Newcastle Coal
INFRASTRUCTURE GROUP

5 October 2018

By email

PON Revocation
National Competition Council
GPO Box 250
Melbourne VIC 3001

pon@ncc.gov.au

Dear Sir / Madam,

Port of Newcastle - application for revocation of declaration

I refer to the submission by Port of Newcastle Operations Pty Limited (**PNO**) to the National Competition Council (**NCC**) dated 17 September 2018 regarding the above matter, and the NCC's invitation for further submissions on the issues raised in the PNO submission.

I enclose a submission from Newcastle Coal Infrastructure Group (**NCIG**), responding to issues raised in the PNO submission.

Please do not hesitate to contact me if the NCC requires any further information or has any questions regarding this submission.

Yours sincerely

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Newcastle Coal Infrastructure Group

Submission in response to PNO further submission

Revocation Application for the Port of Newcastle shipping channel service

5 October 2018

Contents

1 Executive summary

1 Newcastle Coal Infrastructure Group (**NCIG**) is pleased to provide this further submission to the National Competition Council (**NCC**) in connection with the NCC's consideration of the application from Port of Newcastle Operations Pty Ltd (**PNO**) seeking revocation of the declaration of the shipping channel service at the Port of Newcastle. This further submission responds to points raised by PNO is its submission to the NCC dated 17 September 2018 (**PNO Further Submission**).

2 The PNO Further Submission focusses on criteria (a) and (d), and submits that the NCC should conclude that both of these criteria are now not satisfied. PNO accepts that criteria (b) and (c) are still satisfied in respect of the shipping channel service.

3 In relation to criterion (a), PNO's arguments rely on its claim that Port charges are a "very small" or "immaterial" part of the cost of supplying coal. NCIG submits that the NCC cannot reasonably conclude that criterion (a) is now not satisfied on the basis of PNO's analysis, for three reasons:

(a) The PNO analysis ignores the differential effect of port charges on different users. While some users may have the ability to absorb higher port charges, other users (or potential users) may not be able to. Consequently, an increase in port charges may distort competition in dependent markets and raise barriers to new entry.

(b) The PNO analysis is a static, point-in-time analysis, which rests on certain assumptions regarding the margins of Hunter Valley coal producers. NCIG considers that it would be unsound for the NCC to conclude on the basis of this analysis that port charges are likely to be immaterial relative to the margins of coal producers in the Hunter Valley over the term of the declaration.

(c) PNO's analysis ignores potentially relevant information from the Glencore arbitration proceedings. In circumstances where information is available (or is likely to become available) as to the effect that declaration is having on the terms and conditions of access, the NCC should take this information into account in its criterion (a) assessment. Without this information, the NCC cannot be positively satisfied that there has not been, and will not be, a promotion of competition in any dependent market.

4 In relation to criterion (d), PNO's analysis is deeply flawed and premised on a misunderstanding of the proper legal test. It is not the case that, in assessing whether declaration would promote the public interest, the NCC must ignore economic benefits associated with the satisfaction of other criteria. Criterion (d) calls for a holistic assessment of the public interest, which may properly include consideration of public benefits flowing from promotion of competition and/or increased economic efficiency.

5 PNO claims that there is insufficient basis for the NCC to be satisfied that declaration would promote the public interest and asserts that "*the relatively low level of interest from the public to the revocation application supports this view*". This is a remarkable assertion, in light of the strong opposition to revocation from across the Hunter Valley supply chain. The application for revocation of the existing declaration is opposed by both NCIG and Port Waratah Coal Services (**PWCS**). NCIG shareholders include a range of significant coal producers operating in the Hunter Valley and PWCS shareholders include a mix of Hunter Valley coal producers and Japanese coal customers. Together, NCIG and PWCS comprise the largest coal export facility in the world with combined throughput capacity of 210 mtpa. The opposition to revocation by these two entities alone demonstrates a broad level of concern in the Hunter Valley coal supply chain about the future state of competition and the health of the Hunter Valley coal market without declaration.

6 NCIG maintains its view that the NCC should recommend against revocation of the existing declaration of the shipping channel service.

2 Statutory interpretation issues

7 Before proceeding to address a number of factual issues raised in the PNO Further Submission, it is important to first address a number of difficulties with the submissions made by PNO about the approach to legal construction which ought to be adopted by the NCC, following the amendments made to the Part IIIA access criteria.

2.1 Assessment of promotion of competition

8 In its application for revocation and further submission, PNO places significant weight on comments made by Edelman J (and Keane J) in the High Court special leave hearing of the *Port of Newcastle* case that the amendment to criterion (a) introduced following the Harper Review "*effectively reverses the result of the Full Court in* Sydney Airport".[1]

9 PNO goes on to submit that this means that it is "*clear the Service would never have been declared under the new criteria.*"[2]

10 This proposition significantly simplifies and overstates the impact of the legislative changes to criterion (a) and, as a result, the conclusion reached is wrong. While one aspect of the operation of criterion (a) changed following the amendments (the counterfactual test to be applied), the other aspect of the test (whether this promotes competition) as applied by the Full Federal Court in *Sydney Airport FC* has not been touched by the amendments and remains as it has been for over a decade.

11 The competition assessment in criterion (a) has always had two essential elements:

(a) first, an identification of the relevant likely counterfactual scenarios (i.e. "with or without access" or "with or without declaration"); and

(b) second, assessment of the degree to which competitive conditions are likely to differ in each identified counterfactual scenario – and whether competition is promoted in the circumstances.

12 In this case, NCIG submits that declaration is justified under either of the alternative counterfactual tests, if the correct – and longstanding – approach is taken to what is meant by declaration resulting in a material promotion of competition under the second limb.

13 The Full Federal Court's decision in *Sydney Airport FC*[3] was focused principally on the first of these questions and was taken as support for the view that the relevant counterfactual comparison should be "*with and without access*" and not "*with and without declaration*" as the Tribunal had found.[4] *That* aspect of the construction of criterion (a), the first step referred to above, is the only one that has been changed by the recent Harper amendments and which is the subject of the comments by the High Court.

14 The previous two decades of settled case law on the meaning of the second limb – as to what constitutes a relevant *promotion of competition in a dependent market* – have not been affected by the recent legislative amendments. The correct test for assessing whether there has been a promotion of competition under criterion (a) has not been challenged and remains as it was described in *Re Sydney Airports* as:[5]

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[1] PNO, Application for revocation, 2 July 2018, at 12; PNO Further submission in response to letter from NCC dated 4 September 2018, 17 September 2018, at 6

[2] PNO Further submission in response to letter from NCC dated 4 September 2018, 17 September 2018 (**PNO Further Submission**) at 6

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

[4] *Sydney Airport FC,* at [81]

[5] Re Sydney International Airport (2000) 156 FLR 10

The Tribunal considers that the notion of "promoting" competition in s44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.[6]

15 The test has been adopted in a number of decisions over the years, including most recently by both the Tribunal and Full Federal Court in *Port of Newcastle.*[7]

- The Tribunal in Fortescue applied the *Re Sydney Airports* test – and this was not altered on appeal by either the Full Federal Court or the High Court.

- While criterion (a) was amended in 2006, those amendments did not disturb the correct approach to assessing whether competition would be promoted. Indeed, the Explanatory Memorandum accompanying the 2006 amendment makes clear that it was not intended to alter the approach to assessing whether had been a change in competition. Rather, the amendments were directed at more clearly expressing the *magnitude* of expected changes to the competitive environment that were required – that is, such changes should be more than trivial changes. Indeed, the Tribunal Fortescue found in relation to this change that "*the amendment brought no change to the existing law. The Tribunal had always taken the position that criterion (a) required a non-trivial increase in competition.*"[8]

- Neither the recommendations and analysis of the Productivity Commission in 2013[9] nor the Harper Committee in 2015[10] altered the *Re Sydney Airports* test.

- Most recently, this is the approach also accepted by the Queensland Competition Authority (**QCA**) when applying the same criteria in the context of their review of declarations under the QCA Act.[11]

16 As this shows, the test for promotion of competition applied by the Tribunal and upheld by the Full Federal Court in *Re Sydney Airports* have been subject to review by the Productivity Commission, the Harper Committee and a number of subsequent Part IIIA decisions – and despite substantial amendment to other aspects of criterion (a), the test for how any 'promotion' of competition is to be understood has not been overturned, abandoned or amended.

17 For these reasons, it is not safe to assume, as PNO does, that the "*effective reversal*" of *Sydney Airport FC* has so fundamentally altered the settled approach to criterion (a) that it is "*clear the Service would never have been declared under the new criteria.*" In order to revoke the existing declaration on the basis of criterion (a), the NCC must still be satisfied that the existing declaration does not materially improve the conditions or environment for improving competition in the relevant dependent markets. For the reasons outlined in the NCIG's original submission and further elaborated below, at section 3 of this further submission, NCIG submits that the NCC cannot be satisfied of this.

2.2 Nature of public interest assessment

18 PNO repeat their submission that it would be inappropriate for the NCC to take into account benefits that flow from increased competition in dependent markets in their assessment of whether or not criterion (d) is satisfied. PNO submits that:

[6] Re Services Sydney Pty Limited [2005] ACompT 7

[7] *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124, [34], [182]

[8] Fortescue Metals Group Limited [2010] ACompT 2 at [584]

[9] Productivity Commission 2013, *National Access Regime*, Inquiry Report no. 66 pages 167-173

[10] Competition Policy Review, *Final Report,* March 2015 at pages 432-433

[11] QCA Staff issues paper, *Declaration reviews: applying the access criteria*, April 2018, p 18.

> *Any alleged public benefits flowing from improved competition properly fall for consideration in criterion (a), not criterion (d)… any claimed public benefits said to arise from improved competition in dependent markets cannot satisfy criterion (d).*[12]

19 This misconstrues the nature of the public benefit assessment under the new criterion (d). A primary objective of Part IIIA is to *"promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets*".[13] To suggest that the very benefits that Part IIIA is designed to promote must be ignored in assessing whether declaration would be in the public interest under criterion (d) would be to frustrate the fundamental objective of the national access regime.

20 It should be noted that the new criterion (d) differs from the old criterion (f) that was considered by the High Court in *Pilbara Infrastructure*, (a case that is referred to by PNO in support of its preferred construction).[14] The old criterion (f) called for identification of any matters which might indicate that access (or increased access) would be *contrary* to the public interest. The High Court observed that, as part of this assessment, any costs of declaration that had already been accounted for in the criterion (b) assessment should not be 'double counted' – in other words, it should not be concluded that access would be *contrary* to the public interest on the basis of costs that had already been factored into an assessment of net social benefits under criterion (b) (the 'net social benefit' test being one approach to criterion (b) contemplated in that case). By contrast, the new criterion (d) calls for an assessment of whether access on reasonable terms as a result of declaration would, on balance, promote the public interest (criterion (b) has also been changed so that there is no longer scope for a 'net social benefit' test to be applied, as there was in *Pilbara Infrastructure*).

21 Another important aspect to the recent legislative amendments is the explicit identification of certain matters which the NCC or designated Minister must have regard to as part of the criterion (d) assessment.[15] The matters which the NCC / Minister must have regard to include certain matters which may be directly connected with the satisfaction of criterion (a) and / or criterion (b). For example, the effect that declaration would have on investment in markets that depend on access to the service is likely to be closely connected with the effect that declaration would have on competition in those markets. It is difficult to see how the NCC / Minister could properly have regard to the mandatory considerations set out in s 44CA(3) while ignoring matters addressed under criteria (a) to (c).

22 The proper method for assessing the public interest under the new criterion (d) is outlined in the explanatory memorandum for the *Competition and Consumer Amendment (Competition Policy Review) Bill 2017*:

> *Criterion (d) does not call into question the results of subsections 44CA(1)(a), (b) and (c). It accepts the results derived from the application of those subsections, but it enquires whether, on balance, declaration of the service would promote the public interest. It provides for the Minister to consider any other matters that are relevant to the public interest.*

23 Consistent with a logical and holistic reading of the criteria for declaration, the EM is explaining that the Minister is required to weigh up the benefits that are identified from an assessment of criteria (a) – (c) (but not to question or re-assess the outcomes of the prior assessment of those criteria), along with any other matter that is relevant to the public interest (including the matters specified in s44CA(3)) and judge whether, on balance, declaration would promote the public interest. To suggest that in doing this exercise, the Minister should instead ignore benefits to competition in dependent markets that were identified in assessing criterion (a), but instead only

[12] PNO Further Submission, at 6

[13] *Competition and Consumer Act 2010,* s 44AA

[14] *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 246 CLR 379, referred to in section 7.1 of PNO's submission dated 2 July 2018.

[15] CCA, s 44CA(3).

identify and be satisfied of other benefits unrelated to competition, would be to divorce criterion (d) from the objective and structure of Part IIIA in a way that has no support in the legislation or supporting materials.

24 Contrary to the PNO submissions, such an approach would not make criteria (a) to (c) 'redundant'. Rather, this approach ensures that any economic benefits that are identified from an assessment of criteria (a) – (c) are properly balanced with any other matters relevant to the public interest.

3 Criterion (a) – promotion of competition

25 PNO's primary argument as to why the NCC should be satisfied that criterion (a) would not be satisfied, such that it should revoke declaration, is that access to the Service on reasonable terms and conditions as a result of declaration, will not have any material impact on any dependent markets because the relevant port charges are not material to investment decisions or decisions to acquire and dispose of exploration and / or mining authorities. PNO suggests that the charges amount to approximately one percent of the profit earned from supplying coal.

26 NCIG considers that this is a highly simplistic analysis, and makes the following points in response to this argument:

(a) while high port charges without declaration will affect all users, they are likely to have a differential impact on different types of coal producers, which is likely to distort the competitive process in dependent markets in a material way;

(b) PNOs analysis of the materiality of the port charges is simplistic and focussed on one type of a producer at a particular point in time; and

(c) in order to properly assess whether criterion (d) would be satisfied, the NCC should seek information about the terms of access proposed by the ACCC in relation to the dispute notified by Glencore for access to the service, or exercise its discretion to refuse revocation until such time as that information is available.

3.1 Differential effect of high port charges

27 In the absence of declaration, PNO will be a natural monopoly that is unconstrained by regulation. As a natural monopoly, it will have an incentive to maximise its profits, and not throughput at the port. A logical consequence of this is that, in the absence of declaration, PNO can be expected increase port charges over time to the point where the reduced revenue from additional declines in demand offset the increased profits it earns from remaining users.[16]

28 The impact of what is likely to be these increased port prices will be felt differently by different users. Some users, which have low costs of production or relatively higher value resources will have reduced profits but may continue to operate at similar production levels. However, other users (or potential users) with higher costs of production or more marginal or lower value resources will be more greatly affected by these price increases. This includes new or smaller mining or exploration companies, those that have weaker balance sheets, or those that are closer to being financially unviable than well-established miners. These users are more likely to exit the market or otherwise reduce the scale of their competitive activity in the relevant dependent markets.[17]

29 The fact that monopoly pricing would have a differential impact on different types of competitors was key to the finding of the Tribunal in *Virgin Blue* that criterion (a) was satisfied. In that case, the Tribunal found that adoption of a pricing model based on maximum take-off weight (**MTOW**)

[16] Synergies, Assessment of revocation application by Port of Newcastle Operations, 8 August 2018 at 2.3.1

[17] See NCIG, Submission to the NCC: Revocation application for the Port of Newcastle Shipping channel service, 8 August 2018 at 5.2 for an analysis of the relevant dependent markets

rather than a passenger service charge (**PSC**) would distort competition in the domestic aviation market, due to its differential effect on airlines with different cost structures. The Tribunal noted:[18]

> *Competitors generally do not have identical cost structures, nor do they serve identical customers. Thus any particular tariff will have differential effects on different competitors compared with other tariff structures.*

30 PNO notes that it "*is not able to set terms and conditions of access that discriminate between mines*".[19] If it acts on its incentive to increase port costs over time, which can be expected, these cost increases will be felt across all Hunter Valley coal producers, but will inevitably have the effect of making lower-margin suppliers weaker competitors. It is also likely to increase barriers to entry into dependent markets for smaller or more marginal suppliers. This is likely to have a material distortionary effect on competition in the dependent markets. As a result, NCIG submits that the NCC cannot conclude that criterion (a) would not be satisfied, such that it should revoke declaration.

3.2 Analysis of the materiality of the port charges

31 PNO's conclusion that port charges are "immaterial" rests heavily on its analysis of the margins earned by an average Hunter Valley coal producer.[20] PNO concludes that the average Hunter Valley coal miner earns an average margin of AU$45.39/t, and this figure forms the basis of their economic analysis of investment incentives.[21]

32 NCIG considers that it would be unsound for the NCC to conclude on the basis of this analysis that port charges are likely to be immaterial relative to the margins of coal producers in the Hunter Valley over the term of the declaration for a number of reasons, including that:

(a) PNO's analysis assumes a coal price of $88.42/t, which reflects the average spot price for thermal coal in 2017. However 2017 was a particularly strong year for thermal coal prices (and therefore margins), and is unlikely to be representative of prices and margins over the term of the declaration – for example, the average spot price was significantly lower in each of the three prior years. Coal prices are generally volatile, and at less strong points in the cycle, small changes in costs can impact whether a producer is able to produce a positive margin or not;

(b) PNO's analysis does not take into account different grades of coal, some of which trade at a price that is materially lower than high grade thermal coal;

(c) miners in the Hunter Valley have a very wide range of costs, and therefore margins are likely to vary between individual users (a point that is relevant to the differential effect of high port charges, as discussed above); and

(d) PNO assumes "overhead" costs of $1.49/t, however it is not clear that these include ongoing overhead costs such as cost of capital and depreciation.

33 In any event, in the absence of declaration, there will be no regulatory or commercial constraint preventing the monopoly port charges increasing over time (up until the point where the charges have such a material effect on demand that reductions in volume outweigh additional revenue) so it would be unsafe for the NCC to conclude that the charges will remain an immaterial proportion of coal producers revenue.

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[18] *Application by Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [533]-[535].

[19] PNO Further Submission, at 3

[20] PNO, Application for revocation, 2 July 2018 at 26 - 28

[21] HoustonKemp, Effect of declaration on incentives to invest in coal mines, 14 September 2018, at 2.2.2

34 Finally, PNO seeks to rely heavily upon the conclusion of an individual business analyst (Cecilie Naess of ResourcefulNaess Consulting) that port costs are "*less than 1% of total operating cost*" and therefore immaterial to coal producers. This figure is not supported by any evidence in the supplementary report and, for the reasons set out above, NCIG submits that the bald conclusion reached by Naess is simplistic and not grounded in evidence.

3.3 Importance of access to information about terms of access with declaration

35 In order to assess of the impact of declaration on dependent markets the NCC is required to make an assessment of the likely terms of access with and without declaration. The NCC has some insight into what the terms of access would be without declaration, as the PNO has previously set port prices in an environment where it was unconstrained by declaration. However, on the basis of the public information currently available in this process, the NCC can only speculate as to what the terms of access would be with declaration, and following arbitration by the ACCC.

36 For this reason, NCIG strongly urges the NCC to obtain, on a confidential basis, information about the terms of access that the ACCC proposes to set pursuant to the arbitration lodged by Glencore over the terms of access to the Service. This information will provide critical insight into the likely future with and without declaration and will inform the NCC's assessment of whether criterion (a) is likely to be satisfied. If that information is not available, NCIG considers that it would be appropriate for the NCC to exercise its discretion to refuse to revoke the declaration until such time as the likely outcome of that process is known.

37 Without information as to the effect that declaration is having on the terms and conditions of access (through access to arbitration), the NCC cannot be positively satisfied that there has not been, and will not be, a promotion of competition in any dependent market arising from the current declaration.

3.4 New container terminal proposal

38 PNO provides further information regarding its proposal to develop a container terminal at Port of Newcastle, if state government development restrictions are relaxed.

39 NCIG submits that the relevance of the potential for container traffic at the Port is to highlight the increasingly diverse types of customers and services that are served through the Port and why this creates a significant and continuing risk of discrimination against coal customers. If a container terminal is developed, PNO will need to compete strongly to attract and keep shippers and shipping lines involved in containerised trade. In that market, the Port competes with Port Botany and Port Kembla (and potentially, to a lesser extent, with Port of Melbourne and Fisherman Island in Brisbane). This contrasts with its monopoly position serving the Hunter Valley coal chain, where producers have no alternative but to export through Port of Newcastle.

40 In those circumstances, PNO has both a clear incentive and ability to discriminate in favour of containerised services. This is not simply an issue that can be resolved by arguing, as PNO attempts to do, that there is sufficient total capacity. That submission misses the point.

41 If declaration were to be removed, the increasing number and diversity of services being supplied through the Port provides a strong incentive for PNO to shift costs through discriminatory pricing and to provide preferential access to capacity (through beneficial scheduling) to those services where the Port potentially competes with others, such as containers or bulk grain – to the detriment of the Hunter Valley coal market. In this context, declaration will continue to provide a critical support for ensuring continued non-discriminatory access by coal producers to the Port.

4 Criterion (d) – public interest

42 In its Further Submission, PNO claims that there is insufficient basis for the NCC to be satisfied that declaration would promote the public interest and makes the remarkable assertion that "*the relatively low level of interest from the public to the revocation application supports this view*." This is a remarkable submission.

43 First, it has long been the case that what is "of interest to the public" should not be confused with the legal test of what is in the public interest.[22] The PNO submission is legally unsound.

44 Second, the application for revocation of the existing declaration is opposed by both NCIG and PWCS. NCIG shareholders include a range of significant coal producers operating in the Hunter Valley[23] and PWCS shareholders include a mix of Hunter Valley coal producers and Japanese coal customers.[24]

45 At NCIG, they are, no less:

(a) BHP Billiton ;

(b) Yancoal;

(c) Whitehaven Coal;

(d) Peabody Energy; and

(e) Centenial Coal.

46 Together, NCIG and PWCS comprise the largest coal export facility in the world with combined throughput capacity of 210 mtpa. Coal exports through the NCIG and PWCS terminals account for over 90% of NSW coal exports. The opposition to revocation by these two entities alone demonstrates the deep and broad level of concern across the Hunter Valley coal supply chain about the future state of competition and the health of the Hunter Valley coal market if declaration is removed at Port of Newcastle.

47 The operators of these ports have material concerns that in the absence of declaration PNO would, over time, have the ability and incentive to act in a way which significantly impacts the Hunter Valley coal industry. This is an industry of vital importance to the NSW and Australian economy; in 2015/16 the Hunter Valley mining industry (over 95% of which is coal) made a direct contribution to the NSW economy of $4.6bn and directly employed over 12,600 people, and further indirect contributions of $6.1bn in supply chain goods and purchasers and more than 50,000 additional jobs supported in the region.[25] Coal is easily the biggest single export earner for NSW, and has recently eclipsed iron ore as the biggest single export earner for the Australian economy.[26]

48 NCIG submits that criterion (d) is clearly satisfied. Declaration will promote a material increase in competition in a range of dependent markets and help to support investment certainty and the long term future of the Hunter Valley coal industry. The NCC should not accept PNO's legally flawed analysis of the public interest assessment, and should conclude that it cannot be satisfied that the public interest would not be promoted by declaration.

[22] For example: *Director of Public Prosecutions v Smith* [1991] 1 VR 63.

[23] https://www.ncig.com.au/business/for-investors

[24] https://pwcs.com.au/who-we-are/about-us/

[25] http://www.nswmining.com.au/NSWMining/media/NSW-Mining/ExpenditureJobsSurveyHunter.pdf

[26] Department of Industry, Innovation and Science Office of the Chief Economist, *Resources and Energy Quarterly*, September 2018.