent (including in the form of a confidentiality waiver), unless otherwise compelled to do so by law. Please advise PNO if this is not the case.

Should the Council be compelled by law to disclose the confidential information, PNO asks the Council to give as much notice as possible to PNO before disclosing the confidential information, so that PNO may consider seeking an order from the Court to protect the information from disclosure.

Yours sincerely

A handwritten signature in black ink, appearing to read "Geoff Crowe".

Geoff Crowe
Chief Executive Officer
Port of Newcastle Operations Pty Ltd

ATTACHMENT A – PNO’S RESPONSE TO THE NOTICE

For ease of reference, we have repeated the questions stated in the attachment to the Notice before providing the answers to each of them.

Please note that a number of the Council’s questions proceed on the basis that the statutory charges are fees for service, which PNO does not concede (see PNO’s submission at Attachment E).

1 Glencore states in its submission in response to the Council’s draft recommendation that China Merchants Group, one of the 50% owners of PNO, has a bulk carrier fleet which includes bulk coal carriers (at p. 17).

1.1 Describe the nature and extent of any vertical integration between PNO and shipping services provided by China Merchants Group or its subsidiaries (CMG), including details of any bulk carrier fleet or vessels in which CMG has an interest.

There is no vertical integration between PNO and shipping services provided by China Merchant Group (CMG) or its subsidiaries or affiliates for the following reasons:

CMG has no ability to determine PNO operational matters

- CMG is not a direct shareholder in PNO. China Merchants Union (CMU) directly holds 50% of the issued shares in PNO, CMG owns 50% of CMU with the other 50% held by Guoxin International (GX). GX is an independent company not affiliated with CMG, and GX and CMG have equal governance rights in relation to CMU.
- CMU itself does not have positive control over PNO. The Infrastructure Fund (TIF), which is managed by Hastings, owns the other 50% of issued shares in PNO and Hastings and CMU have equal governance rights in relation to PNO.
- The interposition of two 50:50 joint ventures between PNO and CMG where the shareholders have equal governance rights means that CMG has no ability to influence PNO operational matters.
- In any event, as a result of the confidential governance arrangements in relation to PNO, CMU has no ability to influence priority of access to the Port. Further details are provided below.

No material interests held by CMG in bulk carrier fleets

- CMG does not hold any direct interests in bulk carrier fleets.
- CMG's only indirect interest in bulk carrier fleets is via its ownership stake in Shanghai stock exchange listed - China Merchant Energy Shipping Co Ltd (CMES). CMG is the largest shareholder in listed CMES which was jointly established in 2004 by CMG along with Sinopec Group, Sinochem Group, COSCO Group and CNOOC Group. CMES successfully listed in 2006 and operates with its own board and management structure.
- Since PNO commenced to operate the Port on 30 May 2014, no ships owned by CMES or its subsidiary, Ming Wah Shipping Company (Ming Wah), have called at the Port of Newcastle.

PNO notes that the ACCC conducted a thorough review of the proposed PNO ownership arrangements prior to PNO commencing to operate the Port of Newcastle, and cleared the transaction from a competition law perspective.

Further details regarding CMG's interests, and CMU's rights are provided below.

CMG does not hold any direct interests in bulk carrier fleets

CMG does not directly own any bulk carrier fleets.

CMES and Ming Wah control a fleet of LNG Carriers, Oil Tankers (VLCC and Aframax) and Bulk Carriers (Handymax, Panamax & Capesize).

There is no current port capacity or trade requirement for LNG Carriers or Oil Tankers (VLCC and Aframax) at the Port of Newcastle.

CMES and Ming Wah operate a fleet of 21 bulk carrier vessels as follows:

Table 1: Bulk Carrier Vessels operated by China Merchant Energy Shipping Co Ltd and Ming Wah

Vessel Type	CMES Vessels	Ming Wah Vessels	Description / Comment
Bulk Carriers Capesize	7		Large bulk carriers at the upper limit of the ports capacity for coal cargoes at 295m LOA and 46m beam.
Bulk Carriers Panamax		2	Medium size bulk carrier
Bulk Carriers Handymax	6	6	Average size bulk carrier at 190m LOA with 32m beam is consistent in size of regular calling coal vessel.

No ability for CMU to influence priority

The agreement between PNO's shareholders (**Shareholders' Agreement**) does not allow CMU to exercise influence to discriminate in favour of ships owned by its related companies or affiliates, or against other ships which are not owned by its related companies or affiliates, in accessing the Port of Newcastle.

The Shareholders' Agreement prohibits CMU and its appointed directors from voting on, and from receiving any information that may be used in deliberations relating to, any proposed transaction involving a related party (including a director of CMU or a related body corporate of CMG). As such, CMU is excluded from the decision making process, at the board level, in relation to any proposed transaction with a shipping line within the CMG group of companies.

[Confidential to PNO]

1.2 State whether any bulk coal carriers owned or operated by CMG use or service the Port of Newcastle and, if so, provide the details of any visits by those vessels to the Port of Newcastle between 1 January 2014 and the date of this Notice.

Having cross-referenced Lloyd's Register of ship ownership records and the Port's vessel visit records extending back to 1 January 2014, PNO has identified only one vessel operated by CMES or Ming Wah

that has visited Newcastle since this date. That vessel, the Pacific Prospect operated by Ming Wah, visited the Port for a single cargo on 22 March 2014 (i.e. prior to PNO commencing to operate the Port of Newcastle).

Records of vessel ownership is not information which PNO maintains or considers in conducting its vessel scheduling functions. When a shipping agent books a vessel it does so by referencing the vessel name. PNO's systems do not capture relevant ship owners or operators and therefore PNO does not have visibility of the ship owner or its charterer.

Vessel ownership can be researched using Lloyd's Register or Seaweb. PNO has used Lloyd's Register to respond to this question. However, this is not done on any routine or procedural level. PNO has no operational need, necessity or incentive to do so given movements of vessels are scheduled based on interaction with the coal export terminals and scheduling rules issued to PNO by the Ports Authority New South Wales (**PANSW**) (see paragraph 1.3 below of this Response).

1.3 Provide details of any procedures, protocols or other measures PNO has in place to prevent any favourable treatment by PNO of CMG vessels using the Port of Newcastle.

PNO does not, in conducting its scheduling function, favour any individual shipping lines or ship. As stated in paragraph 1.2 above, PNO has no visibility of vessel owners or operators during the course of conducting its vessel scheduling function.

The scheduling of vessel movements is undertaken by PNO having regard to the operational requirements of the coal export terminals as well as scheduling rules issued by PANSW.

PANSW rules for priority movements have regard to whether a vessel requires a tidally restricted movement, whether a vessel is a daylight entry only vessel and if a vessel is suitable for a slack-water movement. All of these requirements have regard to navigational safety. Outside of these navigational safety priorities, vessels are booked as and when required by coal export terminals which generally apply a turn of arrival priority basis.

To assist the coal terminals with efficient arrivals and departures of the vessels nominated to their terminals, PNO convenes four live run 'phone hook ups' and one planning phone hook up with PANSW, Port Waratah Coal Services (**PWCS**), Newcastle Coal Infrastructure Group (**NCIG**) and the Hunter Valley Coal Chain Coordinator in each 24 hour period to discuss the port-wide program.

2 Glencore has made the following statements in its submission:

- 'Assessing what has occurred to date, the Channel access fees were increased without consultation and apply in a discriminatory manner to larger coal vessels that are more efficient and service only certain types of ports.' (at p. 7)
- PNO '...will seek to recover at least an additional (in addition to the recent \$20m increase) amount between \$60m per year and up to \$180m per year, representing even on PNO's calculations between 3-6% of the total exported coal price.' (at p. 12) This is a conclusion from the report from Synergies Economic Consulting that estimates, based on publicly available information, PNO's cost base, revenue requirements and possible future price increases.

Glencore has also provided a report from RBB Economics that offers an economic assessment of the Council's draft recommendation, together with a report by the Reserve Bank of Australia entitled *Developments in Thermal Coal Markets*.

2.1 State the process PNO undertook to set the prices for the navigation and wharfage charges for the services that are the subject of the application. In doing so, include:

- (a) **PNO's considerations, including reasons, as to whether its changes to navigation and wharfage charges would or would not be likely to affect coal mining production in the Hunter Valley generally, or on any particular mines or mining operators specifically; and**

Factors considered by PNO

As set out in PNO's submission to the Council dated 18 June 2015 (**PNO's Submission**), PNO sets its prices in a way that is mindful of the impact of changes on its users. A thorough assessment of the potential impacts on markets, stakeholders, community, reputation and government monitoring and controls is critical to informing its pricing decisions.

The price monitoring conducted by the State, the likely response from the State and the threat of government intervention or regulation, the regulatory burden such a change would entail and the uncertainty it would create for the Port and users are also key factors considered.

In addition the long-term expectations of volumes, operating expenditure, capital expenditure, intrinsic value of the ports assets, risks and appropriate returns are also key factors in pricing decisions.

PNO's restructure and realignment of charges (the first for 20 years) took effect on 1 January 2015, approximately 7 months after the change in ownership following the long-term lease of the port from the State. This followed a careful and rigorous assessment by the Board and management, based on the kind of principles that would be applied by a regulator, with the aim of ensuring that the revised charges were set to comfortably under-recover, or sit below any likely regulatory account of the costs of owning, operating and maintaining PNO assets including the channel, dredging, survey operations, vessel scheduling, navigation aids, wharves, jetties, breakwaters, roadways, railways and other fixtures, plant and equipment.

PNO took all trades into consideration. PNO's business depends on the continued success of customers of the Port of Newcastle and it has a commercial imperative to see all trades within the Port of Newcastle increase in volume.

The commercial objective of PNO is to recover its efficient costs (including an appropriate return on assets commensurate with the regulatory and commercial risks involved) over the medium to longer term through a combination of charges. To realise its commercial objective, PNO needs to provide open and competitively priced access to all access seekers and trades and invest in sufficient infrastructure to meet growing demand for throughput.

Given the existing excess capacity in the Port of Newcastle, PNO seeks to encourage growth such that PNO will benefit through increased revenues as Port of Newcastle users increase levels of imports and exports through the Port.

Charges have no material impact

PNO's conclusion on the impact of changes to the navigation services and wharfage charges was that those changes would not have any impact on coal mining production in the Hunter Valley generally. Participants in the coal supply chain regularly consider and absorb much more substantial changes in operating and market conditions when making operating and investment decisions. While port charges may be a cost which depending on circumstances could be absorbed by producers, supply chain participants (agents or shipping lines) or by the ultimate coal end-users, the port charges are not material in relation to the types of decisions that impact competition in any dependent market.

Material factors which could impact coal mining production are:

- Supply chain constraints (particularly rail and terminal capacity);
- Global coal demand and supply expectations;
- Forecast coal price (USD) and volatility;
- Foreign exchange rates (AUD / USD and others);
- Financing;
- Operating costs (including labour and fuel costs); and
- Shipping costs (but only if these are either met by the producer directly or as has been argued these are passed through to the producer).

In PNO's view, a once in 20 years restructure and realignment which increased charges by less than 15 cents a tonne, could not have (and has not had) any material effect on competition in any dependent market. PNO's prices contribute less than 1% to the total delivered cost of buying Newcastle thermal export coal.

No differential impact on particular mines or mining operations

PNO does not have access to information that would enable it to determine the profitability of individual mines or mine operations. Nor does it have access to that information about other participants in the supply chain.

Therefore, no regard was had to profitability of individual mines or mining operators, or the competitiveness of individual mines.

PNO does not consider that its charges should fluctuate based on the profitability of mines or mining operators generally (ie, increase when times are good and decrease when bad). PNO would need to earn a far higher return to absorb these kinds of risks, leading to an outcome that is likely to produce far higher charges than are currently charged.

PNO does not have visibility of which coal producer has produced the coal loaded onto a particular vessel until after the vessel has left the port. In most but not all cases, PNO is advised of the details of the producer of the coal on a vessel when the shipping agent submits the vessel manifest. Generally this information identifies the coal producer but not necessarily the particular mine. In some cases the manifest will identify the owner of the coal as a trader and in those cases the mine or producer will not be identified.

The wharfage charge and the navigation services charge are levied based on the respective mass of coal tonnes loaded and the size of the ship in gross tonnage respectively. In either case the charges are levied at the published rate irrespective of the owner or producer of the coal or the owner or charterer of the ship.

The structure of the rates charged by PNO is non-discriminatory, and there is simply no ability or incentive for PNO to use those rates to impact individual mines.

- (b) a description of any consultation undertaken by PNO in relation to the introduction of the new navigation and wharfage charges for the coal-related services at the Port of Newcastle.**

Consultation on the navigation services charge

PNO provided advanced notice of its 2015 and 2016 pricing to coal and non-coal customers in November 2014. This was well in advance of the required notice period of 10 business days.

- Pursuant to section 80 of the *Ports and Maritime Administration Act 1995* (NSW) (**PAMA Act**), PNO provided written notification to the NSW Minister for Roads, Maritime and Freight on 17 November 2014.¹
- On 26 November 2014, PNO customers were mailed and emailed Port of Newcastle's 2015 and 2016 pricing schedule which details all port charges.
- A covering letter accompanied the schedule to provide further context on the type of charge that the customer pays to PNO, that is:
 - further context in relation to the coal navigation services charge was provided to coal shipping lines and their shipping agents;
 - further context in relation to wharfage charge was provided to coal producers; and
 - a general letter in relation to non-coal charges was provided to cargo owners, shipping lines and shipping agents.
- Each letter provided the name and phone number of a PNO representative, and invited customers to contact PNO if they wish to discuss the matter further.

PNO's customers for the navigation services charge are agents on behalf of ship owners and charterers. PNO has no visibility on the arrangements that sit behind our customers. PNO did consult with the users of the services, being ship owners and charterers and their agents. This is analogous to the approach taken by airport operators, which will consult with the airlines about airport prices, rather than with air passengers or cargo owners.

To provide further information regarding the realignment of the navigation services charge for coal vessels, PNO met with six coal shipping lines and seven shipping agents, and industry group, Shipping Australia Limited. This also provided an opportunity for customers to ask questions or provide feedback.

A confidential list of the shipping lines and shipping agents that PNO met with is attached for the Council's information (at **Confidential Annexure A** to this Attachment A).

Following the delivery of the pricing schedule, a shipping line wrote to PNO seeking further clarification, which PNO provided.

¹ PNO's confidential correspondence with the NSW Minister for Roads, Maritime and Freight has been provided for the Council's information at **Confidential Annexure B** to this Attachment A, together with copies of PNO's confidential correspondence with customers regarding the new navigation services and wharfage charges.

Consultation on the wharfage charges

PNO consulted with coal producers directly in respect of the wharfage charges (which, unlike the navigation service charges, are paid directly by the producers). We note that in the course of consulting with producers on the wharfage charges, PNO provided the producers with a pricing schedule which included all charges (including the navigation services charge, notwithstanding that it was not relevant to these discussions).

PNO invited coal producers to contact PNO regarding the changes in port pricing and PNO received meeting requests from two coal producers (including Glencore) and the NSW Minerals Council, and discussions were held between these parties and PNO's then CEO Mr Jeff Coleman regarding both the changes to the wharfage charge and the navigation services charge. Glencore wrote to PNO seeking further clarification, which PNO provided.

2.2 What are PNO's considerations, including reasons, as to whether future changes to navigation and/or wharfage charges would or would not be likely to affect coal mining production in the Hunter Valley generally, or on any particular mines or mining operators.

PNO has not finalised any decisions regarding future changes to charges beyond those for 2016 flagged in its pricing schedule. Prior to deciding to change its charges in future PNO expects it would follow a similar process to that outlined in paragraph 2.1 of this Response. Now and for the foreseeable future, PNO sees the success of the Port of Newcastle as being inextricably linked to the continued growth in coal exports through the port and by necessary implication the success of the miners exporting through the Port of Newcastle.

There is therefore no rational incentive for PNO to undertake any initiative that would harm the coal export industry through the Hunter Valley such that it might precipitate a reduction in either growth of export volumes or an actual decline in exports or regulatory or political intervention.

Furthermore, there is no evidence that charges have been a factor in any decisions to mothball or close mines based on PNO's review of submissions and public statements made by producers (see PNO's Submission, sections 8.4 and 8.5).

PNO did engage in genuine consultation with customers that are the users of these navigation services (that is, the ship owners and charterers).

As noted by the Council in its draft recommendation dated 30 July 2015 (**Draft Recommendation**),² one effect of PNO's pricing changes was that charges are no longer discriminatory. Previously, charges had favoured larger coal vessels that use the fullest extent of the channel depth. However, PNO did not think it made commercial sense for larger vessels to continue to pay relatively lower charges on a per tonne of coal basis, as compared with smaller vessels.

The current pricing structure established under the PAMA Act incentivises growth in coal export volumes and the pricing structure is agnostic as to which miner, mine or coal export terminal produces or handles that coal or which ship owner or charterer carries the coal.

2.3 In relation to the RBB Economics report, please provide PNO's response to the views expressed that:

- (a) ...PNO should be able to maintain returns to shareholders whilst lowering unit prices taking into account the volume effect (p. 5);**

² Draft Recommendation, Paragraph 5.24

PNO acknowledges that a well-known effect of infrastructure economies of scale is that, for a given asset value and target rate of return, a long term increase in the utilisation of a fixed infrastructure asset will cause unit throughput charges to decrease over time.

However, RBB's observation regarding this basic principle has no bearing on the separate question of whether the asset value and cost of capital (target rate of return) that underpin the determination of actual charging levels are appropriate for a particular asset or, more generally, whether or not an operator's prices are consistent with prices that would be determined under the second stage of a Part IIIA process.

Consistent with these broader considerations, and as set out in paragraph 2.1 of this Response, 'the volume effect' is only one of a number of factors that go into pricing decisions along with other important factors such as operating costs, starting price levels, the business's asset base, current state of market and business specific risks and the business's required return on and of capital.

- (b) **...approximately a third of the affected mines are currently cash negative indicates that the closure of mines cannot be discounted [and] that some mines are already closing and it is likely that further increases in access charges would lead to more closures (p. 7);**

In PNO's view, the closures that have occurred are due to resource economics not port charges (see PNO's Submission, sections 8.4 and 8.5). More broadly, PNO considers that consolidation of smaller producers/assets is occurring as producers attempt to improve scale economies in response to prevailing supply/demand factors.

Given the port charges are not a material input and the effect of the price increase is less than AUD 0.15 per tonne of coal out of an average selling price in excess of AUD 80.00 per tonne of coal a multitude of significantly larger factors will effect competition in each market before port charges have any effect.

As we have previously demonstrated, port prices are not material to future investment decisions (see PNO's Submission, particularly sections 10 and 11). We do not accept there is a market for the finite aggregate exposure to common risks associated with the Hunter Valley coal chain infrastructure, and understand financiers generally find an equilibrium price to balance any set of given risks against opportunity.

In any case port charges are not separately identified or considered as a material factor by financiers in Hunter Valley mine financing decisions.

A review of statements on the public record demonstrates that PNO charges have not been cited as a factor in any announcement by any miner in the Hunter Valley.

Foreign exchange gains since the price increase have significantly increased free cash flow of many mines since the price increase and Glencore's original submission. As calculated in the table below movements in AUD/USD exchange rates have favourably offset the port charges price increase 46.6 times over.

Table 2: AUD/USD exchange rates vs. port charges

	Exchange Rate	Australian thermal coal price (USD)	Australian thermal coal price (AUD) equivalent	AUD Price increase per tonne since 1 January 2015	AUD Port Charge increase per tonne since 1 January 2015	Relative impact ratio
Price Increase Implemented - 1 January 2015	0.8202	66.54	\$ 81.13			
Glencore Submission received by NCC - 13 May 2015	0.7967	64.71	\$ 81.22	\$ 0.10		
Glencore Submission received by NCC - 9 September 2015	0.7057	62.18	\$ 88.11	\$ 6.98	\$ 0.15	46.6
AUD/USD Exchange Rate	http://www.rba.gov.au/statistics/historical-data.html#exchange-rates					
Coal, Australian thermal coal Monthly Price - US Dollars per Metric Ton	http://www.indexmundi.com/commodities/?commodity=coal-australian&months=60					

There is no causal link between the decisions to close mines or place mines into care and maintenance and PNO's pricing restructure and realignment. Given the timing of the decisions to close or place coal mines into care and maintenance in the Hunter Valley, and the announced key reasons for closures decisions or decisions to place into care and maintenance, there is no plausible link between them and PNO's pricing restructure and realignment. Rather, the decisions are natural responses to global demand conditions for coal. It is the global demand for coal and coal price expectations that fundamentally drive decisions in coal dependent markets, including competition.

Further, the scale of recent closures is relatively small compared to the scale of the operational mines in the Hunter Valley and the potential planned new project and additional capacity which we anticipate will occur in the Hunter Valley.

(c) PNO can only generate a commercial return to its investors by imposing significant price increases into the future (p. 9).

Our Business Strategy includes in its vision:

To maintain Newcastle's position as one of the leading and most efficient global scale coal export ports and facilitate continued growth and development of existing and new trades in a sustainable manner.

PNO has no incentive to increase prices to a level which would adversely affect anticipated volume growth.

No decisions on future price increases have been taken, with the exception of the previously announced 3.9% increase effective 1 January 2016. This was communicated as part of the initial price increase communications to provide some longer term certainty to the market and supports the statement that the initial increase was a restructure and realignment.

PNO took a careful and considered approach to pricing as set out in paragraph 2.1 above of this Response, and will continue to do so. Target returns may be achieved by optimising the mix of debt and equity funding, supporting property development at the Port including the take-up of vacant land, growing trade volumes and a range of other drivers, including pricing.

As PNO has previously submitted to the Council, the price increase was a "restructure and realignment" to reflect over 20 years of under recovery whilst under government

ownership and any future price movement will give due consideration to ensuring there can be no adverse effects on competition in dependent markets.

CONFIDENTIAL ANNEXURE A TO RESPONSE

[Confidential to PNO]

CONFIDENTIAL ANNEXURE B TO RESPONSE

[Confidential to PNO]

ATTACHMENT B – HOUSTONKEMP REPORT



HOUSTONKEMP
Economists

Potential Declaration of Services Provided at Port of Newcastle

A report for Port of Newcastle Operations

1 October 2015

Report Author/s

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1. Introduction

This report has been prepared for Port of Newcastle Operations Pty Ltd (PNO), the provider of a range of port-related services at the port of Newcastle.

Glencore Coal Pty Ltd (Glencore) has made an application to the National Competition Council (the Council, or NCC) seeking a recommendation that certain services provided by PNO be declared, under the provisions of Part IIIA of the *Competition and Consumer Act 2010* (the Act). The services the subject of the declaration application are access to the shipping channels and vessel berth areas at the coal terminals at the port of Newcastle (the relevant services). These services are provided:

- in the case of access to the shipping channels, to shipping lines that either own or charter vessels visiting the port of Newcastle, the majority of which provide bulk coal transportation services to shipping agents and/or cargo owners; and
- in the case of access to the berthing areas, to cargo owners – primarily, coal miners – directly.

On 30 July 2015, the NCC issued a draft recommendation¹ (the draft recommendation) not to declare the relevant services. Instrumental in the Council's draft recommendation was its finding that criterion (a), listed at section 44G(2) of the Act, was not satisfied. Criterion (a) states that the designated Minister cannot declare a service unless he/she is satisfied that:

(a) access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia) other than the market for the service.

Glencore submitted a response to the Council's draft recommendation on 9 September 2015, including a range of material contending that access on reasonable terms would materially increase competition in a number of related markets. Glencore's submission was supported by reports with economic analysis undertaken by RBB Economics² (RBB) and Synergies Economic Consulting³ (Synergies).

PNO has asked us to comment on three economic aspects of Glencore's application and associated submissions, with particular attention to various observations drawn by RBB and Synergies. These are:

- the likely effect of declaration on the level and variability of the relevant PNO charges;
- the likely effect of increases in the relevant PNO charges on competition in any related markets; and
- whether any potential for future increases in the relevant PNO charges are likely to have a material effect on incentives for an individual mining company to invest in the Hunter Valley coal mines served by the port of Newcastle.

Our report is structured by reference to each of these questions.

¹ National Competition Council, *Declaration of the shipping channel service at the Port of Newcastle*, Draft recommendation, 30 July 2015

² Simon Bishop, RBB Economics, *An Economic Assessment of NCC's Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015

³ Euan Morton, Synergies Economic Consulting, *Potential for Increase in Navigation Services Charges at Port of Newcastle*, letter to Anthony Pitt, Glencore, 1 September 2015.

2. Effect of Declaration on Prices

Glencore contends that, in the absence of declaration, PNO has an ‘unfettered ability’ to increase prices⁴ for the relevant services and that PNO will likely impose further price increases as it seeks to achieve its target returns in relation to the channel services.⁵ RBB states that Glencore’s primary complaint regarding access to the shipping channel focuses on two issues, ie:⁶

- the excessive prices for access to the shipping channel; and
- the unconstrained nature of PNO’s ability to determine such prices in to the future and the consequent uncertainty this creates for channel service users.

PNO has asked us to consider the extent to which declaration would be likely to reduce either the level or ‘volatility’ of the charges for the relevant services.

2.1 The effect of declaration on price levels

The object of Part IIIA is described by the Council as providing a means of promoting competition in markets where the ability to compete effectively is dependent on being able to use – on reasonable terms and conditions – an infrastructure service provided by a facility that is uneconomical to duplicate.⁷ The declaration process is one means by which an access seeker may seek to gain access on such reasonable terms, when attempts at commercially negotiated access are unsuccessful.

Our analysis shows that there is no firm basis on which to conclude that, if declared and in the event that any dispute in relation to prices for the relevant services was determined by arbitration decided by the Australian Competition and Consumer Commission (ACCC), this would result in significantly lower future prices for the relevant services. In drawing this conclusion, we have considered the approach the ACCC is likely to take in determining ‘reasonable’ terms and compared this with PNO’s existing approach to price setting and the implications of the existing regulatory price monitoring arrangements.

In approaching the question of whether or not existing prices are reasonable, it is important to recognise that it is not the intention of Part IIIA of the Act to require the owners of infrastructure assets to provide services at prices that are outside the bounds established by the normal conditions of economic efficiency. By definition, economically efficient prices enable service providers to earn a reasonable rate of return on the assets employed in providing the service, given the relevant business risks. Prices below this level are unlikely to be sufficient to ensure long term investment in maintaining and expanding the relevant service and so, ultimately, will be to the detriment of users.

It is also not the intention of Part IIIA that the owners of essential facilities be required to cushion cyclical fluctuations in the profits of users, by being forced (encouraged) to accept a lower (higher) return during downturns (upturns) in the business cycle. If asset owners were to be expected to make some form of contribution as ‘guarantors’ of users’ profits, thereby assuming a proportion of the business risks arising in up or downstream markets, the effect would be to allocate risk away from the parties best positioned to manage that risk. Ultimately, any such increase in business risks for the service provider would manifest itself as higher prices to users, as infrastructure owners sought compensation for such risks through prices.

⁴ Glencore, *Submission to the National Competition Council*, 9 September 2015, page 1.

⁵ Glencore, *Submission to the National Competition Council*, 9 September 2015, page 2.

⁶ Simon Bishop, RBB Economics, *An Economic Assessment of NCC’s Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015, page 4.

⁷ National Competition Council, *Declaration of the shipping channel service at the Port of Newcastle*, Draft recommendation, 30 July 2015, para 3.2

Consistent with these observations, the pricing principles that must be adopted by the ACCC in the event it is called to arbitrate a dispute in relation to the terms for use of a declared service require that prices be set so as:⁸

- to generate expected revenue that is at least sufficient to meet the efficient costs of providing access to the relevant service; and
- to include a return on investment commensurate with the regulatory and commercial risks involved.

In the event of an arbitration, it is reasonable to expect that the ACCC would rely on a building block approach to assess the appropriate level of prices, given the value of utilised assets and the required return on assets.

In the twenty year history of Part IIIA, the ACCC has only concluded one formal arbitration of the prices for declared services, being a 2007 dispute between Services Sydney Pty Ltd (Services Sydney) and Sydney Water Corporation (Sydney Water) in relation to the declared sewage transportation services supplied by Sydney Water. In its final determination, the ACCC stated that prices paid by Services Sydney to Sydney Water were to be determined using a retail-minus methodology,⁹ rather than the bottom-up building block approach. However, the ACCC stated that the bottom-up approach is more appropriate for other services (such as electricity) where the functional components of supply are structurally separated. Consistent with this observation, in our opinion it is most likely that a building block approach would be adopted in the event of an arbitration in relation to prices for the relevant port services.

Further, the invoking of the dispute resolution process available for declared services is not a cost-less exercise. In the event of arbitration, the ACCC can be expected to issue a determination within six months of receiving the dispute notice, provided it has sufficient information at each stage of the arbitration process – however, this timeline is not binding and arbitration proceedings may go on much longer.¹⁰ Such proceedings are resource-intensive and involve numerous hearings and submissions. Ultimately, these costs must be borne by the users of the relevant service, increasing the prices that would eventuate under declaration.

Against this backdrop, there is no evidence that PNO has or will set prices at levels that would exceed those that could be expected to result from an arbitration applying the relevant principles. Similarly, there is also no evidence of PNO earning ‘super-normal’ profits or applying a pricing methodology that would necessarily lead to such outcomes.

On 1 January 2014, PNO restructured and realigned its prices, the first such change in 20 years. This restructuring removed the two-tiered navigation services charge as well as the maximum navigation services cap for large coal vessels, and replaced these charges with a flat rate per gross tonne for coal vessels. PNO advised that the previous, two tier price and cap structure did not reflect the operational or commercial realities of the port’s operations, and that there is no efficiency or other basis to provide discounted or capped fees for larger vessels while relatively disadvantaging smaller vessels.¹¹

In setting its price levels, PNO states that it is mindful of a number of factors, including:

- usage levels (volumes);
- the asset base;
- its view of the regulatory shadow building block model and the suggested prices;

⁸ Section 44ZZCB, *Competition and Consumer Act 2010*.

⁹ Australian Competition and Consumer Commission, *Access dispute between Services Sydney Pty Ltd and Sydney Water Corporation, Arbitration report*, 19 July 2007, page 1.

¹⁰ Australian Competition and Consumer Commission, *Arbitrations, A guide to resolution of access disputes under Part IIIA of the Trade Practices Act 1974*, April 2006, page 13.

¹¹ Port of Newcastle Operations, *Submission in response to Glencore’s application to the National Competition Council*, 18 June 2015, pages 6 to 7.

- the assessment of impacts on markets;
- stakeholder, community and reputation impacts; and
- government monitoring and controls.

PNO states that it uses a building block approach to ensure that the company recovers no more than its costs and a reasonable return on its assets.¹² PNO has advised that its model incorporates a return on assets based on its weighted average cost of capital (WACC), estimated using the capital asset pricing model, and asset values determined on the basis of depreciated optimised replacement costs (DORC). This model is intended to replicate the maximum return that a firm could earn in a perfectly contestable market. Importantly, the DORC value (and so the resultant prices for the services) is unrelated to the price the PNO owners paid for the lease.

Current prices for the relevant services provided at the port (after the 2015 price increase) are considered by PNO to be in line with the lower end of the estimated pricing range established under this building block approach. In other words, the prices set by PNO are consistent with the company's lower-bound estimates of the DORC value of its assets (\$1.7 billion) and its WACC (7%). These lower-bound estimates compare with upper-end estimates for DORC of \$3.5 billion and WACC of 10%.¹³

The above material establishes that there is no reason to presume that PNO's approach to applying the building block model is inconsistent with the methodology that would be adopted by the ACCC. It strongly suggests that the prices currently set by the PNO are within the limit of those that could be expected to eventuate in the event of arbitration by the ACCC.

Further, the analysis provided by Synergies¹⁴ supports the contention that declaration could result in significant price increases in the event the ACCC was to apply a building block approach using Synergies' assumptions. According to Synergies' analysis, in order for PNO to achieve a commercial return on its invested capital, prices would need to increase by between 70 to 211 per cent.

Both the Synergies' analysis and available information in relation to PNO's current prices are inconsistent with the suggestion that PNO is or can be expected to earn excessive profits. It also demonstrates that PNO does not presently have an 'unfettered ability' to impose increases in the price for services – such propositions are incapable of explaining why PNO's charges have not already been set at substantially higher than their current levels.

Rather, the conclusion more consistent with the evidence is that PNO's prices are constrained by the existing regulatory regime applicable to services provided by the port, which is comprised of the following provisions:¹⁵

- the *Ports and Maritime Administration Act 1996* – which establishes a price monitoring regime that requires the PNO to publish occupation, wharfage and navigation services charges, publish and give notice to the Minister of proposed changes in its charges, and provide annual information as required under section 81. The PNO does not have the power to fix and collect berthage charges (only the Minister has that power);
- the *Ports and Maritime Administration Regulations* – which are supplemental to the Act and set out principles for calculating port charges;

¹² Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, pages 80 to 83.

¹³ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figures 12 and 13.

¹⁴ Euan Morton, Synergies Economic Consulting, *Potential for Increase in Navigation Services Charges at Port of Newcastle*, letter to Anthony Pitt, Glencore, 1 September 2015, table 1.

¹⁵ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, page 58.

- the *Independent Pricing and Regulatory Tribunal Act 1992* – which gives IPART the power to conduct investigations and make reports on matters relating to pricing, industry or competition that are:
 - > referred to it by the Minister if he/she considers the prices charged at the PoN are inappropriate; or
 - > requested by IPART for the Minister's referral if IPART has received one or more complaints from industry participants;

Associated with these provisions is the subsequent risk of a more stringent form of regulatory intervention, under the jurisdiction of the NSW government; and

- the *Competition and Consumer Act Part IV* (as required by clause 39.1 of the Port Lease).

In addition, the long term port lease between the PNO and the state provides additional, contractual, protection to users. Under the terms of the lease, PNO has an obligation to contribute to the ongoing improvement of productivity and efficiency in port and port-related matters and to cooperate with relevant industry bodies to achieve the objective of the port being a major seaborne trade gateway for NSW.¹⁶ PNO is also required to ensure that the port is capable of providing access to intrastate, interstate and international shipping and that it is no less capable of doing so than at the commencement date. A breach of this provision would allow the state to terminate the port lease with the PNO's equity investment written down to zero.¹⁷

The suggestion that PNO may seek to impose substantial future price rises that would allow it to earn excessive profits does not take account of these existing checks and balances and is incapable of explaining why current prices are below the levels suggested by a building block estimation of costs. That such a 'light handed' regulatory framework can be effective in constraining market power is well illustrated by the experience of airside services provided by capital city airports in Australia. Successive independent reviews by the Productivity Commission of the light handed regulatory arrangements applying to these services have found them to be operating effectively.

On the basis of the above analysis, we conclude that declaration of the relevant services is unlikely to lead to significantly lower future prices. In fact, given the costs associated with arbitration proceedings and potential changes to the service's risk profile following declaration, such an outcome may even result in higher prices than under the existing framework.

2.2 The effect of declaration on price 'volatility'

RBB Economics has noted that price certainty may be increased with declaration.¹⁸ In our opinion, this is an unlikely outcome and, further, there is a risk that price volatility may be increased under declaration.

Whereas PNO sets its prices in a way that is mindful of the impact of significant changes on its users and embodies a long-term perspective of cost drivers, such as its estimated WACC capital and anticipated usage levels, the ACCC may well take a shorter-term perspective (such as the five year period typically applied in infrastructure price determinations) in any arbitral determination of applicable prices. Such an approach may well result in prices fluctuating by a greater extent under declaration than the existing regulatory arrangements.

By way of example, if the ACCC was to determine prices for a five year period, the applicable rate of return would likely be affected by the significant changes in financial markets that have recently been experienced within those timeframe. Based on the historical volatility in ten year BBB corporate bond yields, PNO has

¹⁶ Clause 8.9 of the Port Lease.

¹⁷ Clause 8.2 of the Port Lease.

¹⁸ National Competition Council, *Declaration of the shipping channel service at the Port of Newcastle*, Draft recommendation, 30 July 2015, para 3.13.

estimated a hypothetical regulatory WACC that ranges from seven per cent to 12.3 per cent,¹⁹ over a ten year period.

Some regulators, including IPART and the Australian Energy Regulatory (AER), are moving towards longer run approaches to WACC, including the use of a ten year trailing average for estimating the cost of debt,²⁰ which is expected to reduce the volatility in regulatory WACC. However, it is not evident that the ACCC would be inclined to adopt such a longer-term perspective, or that it may be suited to the occasional nature of an arbitration process. Even if it were to do so, an ACCC-determined regulatory WACC may remain more volatile than the perspective of PNO, which has more latitude to take account of the long-lived nature of the relevant assets.

For similar reasons, short-term fluctuations in demand may also result in more significant price movements in the event of arbitration arising from declaration than would be the case under the existing regulatory settings.

We note that one option for reducing future uncertainty in prices would be for the mining companies to enter long term contracts with PNO. We understand that PNO's customers have never approached it seeking such longer term price and/or volume commitments, presumably because this would not be consistent with their own business model, which allow the mining companies to vary their ships, agents, and volumes on a regular basis. Further, since PNO is not generally able to observe the source of coal on each vessel – at least until after it has sailed – it may be impracticable for PNO to monitor and enforce an individual mining company's adherence to the terms and conditions of a long-term contract.

¹⁹ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figure 14.

²⁰ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, page 25.

3. Effect on Competition in Related Markets

Section 44G(2)(a) of the CCA (criterion (a)) provides that the NCC cannot recommend that a service be declared unless it is satisfied that access (or increased access) to the service would promote a material increase in competition in at least one market other than the market for the service.

We explained in section two that it is unlikely that declaration would result in either lower or more certain prices for port users. On that basis there is no reason to presume that declaration – and so, access on reasonable terms – would affect competition in any dependent market.

However, even if it were the case that declaration led to either lower or less volatile prices, the insignificance of the prices paid for services provided by PNO for the total cost of coal handled by the port means that access on reasonable terms could still not give rise to a material improvement in competition in any related market. We demonstrate this conclusion below, by reference to the implications for the most directly related market, that for seaborne thermal coal.

3.1 Recognising a material improvement in competition

In assessing the implications of a hypothetical reduction in the price of the relevant service on competition in one or more related markets, it is important to be clear as to what constitutes a “material improvement in competition”. This includes taking care to distinguish between an improvement in competition in a market, and an improvement in outcomes for a particular sub-set of competitors in that market.

Competition, and the question of whether or not it is likely to be promoted, is essentially a question as to the degree of rivalry in a market. There is no reason to presume that competition in related markets would be promoted as a result of a straightforward reduction in the price of the related (declared) service, unless it results in an increase in rivalry in the relevant dependent market. An improvement in competition could arise, for example, from a reduction in barriers to entry or if access on reasonable terms encourages firms to remain in (or to enter) the market that may otherwise exit (or stay away).

By contrast, RBB notes in its report submitted on behalf of Glencore that:²¹

If an increase in port access charges were to lead to an increase in the price of coal in export markets then that would constitute an adverse impact on competition; in other words, a lessening of competition.

In our opinion, RBB’s statement is incorrect. Although the essence of competition is that an increase in the degree of rivalry in a dependent market – all else equal – can be expected to give rise to a reduction in prices and expansion of output in that market, it does not follow that a reduction (increase) in the cost of an input can be equated with an increase (reduction) in competition. Whereas a price increase may signal a lessening in competition, it may equally signal a general change in the cost of providing a service.

Such a suggestion falls into the trap of relying on observations that are consistent with a change in competition to infer that any such observation must have been caused by a change in the degree of competition or, at a yet greater extreme, to suggest that the observed phenomenon actually caused a change in degree of competition. The causal link may operate reliably in one direction, where reduced competition can be expected to cause higher prices, but does not reliably operate in the other, ie, that higher prices lead to reduced competition.

Market outcomes (in terms of output produced and prices paid) are affected by many variables – each with the potential to alter either the cost of supply or the demand for the product – that have nothing to do with the

²¹ Simon Bishop, RBB Economics, *An Economic Assessment of NCC’s Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015, page 6.

degree of rivalry among suppliers. There is no economic principle that suggests the simple possibility or existence of changed market outcomes can, by itself, be used to infer that there has been a change in the degree of rivalry.

We note also that RBB does not directly address the question of whether or not declaration is likely to materially promote competition. Rather, the RBB report:²²

...discusses whether the level of access charges to the shipping channel can never have an adverse effect on competition in the related export coal market.

Further, RBB appears to take a different view from the prevailing interpretation of criterion (a), suggesting that, in this case:²³

.... because this issue is essentially one of constraining excessive pricing and not, as is the case in "standard" access cases, of interfering with an asset owner's property rights by mandating third party access to that asset, the threshold for declaration ought, in my view, to be subject to a lower evidentiary hurdle. This is particularly the case where the "access" problem arises due to the Government selling-off existing assets.

In our opinion, the emphasis disclosed by these statements causes the focus of RBB's report to be misdirected to the effects of access on reasonable terms, by reference to the substantively lower threshold of whether it could *ever* promote competition rather than whether it would be likely to promote a *material* increase in competition.

In the following sections, we examine the conditions for rivalry in the relevant market in order to assess whether competition can be said to be likely to be materially promoted if access was to be granted on reasonable terms. We focus on the global market for seaborne thermal coal, since this is the most directly related market and so the one most likely to be materially affected by changes in port charges. We note that RBB similarly focuses its assessment of the effect on competition in this same market.

3.2 Implications for the world coal market

Glencore has submitted that there is a coal export market and, similarly, PNO has submitted information regarding a global market for seaborne thermal coal. In our opinion, the appropriate market is likely to be somewhat wider than only that which is seaborne, and may potentially include coal that is consumed close to source as well as that which is seaborne. Even though coal that is used close to the point where it is mined may not currently be offered on the world market, it is reasonable to expect that a significant increase in coal prices could encourage these suppliers to sell more widely. However, for the present purpose, the precise boundaries of the relevant market are unlikely to make any difference to the conclusions.

We noted above that competition essentially depends on the degree of rivalry, and that for access on reasonable terms to bring about a material improvement in competition and competitive outcomes in a dependent market it must:

- materially reduce the price of the access service;

and the reduction in price must:

- enhance the potential for new competitors to enter (or discourage exit from) the market, resulting in a material increase in rivalry; and
- be passed on to end users in the form of lower prices (in this case coal prices) and, in doing so, materially reduce prices in the end market.

²² Simon Bishop, RBB Economics, *An Economic Assessment of NCC's Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015, page 1.

²³ Simon Bishop, RBB Economics, *An Economic Assessment of NCC's Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015, page 2.

In section two we explained the very low likelihood of declaration bringing about a material reduction in prices for PNO's relevant services. In the remainder of this section we consider the prospect of the other two conditions being met in the unlikely event that access on reasonable terms was to reduce the prices of the relevant services materially, say, by 25 per cent.

3.2.1 The effect of declaration on rivalry

For rivalry to be increased, declaration would need either to encourage entry into the relevant dependent market or to discourage exit. Further, for competition to be materially improved, such entry or exit would need to be significant in the relevant market, ie, the global seaborne thermal coal market.

In our opinion, it is extremely unlikely that declaration of the relevant service would have a sufficiently significant effect on the level and/or volatility of PNO's prices such that entry and exit would be affected. RBB notes that it is 'likely that the demand for access to the shipping channel is reasonably inelastic', which itself suggests there would be limited effect on competition in related markets.

Glencore has argued that, while declaration is unlikely to affect the operation of existing mines, it could encourage future investment:²⁴

Given the sunk investments in existing mines and mine infrastructure, those existing assets will continue to be operated so long as they generate some cash from their operations...However, to the extent that prices are raised – and certainly in any scenario in which prices are raised to the extent that this impact on the ability of infrastructure and mine asset owners to achieve a return on capital rather than an operating cash surplus – this will preclude any further investment in, development or expansion of mines or mining infrastructure.

However, even taking a 'best case' scenario that access on reasonable terms was to bring about a significant change in PNO's prices, the trivial extent of these costs within the relevant mines' total costs makes such a relationship between investment in new or expanded mines and port costs implausible. In particular, port costs make up such a small proportion of total costs that any variation in them is unlikely to be a relevant variable in any serious financial analysis.

To put these costs in context, information compiled by PNO and ResourcefulNæss Consulting shows that port charges make up only a very small component of total delivered cost of coal, ie:²⁵

- navigation services charges and security charges make up approximately 0.45 per cent of a coal buyer's costs;
- wharfage charges make up approximately 0.12 per cent of a coal producer's costs; and
- even with the recent price increases, port charges are estimated to make up less than one per cent of the total free on board (FOB) cost for a typical tonne of coal produced in the Hunter Valley.²⁶

It follows that even substantial increases in the price for the declared services would increase the FOB cost by less than one per cent. Correspondingly, port prices are not considered to be a key determinant of the profitability of a coal mine operation. According to the report by ResourcefulNæss Consulting, the main determinants are:²⁷

- coal resource and mine plan: strip ratio being the most important determination of site operating costs;
- coal quality, with higher quality coal generating higher revenue but requiring same operating costs;

²⁴ Glencore, *Submission to the National Competition Council, Applicant's response to the draft recommendation not to declare the shipping channel service at the Port of Newcastle*, 9 September 2015, page 11.

²⁵ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figure 9.

²⁶ ResourcefulNæss Consulting, *Report from Ms Cecilie Næss*, 17 June 2015, page 3.

²⁷ ResourcefulNæss Consulting, *Report from Ms Cecilie Næss*, 17 June 2015, page 3.

- environmental and community constraints; and
- the coal market, both in terms of pricing and volume.

It follows that variations in the price of coal and other input costs play a far more significant role than port charges in determining the profitability of a coal mining operation. For example, we note that:

- Newcastle benchmark thermal coal prices have ranged from US\$20/tonne to US\$180/tonne in the past 15 years;²⁸
- the coal price exhibits a standard deviation that is 39.6 times (132.6 times) that of the increase in port charges in the period May 2014 – May 2015 (January 2010 – May 2015);²⁹
- shipping (bulk freight) rates are highly volatile, ranging from approximately US\$8/tonne to US\$53/tonne in the last 10 years;³⁰
- freight costs have a standard deviation that ranges from 9.6 times to 18.5 times (depending on time period and export destination) that of the increase in port charges in the period March 2011 to May 2015;
- site costs have a standard deviation that is 46 times that of the increase in port charges in the period 2006 to 2014;
- transportation costs have a standard deviation that is 8.6 times that of the increase in port charges in the period 2006 to 2014;
- marketing and finance costs have a standard deviation that is 2.8 times that of the increase in port charges in the period 2006 to 2014;
- business cost (free on board) have a standard deviation that is 49.6 times that of the increase in port charges in the period 2006 to 2014; and
- exchange rates have ranged from approximately 0.70 USD/AUD to 1.1 USD/AUD in the last five years, although a relatively high correlation between the AUD/USD exchange rate and USD thermal coal price have negated some of the effects of this volatility.³¹

The extent of the variability in the price of other, substantial inputs to coal mining suggest it is extremely unlikely that decisions to invest in a new mining operation or the expansion of an existing operation would be materially affected by expectations of future port charges, even if one were to assume that declaration would substantively reduce these prices.

Further, even in the unlikely event that an investor: (1) expected declaration to significantly reduce PNO charges; and (2), decided to increase his/her investment as a result, it remains extremely difficult to conclude that this would have a material effect on the world coal market, since:

- Australia makes up approximately 18 per cent of global thermal coal exports;³²
- the port of Newcastle handled 154.5³³ million tonnes of coal exports in 2013-14, approximately 42³⁴ per cent of Australia's exported coal – this represents eight per cent of global thermal coal exports and two per cent of global thermal coal production;

²⁸ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figure 30.

²⁹ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figure 27.

³⁰ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figure 32.

³¹ Port of Newcastle Operations, *Submission in response to Glencore's application to the National Competition Council*, 18 June 2015, figure 37.

³² Trent Saunders, *Developments in Thermal Coal Markets*, Reserve Bank of Australia Bulletin, June Quarter 2015, graphs 2 and 3.

³³ Newcastle Port Corporation, *Annual Report 2013-14*, page 8.

³⁴ <http://www.worldcoal.org/resources/coal-statistics/>

- the Hunter Valley ‘coal chain’ consists of 35 coal mines owned by 11 coal producers:^{35,36}
 - > the five largest producers are Glencore Coal, BHP Billiton, Coal & Allied Industries, Peabody Energy and Yancoal; and
 - > the remaining coal producers are considerably smaller, comprising Anglo Coal, Bloomfield, Centennial, Idemitsu Australia, Lake Macquarie Coal and Whitehaven.

On this information, it seems very unlikely that investment would be encouraged to the extent that it could be described as having a material impact on competition in the dependent market. Therefore, even under unrealistically optimistic assumptions regarding the benefits of declaration, one cannot conclude that a material improvement in competition is likely.

3.2.2 The effect of declaration on world coal prices

Our discussion above demonstrates that declaration is unlikely to have a material effect on the degree of rivalry in the relevant dependent market. However, even if rivalry were to be increased, this could only be said to be material if it resulted in a noticeable benefit to consumers in the related market, ie, by way of a material reduction in prices.

The NCC remarked that:³⁷

Glencore notes that it and other coal producers operating in the Hunter Valley export their product into a highly competitive global market. It notes that coal is a globally traded commodity with prices determined by international markets, and that coal producers can be regarded as price-takers. As such, there is limited scope for Hunter Valley producers to recover any increases in transportation costs from customers, and producers must instead absorb any such increases through a corresponding reduction in the price they receive from end-users.

Under these conditions, it seems highly unlikely that changes in PNO’s prices for the relevant services could affect prices in the global market for seaborne thermal coal. Even if the Hunter Valley mining companies were to pass 100 per cent of any savings on to end users, for example as a result of increased rivalry, the impact on coal prices would be so minimal that it could not be said to have a material impact on prices for coal customers.

This same conclusion can be inferred from information on the breakdown of Newcastle coal costs provided by PNO in its submission. At the time the analysis was undertaken, the thermal coal spot price was AU \$82.22 and the combined cost of PNO’s ‘navigation and security’ and ‘wharfage charge’ was AU \$0.51. Thus, the port charges comprise 0.62 per cent of the cost of coal to end users.

Even under the extremely unlikely scenario, whereby:

- port prices were to double in the absence of declaration;
- declaration was to reduce these prices by 50 per cent; and
- this price reduction was fully passed through to customers rather than retained by the mining companies in the form of higher profits,

then the effect on prices to end customers would be a 0.62 per cent reduction (relative to the ‘no declaration’ outcomes).

Further, this small reduction in price would not be available to all coal customers. Newcastle coal makes up around eight per cent of the supply of seaborne thermal coal, and we understand that much of this output is

³⁵ Newcastle Port Corporation, *Annual Report 2013-14*, page 9.

³⁶ Port of Newcastle Operations, *Submission in response to Glencore’s application to the National Competition Council*, page 47.

³⁷ National Competition Council, *Declaration of the shipping channel service at the Port of Newcastle*, Draft recommendation, 30 July 2015, page 14

sold directly to overseas buyers under long term contracts. Although it is possible that at any particular time the remaining Newcastle coal, sold into the spot market, may be the 'marginal coal' that sets the spot market price, as suggested by RBB,³⁸ this generally seems very unlikely.

The nature of spot markets is that they are fluid and the prevailing price will be set depending on many factors, including the location of the buyer relative to the sellers, exchange rates and the myriad business decisions that determine a particular company's willingness to supply at a given price. The extent of variation from year to year in the estimated global supply curves for seaborne thermal coal³⁹ confirms the dynamic and unpredictable nature of the production side of this market. Further, RBB's supposition contradicts Glencore's description of coal producers as 'price takers', and pre-supposes that mine entry and expansion decisions are taken on the basis of anticipated spot rather than contract prices, or a combination of the two.

In sum, even under an extreme assumption that declaration was to halve PNO charges and that mining companies were to 'pass on' the full extent of a reduction in port charges on to their customers, the impact on prices is a 0.62 per cent price reduction for less than ten per cent of final coal consumers. It is difficult to contemplate how such a hypothetical change could be considered to give rise to a material impact on competitive outcomes.

³⁸ Simon Bishop, RBB Economics, *An Economic Assessment of NCC's Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015, page 7.

³⁹ Trent Saunders, *Developments in Thermal Coal Markets*, Reserve Bank of Australia Bulletin, June Quarter 2015, graph 13.

4. Effect of Declaration on Incentives to Invest

Glencore contends that, without declaration, there will be a chilling effect on investment in the mining industry, due to the increased costs and risks associated with such ventures. Glencore has submitted that:⁴⁰

A private infrastructure owner is likely to set prices at a level which will extract some of the “quasi-rent” earned by existing sunk investments in mines and mine infrastructure. By setting prices at these levels it will create disincentives and preclude future investment in new or expanded mines and mine infrastructure and in productivity measures for existing assets. This chilling in investment in mining will flow through to the other dependent markets.

RBB writes in support of Glencore's submission noting:⁴¹

An alternative, and, in this case, more likely mechanism via which excessive access charges could lead to adverse competitive outcomes in related markets is through the blunting of the incentives of Hunter Valley producers to invest in expanding capacity in the region whether at existing mines or in developing new mines.

In our opinion, for the reasons set out in sections two and three above, it is implausible that declaration would affect the investment decisions of mining companies. We explained in section two that PNO neither sets prices in such a manner that causes it to earn an excessive return on its assets, nor is expected to do so in the future. The current regulatory regime, incorporating the *Ports and Maritime Administration Act*, the *Ports and Maritime Administration Regulations* and the risk of review by IPART, appears effective in constraining port charges. It is therefore unlikely that declaration, and so any subsequent ACCC arbitral decision, would result in a significant reduction in prices for the relevant service. Further, it seems reasonable to expect that, when making investment decisions, most mining companies would recognise that PNO does not in fact have unfettered pricing power in the absence of declaration.

Further, even if one were to assume that PNO's prices would be reduced by declaration, it is unlikely that this would be sufficient to affect investment decisions. In section 3.2.1, we discussed the magnitude and volatility of the PNO charges relative to other business costs and revenues, demonstrating that PNO charges are not a significant driver of expected profitability. This is consistent with the analysis provided by ResourcefulNæss Consulting, which concluded that:⁴²

- Port of Newcastle cost is not considered a material cost of operating or developing a coal mine. It amounts to less than 1% of total cost and this is within the margin of error for any mine development. Consequently the Port of Newcastle cost is not a determinant of final investment decisions to open or expand coal mines.

Both Glencore and RBB emphasise comments made by Rod Sims, the chairman of the ACCC, as follows:⁴³

The threat of expropriation of rents by a monopoly service provider in such a situation does not merely result in a pure transfer. Rather, the threat of such expropriation can limit future investment and innovation by the upstream firms.

What miner would invest in reducing its extraction costs if it knew that the lower extraction costs would simply be met by higher transportation charges? More generally, what miner would invest

⁴⁰ Glencore, *Submission to the National Competition Council, Applicant's response to the draft recommendation not to declare the shipping channel service at the Port of Newcastle*, 9 September 2015, page 2

⁴¹ Simon Bishop, RBB Economics, *An Economic Assessment of NCC's Draft Recommendation not to declare the Shipping Channel at the Port of Newcastle*, 10 September 2015, page 7.

⁴² ResourcefulNæss Consulting, *Report from Ms Cecilie Næss*, 17 June 2015, page 2.

⁴³ Glencore, *Submission to the National Competition Council, Applicant's response to the draft recommendation not to declare the shipping channel service at the Port of Newcastle*, 9 September 2015, page 8.

in its mines knowing that the benefits of that investment could be expropriated by a monopoly somewhere else in the supply chain?

In our opinion, the applicability of the very general principle cited by Mr Sims does not extend to the particular circumstances of PNO. In order for PNO to expropriate profits in the manner implied by Mr Sims, port charges would need to be set in a way that was specific to each mining operation. Unless charges were set and adjusted on a mine-specific basis, any individual mine will always have an incentive to pursue and will benefit from all cost-reducing or efficiency-enhancing measures at its disposal. Put another way, for Mr Sims' proposition to affect investment decisions of individual Hunter Valley mines, it would be essential for PNO to have the ability to price discriminate between each and every mine.

In contrast, the nature of port services negates any risk of PNO engaging in such price discrimination. PNO's customers are the ship owners and charterers (via their agents) and, in practical terms, in the process of setting and collecting charges for its navigation service, PNO is unable to observe which mine is the source of coal on any given ship. Without the ability to identify the source of coal, the port is unable to set navigation service charges in such a manner that it could expropriate profits from investment projects, even assuming ship owners and charterers treat these costs as pure pass through' items.



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ATTACHMENT C – CASTALIA REPORT



Review of Report on Potential Price Increases at Port of Newcastle

30 September 2015

1 Introduction

We have been asked to comment on the report prepared by Synergies Economic Consulting (Synergies) on potential for increase in navigation services charges at Port of Newcastle (PoN). The report uses publicly available information and the standard cost-of-service building block technique to estimate the likely revenue requirement of PoN. It then uses these estimates to infer that significant future price increases are likely in the absence of regulatory oversight.

In our view, the information presented in the Synergies report does not provide any basis for differentiating possible future price increases with and without regulatory oversight.

While one can obviously debate the detail of the allocation of assets between services, assumptions about depreciation rates and the WACC estimate, Synergies' overall approach to estimating required revenue from the Navigation Service Charges (NSC) represents a conventional use of the building block methodology. However, for the Synergies' report to provide any useful insight into what might occur in the absence of regulatory oversight compared to what might happen with such oversight, it would need to demonstrate that the building blocks it uses to calculate the revenue requirement would be materially different from the building blocks which the ACCC may use in a potential future price arbitration.

Synergies correctly point out that, from a regulator's perspective, "the acquisition cost does not provide a proper basis for regulatory price setting". It appears that Synergies were not asked to assess what would be a reasonable regulatory asset base. Yet, their results cannot be validly interpreted without forming an opinion about the likely regulatory asset valuation and how it might compare to the asset values used to estimate likely price increases in the absence of regulatory oversight. As long as the regulatory asset valuation is similar to or higher than the values used by Synergies, the potential for price increases with regulatory oversight would be the same or higher as in the absence of regulatory oversight.

2 Potential Regulatory Asset Base

In the event of declaration and subsequent pricing dispute—the situation with regulatory oversight—the key question for the ACCC in arbitrating prices will be the setting of the initial Regulatory Asset Base (RAB).

There are relatively few precedents in Australia for a RAB being set for an existing business when it first becomes subject to price regulation. We review the relevant experiences below.

Gas Networks

In the case of the Dampier to Banbury Natural Gas Pipeline (DBNGP) and the AGL NSW gas distribution networks the initial asset base decisions were made under the National Third Party Access Code for Natural Gas Pipeline Systems.

The Gas Access Code set out the following considerations for the regulators in the setting of the initial capital base:

- (a) the value that would result from taking the actual capital cost of the Covered Pipeline and subtracting the accumulated depreciation for those assets charged to Users (or thought to have been charged to Users) prior to the commencement of the Code;*
- (b) the value that would result from applying the “depreciated optimised replacement cost” methodology in valuing the Covered Pipeline;*
- (c) the value that would result from applying other well recognised asset valuation methodologies in valuing the Covered Pipeline;*
- (d) the advantages and disadvantages of each valuation methodology applied under paragraphs (a), (b) and (c); (e) international best practice of Pipelines in comparable situations and the impact on the international competitiveness of energy consuming industries;*
- (f) the basis on which Tariffs have been (or appear to have been) set in the past, the economic depreciation of the Covered Pipeline, and the historical returns to the Service Provider from the Covered Pipeline;*
- (g) the reasonable expectations of persons under the regulatory regime that applied to the Pipeline prior to the commencement of the Code;*
- (h) the impact on the economically efficient utilisation of gas resources;*
- (i) the comparability with the cost structure of new Pipelines that may compete with the Pipeline in question (for example, a Pipeline that may by-pass some or all of the Pipeline in question);*
- (j) the price paid for any asset recently purchased by the Service Provider and the circumstances of that purchase; and*
- (k) any other factors the Relevant Regulator considers relevant.¹*

In Table 2.1 we show the final RAB from the two gas pipeline systems.

Table 2.1: Initial RAB for DBNGP and AGL distribution (\$ million)

	DBNGP	AGL Gas
Final RAB set by regulator	\$1,550	\$1,550
Applicant’s DORC	\$1,234	\$2,101

¹ National Third Party Access Code for Natural Gas Pipeline Systems, 1998, Section 8.10

Depreciated Cost (book value)	\$936	\$1,002
Purchase Price	\$2,047	N/A
Initial RAB set by regulator	\$1,234	N/A

Source: Independent Gas Pipelines Access Regulator, Further Final Decision, December 2003 and IPART Final Decision, July 2000

Dalrymple Bay Coal Terminal

The Queensland Competition Authority (QCA) received a draft access undertaking for the DBCT on 20 June 2003. The price for access to DBCT's coal handling service at the time the draft access undertaking was submitted was \$2.08/tonne. This price was agreed prior to the terminal's lease and at a time when it was operated by the Ports Corporation of Queensland.

When DBCT submitted its draft access undertaking, it proposed a price of \$2.77/tonne. The submission was based on an asset value of \$1,084 million calculated on the basis of the Depreciated Optimised Replacement Cost methodology.

The QCA adopted a price of \$1.72/tonne, based among other things on an asset value of \$850 million. This was also calculated using the DORC methodology, but with somewhat different assumptions. Specifically, the QCA accepted a 48 month period for the project, covering planning, design, construction and commissioning. Expenditure was allocated to each month via a standard project "S" curve and resulted in allowance in the DORC RAB value of \$78.8 million for interest during construction, and \$18.8 million for upfront financing costs.

Conclusion

The available precedents strongly support a view that a reasonable DORC valuation represents a likely approximation of the initial RAB if an existing port became subject to regulation. The purpose of a DORC valuation is to replicate—as far as possible—all the costs that would be faced by a new entrant in constructing assets with the same service potential. A number of technical issues arise in the preparation of DORC valuation, allowing considerable room for judgement.

DORC valuations involve the following high level steps:

- Estimate the physical quantities and types of the actual assets involved, for example, volume of fill for reclaimed land, volume of channel dredged, meters of seawall, meters of berth, area of hardstand etc. This is usually done from engineering designs and drawings and verified by actual in field surveys
- Allocate the modern engineering equivalent of the actual assets—that is how assets of equivalent capacity now would be constructed—for example for gas distribution systems plastic would now replace cast iron for low pressure gas lines. This step usually involves selecting from a standardised suite of replacement asset types
- Optimise the assets—that is, remove or reduce the capacity of assets that are redundant or underutilised. Optimisation is done on a "life cycle" basis—that is the most cost efficient capacity for an asset is the one that minimises the present value of the total costs of the assets and their use over their standard life. Optimisation thus considers what is the most cost efficient capacity for an asset given current and projected future utilisation

- Price the modern engineering equivalent assets both in terms of material costs and labour and services for design construction and installation as well as overhead costs such as environmental and other approvals, design and project management costs, contingencies and financing costs. The objective is to capture the total costs of replacement including both the asset owner's costs as well as the costs of construction, and
- Depreciate the assets based on the remaining economic lives of the actual assets. Straight line depreciation is almost universally used.

The ACCC would be likely to subject any DORC valuation to critical scrutiny. Since there is no detailed specification for DORC valuation techniques and since regulators can take other information into account, any single DORC valuation is only a broad indication of the decision that a regulator would make with respect to RAB.

3 Regulatory Building Blocks for PoN

We understand that PoN's trade assets valuation has been prepared on the basis of the depreciated replacement cost. Hence, the opening asset base of \$2.389 billion derived by Synergies from PoN's Annual Trade Report is well within a reasonable range of possible DORC estimates. Without second-guessing a potential future regulatory decision by the ACCC, we see no reason to believe that the regulatory asset value would be significantly different from the higher of the two values Synergies used in its analysis.

Similarly, it is possible that the regulatory WACC could be somewhat higher or somewhat lower than the level estimated by Synergies. WACC would obviously vary over time. However, again, we do not believe that the regulatory WACC in a potential future regulatory decision would be materially different from target levels estimated by Synergies.

Some of the building block assumptions made by Synergies appear to be incorrect. For example, the Annual Trade Report showed opex and revenue for seven months. Hence, grossing it up to a year by multiplying it by two would tend to overstate the numbers. Similarly, the depreciation allowance for the channel is somewhat more complex than represented by Synergies, and would tend to result in a lower overall depreciation charge. However, these errors would not materially alter the estimates of required revenues with or without regulatory oversight.

Overall, any reasonable reading of Synergies report shows that a substantial price increase would be possible with or without regulatory oversight. A calculation of the required revenue using building block methodology does not show any clear difference between the two regimes.

4 Interpretation of Results

The Synergies report shows that PoN currently does not appear to be earning the cost of capital on the investor's funds. While this observation does not prove that potential future price increases without regulatory oversight would be higher than with regulatory oversight, it is useful to ask what it might be telling us about market power and possible commercial objectives.

As economists, we assume that PoN is unlikely to be leaving money on the table. Rather, it would be rational for PoN not to seek immediate full cost recovery from port charges if:

- It expects that over time volume growth would deliver the required level of revenue
- It expects other revenue flows, such as property development on vacant land, to meet the revenue target
- It is subject to other forms of regulatory oversight that restrain price increases.

We can ask what would be rational if prices were set through regulatory arbitration. If the total required/allowed revenue is about the same with or without direct regulatory oversight, the key question is what would be the incentive on PoN to move to the target/regulatory ceiling level. PoN's revealed behaviour shows that an immediate jump to the target in the absence of regulation has not occurred. This is consistent with the commonly observed commercial tactic of growing revenue with volume.

However, with regulation, an immediate jump to the regulatory ceiling would be more likely. As a general observation, regulation produces distinctly different price paths to the commercial outcomes expected in the market. The conventional regulatory approach is to ensure “financial capital maintenance”: that is, to enable investors at all times to preserve the value of their asset base. Financial capital maintenance is consistent with the objective of ensuring that investors are paid just enough to induce them to invest, but no more. Clearly, if investors do not expect the value of their capital to be maintained in the medium term, they are unlikely to invest.

Financial capital of an investor in a regulated asset is maintained by setting the allowed return at the estimated weighted average cost of capital (WACC) and by adjusting WACC at regular intervals to reflect market conditions. By doing this, the regulator changes the cash flows of the regulated business: income increases when the opportunity cost of capital rises and falls as it falls. If the regulated WACC is set correctly by a regulator, the value of the firm shouldn't change. In other words, an increase in the cash flow associated with a higher WACC should not increase the underlying value of the assets as long as it just compensates for the higher opportunity cost of capital.

However, this type of movement in cash flows is fundamentally different to what would normally be observed in an unregulated market. In unregulated commercial settings, a firm has no guarantee of financial capital maintenance—but is free to aim for returns above the opportunity cost of capital. This usually means that an increase in WACC results in a reduction in the value of the firm, while a decline in WACC tends to increase the value, while prices remain steady.

To some extent, this explains why returns for regulated firms are usually seen as generous in times of economic downturn. Financial capital maintenance typically ensures that regulated returns are relatively higher in those periods when compared to the returns of unregulated firms, whose share values may be collapsing. However, in times of booming economic conditions, the returns of regulated firms are relatively lower, although this is less commented upon.

Further, in regulated price settings, it is typically difficult to make up for under-recovery in one period with an over-recovery in another period. Hence, with regulation, PoN would have a stronger incentive to increase prices in the short term to full cost recovery level at current volumes, and then to reduce prices over time as volumes increase.

ATTACHMENT D – APPROACH TO CRITERION (a)

1 Glencore’s approach to criterion (a)

Glencore’s response dated 9 September 2015 to the Draft Recommendation (**Glencore’s Response**) states:

“... Glencore submits that the Council’s preliminary approach to applying Criterion (a) in the particular circumstances of this matter is not consistent with the intentions of Part IIIA and is a very dangerous precedent for future privatisations involving export supply chains. In particular the Council appears to have been led into error by focussing on an initial price increase and the extent of that price increase compared to the overall cost of production and export of coal. Criterion (a) does not call for any analysis of the current price or future prices, against a background of the cost of production or sale price of a commodity, either explicitly or implicitly. Criterion (a) requires only that access (or increased access) to the facility materially increases competition in another market.”³

Glencore appears to take issue with the Council’s approach to criterion (a) on the basis that it is contrary to precedent established in the *Sydney Airport*⁴ case. For example, Glencore’s Response states:

“The [Sydney Airport case] is an important precedent for Criterion (a) and offers a number of important findings that are particularly relevant for Glencore’s Application and which Glencore believes the Council should attach greater significance to in finally determining satisfaction of Criterion (a).”⁵

Glencore’s Response argues that the *Sydney Airports* case establishes that access in criterion (a) should be read as ‘declaration’ and that the correct counterfactual test under criterion (a) is to compare access with no (or limited) access. Glencore’s Response implies that this approach precludes consideration of a number of factors that have been taken into account by the Council in relation to the current and likely future provision of the service by PNO (i.e. the ‘status quo’).

PNO wishes to make a number of points rebutting this aspect of Glencore’s Response. These are summarised below, and then expanded upon in the subsequent sections.

- The precedential value of the *Sydney Airport* case has been significantly reduced by the High Court’s decision in the *Pilbara* case⁶ which, while not addressing criterion (a) in detail, decided that the Full Federal Court’s approach to assessing the declaration criteria in the *Sydney Airport* case was fundamentally wrong.
- The findings in the *Sydney Airport* case referred to above do not form part of the Court’s *ratio decidendi*, it having already dismissed the fundamental argument made by Sydney Airport Corporation Limited (**SACL**) in its appeal that in order for criterion (a) to be capable of being satisfied, access to the service must have been denied.
- PNO agrees with the Council’s submission dated 8 February 2013 to the Productivity Commission’s Inquiry Report on the National Access Regime (**PC Inquiry Submission**) that this finding of the Full Federal Court in the *Sydney Airport* case has been superseded by the *Pilbara*

³ Glencore’s Response, page 1.

⁴ *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146 (**Sydney Airport case**)

⁵ Glencore’s Response, page 3.

⁶ *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (**Pilbara case**)

case, which establishes that the reference to access in criterion (f) is a reference to “access on such reasonable terms and conditions as may be determined in the second stage of the Pt IIIA process [i.e. following declaration]”⁷. This reasoning must apply equally to criterion (a), which is expressed in the same terms as criterion (f) as regards access.

- PNO agrees with the Council that this implies a counterfactual test which compares the future state of competition in the dependent market with a right to access on reasonable terms and conditions (but not involving an assessment of what the outcome of any arbitration by the Australian Competition and Consumer Commission would be) with the future state of competition in the dependent market without such a right (the status quo).
- PNO considers that the introduction of a materiality threshold to criterion (a) since the *Sydney Airport case* supports this position by evidencing the legislature’s intention that criterion (a) should not be too easily satisfied;
- Glencore seeks to draw parallels between the reasoning in the *Sydney Airport case* and the present case. As stated in PNO’s Submission, the facts of that case are highly distinguishable from the present Application, in particular the manner in which the service has been provided and the characteristics of the dependent markets involved. These factors, on the basis of the Full Federal Court’s own reasoning in the *Sydney Airport case*, are relevant to the assessment of criterion (a);
- The Council’s approach to criterion (a) is not erroneous. It considers the nature of the service in question and the characteristics of the dependent markets identified by Glencore, and asks whether increased access would materially promote competition in those markets. It concludes that this is unlikely given that, on any basis, the service represents a very small component of the overall cost of the production and sale of coal for export from the Hunter Valley. This reasoning applies regardless of any counterfactual assessment that may be applied.

2 The precedential value of the *Sydney Airport case*

It is true that the *Sydney Airport case* is the most recent case that considered criterion (a) in detail.

However, the *Sydney Airport case* pre-dates both the decision of the High Court in the *Pilbara case* and the passage of the *Trade Practices Amendment (National Access Regime) Act 2006* (Cth).

The *Pilbara case*, as well as involving a detailed consideration of criteria (b) and (f), establishes fundamental principles relevant to the application Part IIIA, and to the assessment of all declaration criteria, including criterion (a).

In particular, the High Court’s finding in the *Pilbara case* that the designated Minister has no residual discretion not to declare a service if he or she considers that the declaration criteria are satisfied removes a fundamental basis of the Full Federal Court’s reasoning in the *Sydney Airport case*.

In the *Sydney Airport case*, the Full Federal Court proceeded on the basis that satisfaction of the declaration criteria function is necessary but not sufficient for declaration, and that other considerations could be taken into account by the Minister in deciding whether to declare a service provided those considerations were not irrelevant:

“After the considerations in s 44H(2) and (4) are dealt with, the decision to be made whether or not to declare a service may be affected by a wide range of considerations of a commercial,

⁷ *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58 at paragraph 112 (**Pilbara Full Court decision**).

economic or other character not squarely raised by, nor falling within, the necessary pre-conditions in s44H(4). Of course any such considerations must not be irrelevant in the sense discussing in Minister for Aboriginal Affairs v Peko-Wallsend Ltd (1986) 162 CLR 24 at 39-42 . . .”⁸

This formed a key aspect of the Full Federal Court’s approach to criterion (a), and in particular to its assessment of the correct basis on which to conduct a counterfactual analysis in relation to criterion (a):

“Virgin is correct in its submission that 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 to use the service.

We do not accept the Tribunal’s basis for rejecting the submission that it would be unrealistic to undertake a counterfactual analysis which discounts the fact that Virgin has access. That, with respect, is not the point. The terms of s44H(4)(a) do not incorporate the requirement for comparison with what is factually the current position in any given circumstances. Once a declaration is made any potential user can take advantage of it. Thus, it is an unnecessary constriction of a provision by way of pre-condition, to engage in a detailed factual enquiry heavily dominated by the past and the present.

That is not to say that what has happened in relation to the service, how the provider has behaved and the degree to which it can be said that monopolistic behaviour has or has not impeded the efficient operation of the market in question may not be relevant considerations attending the making of the decision. For instance, if it can be demonstrated that the service has been provided in a manner that can be described as fair, even-handed and in a way most likely to maximise vigorous competition in the downstream market that may be a powerful and relevant consideration as to why no declaration should be made. Thus it may be that a with and without declaration counterfactual (or some aspect of it) can be seen as relevant to the decision at hand. That inquiry is simply not mandated by the pre-condition of satisfaction in s 44H(4)(a).”⁹

In the *Pilbara* case, the High Court found that the Full Federal Court was wrong to approach its assessment of criterion (a) in this way:

“BHPB submitted in this Court that there is a residual discretion. In aid of that submission, BHPB relied upon the decision of the Full Court of the Federal Court in Sydney Airport Corporation Ltd v Australian Competition Tribunal and the Explanatory Memorandum for the Competition Policy Reform Bill 1995, which introduced Part IIIA into the Act. Those submissions drew attention to s 44H(2), which provides:

“In deciding whether to declare the service or not, the designated Minister must consider, whether it would be economical for anyone to develop another facility and could provide part of the service. This subsection does not limit the grounds on which the designated Minister may make a decision whether to declare the service or not.”

The second sentence of s 44H(2) is, by its terms, limited to that sub-section and so has no relevance to the existence or otherwise of a residual discretion. And in so far as the Explanatory Memorandum referred to a discretion whether or not to declare a service, those references simply emphasised that the Minister has to declare a service, those references simply emphasised that the Minister has to consider whether it would be economical for anyone to develop another facility to provide part of that service.

⁸ *Sydney Airport* case at paragraph 39.

⁹ *Sydney Airport* case at paragraphs 84 to 85.

There is no residual discretion and it follows that, on review, the Tribunal has no residual discretion to exercise. The Tribunal and the Full Court were wrong to proceed on the footing that there was a residual discretion to be exercised.”¹⁰

Given that the existence of a residual discretion formed a key basis of the Full Federal Court’s reasoning in the *Sydney Airport case*, the precedential weight to be attributed to that decision must be questioned in light of the *Pilbara case*.

Put another way, if, as the High Court has determined, the declaration criteria do not function as pre-conditions, then on the Full Federal Court’s own reasoning it cannot be “*an unnecessary constriction of a provision by way of pre-condition, to engage in a detailed factual enquiry heavily dominated by the past and the present*”¹¹. That is because in light of the *Pilbara case* the constriction would be necessary to take account of factors which the Full Federal Court itself considers relevant, i.e:

“... how the provider has behaved and the degree to which it can be said that monopolistic behaviour has or has not impeded the efficient operation of the market in question”

“... [whether] the service has been provided in a manner that can be described as fair, even-handed and in a way most likely to maximise vigorous competition in the downstream market”

“Thus it may be that a with and without declaration counterfactual (or some aspect of it) can be seen as relevant to the decision at hand.”

[Sydney Airport case at paragraph 85]

Conversely, the *Pilbara case* means that if Glencore’s interpretation of the *Sydney Airport case* were followed on this point, the Minister could not take account of matters which, by the Full Federal Court’s own reasoning in that case, are relevant to a declaration decision and should be taken into account.

The *Sydney Airports case* must accordingly be read in light of the High Court’s decision in the *Pilbara case*, and does not support the interpretation of criterion (a) argued for in Glencore’s Response. By contrast, when read in light of the *Pilbara case* it supports the Council’s approach.

3 Status of the Full Federal Court’s finding in relation to the meaning of access and the counterfactual in the *Sydney Airport case*

It is important to note that the Full Federal Court’s finding on this point is not part of its *ratio decidendi* because the Court rejected the fundamental basis of SACL’s appeal prior to addressing this point. The fundamental basis for the appeal was that in order for criterion (a) to be satisfied, the existence and extent of a denial or restriction of access must be identified before an assessment can be made regarding whether access or increased access would promote competition in a dependent market – in other words, that because Virgin already had access, criterion (a) could not be satisfied:

“The whole scheme of Part IIIA, when understood against the background to its passing, is antithetical to s 44H(4)(a) operating to limit the possibility of declaration except where it can be demonstrated as a fact that the service provider has in the past denied or restricted access to the service or supply of the service.

The above is enough to lead to the conclusion that the application should be dismissed.
However Virgin’s second argument that there is a simpler construction of s 44H(4)(a) to that

¹⁰ *Pilbara Full Court decision* at paragraphs 117 to 119.

¹¹ *Sydney Airport case* at paragraph 84.

*which was applied by the Tribunal was fully argued and should be dealt with.*¹² [emphasis added]

PNO agrees that the *Sydney Airport case* stands for the proposition that a denial of access is not required for criterion (a) to be satisfied. However, the *Sydney Airport case* does not establish a precedent that in assessing criterion (a) the existing or likely future terms of access must be ignored, and that the assessment of criterion (a) should be limited to a purely theoretical inquiry into the likely state of competition in dependent markets with access compared to the likely state of competition with no access.

4 The Full Federal Court's finding in the *Sydney Airport case* has been superseded

In any event, and notwithstanding the arguments made above, the reasoning of the Full Federal Court in the *Sydney Airports case* has been superseded.

PNO agrees with the Council's PC Inquiry Submission on this point, the key aspects of which are set out below:

4.31 The Full Federal Court in [the *Sydney Airport case*] determined that 'access' in criterion (a) means 'access' and not 'declaration under Part IIIA' ([the *Sydney Airport case*], [81]–[84]). It is uncontroversial that the same meaning should be attributed to the use of the word 'access' in criterion (f).

4.32 Prior to this decision the Council and the Tribunal had considered the effect of the application of Part IIIA on competition in dependent markets when considering criterion (a); in effect examining the likely effect of declaration and the negotiate-arbitrate process on competition in dependent markets and on the public interest.

4.33 When considering the application of criterion (a) in *Re Fortescue*, the Tribunal said that:

[w]hat matters is the likelihood of access, the sufficiency of access and the likely timing of access. For the Full Court [in Sydney Airport No 2] to hold that it is impermissible to consider whether, when and to what extent, access will be taken up could easily lead to the result that criterion (a) is not satisfied although a close examination of the facts may show otherwise. This result could hardly have been intended. If it was, it is necessary for Parliament to intervene. That said, we accept that in assessing the extent to which access would be taken up, the Tribunal should assume that access is on reasonable terms and conditions, without speculating about any particular terms that might be imposed by arbitration under Part IIIA.

4.34 The Full Federal Court has since said that:

[i]t may be accepted ... that "access" in criterion (f) is access on such reasonable terms and conditions as may be determined in the second stage of the Pt IIIA process. (Pilbara Full Court decision, [112]).

4.35 As this question was not addressed by the High Court in the Pilbara Appeal decision, the judgment of the Full Federal Court is authoritative.

4.36 The Council believes that the interpretation that appears to result from this line of authority is satisfactory, in that it allows for consideration of the effect of access on

¹² *Sydney Airport case* at paragraphs 79 and 80.

reasonable terms and conditions in assessing criteria (a) and (f) but does not require the specific terms of access that may result from an arbitration to be predetermined.

PNO considers that the correct counterfactual test is a comparison of the future state of competition in the dependent market with access on reasonable terms and conditions (but not involving an assessment of what the outcome of any ACCC arbitration would be) with the future state of competition in the dependent market without access on such terms, and that the status quo should be used as a proxy for this factual scenario.

5 The inclusion of a materiality threshold in criterion (a) supports the above position

Criterion (a) was amended by the *Trade Practices Amendment (National Access Regime) Act 2006* (Cth) which added the requirement that the promotion of competition brought about by access or increased access must be material.

This amendment was made in response to a report of the Productivity Commission in 2001 (Review of the National Access Regime, Inquiry Report, Report No 17, 28 September 2001). The Productivity Commission reported that it had received many submissions expressing concern that Criterion (a) was too easily satisfied. Ostensibly, the decision of the Australian Competition Tribunal in *Re Sydney International Airport* [2000] ACompT 1 was the case that crystallised the concern of many of those who made submissions to the Productivity Commission.

In that case, the Treasurer had made a declaration in respect of the freight aprons and hard stands to load and unload aircraft at Sydney International Airport and an area of the airport to store that equipment and transfer freight from/to the aircraft to/from the trucks. SACL sought review of that decision by the Australian Competition Tribunal.

Under the previous iteration of the legislation, the Treasurer (making a decision under section 44H(4) (which is identical to section 44G(2))) only had to be satisfied that increased access to the services would promote competition in at least one other market. It was submitted by SACL that “*a finding that increased access would promote competition requires satisfaction that there is more than a likelihood that declaration would have the requisite effect and that the promotion of competition must be substantial and not merely trivial or transient*”. Further, SACL (then owned by the Commonwealth) argued that the word “promote” had to mean something stronger than “encourage” but instead required there to be an advancement of the extent or degree of competition to satisfy criterion (a).

The Tribunal did not accept these submissions. Instead, the Tribunal found that “promoting” competition under criterion (a) “*involves the idea of creating the conditions or environment for improving competition from what it would be otherwise*”. Specifically, the Tribunal determined that where it was satisfied that a declaration would enhance the conditions or environment for competition, then that of itself created a likelihood of increased competition that is not “trivial”. This would be sufficient to satisfy the Tribunal that criterion (a) had been made out.

It was this outcome that caused a number of parties to make submissions to the Productivity Commission. *Re Sydney International Airport* [2000] ACompT 1 was used as an example of how criterion (a) was too easily satisfied and, in some respects, was self-perpetuating. That is to say, a declaration by the Treasurer removing a barrier to access of a service would almost always “promote competition”.

The Productivity Commission suggested that the word “substantial” be included in criterion (a) in order to redress the concern that trivial increases in competition were sufficient to satisfy that criterion.¹³

¹³ Productivity Commission Report No. 17 dated 28 September 2001, *Review of the National Access Regime*

The Explanatory Memorandum to the *Trade Practices Amendment (National Access Regime) Act 2006* (Cth) confirmed that a materiality threshold was included in Criterion (a) “to ensure that access declarations are only granted where the expected increase in competition in an upstream or downstream market is not trivial”. The Second Reading speech in relation to the Bill states:

However, as identified by the Productivity Commission, the current declaration criteria do not sufficiently address the situation where, irrespective of the significance of the infrastructure, a declaration would result in only marginal increases in competition.

PNO considers that this evidences a clear intention by the legislature that criterion (a) not be a ‘*fait accompli*’, and considers that this intention must inform how the *Sydney Airport* case is applied in addition to the points made above.

PNO notes that while the *Sydney Airport* case may represent the most recent, detailed consideration of criterion (a) by the Federal Court, the Tribunal’s decision in *Fortescue Metals Group Limited* [2010] ACompT 2 represents the only detailed consideration of criterion (a) since it was amended. As stated above that case is notable because it rejects the proposition that ‘mere access itself will promote a material increase in competition’¹⁴. This, Port of Newcastle submits, is consistent with the intentions of the legislature for the amended criterion (a).

This supports our view regarding the correct counterfactual test to be applied, because the counterfactual test proposed by Glencore’s Response would result in criterion (a) being satisfied by ‘mere access’ and in criterion (a) (as amended by the legislature) having no operation.

6 The Sydney Airport case is distinguishable from the present Application

As stated in Port’s Submission, the facts of the *Sydney Airport* case were very different to the present case:

- In the *Sydney Airport* case, the new charging basis introduced by SACL gave a competitive advantage to Qantas over Virgin Blue (as a low-cost carrier) because the charges discriminated against Virgin Blue – that is, it involved an exercise of monopoly power that could affect competition.
- This was in a context where the dependent markets were highly concentrated, with Qantas and Virgin Blue being the only significant competitors and Virgin Blue having a low cost business model.
- In this case, the new prices introduced by PNO for coal vessels are not *and cannot be* discriminatory given that they comprise a rate per GT, *as is required by* the PAMA Act and PAMA Regulation applied consistently for all coal vessels. In fact, the current charges are more competitively neutral than the charges previously levied by the State which favoured larger vessels on a per tonne of coal basis.
- The dependent markets identified by Glencore are highly competitive.

The reasoning of the Tribunal and of the Full Federal Court which Glencore cites as relevant to this case, and supportive of a conclusion that criterion (a) is satisfied, is all premised on facts (i.e., the existence of a discriminatory charging regime imposed by SACL) which are not present in (and would not be present in the factual scenario of) this case. The following citations made in Glencore’s Response illustrate this point:

¹⁴ *Fortescue Metals Group Limited* [2010] ACompT 2 at paragraph 1066.

*“One of the principal issues canvassed in the proceedings was whether SACL **had misused its monopoly power in such as a manner as warranted the conclusion** that there had been, and would continue to be in the absence of declaration of the Airside Service, and effect on competition in the dependent market.” [Virgin Blue Airlines Pty Limited [2005] ACompT 5 (Tribunal Decision) at paragraph 13, emphasis added]*

*“Virgin submitted that, on its alternative construction, which we favour, it is clear that s 44H(4)(a) would be satisfied because . . . (as substantially found by the tribunal) (a) Sydney Airport is a natural monopoly **and SACL exerts monopoly power.**” [Full Federal Court Decision at paragraph 91, emphasis added.]*

PNO has not misused any market power it may hold. On the contrary, it has introduced a pricing structure that is no longer discriminatory, and used a methodology in setting the level of those prices that indicates that they are within the limit of those that could be expected to eventuate in the event of arbitration by the ACCC (see the HoustonKemp Report at Attachment B and the Castalia Report at Attachment C to this letter).

7 The Council’s approach to criterion (a) is not erroneous

The thrust of Glencore’s argument appears to be that facts relevant to the potential impact of access on competition in dependent markets should be ignored by the Council in its assessment of criterion (a), and that this is required by the *Sydney Airport case*. This is wrong. As set out above:

- the Full Federal Court considered that these matters *are* relevant to the declaration decision, and only found that they should be excluded from the assessment of criterion (a) because it considered that a residual discretion was left to the Minister. The High Court has since determined that this is wrong; and
- consistent with the view of the Council, in PNO’s view the *Sydney Airport case* (to the extent it had precedential value) does not represent the current law in relation to the assessment of criterion (a).

In any event, even if the finding of the Full Federal Court in the *Sydney Airport case* were followed in the manner suggested by Glencore, it would not disturb the Council’s reasoning in its Draft Recommendation.

In order for criterion (a) to be met, the Council must be satisfied that access or increased access to the service in question would materially promote competition in a dependent market.

In its Draft Recommendation the Council, after considering in detail the submissions made on this point by both Glencore and PNO, concludes that increased access would be unlikely to materially promote competition in a dependent market because the cost of the service in question is not material to competition in any dependent market.

The Draft Recommendation states:

“while producers are undoubtedly sensitive to the charges [for the service], it is difficult to conclude that changes to those charges would have a material impact on decisions that would affect competition in any relevant market. Consequently, it is difficult to conclude that increased access to the service would materially promote competition in a relevant market.”¹⁵

It is important to note, given some of the arguments made in Glencore’s Response, that this assessment does not form part of the Council’s counterfactual analysis in relation to Criterion (a).

¹⁵ Draft Recommendation at paragraph 4.23.

Paragraph 4.33 of the Draft Recommendation makes it clear that, given the Council's assessment of the low potential for increased access to impact competition, "it does not propose to conduct a detailed counterfactual assessment for this matter".

This is an approach which the Council is entitled to take because if the Council's assessment is that increased access to the service is not material to competition in a dependent market, there will be no difference between the factual and the counterfactual, regardless of the precise test or reasoning applied.

In any event, and for the reasons given above, PNO considers that Glencore's focus on the *Sydney Airport case* is misguided and incorrect. Once the *Pilbara case* is taken into account, it is clear that the matters taken into account by the Council in its Draft Recommendation are relevant and necessary to the assessment under criterion (a).

ATTACHMENT E – CHARACTERISATION OF PORT CHARGES

1 Appointment of Port operator

Part 5 of *Ports and Maritime Administration Act 1995* (NSW) (**PAMA Act**) provides for the imposition of statutory charges on users of the Port of Newcastle.

PNO is the “port operator” of the Port of Newcastle for the purposes of the PAMA Act, [Confidential to PNO].

As the “port operator”, the PNO has the right to fix and collect, without Ministerial approval, the site occupation charges, wharfage charges and navigation services charges.

The “port operator” does not have power to fix and collect berthage charges under the PAMA Act. Only the Minister has that power.

PNO published a “Schedule of Port Pricing” with effect from 1 January 2015. Amongst other things it lists the navigation services charge “as levied by [PNO] on vessels at the time of port entry for the general use of the Port and its infrastructure”. The Schedule indicates that different navigation services charges apply; depending upon whether the vessels are “entering port to load coal” or are “other vessels”. An additional component of the navigation services charge is the “port security charge”; a levy imposed to cover the cost of implementing security legislation. Navigation services charges are, in practice, paid by the owner of the vessel (or their agent) to PNO.

Coal carrying vessels enter the Port of Newcastle and dock at either the NCIG or the PWCS terminals. The vessels are then loaded with coal mined in nearby mines and freighted to the terminal by rail. Upon entry into the Port of Newcastle each vessel is subjected, amongst other things, to a navigation services charge. Those charges were recently increased by PNO.

On 13 May 2015, Glencore’s Application sought a recommendation from the Council to the designated Minister to declare a service described as being the provision of the right to access and use the shipping channels (including berths next to the wharves as part of the channels) at the Port of Newcastle.

2 Part IIIA access regime

Persons may obtain access to services provided by facilities owned by others under the two stage process set out in Part IIIA of the CCA. In the first stage the person may only apply to the Council to recommend that a particular service provided by the facility be declared. If a favourable recommendation is made the designated Minister must either declare the service or not declare the service. If the service is declared then an enforceable right to negotiate the terms of access to the service vests in both the applicant and any other interested person. The second stage of the process may include arbitration of the terms of access by the ACCC if the parties are unable to reach agreement by negotiation.¹⁶

In making its determination in an arbitration, the ACCC must take into account the pricing principles set out in section 44ZZCA of the CCA. During the arbitration, the Commission may deal with any matter relating to third party access (subject to certain limitations).¹⁷

¹⁶ Division 3 of Part IIIA of the CCA.

¹⁷ Sections 44V, 44W and 44X of the CCA.

3 Issue

The issue is whether a binding arbitration by the Commission setting the price for the provision of the service defined by Glencore in its Application is available if the “navigation services charges” and the “wharfage charges” imposed under the PAMA Act are taxes and not fees for services. Taxes by their nature are not fees for services.¹⁸ On that basis, there is no power in the Commission to subject their imposition to a determination made under section 44V.

4 The legal nature of a tax

A tax is a “compulsory exaction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered”.¹⁹

The reference to ‘payments for services rendered’, is only one example of various special types of exactions of money which are not taxes. In particular circumstances, charges for the acquisition or use of property may also not amount to a tax.²⁰

The description of a compulsory exaction as a fee for service does not prevent the exaction from being characterised as a tax merely because it is described as a ‘fee for service’. If there is no choice about whether or not the service will be acquired and there is no discernible relationship with the value of what is acquired, the circumstance of the imposition of the fee may nevertheless characterise it as a tax.²¹

The relationship need not be precise if services were actually provided and the charges recovered the costs of their provision.²² However, if what is actually being provided could not properly be seen as a service at all then the impost could not be regarded as a fee for service.²³

At least at the State level, it would seem possible for the power to levy a tax to be “leased” to a private company.²⁴

5 Navigation services charge

The PAMA Act makes provision for the imposition of the port charges set out in Part 5. Section 50(1) provides that a ‘navigation services charge’ is payable “in respect of the general use by a vessel of a designated port and its infrastructure”. The charge is payable on each entry by the vessel into any designated port and is calculated by reference to the gross tonnage of the vessel.²⁵

The quantum of the navigation services charge is fixed by the ‘relevant port authority’ and not by the PAMA Act.²⁶ For the Port of Newcastle, the ‘relevant port authority’ in relation to a navigation services

¹⁸ See e.g. *Matthews v Chickory Marketing Board (Vic)* (1938) 60 CLR 263 at 276.

¹⁹ *Matthews v Chickory Marketing Board (Vic)* (1938) 60 CLR 263 at 276 per Latham CJ; *Roy Morgan Research Pty Ltd v FCT* (2011) 244 CLR 97 at 109-110.

²⁰ *Luton v Lessels* (2002) 210 CLR 333 at 352-353.

²¹ *Air Caledonie International v Cth* (1988) 165 CLR 462 at 467.

²² *Air Services Australia v Canadian Airlines International Ltd* (1999) 202 CLR 133 per Gleeson CJ and Kirby J at 178.

²³ *Air Caledonie International v Cth* (1988) 165 CLR 462 at 467.

²⁴ *CCM Holdings Trust Pty Ltd v Chief Commr of State Revenue; CCT Motorways Company Nominees Pty Ltd v Chief Commr of State Revenue* [2013] NSWSC 1072.

²⁵ Section 50(4) of the PAMA Act.

²⁶ Section 51(1) of the PAMA Act.

charge is each of the port operator and the appropriate public agency for the Port.²⁷ **[Confidential to PNO]** As no port corporation has been designated, the 'appropriate public agency' is the Minister.²⁸

Section 47(2A) then provides that if the relevant port authority in relation to a charge is each of the port operator and the appropriate public agency, the port charge can be fixed and collected by either or both of the port operator and the appropriate public agency. As the Port is a 'private port' under section 3(1), the site occupation and wharfage charges and port infrastructure charge may also be fixed and collected by either or both of the PNO and the Minister. However, section 50 contemplates that only one navigation services charge is payable in respect of the entry by a vessel into the port by its reference to "a navigation services charge".

The identity of the 'relevant port authority' is also relevant to Division 8 Part 5 concerning payment and collection of the port charges imposed under Part 5. Section 68(4) provides that such a charge, including a navigation services charge, is a debt due to the relevant port authority from the person liable to pay it. That is, the charge is due to both PNO and the Minister. Remittance of any part of a navigation services charge to the Minister as the relevant port authority is to be paid into the Consolidated Fund.²⁹

The fact that the navigation services charges may be imposed by either or both PNO and the Minister (and are in fact imposed by PNO) should not prevent their characterisation as a tax. The charge is a legal debt which consists of a single claim against the owner of the vessel: section 68(4) PAMA Act. There is nothing in Division 8 Part 5 PAMA Act which suggests that the vessel owner has undivided but distinct debts for the navigation services charge which are owed to different entities. Section 47(2A) does not operate to create any such distinct indebtedness to the relevant port authority who may have fixed the charge. Section 47(2A) only applies for the purposes of 'fixing and collecting' port charges; each of which are specific acts under Part 5. 'Fixing' a navigation services charge is dealt with by section 51. The 'collection' of a charge is an act in relation to the appointment of agents to collect the charge: sections 68(2) and (3). Collection is therefore distinguishable from the identification by section 68 of the charge as being a debt due to the 'relevant port authority'; being each of the port operator and the Minister. Accordingly, in common with debts in respect of which there is joint ownership, the vessel owner is able to make a payment to one of the relevant port authorities and discharge its liability to the other. As one of those persons to whom payment may be made is the Minister, the requirement of the charge being imposed by a public authority is satisfied. The arrangement contemplated by the PAMA Act is also consistent with the right to impose a tax being "leased" by the State.³⁰

The question is then whether the navigation services charge is a fee for service. It is described in section 50 and the Schedule of Port Pricing as for the general use of the port and its infrastructure. More specifically, it is imposed upon entry by a vessel into the Port. It is also imposed again if the vessel is "removed to an offshore anchorage and followed by a subsequent re-entry". Whilst it is stated to be a charge 'for the general use of a port and its infrastructure' it is a debt owed jointly to the Minister and may be discharged by payment to the Minister. However, the Minister is not the entity which is making the use of the Port available to the vessel. The Port and its facilities have been the subject of lease and sub-lease arrangements with, amongst others, PNO. The relationship of the charge with its stated purpose is one which does not in fact exist and the charge should not be a fee for a service. Consequently, the navigation services charge should be regarded as a tax.

²⁷ Section 47(1)(a1) of the PAMA Act.

²⁸ Section 47(1) definition, PAMA Act.

²⁹ Section 69 of the PAMA Act.

³⁰ *CCM Holdings Trust Pty Ltd v Chief Commr of State Revenue; CCT Motorways Company Nominees Pty Ltd v Chief Commr of State Revenue* [2013] NSWSC 1072.

6 Wharfage charges

Wharfage charges are also imposed under the PAMA Act. The analysis set out above in relation to the navigation service charge also applied to the wharfage charge.