



2 September 2014

Mr Gavin Jones
Director
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

Email adjudication@acc.gov.au

Dear Mr Jones

N97609 – Coal Reuse – submission

I refer to the notification of exclusive dealing made by Coal Reuse on 25 July 2014 and the Commission's request for submissions from interested parties on 12 August 2014.

Envirospheres is pleased to make the **attached** submission opposing the notification.

Confidentiality

This letter may be placed on the Commission's public register. A separate version of this letter has been provided subject to a claim for confidentiality without the confidential and commercially sensitive material redacted.

Envirospheres notes that Coal Reuse appears to have made a number of confidential and commercially sensitive submissions in support of its notification. Because these have been completely excluded from the public register, Envirospheres is not able to comment on these submissions. As these submissions cannot be tested through the public consultation process, Envirospheres submits that the Commission should give them little weight.

Envirospheres would be pleased to respond to any further queries the Commission may have after reviewing our submission.

Yours sincerely

Anthony Caccamo
Chief Executive Officer

envirospheres

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Envirospheres submission to ACCC on Coal Reuse notification

Summary

- Cenospheres constitute a separate market from other fly ash products. Stanwell cenospheres make up a substantial proportion of that market because of the particular quality attributes of Stanwell cenospheres.
- The proposed arrangement is likely to substantially lessen competition in the market for cenospheres and downstream product markets, by excluding competitors of Coal Reuse for a substantial period, by creating incentives for Coal Reuse to vertically integrate in the supply of cenospheres and raise its downstream rivals' costs, and by giving Coal Reuse a substantial degree of power in the market for the supply of cenospheres.
- Coal Reuse's commercial conduct to date already demonstrates that it will abuse this market power. Envirospheres has significant concerns that Coal Reuse will raise prices for and withhold supply of cenospheres and other CCPs.
- Coal Reuse overstates the public benefits that will flow from its exclusive arrangements, and none of those public benefits arises from its exclusive access to cenospheres.
- There will be substantial public detriments from the exclusive arrangements, including possible job losses, inefficient wastage of plant and probable higher prices for cenospheres.
- The Commission should give Coal Reuse a notice under section 93(3), at least in relation to the conduct as it relates to the exclusive supply of cenospheres.

Background

Envirospheres

Envirospheres is an Australian company focused entirely on the manufacture and supply of the highest quality cenospheres, marketed as microspheres.

Until Coal Reuse was appointed under the arrangement the subject of this notification, Envirospheres had a first right of refusal to acquire cenospheres from defined sources at Stanwell's coal-burning power plants in Nanango and the Meandu Mine in south-east Queensland, having been appointed under successive agreements over a 16-year period following competitive open tender processes.

Envirospheres' contracts with Stanwell were usually of around 3-5 years in length. The agreement that has just expired was for 2 years with two 6-month options. The specific sites where Envirospheres had first right of refusal were **[commercial-in-confidence]**. Envirospheres had no specific rights to cenospheres potentially available from other sources at Stanwell's coal-burning power plants in south-east Queensland.

Envirospheres has invested in specialist equipment to harvest cenospheres at Stanwell sites, including the Meandu mine void. It has also acquired and made significant upgrades to a factory it operates in Nanango for the processing of cenospheres, providing employment in the region.

Coal Reuse

Coal Reuse claims in its submission of 25 July 2014 that it is a special purpose vehicle established to operate the business of development and managing markets for coal combustion products. It claims that it does not have any interest in the concrete industry or any business which uses CCPs, and that it

intends to act wholly as a reseller of the CCPs it acquires. It claims that it proposes to commence its business with the Stanwell arrangements the subject of the notification.

Envirospheres disputes these claims on the following basis:

- (a) Coal Reuse came into existence in July 2012. Subsequently, Coal Reuse took an assignment of the contract between Rockshore International (**Rockshore**) and Stanwell to access any excess CCPs from Stanwell sites not sold to other off-takers. Envirospheres understands that in the last two-year period, Coal Reuse has not removed or sold any commercial quantities of CCPs from Stanwell sites. Also during this period (**[Commercial-in-confidence]**), Stanwell suggested to Envirospheres that it should make contact with Rockshore and subsequently Coal Reuse to discuss the purchase from Coal Reuse of any Stanwell cenospheres from other sources at Stanwell sites. While it had informed Stanwell and Envirospheres it would generate Cenospheres from the recovery and sale of pond ash, to the best of our knowledge, Coal Reuse was never able to generate any commercial quantities of cenospheres from other sources at Stanwell sites. It is incorrect therefore to state that it is beginning its business with this exclusive arrangement with Stanwell.
- (b) **[Commercial-in-confidence]** Again, this is contrary to the claim that Coal Reuse is only beginning its business with this conduct.
- (c) **[Commercial-in-confidence]** This is contrary to the claim that Coal Reuse does not intend to be vertically integrated and has not been in business until now.
- (d) **[Commercial-in-confidence]** This runs counter to Coal Reuse's claim in its submission that it proposes to be a wholesaler only, at least with respect to cenospheres.

Cenospheres

Cenospheres are a particular form of coal combustion product that presents significant differences from all other CCPs.

Cenospheres are small, hollow, hard-shelled, ultra low-density spheres that float on the ash dam and elsewhere. They have a number of specialised uses, that are completely different from other forms of CCP. Cenospheres can be used as a lightweight filler and in the manufacture of construction, automotive, refractories materials and specialised surface coatings. They are also widely used in the composites industry as they are light but extremely strong and resistant to heat and chemically inert.

Cenospheres must be harvested differently from other CCPs. Because they float on water, the process for harvesting them is very specialised. The techniques for processing them are also very specialised. Significant capital investment is required to harvest and process cenospheres compared to other ash products. In addition, the nature of and capital investment required for the harvesting process is that it is impracticable for several off-takers to harvest cenospheres from the same site. Harvesting cenospheres off the ash dam essentially involves the provision of an environmental service. Daily environmental monitoring is required because harvesting is wind/weather-dependent. Specialised equipment is maintained on-site so that harvesting can occur immediately on days when it is safe to proceed.

It should also be noted that harvesting from the mine void involves harvesting cenospheres from fly ash that has been permanently disposed of (i.e. cenospheres are the only CCP that will be available from that fly ash in the future). Any suggestion of developing new or different recovery methods or use only relates to fly ash deposited in the ash dam (what Coal Reuse refers to as 'pond ash'). Coal Reuse appears to believe it will be able to develop the capability to dredge that ash in the future, although, Envirospheres understands it had advised Stanwell it had this capacity but failed to do so during its last contract with Stanwell. At any rate, none of the possible new techniques Coal Reuse suggests it will be

able to develop for recovering other ash products applies to the ash permanently disposed of already in the mine void.

Stanwell cenospheres, particularly those generated from the Tarong and Tarong North power stations, have unique properties not usually found in other sources of cenospheres. These include:

- (a) **colour** – [Commercial-in-confidence];
- (b) **chemical properties** – [Commercial-in-confidence]
- (c) **compressive strength** – [Commercial-in-confidence]

Envirospheres has also developed a number of new customer markets for cenospheres based on these special characteristics beyond those mentioned above. Some of Envirospheres' customers will not be able to source suitable alternatives if they cannot continue to access Tarong cenospheres at a reasonable price, with consequent impacts on their ability to compete in their respective product markets.

The price available for cenospheres is also substantially different from the price for other CCPs. As a rough measure, 20,000 tonnes of processed cenospheres would have a market value in excess of \$20 million, whereas the market value of 20,000 tonnes of fly ash would be around \$2 million.

These factors mean that there is unlikely to be supply-side substitution between off-take of cenospheres and other CCPs, and there is unlikely to be demand-side substitution, since the uses and price of cenospheres are so markedly different from other CCPs.

There is also a limited supply of cenospheres in Australia. Customers seeking processed cenospheres often import them.

Envirospheres therefore submits that there are separate markets in Australia for the supply of raw cenospheres and for the supply of processed cenospheres. There are also downstream markets in which cenospheres are an important input.

Coal Reuse seeks to rely on the market definition from the Commission's decision on the authorisation of CCP supply arrangements between Stanwell and Pozzolanica and on the Federal Court's judgment in the *Cement Australia* decision. However, as cenospheres were not acquired under those arrangements, they were not considered as part of the market analysis. None of Coal Reuse's further analysis of the possible dimensions of the market takes any account of cenospheres and their unique characteristics.

Contrary to what Coal Reuse has stated in its submission, cenospheres are not a processed by-product of other CCPs. They form naturally with fly ash as part of the coal combustion process and are harvested in their 'raw' state. They must then be taken to a processing plant to produce the end product for sale.

Cenospheres make up only a small proportion of the total CCPs, but their higher value in use has always resulted in higher recovery and utilisation rates. Under its previous contracts with Stanwell, Envirospheres was able to achieve a near 100% off-take and sale of cenospheres, compared to much lower utilisation of other CCPs like fly ash. It is incorrect for Coal Reuse to assert that cement grade fly ash is the only CCP being purchased in material volumes from Queensland power stations.

Arrangement with Stanwell

Coal Reuse has asked and the Commission has agreed to exclude the entire agreement between Coal Reuse and Stanwell from the public register. Envirospheres is disappointed that the Commission did not insist that Coal Reuse instead redact those parts of the agreement that are truly confidential and commercially sensitive. As has already been shown, Envirospheres disputes a number of the factual claims about the products and industry that Coal Reuse has made. It would be useful for those in the

industry to be able to review the arrangement between Coal Reuse and Stanwell to raise any further issues of concern that may not be immediately apparent to the Commission.

Based on what has been disclosed about the agreement in Coal Reuse's submission, the arrangement:

- (a) is for an initial term of 10 years (and so presumably can be extended for an even longer term);
- (b) allows Coal Reuse to set a 'transparent' reserve price on auction processes for the CCPs;
- (c) allows Coal Reuse to set what it considers to be a 'reasonable market price' for the products in the spot market until the auction process establishes a market price;
- (d) provides for Coal Reuse to auction short-term rights of access to multiple parties concurrently; and
- (e) allows Coal Reuse to remove up to 20,000 tonnes of CCPs free of charge each year.

Addressing each of these in turn, the long-term nature of the arrangement inherently raises substantial competition concerns. No competitor of Coal Reuse can hope to compete directly for Stanwell's CCPs for at least 10 years, but instead must compete in a new market downstream of Coal Reuse. In particular, Envirospheres is locked out of dealing directly with Stanwell to off-take cenospheres from Stanwell sites, and must try and seek access from Coal Reuse. There are limited alternative sources of cenospheres available for competitors of Coal Reuse, particularly for cenospheres with the qualities and attributes of Tarong cenospheres. As the exclusive off-taker of all CCPs from Stanwell over a very long period, Coal Reuse will be able to act unconstrained by competition.

To date, it has proved impossible for Envirospheres to make any commercially viable arrangements with Coal Reuse to ensure any sort of continuity of supply of cenospheres to Envirospheres to ensure we can continue to operate our business, keep our processing plant in Nanango operating and continue the employment of our staff at that plant. **[Commercial-in-confidence]**

An auction system may superficially seem like an appropriate way to reach the best price that maximises the seller's returns by selling to the buyer with the greatest willingness to pay. However, where the auction system also involves a published reserve price, and no obligation for that reserve to be reasonable, buyers are required to compete above a certain known threshold. This will give Coal Reuse a powerful ability and incentive to increase price, despite the existence of an auction system. As its conduct towards Envirospheres has already shown, Coal Reuse is likely to seek to inflate the price of CCPs.

Similarly, the process of determining a 'reasonable market price' for the spot market allows Coal Reuse to inflate prices by setting a high initial spot price and then ensuring the price remains high through the 'transparent' reserve.

These are indicators of market power not constraints on market power.

Because of the specialised harvesting methods for cenospheres, it will not be possible to auction short-term rights of access to multiple parties. As has been detailed above, whether or not cenospheres can be harvested on a particular day is heavily wind/weather-dependent.

Further, harvesting from the mine void does not lend itself to short-term harvesting by multiple off-takers. In the case of the mine void, there is no possibility of recovering any other CCP from this location except cenospheres. Once filled, the void will be capped and the land remediated. It is essentially a permanent waste facility. Harvesting the floating cenospheres from the mine void before it is full and to be capped off is essentially a mining operation to recover those materials from what is otherwise permanent waste. Access to the site and recovery of the cenospheres must be done in accordance with strict mining regulated procedures and environmental obligations. Envirospheres believes the only

appropriate way this can be done efficiently and in accordance with those obligations is to conduct an open and competitive tender process to appoint a single off-taker to undertake the environmental monitoring required and to harvest the cenospheres and comply with the statutory requirements of mining operations. The system proposed by Coal Reuse will be inefficient and ineffective, potentially resulting in fewer cenospheres being harvested before the mine void is full and has to be capped off. These efficiency losses are a public detriment that the Commission must take into account in assessing this notification.

Finally, the ability to take 20,000 tonnes of CCPs each year is very concerning. As has already been discussed, 20,000 tonnes of cenospheres is worth substantially more than 20,000 tonnes of fly ash. Coal Reuse essentially has the right to take all of the cenospheres produced at Stanwell sites in a year for free and keep the profits from their sale for itself. Based on the anticipated volumes disclosed in Stanwell's EOI documentation, Coal Reuse will be able to take the entire cenospheres tonnages produced at Stanwell's sites every year within this allowance. There is little incentive for Coal Reuse not to take the entire cenospheres production for itself.

The impact of this on the market for cenospheres will be anti-competitive. Coal Reuse's incentives will be to set an inflated price for Tarong cenospheres (**[Commercial-in-confidence]**). Stanwell will no longer benefit from the higher price available for cenospheres.

It would also be expected that Coal Reuse will face strong incentives to source its own cenospheres processing capability to take full advantage of its free cenospheres arrangement with Stanwell.

[Commercial-in-confidence]

Envirospheres therefore has substantial concerns that the arrangement will substantially lessen competition in the markets for raw and processed cenospheres. If Coal Reuse has incentives to vertically integrate (either directly or through related parties) and the ability to inflate prices to its downstream competitors, it will also substantially lessen competition in downstream markets that rely on processed cenospheres.

[Commercial-in-confidence]

Public benefits

The public benefits posited by Coal Reuse in its submission relate primarily to correcting perceived market failures. These market failures (uncertainty of volumes, quality levels, delivery logistics and pricing certainty) all relate to CCPs other than cenospheres.

To the extent there are market failures (which Envirospheres does not necessarily accept) in other markets, Envirospheres submits that the public benefits that flow from correcting those market failures would need to be overwhelming to justify a substantial lessening of competition in another market that will not benefit at all from those corrections.

Nevertheless, it is unlikely that the improvements suggested by Coal Reuse will eventuate. While Coal Reuse proposes to allow customers to bid for five-year contracts at minimum volumes, it may be that these will be at an inflated price. Also, Coal Reuse has made it clear that it will not allow customers to acquire all of their requirements as part of a minimum volume contract. Coal Reuse admits that the current largest customer, Cement Australia, has volatile volume requirements. This will mean Cement Australia must either over-commit to a minimum volume to ensure it has enough volume to meet this volatility, or supplement its requirements above a minimum volume through the spot market. This will not give any volume or pricing certainty that will allow a company like Cement Australia to bid on major infrastructure projects.

Coal Reuse states that Australia compares very poorly in overall reuse of CCPs with international reuse levels. It suggests that 80% of CCPs produced in Australia are being dumped, predominantly in storage dams. It has not demonstrated that this is true of Stanwell, which is the only utilisation it can hope to

improve through this arrangement. In addition, utilisation of available cenospheres is much higher and approaches 100% in Australia – a further indicator that there is a separate product market for cenospheres and no demonstrated market failures or inefficiencies in cenospheres to justify the approach being taken by Stanwell and Coal Reuse.

In fact, Australia's CCP reuse levels compare favourably to international levels. Reuse levels in Australia for CCPs generally are close to 46%. While reuse levels in Europe (90.9%) and Japan (96.4%) are significantly higher, this is because on a per capita basis there are fewer coal-powered power stations in Europe and Japan and very large populations to support consumption of CCPs. Reuse levels in Canada are 33.8%, in the US are 42.1% and in India are 13.8%. On a per capita basis, Australia's reuse levels are quite high. Australia generates the highest amount of CCPs per capita (600kg) but also has the highest effective utilisation rate per capita (270kg). Europe has a utilisation rate of 100kg per person and Japan 80kg.¹

Coal Reuse claims that the arrangement will result in overall cost savings by Stanwell. In fact, there is a strong likelihood that the arrangement will substantially reduce revenue to Stanwell. If Coal Reuse takes all the lucrative cenospheres for its own profit (so that Stanwell earns less from off-takers overall) and the arrangements mean that a large customer like Cement Australia must seek alternatives to ensure the volumes and price certainty it requires for large construction projects, Stanwell will face a revenue shortfall and therefore lower returns to government. **[Commercial-in-confidence]**

Finally, Coal Reuse suggests that there will be an improvement in safety because it is managing access to the CCPs. Unless it is suggesting that Stanwell was unable to manage safety or implement safety plans, it is difficult to see how this will result in measurable public benefits that would not be attained without the exclusive dealing conduct. Stanwell wanted to achieve administrative efficiencies through reducing the number of off-takers. There was no suggestion that Stanwell was unable to manage the safe access of multiple off-takers to the site.

On the other hand, the specialised harvesting techniques and high capital cost of cenospheres harvesting equipment mean that it is inefficient and potentially unsafe to try and have multiple harvesters on the ash dam and mine void at the same time. Coal Reuse will make cenospheres harvesting less safe and less efficient, which will not result in any cost savings for Stanwell.

Other public detriments

Given the difficulties EnviroSpheres has had establishing arrangements to acquire cenospheres from Coal Reuse, and the indications that Coal Reuse is likely to substantially increase the price of cenospheres to EnviroSpheres, we are concerned that it will no longer be efficient to maintain a cenospheres processing factory in Nanango. This would result in possible job losses in the Nanango area.

Conclusion

There is a separate market for cenospheres. The exclusive arrangement put in place between Stanwell and Coal Reuse is likely to substantially lessen competition in that market. The proposed arrangement will in fact create and entrench market power in that market rather than improve competitive conditions.

Few or none of the posited public benefits relate to the market for cenospheres. Even so, they are unlikely to eventuate, at least not to the extent suggested by Coal Reuse, in the market(s) for other CCPs. The Commission cannot be satisfied that there are sufficient public benefits to outweigh the detriments to the public arising out of the substantial lessening of competition in the market for cenospheres and markets downstream from it.

¹ Heidrich, Feuerborn and Weir, 'Coal Combustion Products: A Global Perspective', Paper presented at the 2013 World of Coal Ash Conference, 22-25 April 2013, Lexington KY (<http://www.flyash.info/>)

Envirospheres has contested a number of the claims Coal Reuse has made in its notification.

The Commission should give Coal Reuse notice under section 93(3) of the Competition and Consumer Act.