PORT WARATAH
COAL SERVICES

4 February 2019

Submissions – PNO Revocation
National Competition Council
GPO Box 250
MELBOURNE VIC 3001

Email: pon@ncc.gov.au

Dear Sir or Madam

POSSIBLE REVOCATION OF DECLARATION OF CHANNEL SERVICE AT THE PORT OF NEWCASTLE

Introduction

Port Waratah Coal Services Limited (**Port Waratah**) appreciates the opportunity to provide this submission in response to the NCC's Statement of Preliminary Views.

In Port Waratah's view, revoking declaration of the channel service has the potential to be highly damaging to the Hunter Valley coal industry and the supply chain that supports it. In particular, revocation is likely to materially reduce competition in coal and coal chain markets that depend on the shipping channel and would be contrary to the public interest. Accordingly, Port Waratah asks the NCC to rethink its preliminary view.

About Port Waratah

Port Waratah has been receiving, stockpiling, blending and loading coal for export at the Port of Newcastle for over 40 years. It owns and manages the Kooragang and Carrington coal terminals, with a combined capacity of 145 million tonnes per annum. Port Waratah employs approximately 320 people across its business and operates its terminals 24 hours per day 7 days a week.

Port Waratah is industry owned. Its shareholders comprise Hunter Valley coal producers and Japanese customers. Port Waratah exists to service the coal industry and operates effectively on a cost break even basis (including earning a set return on the original investment of shareholders).

It is also noteworthy that Port Waratah has directly, and the Hunter Valley export coal industry has indirectly funded the construction of deep-water "berth pockets" associated with the expansion of its Kooragang Terminal berth infrastructure. This infrastructure has been constructed over the past twenty years, culminating with the completion of Port Waratah's K7 Berth in 2011. Accordingly, we and the industry have a keen interest in the channel dredging component of any Port of Newcastle (**PNO**) regulated asset base.

In summary, Port Waratah is an industry owned company, integrally involved in the Hunter Valley coal supply chain, whose profits are not directly affected by charges for use of the shipping channel. As a result, Port Waratah is well qualified to provide the NCC with an objective view on the likely effects of revoking declaration of the shipping channel.

Revoking declaration would be harmful to competition and contrary to the public interest

The provider of the shipping channel service at the Port of Newcastle controls a natural monopoly, on which the entire Hunter Valley coal industry and coal chain depends. Port Waratah agrees with the following statement in the NCC Statement of Preliminary Views:

> 6.26 As a commercial entity, PNO has an incentive to maximise profits. The Council accepts that the Port occupies a bottleneck position in the Hunter Valley export coal supply chain (see Chapter 7 for the Council's preliminary views on criteria (b)) and may therefore have both the ability and incentive to earn monopoly profits by denying access to the service, significantly increasing charges for the service or cross-subsidising in a way that materially affects competition in a dependent market.

In the absence of declaration, there is nothing constraining PNO from charging a monopoly price for use of the shipping channel. Port Waratah strongly agrees with the ACCC's statement (press release dated 19 December 2018):

> 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. 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.

As an unregulated monopolist, the prices PNO can charge for use of the shipping channel will be constrained only by the ability of users to pay. As a matter of economic principle, a party in the bottleneck monopoly position of PNO could extract from coal miners and other participants in the coal supply chain all, or a substantial proportion, of the profits that those coal industry participants could otherwise earn in a situation where a regulated or market price was charged. In its Statement of Preliminary Views, the NCC seems to have been significantly influenced by the quantum of the price increase PNO proposed previously. In Port Waratah's submission, the NCC should be focussed not on the quantum of any particular port price increase, but rather on the price that an unregulated PNO could profitably impose. Furthermore, the quantum of that price should be compared to potential industry profits (not total costs) both of coal miners (new and prospective) and other participants in the coal supply chain.

PNO charging a monopoly price that extracts profits from other industry participants involves more than 'just' an allocation of profits between stages in the supply chain (as suggested in the NCC Statement of Preliminary Views). The presence of an unregulated monopolist at a bottleneck in the supply chain will significantly dampen the incentives for investment in each market that is ultimately dependent on the channel service. For example, a miner considering investing in a new coal mine will be reluctant to make an investment where PNO is unregulated either because the existing price of the channel service may make the mine uneconomic or because of a concern that, having made an investment, the assumed future profits on which the investment was premised may be removed by subsequent increases in the channel service fee. This significant impact on new investment will be felt, not only in relation to development of new coal mines, but in each other market in the coal supply chain. Parties considering acquiring coal tenements will be more reluctant to do so as the future profits that could be made from developing the coal tenement might be negligible because of the existing price of the channel service or because of a concern that having made an investment in the tenement any future profits that could have been made might be removed by subsequent increases in the channel service fee (holdup by PNO). Similarly, a party considering investing in providing new rail haulage services will be more reluctant to do so if it feels the ability of coal mines to pay an attractive rail haulage fee will be diminished because of high channel service fees or potential future increases in the channel service fee.

As a result, revoking declaration would materially reduce competition in relevant coal markets and other markets that depend on the channel service, including the market for tenements, the market for rail haulage services, etc. Port Waratah agrees with the following statement in the NCC's Statement of Preliminary Views:

> 6.51 The Council considers that competition is a dynamic process and the promotion of a material increase in competition involves an improvement in the opportunities and environment for competition such that competitive outcomes are materially more likely to occur.

Competitive outcomes and the opportunities and environment for competition are all enhanced where there are appropriate market incentives to invest. In relation to the thermal coal market, the Hunter Valley represents a significant proportion of the global seaborne thermal coal market. Discouraging investment in the Hunter Valley will diminish the opportunities and environment for competition and competitive outcomes in the seaborne market. Because mines are developed in the Hunter Valley to supply both the export market and domestically, any reduction in incentives to invest would also have an impact on any domestic thermal coal market (even though by definition the shipping channel is used for the purposes of export). The same result applies, perhaps even more strongly, in markets for services related to the coal industry (including the market for coal tenements, the market for rail haulage services, etc).

In addition to being harmful to competition, dampening investment incentives in a crucial export industry in New South Wales would clearly be contrary to the public interest. Port Waratah does not agree with the NCC's preliminary view that there are both benefits and detriments that would be realised from continuing with declaration of the service. In particular, Port Waratah does not agree that declaration would lessen PNO's incentive to invest in maintaining or improving the port or the channel service, due to limiting the returns which might otherwise have accrued. Regulated prices will provide PNO with a reasonable return on capital invested. Experience in other regulated industries (for example, electricity) illustrates clearly that regulation does not of itself remove incentive to invest. Conversely, it is very clear that the presence of an unregulated bottleneck monopoly able to charge monopoly prices will deter investment in any industry that is dependent on that bottleneck monopoly.

Port Waratah is concerned that revoking declaration would have serious negative effects on the coal supply chain and so indirectly on Port Waratah's business (in particular, it depends on coal export volumes being maintained or increasing in order to underwrite infrastructure investments). Port Waratah is also concerned that due to the privatisation of the Port of Newcastle, Port Waratah will need to negotiate with PNO in relation to its upcoming lease renewal of the Carrington terminal and the effects that revoking declaration and allowing PNO to impose unconstrained price increases may have.

Port Waratah urges the NCC to reconsider its preliminary view that declaration should be revoked. Please do not hesitate to contact me on if you wish to discuss this submission further.

Yours sincerely

HENNIE DU PLOOY
CHIEF EXECUTIVE OFFICER