



Australian
Competition &
Consumer
Commission

11 May 2011

Statement of Issues — Wesfarmers Ltd – possible acquisition of interests in Burrup Holdings Ltd and/or Burrup Fertilisers Pty Ltd

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the possible acquisition of interests in Burrup Holdings Ltd (**Burrup Holdings**) and/or Burrup Fertilisers Pty Ltd (**Burrup Fertilisers**) (together, **Burrup**) by Wesfarmers Ltd (**Wesfarmers**) (**possible acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at www.accc.gov.au) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by 30 May 2011 and anticipates making a final decision on 23 June 2011. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. On 17 December 2010, receivers and managers of PPB Advisory (the **receivers**) were appointed to Burrup Fertilisers and certain shareholdings of its holding company, Burrup Holdings. The receivers have appointed Flagstaff Partners as corporate advisors for the sale process. Flagstaff Partners have not yet commenced a sale process, which is expected to commence shortly.

6. On 14 February 2011, the ACCC commenced a review of Wesfarmers' possible acquisition of interests in Burrup following receipt of Wesfarmers submission on 11 February 2011 requesting ACCC merger review.

The parties

Wesfarmers Ltd

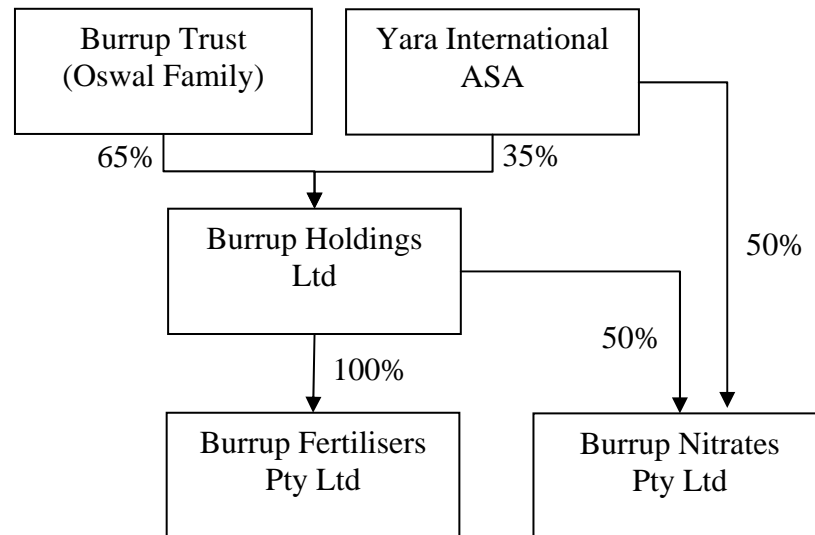
7. Wesfarmers is an Australian listed public company with business operations in the retail, resources, insurance, chemicals, energy, fertilisers and industrial sectors.
8. Wesfarmers subsidiary CSBP Limited (**CSBP**) operates an integrated ammonia, ammonium nitrate and fertiliser complex located at Kwinana near Perth, Western Australia. For ease of reference, Wesfarmers and CSBP are referred to collectively as Wesfarmers for the remainder of this document.
9. Wesfarmers announced in early 2010 that it proposes to expand its current ammonium nitrate production capacity at Kwinana (**the proposed Wesfarmers expansion**). A Public Environmental Review process commenced in November 2010
10. Wesfarmers also has a 50% interest in Queensland Nitrates Pty Ltd (**QNP**) which operates a fully integrated ammonia and ammonium nitrate plant near Moura in central Queensland.

Burrup

11. Burrup Holdings is an Australian based private company which is 65% owned by the Oswal family and 35% by Yara International ASA (**Yara**). Burrup Fertilisers, which is a wholly owned subsidiary of Burrup Holdings, owns and operates an ammonia plant located on the Burrup Peninsula, Western Australia, approximately 300 kilometres from the Pilbara region..
12. The ammonia facility has been operational since June 2006 and is capable of producing 760,000 tonnes of ammonia annually, which represents approximately four percent of world production of traded ammonia. The facility is not vertically integrated, and all of the ammonia produced is sold to Yara pursuant to a 20 year off-take agreement (**Yara off-take agreement**).
13. Burrup Nitrates Pty Ltd (**Burrup Nitrates**) is 50% owned by Burrup Holdings, and 50% by Yara. Burrup Nitrates proposes to construct and operate an ammonium nitrate facility adjacent to the Burrup Fertilisers ammonia plant. Burrup Nitrate's proposed ammonium nitrate plant is expected to have a capacity of 350,000 tonnes per annum and is expected to produce explosive grade ammonium nitrate (**EGAN**).

14. Figure 1 below represents the ownership structure of Burrup:

15. Figure 1: Burrup Ownership Structure



Other industry participants

Yara

16. Yara is a Norwegian based multinational chemical company, listed on the Oslo Stock Exchange. Yara produces nitrogen based fertilisers, ammonia, ammonium nitrate, urea and other nitrogen-based chemicals. Yara has an Australian subsidiary, Yara Australia Pty Ltd. Internationally, it has operations and offices in 50 countries, and sells product to more than 120 countries.
17. Under a 20 year off-take agreement which Yara has signed with Burrup, Yara is the exclusive purchaser of all ammonia produced by Burrup. The ammonia purchased by Yara is sold to customers in Australia including Orica and Wesfarmers, and exported from Burrup to overseas markets.

Orica Ltd

18. Orica Ltd (**Orica**) is an Australian-based publicly listed company which operates through three platforms; Orica Mining Services, Orica Chemicals and Minova.
19. Orica Mining Services operates an integrated ammonia and ammonium nitrate facility at Kooragang Island in New South Wales and an ammonium nitrate facility at Yarwun in Queensland. In addition to these Australian-based facilities; Orica has interests in ammonium nitrate production facilities in the Philippines, Canada, Mexico, the United States of America and Thailand.

Incitec Pivot Ltd

20. Incitec Pivot Ltd (**Incitec Pivot**) is publicly listed on the Australian Securities Exchange and manufactures and supplies fertilisers, explosives products and industrial chemicals to Australian and overseas customers. Incitec Pivot distributes and markets explosives and related products through its subsidiary Dyno Nobel Pty Ltd.
21. Incitec Pivot operates ammonia plants at Phosphate Hill in Queensland, and Gibson Island in Queensland. Incitec Pivot also has a 50% interest in QNP (the other 50% interest in QNP being held by Wesfarmers), an integrated ammonia, ammonium nitrate and nitric acid plant at Moura, Queensland. Additionally, Incitec Pivot is currently constructing an integrated ammonia and ammonium nitrate plant in Moranbah, Queensland.
22. Incitec Pivot's subsidiary, Dampier Nitrogen Pty Ltd, has announced plans to construct and operate an ammonium nitrate facility in Dampier, Western Australia in close proximity to the current Burrup plant. Incitec Pivot is in the process of obtaining environmental approvals.

Industry Background

Ammonia

23. Anhydrous ammonia (**ammonia**) is a gaseous compound of nitrogen (extracted from air) and hydrogen (typically generated from natural gas). It is stored as a liquid at low temperature or under pressure. Natural gas is often the key feedstock for the production of ammonia.
24. Ammonia is a chemical used in the production of nitrogen based fertilisers and in non-fertiliser applications such as metal leaching, plastic production, refrigerator gas and as an input to the production of ammonium nitrate for explosives.
25. According to Fertecon, global ammonia capacity was 204.5 million tonnes a year in 2010. This is forecast to rise to 236.7 million tonnes by 2020.¹
26. Ammonia is produced by manufacturers either for sale (known as merchant ammonia), or for own use at vertically integrated facilities (known as captive ammonia). Some captive producers also trade in merchant ammonia. Operating on the Burrup Peninsula in Western Australia, Burrup is the largest and only exclusive merchant producer of ammonia in Australia (i.e. Burrup is not currently a captive producer of ammonia). Merchant ammonia is produced as a contestable source of ammonia in significant tradeable quantities.
27. Vertically integrated ammonia producers in Australia include Wesfarmers, QNP, Incitec Pivot, Orica and Queensland Nickel Pty Ltd. Each of these entities produces ammonia onsite for their own use, mainly for conversion into fertilisers and/or ammonium nitrate. The ammonia produced at these sites is not typically available for purchase by third parties.

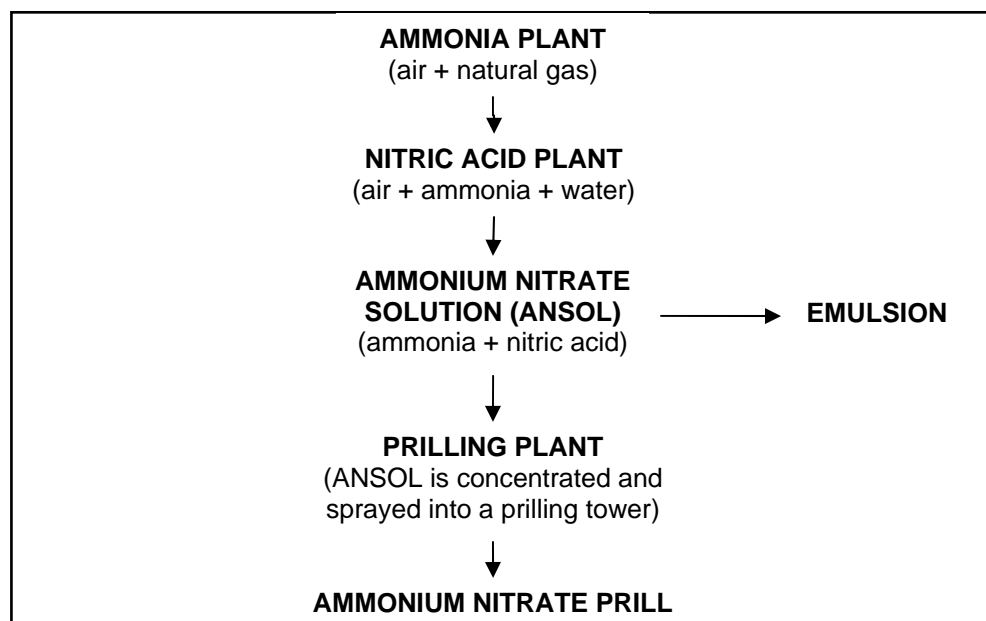
¹ Fertecon Limited, *Ammonia Outlook*, Issue 2010-3, January 2011.

28. Customers not vertically integrated into the production of ammonia are reliant on the supply of ammonia from third parties. In particular, these are customers whose demand may be too small to justify the investment required to produce ammonia themselves or establish an import operation. The main customers of ammonia in Australia, outside of captive ammonia producers, are in the nickel industry and various other industrial users.
29. Ammonia is typically supplied to customers in Australia under fixed price long term contracts, or linked to global ammonia benchmark prices, such as the Far East or Middle East ammonia price as published in industry publications.

Ammonium Nitrate

30. Ammonium nitrate, produced from feedstock ammonia, is a key input to the production of explosives and nitrogen based fertilisers. Ammonium nitrate is manufactured as a solution (**ANSOL**) and can be further processed to form a solid product in the form of granules known as ammonium nitrate prills (Figure 2).

Figure 2: Ammonium Nitrate Production Process



31. There are three broad types of ammonium nitrate:
- **ANSOL**, which is used in the production of ammonium nitrate prills, liquid fertiliser and emulsion explosives;
 - **Fertiliser grade ammonium nitrate (FGAN)** – which are high density ammonium nitrate prills commonly used as a fertiliser but can be used in the production of emulsion explosives; and

- Explosive grade ammonium nitrate (EGAN)² – which are low density ammonium nitrate prills used in the manufacture of explosives.
32. There are three manufacturers of ammonium nitrate in Australia: CSBP (Wesfarmers wholly owned subsidiary), Orica and QNP (a 50:50 joint venture company owned by Wesfarmers and Incitec Pivot).
 33. Unlike ammonia, there is no published index for the price of ammonium nitrate. The ACCC understands that prices of ammonium nitrate reflect the outcome of negotiations between sellers and buyers based on their views of prevailing market prices.
 34. Globally, ammonium nitrate is largely used in the manufacture of nitrogen based fertilisers. However, greater levels of mining activity in Australia have meant that the majority of ammonium nitrate produced in Australia is used to manufacture explosives. The mining industry will continue to account for the bulk of sales as mining production volumes are expected to grow, especially iron ore mining in the Pilbara region of Western Australia.

The transaction

35. As it is not yet known how the sale of Burrup will be structured, Wesfarmers have sought ACCC clearance to acquire all or part of Burrup. The ACCC has assessed the possible acquisition on the basis that Wesfarmers would acquire control of Burrup should the possible acquisition proceed.

Market inquiries

36. On 14 February 2011, the ACCC commenced market inquiries regarding Wesfarmers' possible acquisition. A range of interested parties provided responses, including suppliers and customers of ammonia and ammonium nitrate as well as port authorities.

With/without test

37. In assessing a merger pursuant to section 50 of the *Competition and Consumer Act 2010*, the ACCC must consider the effects of the transaction by comparing the likely competitive environment post-acquisition if the transaction proceeds (the “with” position) to the likely competitive environment if the transaction does not proceed (the “without” position or “counterfactual” position) to determine whether the acquisition is likely to substantially lessen competition in any relevant market.
38. In the event that Wesfarmers does not acquire Burrup, the likely counterfactual appears to be that another alternative entity will be the successful bidder for Burrup and/or interests in Burrup Nitrates. The ACCC commenced a review of Orica's possible acquisition of interests in Burrup on 7 March 2011 and Incitec Pivot's possible acquisition of interests in Burrup on 2 May 2011. However, there may be other potential alternative bidders interested in purchasing the assets.

² EGAN is also known as technical ammonium nitrate (TAN) and industrial grade ammonium nitrate.

39. Although Burrup is in receivership, the ACCC considers it unlikely that Burrup's assets would exit the industry. Market participants indicate that Burrup's ammonia plant is highly regarded in the industry, being a high quality and relatively modern plant that has access to a low cost gas supply. Burrup's ammonia plant is therefore attractive to a number of alternative bidders.
40. As indicated above, the ACCC understands that Burrup Nitrates – a 50:50 joint venture between Burrup Holdings and Yara – has proposed to construct and operate an ammonium nitrate facility adjacent to Burrup Fertiliser's existing ammonia plant on the Burrup Peninsula (**Burrup Nitrates project**).
41. Given that a sale process has not yet commenced, the ACCC is not yet in a position to reach a final view on the likely counterfactual to Wesfarmers possible acquisition at this time. The ACCC notes that the analysis of possible competition issues may differ depending on the counterfactual.
42. At this time, for the purposes of this Statement of Issues, the ACCC has adopted a conservative approach to consider the possible acquisition against a counterfactual in which Burrup is sold to an entity that has no existing manufacturing interests in the supply of ammonia or ammonium nitrate in Western Australia, and would facilitate the timely construction of the Burrup Nitrates project. The ACCC continues to explore the likely counterfactual to the possible acquisition.

The ACCC invites comments from interested parties on the likely counterfactual(s)

The ACCC seeks information to assist the ACCC in forming a view on the relevant counterfactual(s), including information and evidence as to the likely competition effects if the Wesfarmers possible acquisition does not proceed.

In particular, the ACCC is interested in the likelihood of any alternative purchasers creating an increased competitive force in the supply of ammonium nitrate in Western Australia.

Market definition

43. On the basis of its inquiries to date, the ACCC's preliminary view is that the following markets are relevant to the possible acquisition:

- the market for the supply of ammonia in Western Australia and;
- the market for the supply of ammonium nitrate in Western Australia.

Market for the supply of ammonia

44. Ammonia has a range of uses, in particular for the production of nitrogen based fertilisers and ammonium nitrate (which itself can be a fertiliser). Due to its unique characteristics, ammonia has a low degree of demand side substitutability with other chemical products. It is unlikely that customers would consider alternative chemicals to be an effective substitute.
45. On the supply side, it is unlikely that manufacturers of alternative chemicals could readily switch to produce ammonia as significant new investment would be required. Ammonia plants are designed, engineered and constructed for the specific purpose of producing ammonia. Therefore, alternative chemical plants are unlikely to be able to provide supply side substitutability.
46. With regard to the geographic dimension of the market, the ACCC understands that apart from the ammonia produced by Burrup Fertilisers, some of which is consumed by customers on the eastern seaboard, all of the ammonia produced on the eastern seaboard is utilised or sold on the eastern seaboard and all of the ammonia produced in Western Australia is utilised or sold in Western Australia. This suggests that demand-side substitutability may be asymmetric, such that ammonia may be transported from the west coast to the east coast, but not vice versa, due to the lack of merchant ammonia suppliers on the east coast.
47. In any event, the ACCC's market inquiries suggest that sourcing ammonia from the east coast of Australia is not viable because of transportation costs (road/rail) which are prohibitive and that shipping ammonia is not viable for small industrial users of ammonia. Market inquiries suggest that there is a lack of access to independently owned or operated import related infrastructure (e.g. ammonia pipeline and storage tanks) in Western Australia. Further, market inquiries have indicated that the demand for ammonia from customers requiring smaller quantities of merchant ammonia may be too little to justify the investment required to make it economically viable to import ammonia. The competitive threat posed by potential imports of ammonia is further discussed below.
48. In light of the above, the ACCC's preliminary view is that there is a market for the supply of ammonia in Western Australia.

Market for the supply of ammonium nitrate

49. As noted above, ammonium nitrate is used as an input in the manufacture of explosives or fertiliser. Ammonium nitrate is produced and traded in three different forms: (i) ANSOL; (ii) FGAN; and (iii) EGAN.

50. ANSOL is a common input into the production of both FGAN and EGAN. The ACCC understands that some ammonium nitrate plants exclusively produce either FGAN or EGAN, but that there is the possibility of supply side substitution between the two products because it is possible for some plants to produce both products. Thus, it is possible that the pricing of FGAN and EGAN is constrained by the ability of manufacturers to switch between the two products.
51. The ACCC understands that due to cost and technical differences, there is little demand side substitutability between EGAN and FGAN.
52. On the basis of market enquiries to date, the ACCC has taken the view that the product dimension of the market may encompass ANSOL, FGAN and EGAN. However, the ACCC continues to consider whether the extent of any supply side substitutability is sufficient to define a broader product market for ammonium nitrate or whether separate products markets for EGAN and FGAN are more appropriately considered.
53. The ACCC is interested in market participants views as to the timeframes, tooling costs and economic viability of converting production facilities which exclusively produce FGAN to produce EGAN and vice versa.
54. The ACCC considers that, regardless of the product market definition adopted, the competition analysis is unlikely to be affected. As the competitive overlap between the merger parties relates to the supply of EGAN, and this is focus of the competitive analysis set out below, it is unlikely that the competitive analysis would be significantly different if a separate market for EGAN rather than a broader market for ammonium nitrate was identified.
55. Given that EGAN is used almost exclusively as an input into the manufacture of ammonium nitrate fuel oil (ANFO), the ACCC also considered whether ANFO and EGAN should be considered to form an integrated product market. However, despite the fact that ammonium nitrate is used as an input into ANFO, the ACCC's preliminary view is that both ANFO and EGAN are separately traded products with their own supply and demand characteristics.
56. As with ammonia, it is unlikely that manufacturers of alternative chemicals could readily switch to produce ammonium nitrate as significant new investment would be required. Ammonium nitrate plants are designed, engineered and constructed for the specific purpose of producing ammonium nitrate. Therefore, alternative chemical plants are not likely to be able to provide supply side substitutability.
57. With regard to the geographic dimension of the market, market inquiries suggest that there is a distinct Western Australian market for the supply of ammonium nitrate. Ammonium nitrate produced in Western Australia is consumed within the state and, due to transportation costs and other factors, imports generally only occur to cover shortfalls in local supply. The potential for importation of ammonium nitrate is considered further below.
58. In light of the above, the ACCC's preliminary view is that one of the relevant markets in this matter is a market for the supply of ammonium nitrate in Western Australia. However, the ACCC also considers that its analysis is unlikely to

materially differ if the relevant market is a market for the supply of EGAN in Western Australia.

The ACCC invites comments from interested parties on the proposed product market definition for the supply of ammonium nitrate

In particular, the ACCC seeks further information on supply side substitution in relation to the production of FGAN and EGAN and whether separate markets exist for the supply of ANSOL, EGAN and FGAN.

The ACCC seeks further information as to the nature of tooling or other costs and necessary infrastructure as well as timeframes that would be faced by a manufacturer of EGAN in switching into the manufacture of FGAN, or vice versa.

Statement of issues

59. For the purposes of this Statement of Issues, the issues in this matter are divided into two categories 'issues that may raise concerns' and 'issues unlikely to pose concerns'.

Issues that may raise concerns

Market for the supply of ammonium nitrate

60. Notwithstanding that Wesfarmers and Burrup do not currently overlap in the supply of any ammonium nitrate products, the ACCC's preliminary view is that the possible acquisition may raise competition concerns in the Western Australian market for the supply of ammonium nitrate. In particular, the possible acquisition could eliminate a strong potential competitor to Wesfarmers for the supply of EGAN in Western Australia – the Burrup Nitrates project.
61. Market inquiries to date indicate this is a market where there is currently only one local supplier – Wesfarmers – and where imports may only provide a weak competitive constraint on local suppliers. In addition, demand for ammonium nitrate is forecast to increase significantly in the Pilbara area, where large mining companies are expanding their mining operations.
62. As outlined above, Burrup Nitrates has announced plans to build an ammonium nitrate plant on the Burrup Peninsula which is intended to manufacture EGAN. Thus, the supply of EGAN to mining companies and contractors supplying explosives products has been the focus of the ACCC's investigation.
63. In this context, the possible acquisition could lessen competition for the supply of ammonium nitrate in Western Australia by preventing the introduction of a competitive and alternative local source of supply which may occur if Burrup is acquired by Wesfarmers.
64. The ACCC has received no information to suggest that the proposed Burrup Nitrates project could or would manufacture FGAN or be an activate participant in the fertiliser industry. The ACCC understands that the plant is intended to

manufacture and supply EGAN to customers in the Pilbara region for the purpose of manufacturing ANFO. Accordingly, at this time the ACCC has not identified that the issue outlined above would impact significantly on the fertiliser industry. However, the ACCC welcomes market participants views as to the potential impact of the possible acquisition in the fertiliser industry before reaching a concluded view on this issue.

Burrup Nitrates Pty Ltd

65. As indicated above, Burrup Nitrates has plans to construct an ammonium nitrate plant producing EGAN on the Burrup Peninsula, approximately 13km north west of Karratha in Western Australia.³ These plans are currently on hold pending the resolution of the Burrup Holdings' sale process.
66. Market participants indicated that the Burrup Nitrates project would be a strong, competitive, source of supply of EGAN in the Western Australian market.
67. If Wesfarmers acquired a controlling interest in Burrup, it may have the ability and incentive to prevent Burrup Nitrates from constructing this proposed ammonium nitrate plant. This would eliminate a potential source of competition to the Wesfarmers ammonium nitrate plant in Kwinana. This reduced choice of potential options may result in increased prices or reduced quality of service to mining customers and contractors supplying explosives products.

The ACCC invites comments from interested parties on the potential competitiveness of the proposed Burrup nitrates ammonium nitrate plant

The ACCC seeks further information on the competitive threat that could be exerted by the Burrup Nitrates project and the extent to which having two, instead of one, ammonium nitrate manufacturers in Western Australia would deliver better outcomes for end users.

In addition, the ACCC is interested in the likely timing for construction of the proposed Burrup Nitrates plant and whether alternative ammonium nitrate plant/s may be constructed by competing manufacturers within this timeframe.

Barriers to entry

68. There are currently three proposals for new or expanded EGAN plants in Western Australia: (1) the proposed Wesfarmers expansion in Kwinana; (2) the Burrup Nitrates project; and (3) the proposed Incitec Pivot plant in Dampier.
69. Each of these proposed plants is intended to supply EGAN to meet the increasing demand for explosives driven by growth in the mining sector in Western Australia.
70. Market participants have indicated that only one of these plants is likely to be built prior to approximately 2020, as any one of these plants would be sufficient to meet forecast industry demand in Western Australia until that time. Market

³ <http://burrupnitrates.com/project.html>

participants have indicated that it would not be commercially viable to build a plant which would cause the market to have substantial excess capacity for a sustained period of time.

71. The ACCC considers that new entry is only likely prior to approximately 2020 if that new entry has a realistic prospect of securing foundation customer contracts and being operational prior to Wesfarmers' proposed expansion proceeding.

The ACCC invites comments from interested parties regarding barriers to entry into the manufacture of ammonium nitrate in Western Australia

In particular the ACCC seeks information as to whether Wesfarmers' possible acquisition of Burrup reduces the possibility that new entry in Western Australia could occur.

In responding, the ACCC asks interested parties to consider and provide relevant information on:

- the long lead times (regulatory and construction);
- the need to secure long term foundation contracts with ammonium nitrate customers;
- the potential timing advantages of constructing a brownfields expansion of an ammonium nitrate facility (such as Wesfarmers integrated facility at Kwinana) in comparison to a greenfields development of an ammonium nitrate plant in a remote region such as the Burrup Peninsula;
- the potential transport cost advantages of constructing an ammonium plant in the Burrup Peninsula relatively proximate to the location of mining customers in the Pilbara region in comparison to an ammonium nitrate plant located at Kwinana near Perth;
- the potential manufacturing cost advantages of Burrup's gas supply contract pricing (which has been speculated to be significantly cheaper than current gas pricing); and
- the potential construction and ongoing operating cost disadvantage of building an ammonium nitrate plant in a remote region such as the Burrup Peninsula.

Imports of ammonium nitrate

72. A number of market participants have indicated that imports provide only a weak source of competitive constraint upon domestic supply in the Western Australian ammonium nitrate market. However, some market participants have also indicated that any difficulties associated with importation are not insurmountable. The ACCC also notes that there are significant volumes of bulk EGAN imported into Queensland. The ACCC has not reached a concluded view on the competitive constraint posed by imports of EGAN upon domestic supply and is seeking further information and comment on this issue.

73. Presently, no party is engaged in the bulk importation of EGAN into Western Australia. While some bulk imports have occurred in the past, market participants have indicated that such importation is seen as a temporary measure to meet shortfalls in domestic supply and that domestically sourced ammonium nitrate is highly preferable to imported ammonium nitrate.
74. Market participants have highlighted a number of difficulties with importation of EGAN which suggest that a competitor with a local manufacturing presence, based in the Burrup Peninsula, would pose a greater competitive constraint to Wesfarmers:

- **Port access.** Market participants indicated that to be cost competitive, importation of ammonium nitrate would need to involve bulk shipments of at least 3,000-6,000 tonnes per shipment. While there is limited regulatory restrictions on importing small quantities of ammonium nitrate in shipping containers, bulk importation requires the relevant port to have special berth approval from the Western Australian Department of Mines and Petroleum.

Port Hedland is the port most proximate to the Pilbara region where the majority of EGAN is consumed in Western Australia. Port Hedland does not currently have special berth approval for the importation of ammonium nitrate. While special berth approval at Port Hedland is currently being sought, the ACCC understands that due to heavily utilisation of the existing port facilities, such approval is only likely to be granted for the importation of a relatively small volume of ammonium nitrate. However, the ACCC also understands that there are plans to expand the port which may be completed after 2013 and at this point a significant volume of ammonium nitrate may be imported into Port Hedland.

Other ports in Western Australia, such as Broome, Fremantle and Wyndham do have special berth approval for ammonium nitrate importation. However market participants indicated that importation into these ports is an unattractive option due to the added transportation cost of supplying ammonium nitrate to the Pilbara by truck from these distant ports.

- **Port storage facilities.** Market participants also indicated that access to storage at or within a short distance of the port site is important to enable efficient unloading of shipments and avoid excessive handling costs. While such storage facilities are either available or could be built at Wyndham, Broome and Port Hedland, market participants indicated that it was difficult to secure storage facilities of a sufficient size and location near the Port of Fremantle.
- **Product quality and consistency.** Market participants submitted that in considering importation of EGAN, it is important to source product of a consistent quality and consistency. For mining customers, using poor quality EGAN can cause reductions in the productivity of blasting processes and, at worst, product may not be able to be used and must therefore be disposed of. In the Pilbara, it can take several weeks to acquire replacement EGAN due to the long supply chains involved, leaving the miner exposed to a disruption to their production. Product quality and consistency is also an important factor in

being able to effectively and efficiently use ammonium nitrate to produce ANFO explosives.

EGAN is produced as a low-density prill and has a number of technical characteristics that cause it to degrade during importation. As EGAN crosses certain temperature thresholds, it undergoes chemical changes which cause it to cake and become less friable (i.e. it becomes more caked and has a less powdery consistency). Exposure to moisture or humid air can also have the same effect. Friability is an important property of EGAN to allow it to be efficiently mixed with fuel oil to make ANFO in specialised machinery. This means that individual shipments of imported ammonium nitrate will be of variable quality and consistency, requiring measures to be taken to assess landed product quality and physically break up any product which is insufficiently friable to be used to manufacture ANFO.

Issues relating to technical degradation of EGAN are particularly problematic if the product has to be brought across the equator. As a large proportion of internationally available ammonium nitrate is sourced in the northern hemisphere, this is an issue for EGAN imported into Australia.

Market inquiries have indicated that while there are measures which can be taken when importing EGAN to mitigate against product degradation or to restore the product to a usable form once it is landed, these measures add expense and do not entirely eliminate the issue relating to product quality and consistency.

Market participants also indicated that it was not possible to source large volumes of EGAN for importation from a single point of supply. Any importation that was undertaken would have to be done from multiple sources over time. This adds another level of inconsistency to the ammonium nitrate supplied by an importer, meaning the product may require further handling procedures and costs to be suitable for use in the manufacture of ANFO.

- **Security of supply.** Imports of ammonium nitrate involve long lead times when compared to domestic supply. EGAN sourced from Russia, the Middle East or Asia involve between 10 and 24 days sailing time. If the product is purchased on a spot basis, there may be additional delays relating to when suppliers have product available for export. These lead times mean that if there is any supply disruption, obtaining replacement ammonium nitrate may take some time which could potentially cause a disruption to the customer's mining operations. Such a disruption would be extremely costly to Australian miners. The relative security of supply offered by domestic production is another reason why customers may prefer domestic supply.

75. Due to some combination of the above factors, most market participants expressed the view that while it may be possible to import certain volumes of EGAN, domestic supply is preferred when it is available. This is reflected in the fact that market participants appear to be willing to offer ammonium nitrate suppliers a price premium for domestically supplied product

The ACCC invites comments from interested parties on imports of ammonium nitrate

The ACCC seeks information on the level of constraint that imported ammonium nitrate places on domestic manufacturers of ammonium nitrate, in particular, in Western Australia.

The ACCC seeks information on the viability of imported ammonium nitrate in Western Australia as an alternative to local supply. In particular, the ACCC seeks further information on barriers to importation and the extent to which these barriers will be removed in the short to medium term.

The ACCC asks interested parties to comment on the following:

- whether imports of ammonium nitrate are only likely to occur in the future in circumstances where domestic demand exceeds domestic supply;
- to what extent product quality and consistency issues are a barrier to importation;
- whether the level of imports of ammonium nitrate into Western Australia may increase in the foreseeable future, for instance, following increased port access and volume limits at Port Hedland or other ports;
- the extent to which market participants are willing to pay a premium for local as opposed to imported supply; and
- the extent to which anti-dumping duties significantly limit the competitive constraint posed by imports of ammonium nitrate.

Pricing dynamics for ammonium nitrate in Western Australia

76. Whilst market inquiries have indicated, as outlined above, that there are a number of difficulties associated with the importation of ammonium nitrate into Western Australia, some market participants have told the ACCC that pricing of ammonium nitrate in Western Australia was determined by reference to the cost of importation of ammonium nitrate (an import parity price), or by an estimate of forward looking import parity prices in the case of long term contracts.
77. To the extent that the import parity price constrains the price of domestic supplies of ammonium nitrate, then actual or potential ammonium nitrate imports may provide a source of competitive constraint in the Western Australian market. In contrast, if imports of ammonium nitrate are not a competitive constraint then a domestic supplier would not necessarily have regard to the cost of importing in setting prices.
78. The ACCC notes that it may be difficult for market participants to assess the true cost of importation during negotiations surrounding a contracted import parity price. This is because there is no international benchmark pricing of ammonium nitrate and few, if any, parties are actively involved in the bulk importation of ammonium nitrate into Western Australia. Thus it is difficult to assess whether

current pricing levels reflect the true cost of importing ammonium nitrate into Western Australia, and accordingly, to what extent potential imports are an effective competitive constraint in the relevant market.

79. Nevertheless, import parity pricing may be relevant to the way in which prices are set in the relevant market. The ACCC considers that different pricing outcomes for the supply of EGAN may be observed in circumstances where the Western Australia market has excess capacity depending on whether there are one or more local suppliers. If there is one local supplier, the ACCC's preliminary view is that customers are likely to pay the import parity price regardless of whether there is excess capacity as imports are their only other alternative source of supply for customers. In this circumstance the domestic producer would export any excess production.
80. However, the ACCC considers that where there is excess capacity and more than one local supplier, it would be expected that prices would be competed down to export parity levels.
81. Market inquiries suggest that domestic suppliers would find it uneconomic to build sufficient capacity such that the market was oversupplied in the long term. However, if there are two Western Australian producers of ammonium nitrate, the ACCC considers there may be periods of time where competition to secure future demand could cause producers to expand capacity at their plants earlier than they otherwise would in the absence of a competing domestic manufacturer which could lead to situations where the domestic market is oversupplied.

The ACCC invites comments from interested parties on the pricing of ammonium nitrate in Western Australia

The ACCC seeks information as to the extent that pricing of ammonium nitrate is determined by an assessment of the import parity price. The ACCC is also seeking information as to whether market participants consider that there is transparency as to the cost of importing ammonium nitrate, should they be unable or unwilling to acquire supplies from a local manufacturer.

The ACCC also seeks information as to the extent that prices would be likely to be set by reference to import parity prices in the event that a second ammonium nitrate plant was constructed in Western Australia, for instance, on the Burrup Peninsula.

The ACCC also seeks information as to the extent that any existing premium for security of supply and/or product quality and consistency incorporated into domestic pricing for supply of ammonium nitrate would be likely to be removed or reduced in the event a second ammonium nitrate plant was constructed in Western Australia, for instance, on the Burrup Peninsula.

The ACCC also seeks information as to the variance in current domestic pricing for supply of ammonium nitrate in Western Australia (where there is a single manufacturer of ammonium nitrate) in comparison to the east coast (where multiple manufacturers of ammonium nitrate are located).

The ACCC seeks information as to whether and to what extent competition to meet growing demand between multiple Western Australian ammonium nitrate manufacturers could lead to better pricing outcomes, compared to a situation where there was only one manufacturer in the state.

Countervailing power

82. The ACCC notes that many of the end users of EGAN or ANFO in Western Australia are large, multinational mining companies with significant financial resources. However the ACCC does not consider that this fact on its own gives these parties countervailing power. The ACCC considers that the issues outlined above relating to barriers to entry and imports indicate that, regardless of their financial capabilities, customers are unlikely to be in a position to credibly threaten to bypass domestic suppliers to a significant extent.

Issues unlikely to pose concerns

Market for the supply of ammonia

83. The ACCC has examined the potential for competition concerns to arise in relation to the supply of ammonia in Western Australia. The ACCC's preliminary view is that the possible acquisition is unlikely to raise significant competition concerns in this market.
84. In assessing the competition effect of the possible acquisition, the ACCC has focused on the supply of merchant ammonia which is produced as a contestable source of ammonia. Burrup is the only significant supplier of merchant ammonia in Western Australia.
85. In contrast, captive ammonia produced by vertically integrated firms for their own use is not typically traded in the ammonia market. As well as their own production, some captive ammonia producers trade in merchant ammonia.
86. Wesfarmers is a captive ammonia producer as well as a trader of merchant ammonia. Wesfarmers supplies merchant ammonia to customers in the nickel industry and a small number of other industrial users. For the purposes of manufacturing ammonium nitrate, Wesfarmers uses is required to reserve a large amount of its ammonia for captive purposes, rather than trading merchant ammonia.
87. A key factor relevant to the ACCC's assessment of the proposed acquisition is the existence of the Yara off-take agreement between Yara and Burrup. As indicated above, under the 20 year Yara off-take agreement, all of the ammonia produced by Burrup is sold to Yara on an exclusive basis.
88. The ACCC's preliminary view is that the existence of the Yara off-take agreement means that the possible acquisition is unlikely to structurally change the current state of competition in the market for the supply of ammonia in Western Australia in the foreseeable future.

89. Irrespective of Burrup's ownership structure, Yara remains the exclusive purchaser of all ammonia produced by Burrup. On the basis that the Yara off-take agreement continues post-acquisition of Burrup, Wesfarmers would not have direct rights to the ammonia produced by Burrup, with or without the possible acquisition, for the next 15 years or more.
90. Even if the Yara off-take agreement did not continue to exist post-acquisition of Burrup, market inquiries to date suggest that competition between Wesfarmers and Burrup with respect to merchant ammonia is currently limited, and is likely to remain so in the foreseeable future, with or without the possible acquisition. The currently limited competition between Wesfarmers and Burrup for the supply of merchant ammonia appears to be a consequence of the physical distance between Burrup and Wesfarmers existing ammonia customers.
91. Most domestic customers of merchant ammonia in Western Australia are physically located in proximity to Wesfarmers integrated complex at Kwinana. These customers receive product from Wesfarmers by pipeline, truck and/or rail and do not have access to independently owned or operated import infrastructure capable of receiving imports of ammonia by ship.
92. In contrast, Burrup's ammonia plant is located further north on the Burrup Peninsula. The Burrup plant currently does not have any ammonia handling facilities to load ammonia onto trucks or the ability to transport ammonia by rail. All of its ammonia is piped to the Port of Dampier for shipping.
93. Whilst information to date indicates there is limited competition, or potential competition between Wesfarmers and Burrup for the supply of ammonia in Western Australia, the ACCC is interested in seeking further information on this issue prior to forming a concluded view.
94. The ACCC has also examined the potential for imports to constrain the domestic supply of ammonia. The ACCC has received conflicting views from market participants as to the economic viability of importing ammonia and therefore the competitive threat posed by potential imports of ammonia.
95. Market inquiries suggest that there is a lack of independently owned or operated port and related infrastructure to support the shipping, unloading and moving of ammonia in Western Australia. The ACCC understands that only two terminals currently exist in Western Australia which are capable of bulk imports of ammonia. These are the Port of Dampier which is used by Burrup to export ammonia and the Fremantle Port Authority's 'Kwinana Bulk Jetty' at Kwinana which is used by Wesfarmers to import.
96. The ACCC understands that infrastructure required to import ammonia includes a pipeline and sufficiently sized storage tanks capable of receiving large shipments of ammonia.
97. The ACCC understands that Wesfarmers owns or operates the pipeline and storage tanks which it uses to import ammonia into Kwinana. Similarly, Burrup owns or operates the pipeline and storage tanks on the Burrup Peninsula.

98. The ACCC's market inquiries suggest that a limitation on the potential for imports of ammonia for certain customers, in particular smaller customers of merchant ammonia, is the need to have ready access to an appropriately designed port and infrastructure to receive viable sized shipments of ammonia by sea, including a pipeline to move ammonia from the port to sufficiently large storage tanks.
99. Customers requiring smaller quantities are typically supplied by truck and/or rail within the state of Western Australia, whereas larger integrated producers have their own access to import terminals. The demand for ammonia from customers requiring smaller quantities may be too little to justify the investment required to produce ammonia themselves or establish an import operation.
100. While the ACCC's preliminary view is that the acquisition of interests in Burrup by Wesfarmers is unlikely to raise significant competition concerns in the market for the supply of ammonia in Western Australia, the ACCC welcomes comments regarding its preliminary findings in this market; in particular, the ability of imports to pose a competitive constraint and the extent of any competitive overlap between the supply of ammonia from Burrup's and Wesfarmers' ammonia plants.

ACCC's future steps

101. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
102. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
103. Submissions are to be received by the ACCC no later than 30 May 2011. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view in light of the issues raised above.
104. The ACCC intends to publicly announce its final view by 23 June 2011. However the anticipated timeline may change in line with the *Merger Review Process Guidelines*. A public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.