

**SUBMISSION TO THE
NATIONAL COMPETITION
COUNCIL IN RESPONSE
TO NERA ECONOMIC
REPORT**

26 April 2019

NSW MINERALS COUNCIL



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1 About the NSW Minerals Council

The NSW Minerals Council (NSWMC) is the leading industry association representing the NSW minerals industry, providing a united voice for our members. NSWMC works closely with government, industry groups and business and community leaders to foster a sustainable mining industry in NSW.

Many of NSWMC's members are active in the coal mining industry in the Hunter Valley, either as producers, explorers or service providers. Our members include large and small coal miners. A full list of the NSWMC's members is provided in Annexure A to this submission. Glencore Coal is a member of NSWMC. NSWMC's members directly provide over 20,000 Australian jobs, and support more than 100,000 more indirectly.

Mining has been, and will continue to be, a key economic driver for the State of New South Wales. Mining is NSW's largest single export industry, directly injecting more than \$10 billion a year in salaries and business purchases and around \$2 billion in royalties in the current financial year.

2 Introduction

NSWMC makes this submission in response to the email from the National Competition Council (NCC) dated 17 April 2019 regarding the report prepared by NERA Economic Consulting (NERA) dated 8 April 2019 (NERA Report). The NCC commissioned the NERA Report in relation to the application by Port of Newcastle Operations Pty Ltd (PNO) dated 2 July 2018 (Application) for revocation of the declaration of the shipping channel service (Service) at the Port of Newcastle (Port). The NCC has requested submissions by 5pm on 26 April 2019.

NSWMC, on behalf of its members, wishes to respond to the NERA Report. NSWMC has made previous submissions to the NCC including on the NCC's preliminary views released in December 2018 (Preliminary Views). Particularly given the short timeframe in which interested parties have to respond to the NERA Report (noting this review is coming close to one year in length now), this new submission will not repeat our previous submissions in full again. In our view, the NCC has not addressed the issues that we have raised in our previous submissions, and therefore we continue to hold the views expressed in those previous submissions.

This submission will focus on some of the factual assertions on which the NERA Report is based. Our view is that the actual factual situation bears no resemblance to the assertions in the NERA Report. Some of NERA's factual assertions arise from the fact that the NERA Report is based on the Preliminary Views. Our previous submissions set out our views on why the factual assertions in the Preliminary Views were incorrect.

Further, while we make no criticism of NERA, as we anticipate they are following instructions and a limited brief from the NCC, we believe that in respect of such an important matter, a supporting expert report would have been more comprehensive than a 8 pages, would have set out their instructions, their industry expertise and would have been based on an independent factual analysis, rather than being reliant on the Preliminary Views.

We note at the outset that the circumstances surrounding the privatisation of the Port continue to deeply concern NSWMC. In the National Competition Policy Review Report released on 25 August 1993 (known as the Hilmer Report), highly relevant comments to this matter were made at page 226. The Hilmer Committee warned as to the dangers of privatisation and relevantly stated:

However, privatisation is less likely to offer significant public benefit if appropriate structural reforms are not carried out before or concomitant with the privatisation, possibly entrenching the monopolistic structure of the industry.

The concerns in this area are pronounced when one considers that privatisation may be driven by budgetary goals as well as efficiency objectives, and that businesses with a

substantial degree of market power may attract premiums on sale. These concerns have led commentators to warn of the dangers of trading "cash for competitiveness" when privatising government enterprises.

Governments considering privatisation often choose between short-run revenue objectives and longer run costs to the economy associated with transferring the ownership of a business which has not been properly restructured to the private sector, where there are fewer constraints on profit maximising behaviour...

Moreover, unless structural reform is accomplished before or at the time of sale, the only means of addressing industry structure is through divestiture, with implications for the shareholders of the newly privatised entity.

The Hilmer Committee comments in 1993 are very relevant to the issues the NSW mining industry faces at the Port.

3 The commercial incentives of PNO

3.1 The perspectives of the Australian Competition and Consumer Commission (ACCC) and Synergies as to PNO's future behaviour are to be preferred over the theories of NERA

NSWMC remains of the view that, were it not for regulatory constraints imposed by the declaration and therefore the ability for mining companies to have recourse to arbitration, PNO would continue to seek to impose terms and conditions of access (including as to price) on coal exporters that would be materially worse than those that apply at this time.

The NERA Report seeks to focus upon the economic report prepared by Synergies on behalf of Glencore and seeks to claim that PNO would not have the commercial incentives that Synergies suggest. However, the NERA Report is silent as to the matters raised by the ACCC.

The ACCC Chairman Mr Sims stated in the ACCC media release dated 19 December 2018 that "*should the declaration be revoked, the Port of Newcastle will be an unregulated monopolist that is able to determine the terms and conditions of its access with little constraint.*" Mr Sims went on to say that:

It would be reasonable to expect that, without regulation, further price increases at the Port would follow and this would be a bad outcome for users and the economy, particularly given the history here.

The NERA Report seeks to assert that PNO would not have the incentives that Synergies claim because PNO has every incentive to attract new coal miners into the Hunter Valley. In NERA's opinion PNO would not price in the manner Synergies suggest as, while it is a monopolist in relation to existing miners, it would not be in relation to future mining investment as this would lead to a concern of "hold up" with future investment into the Hunter Valley and it would not be in its interest for "hold up" to occur. NSWMC notes that PNO had no such concerns in the past as to how it priced and certainly made no differentiation in its pricing between existing and future miners.

Having regard to past experience we see no basis for NERA's hypothetical analysis. Past actual experience provides a good indication as to the future. On that basis, if the declaration was revoked, we do not see PNO taking any action other than continuing to operate as an infrastructure monopolist and that it will price accordingly for current and future miners with the impact on future investment (including as to mining tenements) that Synergies (and the ACCC) predict based on past experience.

Further, NERA simply has no actual ability to predict PNO's pricing behaviour based on PNO's actual intentions. NERA is a third party economic consultant recently engaged by the NCC. On the other hand, the ACCC have a good knowledge of this industry, the ACCC has undertaken an arbitration of

the access dispute between PNO and Glencore for over a year, and the ACCC has detailed knowledge of how PNO developed its pricing model for the Port. In these circumstances the views and approach of the ACCC are to be preferred.

3.2 Hold up of investment and PNO's commercial relationships with its customers and the NSW mining industry

In the Preliminary Views at paragraphs 6.117 and 6.118, the NCC note that it is not satisfied that PNO is able to price discriminate to a significant extent. The basis on which the NCC formed this view is unclear. In any event the NCC went on to conclude that, even if PNO did price discriminate, that it would not hold up mine investments because:

... it may not be in PNO's interests over the longer term to seek to hold-up its individual customer's coal mining investments as it has long term relationships with those customers. Any chilling effect on investment as a result of hold up would risk those relationships over the longer term and reduce the volume of coal exported through the Port over time.

NSWMC notes that this theory, which appears to resonate with NERA, is flawed. PNO's commercial relationships with its coal mining customers has deteriorated as a result of its behaviour. PNO's actions in seeking revocation, without undertaking any consultation with its customers that NSWMC is aware of, highlights that the long term commercial relationships with its customers are not a significant driver.

NERA describes the "hold up" situation in footnote 2 of their Report as follows:

A firm is "held up" if it is forced to accept a worsening of the terms of its relationship once it has sunken investment. This can occur because a substantial part of the investment cannot be recovered through a sale or redeployment of the asset for other uses.

The simple point is that PNO is an infrastructure monopolist. When it increased its prices in 2015, the impact on its current or future customers was not an apparent consideration as it had no pricing constraints. NSWMC believes that, in the absence of the declaration, PNO would act similarly in future. We deal later in this submission with PNO's focus upon diversifying away from coal, undermining NERA's arguments that PNO would seek to foster new mining and investment in new mining tenements.

3.3 Vertical integration

NERA also makes a significant number of other factual assumptions as to PNO's future behaviour based on a belief that PNO is not a vertically integrated firm. However, as with many other assumptions underpinning NERA's Report, why NERA has concluded that PNO is not vertically integrated is unclear. PNO's 50% shareholder is China Merchants Port Holdings which, based on the information on its website and media articles, has substantial investments in container terminals, container shipping lines and energy transport (eg coal and LNG carriers).¹

¹See:

<https://www.marketscreener.com/CHINA-MERCHANTS-PORT-HOLD-1412600/news/Leasing-Hambantota-land-to-China-Petition-to-mention-on-7-Dec-25447539/>

<https://port.today/china-merchants-port-newcastle/>

<https://newsbase.com/topstories/second-chinese-takeover-port-newcastle>

https://eng.yidaiyilu.gov.cn/info/iList.jsp?tm_id=139&cat_id=10080&info_id=2070

<http://china-trade-research.hktdc.com/business-news/article/The-Belt-and-Road-Initiative/The-Role-of-HK-based-China-Merchants-Group-MCG-in-Djibouti-and-other-B-R-countries/obor/en/1/1X000000/1X0AFYFR.htm>

Therefore it is very clear that PNO is, in fact, vertically integrated via its shareholders and this is likely to significantly influence its commercial motivation and incentives.

3.4 Potential container terminal operations affect NERAs analysis as to PNO's interest in facilitating further coal mines and therefore mining tenements

Much of NERA's analysis is based on the argument that PNO has the incentive to facilitate new mines and mining developments and therefore would not have the incentive to price in the manner that Synergies (and the ACCC) predict.

NSWMC believes that past behaviour by PNO undermines NERA's arguments. But, in any event, the NERA analysis (and the NCC's) to date fails to take into account the focus of PNO and its shareholders in developing the container terminal at the Port. Given that focus, PNO may have less interest in facilitating the development of new mines. To the contrary, PNO's public statements under oath in front of the NSW Government Inquiry into the Impact of the Port of Newcastle Sale Arrangements on Public Works Expenditure in NSW on 31 January 2019 suggest it is seeking to diversify². PNO also highlighted that they wish to develop the container terminal as PNO wants to diversify and has the funds to do so.

PNO's comments are highly pertinent given the recent issues affecting Australia's thermal coal exports to China and the corresponding impact on thermal coal pricing – see the article from The Australian "Chinese power stations prefer Indonesian coal". <https://www.theaustralian.com.au/business/mining-energy/chinese-prefer-indonesian-coal/news-story/3f75dd71164781d584f3519eaabf507c>

In particular, please note the following comments from that article:

Prices for high quality thermal coal from Australian producers fell below \$US75 a tonne over the past week to levels not seen since 2016, accordingly to RBC Capital Markets.

NERA's analysis is flawed in that it has not appropriately considered the public statements of PNO as to the actions of PNO to diversify. PNO's interest in its existing coal customers or the attainment of new coal customers could be significantly reduced when it is looking to diversify. In these circumstances PNO is far more likely to continue to act as an infrastructure monopolist and charge as much as it possibly can from its existing and any future mining customer.

Secondly, NERA's analysis of the hold up issue is flawed in that the Hunter Valley catchment area, as PNO expressly recognises, has the world's best thermal coal. It is not directly substitutable to invest elsewhere for this quality of thermal coal.

Thirdly, the hold up problem is highlighted by the situation faced by large and small miners with sunken investments in existing thermal coal mines being concerned as to future investment in other thermal coal mines in the Hunter region, when they would otherwise seek to build on their existing operations by seeking economies of scale and efficiencies. Those miners may not seek to make new investments if PNO was not subject to the declaration and was unconstrained as to its future pricing.

NSWMC does not see any force in the NERA Report's arguments dealing with this concern based on our actual experience of the mining industry and how investments are made. This concern remains real and is not addressed by NERAs conceptual, but flawed theories.

² <https://www.parliament.nsw.gov.au/lcdocs/transcripts/2166/31%20January%202019%20-%20Corrected%20-%20Port%20of%20Newcastle%20sale%20arrangements.pdf>

3.5 Approach of other experienced regulators to the coal tenements market is different to that of NERA

The NERA Report is inconsistent with the approach taken by other experienced independent regulators dealing with the coal industry on a day to day basis. We again note, as we have in previous submissions, that the Queensland Competition Act has similar provisions to the declaration criterion under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (CCA). The Queensland Competition Authority's (QCA) draft findings on a similar situation involving Dalrymple Bay in Queensland are at odds with the economic analysis undertaken by NERA as to the geographic market for coal mining tenements. See:

<http://www.qca.org.au/Other-Sectors/Access/To/Infrastructure/DeclarationReviews/In-Progress/2020-Declaration-Review>

NSWMC prefers the analysis and approach of the QCA, which is clearly set out on its website. The QCA obtained its own expert evidence including in relation to the impact of declaration on competition in mining tenements. The QCA has found, in similar circumstances to those being considered by the NCC, that the monopoly position of the terminal owner would materially impact investment incentives and that declaration promotes competition in other markets, including the mining tenements market that is in the catchment area of the relevant infrastructure.

NSWMC sees no factual basis to suggest that mining companies located in the Hunter Valley would contemplate there being a broader Asia Pacific market for coal tenements to supply coal to customers located in the Asia Pacific. There are considerable and different risks in investing in mining tenements in other countries compared to the Hunter Valley and we do not see that theory put forward by NERA as being credible. If taken to its logical conclusion, NERA's argument would result in the abandonment of mining in the Hunter Valley.

NSWMC reiterates that in its view the relevant market relating to the Service is the Hunter Valley catchment area. For NERA to suggest otherwise is not realistic and flows against PNO's own arguments made as to catchment areas for the container terminal that it is proposing at the Port. As PNO has stated, Hunter Valley thermal coal has specific properties. Accordingly, we see no support for NERA's arguments from our experience or based on PNO's own statements.

Given the importance of mining to the New South Wales and broader Australian economies, we would be very disappointed to see the NCC seek to give advice to the Treasurer based upon such a theory as advanced by NERA. If that were to occur, we would see that as to be acting against the interests of the Australian economy.

3.6 Synergies price analysis

NSWMC does not have the ability to respond to NERA on its arguments on Synergies price analysis in the time available, other than to note that NERA's analysis appears to be heavily reliant on PNO being subject to the *NSW Ports and Maritime Administration Regulation 2012* (NSW) on the basis of the NCC's comments that it provides "... a degree of transparency over PNO's pricing".

NSWMC notes that there is no transparency to third parties over PNO's pricing, as evidenced by the ACCC arbitration for the first time revealing that PNO had inflated its asset base by including the channel dredging expenditures of the NSW mining industry. NERA's analysis actually supports the continuation of the declaration as true transparency and therefore a constraint on PNO's pricing only arises through the declaration and the publication of arbitration reports by the ACCC, as now can occur.

4 Conclusion

NSWMC believes that, having regard to the objects of Part IIIA of the CCA, the NCC should not recommend revocation of the declaration as there has been no material change in circumstances since declaration.

In any event it is quite clear, even taking into account the NERA Report, that the conditions supporting declaration remain that:

- PNO has monopoly power in the market for the Service. That is accepted by NERA;
- PNO has engaged in monopoly behaviour in the past, such as setting the Port charges to obtain monopoly rents and refusing to negotiate with access seekers. We have canvassed this in detail in our previous submissions and therefore we prefer the analysis of Synergies and the ACCC as to PNO's likely future behaviour to both existing and future mining companies;
- PNO is likely to continue to engage in monopoly behaviour in the future, if the declaration is revoked, including by increasing Port charges;
- PNO's monopoly behaviour in the future without declaration is likely to dampen incentives to invest in new mines in the Hunter Valley (by both small and large miners) and materially reduce competition in the market for tenements; and
- PNO's development of a container terminal raises issues that exacerbate PNO's lack of concern for the mining industry in NSW and which support the continuation of the declaration so as to safeguard the interests of different types of users of the Port.

Accordingly, having regard to all of the above matters, NSWMC remains of the view that the NCC should not recommend revocation of the declaration. If the NCC chooses to do so despite our submission, we urge the Commonwealth Treasurer to take our submission and concerns into account and maintain the declaration to safeguard the New South Wales mining industry and its associated employment and decline the application for revocation of the declaration by the infrastructure monopolist PNO.

Annexure A List of NSW Minerals Council members

Full Members

Alkane Resources Ltd
Anchor Resources Limited
Australian Pacific Coal Limited
BHP Billiton
Bengalla Mining Company Pty Ltd
The Bloomfield Group
Centennial Coal Company Ltd
Cobalt Blue Holdings Ltd
China Molybdenum Co
Clean Teq
Evolution Mining
Fortescue Metals Group Ltd
Glencore Coal (NSW) Pty Limited
Gloucester Resources Ltd
Heron Resources Limited
Hillgrove Mines Pty Ltd
Idemitsu Australia Resources Pty Ltd
Iluka Resources Pty Ltd
Kepco Bylong Australia Pty Ltd
Mach Energy Australia Pty Ltd
Malabar Coal Limited
Newcrest Mining - Cadia Valley Operations
New South Resources Pty Ltd
Omya Australia Pty Ltd
Peabody Energy Australia
Regis Resources Limited
South 32 Illawarra Coal Holdings
Shenhua Watermark Coal Pty Limited
Shoalhaven Coal Pty Ltd
Silver Mines Ltd
Thiess Pty Ltd
Whitehaven Coal Limited
Wollongong Coal Limited
Wyong Areas Coal Joint Venture
Yancoal Australia Limited

Associate Members

Aecom Australia Pty Ltd
Ampcontrol Pty Ltd
ARTC - Australian Rail Track Corporation
Ashurst
Aurizon Holdings LTD
Baccus Resources Pty Ltd
B Marheine Holdings Ltd
Cancer Council NSW
Centre for Mined Land Rehabilitation
Civeo Pty Ltd
Coal Services Pty Ltd
ElectraNet
Emeco International Pty Ltd

Emmerson Resources
EMM Consulting
EMS Group Pty Ltd
Genesee & Wyoming Australia Pty Ltd
Gold and Copper Resources Pty Limited
Golden Cross Resources Ltd
Helix Resources Ltd
Herbert Smith Freehills
Hunter Business Chamber
Hughes Mining Services
Hansen Bailey Pty Ltd
Jodama Pty Ltd
Jervois Mining Limited
Sydney Mining Club
Jennmar Australia
Johnson Winter Slattery
L McClatchie Pty Ltd
McCullough Robertson
Mitsubishi Development Pty Ltd
MRS Services Group Pty Ltd
NuCoal Resources Ltd
NSW Aboriginal Land Council
Niche Environment & Heritage
Newcastle Coal Infrastructure Group
Orica Australia Pty Ltd
Pacific National Pty Ltd
Paradigm Resources Pty Ltd
Peel Mining Ltd
PricewaterhouseCoopers
Port Waratah Coal Services Limited
Hetherington Exploration and Mining Title Services Pty Ltd
Hughes Mining Services
Rangott Mineral Exploration Pty Ltd
Quarry Mining & Construction Equipment P/L
Rimfire Pacific Mining NL
Resource Strategies Pty Ltd
RW Corkery and Company
Seyfarth Shaw Australia
Silver City Minerals Limited
Sparke Helmore Lawyers
Sada Pty Limited
UNSW Mining Engineering
TAFE NSW – Illawarra Institute
Thomson Resources Ltd
Toptung Limited
Umwelt (Australia) Pty Limited
University of Wollongong
XCoal Energy and Resources