DECISION AND STATEMENT OF REASONS CONCERNING GLENCORE COAL PTY LTD'S APPLICATION FOR DECLARATION OF THE SHIPPING CHANNEL SERVICE AT THE PORT OF NEWCASTLE

Competition and Consumer Act 2010, s44H

BACKGROUND

Section 44F of the *Competition and Consumer Act 2010* (CCA) provides that the designated Minister, or any other person, may make a written application to the National Competition Council (NCC), asking the NCC to recommend that a particular service be declared. After receiving the application, the NCC must, after having regard to the objects of Part IIIA of the CCA in section 44AA and the matters specified in section 44G, recommend to the designated Minister either that the service be declared or that the service not be declared.

On 13 May 2015, the NCC received an application under Part IIIA of the CCA from Glencore Coal Pty Ltd (Glencore) for declaration of the shipping channel service at the Port of Newcastle.

The specific service for which Glencore has sought declaration is the provision of the right to access and use the shipping channels (including the berths next to the wharves as part of the channels) at the port, by virtue of which vessels may enter a port precinct and load and unload at relevant terminals located within the port precinct and then depart the port precinct (shipping channel service).

The provider of the shipping channel service at the Port of Newcastle is Port of Newcastle Operations Pty Ltd (PNO) as trustee of the Port of Newcastle Unit Trust. PNO is jointly owned by Hastings Funds Management and China Merchants Group. PNO manages the port under a 98 year sublease, which commenced on 30 May 2014.

On 11 November 2015, the Government received the NCC's final recommendation. The NCC recommended that the shipping channel service not be declared on the basis that the criterion in paragraph (a) of subsection 44G(2) had not been satisfied.

DECISION

Subsection 44H(1) of the CCA provides that on receiving a declaration recommendation from the NCC, I (as the designated Minister) must either declare the service or decide not to declare it.

In deciding whether to declare the service or not, I must consider:

- the objects of Part IIIA of the CCA (subsection 44H(1A)); and
- whether it would be economical for anyone else to develop another facility that could provide part of the service (subsection 44H(2)).

Further, I cannot declare a service:

- that is subject to an access undertaking in operation under Division 6 of Part IIIA of the CCA (subsection 44H(3));
- while a decision of the Australian Competition and Consumer Commission (ACCC) is in force under subsection 44PA(3) approving a tender process, for the construction and operation of a facility, as a competitive tender process, provided by means of the facility that was specified under paragraph 44PA(2)(a) (subsection 44H(3A)); and
- unless I am satisfied of all matters specified under paragraphs 44H(4)(a) to (f).

I am not satisfied that the criterion in paragraph (a) of subsection 44H(4) has been met by the application, and have therefore decided to not declare the shipping channel service.

My conclusions on the application are described below. In arriving at those conclusions I have drawn on the NCC's final recommendation and advice provided to me by the Treasury.

REASONS

Matters specified under subsection 44H(4) of the CCA

a) Would access promote a material increase in competition in a dependent market?

Paragraph (a) of subsection 44H(4) provides that I cannot declare a service unless I am satisfied that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service.

In assessing this criterion, I considered whether there are any separate but dependent markets in which competition may be promoted by increased access to the shipping channel service. I then determined whether increased access would promote a material increase in competition in any of these markets.

I have accepted the NCC's conclusion that there are likely to be 5 functionally distinct, dependent markets relevant to access to the shipping channel service. These markets are:

- a coal export market;
- markets for the acquisition and disposal of exploration and/ or mining authorities;
- markets for the provision of infrastructure connected with mining operations, including rail, road, power and water;
- markets for services such as geological and drilling services, construction, operation and maintenance; and

- a market for the provision of shipping services involving shipping agents and vessel operators, of which ships exporting coal from the Port of Newcastle are a part.

These markets are separate from the market for the service for which declaration is sought. There are no inter-relationships in supply between the service for which declaration is sought and the dependent markets such that they must necessarily be provided together.

I have considered Glencore's arguments that there is also a distinct market for the financing of coal mining projects in the Hunter Valley. In doing so, I have had regard to the definition of 'market' in section 4E of the CCA: *'Market, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services'.* In considering this issue, I found the following to be material:

i) that finance for Hunter Valley coal projects is available through a range of financing markets both within Australia and internationally;

ii) that there is no evidence that there is a limited pool of substitutable financiers or financial instruments for coal projects in the Hunter Valley; and

iii) that there is no evidence that those financing coal mines in the Hunter Valley are unable to finance a range of other projects that are part of a similar class of assets.

On the basis of these factors, I have accepted the NCC's view that there is no functionally distinct, dependent market for the financing of coal mining projects in the Hunter Valley (including the expansion of existing projects).

I have accepted the NCC's view that any impact on the 5 identified dependent markets will be the result of business decisions by coal producers in the Hunter Valley. Those business decisions would have to be materially affected by the changes in the terms of access to the Port before it could be considered that there is a material effect on any of the dependent markets.

For the purpose of determining whether increased access would promote a material increase in competition in a dependent market, I have considered what is meant by 'increased access'. PNO submitted that this dispute is properly characterised as a pricing dispute, rather than an access dispute, as access is not being denied and the pricing regime is not discriminatory against any of the users. However, I have accepted Glencore's argument, and the NCC's finding, based on the legal precedent in relevant court cases, that this is an access dispute such that the service can be declared under Part IIIA of the CCA if all the criteria are met.

In this circumstance, increased access constitutes access on reasonable terms and conditions as may be determined in the second stage of the Part IIIA process. In determining whether

competition is materially promoted, this state is compared to the counterfactual of 'limited access' under which the service is not declared.

I have accepted Glencore's argument that PNO provides a bottleneck service and that the charges imposed by PNO at the Port are an unavoidable component of the costs that Hunter Valley coal producers face in exporting their product. I have also accepted that these producers are price-takers in a competitive international coal market and are unable to pass these costs on to consumers. I have further accepted Glencore's argument that the change to the navigation charges has increased costs for access seekers and that PNO has the ability to make changes to the navigation charges in the future, which creates cost uncertainty.

However, for the reasons set out below, I have not accepted Glencore's arguments that future changes in the navigation charges are likely to materially affect competition in dependent markets.

In considering whether access to the shipping channel service would promote a material increase in competition in the dependent markets, I found the following to be material:

i) there is insufficient evidence that the identified dependent markets are currently not workably competitive;

ii) the navigation charges represent a small fraction of the overall coal price at present and even if the charges are increased significantly in future, it will remain a minor cost element;

iii) coal producers currently manage a range of uncertainties in their businesses, many of which are likely to be far greater than that which exists in relation to navigation charges;

iv) PNO has a 98-year lease on the Port and is heavily reliant upon coal as the largest share of its throughput;

v) PNO has contractual obligations with the New South Wales Government to maintain the Port as a major seaborne gateway; and

vi) PNO is not vertically integrated into any dependent market in a way that affects its business decisions.

On the basis of these findings, I have reasoned as follows:

i) given that

   a. all of the recognised dependent markets are at least workably competitive at present;

b. navigation charges are a negligible component of the cost faced by coal producers, and will likely remain so in future; and

c. the level of uncertainty coal producers face regarding navigation charges is minimal compared to other uncertainties that they already manage as part of doing business;

the terms of access to the service provided by PNO are not a material factor in whether dependent markets will remain workably competitive in future;

ii) PNO is heavily reliant on coal exports for its revenue and has contractual obligations to improve productivity and efficiency at the Port to keep it a major seaborne gateway, so it does not have an incentive to diminish the long-term output of the Hunter Valley coal industry; and

iii) there are no material concerns of vertical integration that would lead PNO to favour any participants in dependent markets.

Therefore, I am not satisfied in relation to the matter specified in paragraph 44H(4)(a).

b) Is it uneconomical to develop another facility?

Paragraph (b) of subsection 44H(4) provides that I cannot declare a service unless I am satisfied that it would be uneconomical for anyone to develop another facility to provide the service.

Consistent with the approach of the NCC, I have construed 'uneconomical' in a private profitability sense. This approach considers the costs and benefits to private and commercial interests, and looks at whether it is privately profitable for someone in the marketplace to develop an alternative to the facility to provide the service.

In considering whether it would be privately profitable for someone in the marketplace to develop an alternative to the shipping channel service, I found the following to be material:

ii) there are significant physical and structural impediments to developing another facility to provide the shipping channel service including:

a. that there is no alternative route to the existing coal terminals through any existing waterway; and

b. that it would be necessary to construct an alternative, artificial channel and reconstruct the existing coal terminals to service vessels arriving via this route;

iii) there are significant cost and administrative barriers to developing an alternative port proximate to the Hunter Valley, could a feasible location be found; and

iv) no party provided evidence that even if the physical or structural impediments could be overcome, it would be profitable for anyone to develop a facility that could provide the shipping channel service.

On the basis of these findings, I have reasoned as follows:

i) given the physical and structural barriers to establishing an alternative shipping channel at the Port of Newcastle, it would not be profitable or economical for anyone to develop another facility to provide the service at the Port; and

ii) given the cost and administrative barriers to establishing a port site sufficiently proximate to the Hunter Valley coal mines, developing an alternative port to provide the shipping channel service would not be profitable.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(b).

c) Are the shipping channels of national significance?

Paragraph (c) of subsection 44H(4) provides that I cannot declare a service unless I am satisfied that the facility is of national significance having regard to:

i) the size of the facility; or

ii) the importance of the facility to constitutional trade or commerce; or

iii) the importance of the facility to the national economy.

In considering whether the shipping channel service is of national significance, I found the following to be material:

i) the Port of Newcastle is one of the largest coal ports in the world handling around 160 million tonnes in trade throughput with a value of approximately $15.5 billion in 2013-14, of which coal comprised around 154 million tonnes with a value of approximately $13.6 billion;

ii) coal is Australia's second most valuable export – it was approximately 12 per cent of Australia's exports by value in 2013-14;

iii) the Hunter Valley coal industry, which relies on exporting from the Port of Newcastle, contributed approximately $5.9 billion to the NSW economy in 2013-14; and

iv) there were no submissions to the NCC expressing a view that the facilities are not of national significance such that this criterion would not be satisfied.

On the basis of these findings, I have reasoned that the shipping channels are of importance to constitutional trade and commerce and to the national economy due to their critical role in

the Hunter Valley coal industry. On this basis I have concluded that these facilities are of national significance.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(c).

e) Is the shipping channel service already subject to an effective access regime?

Paragraph (e) of subsection 44H(4) provides that I cannot declare a service unless I am satisfied that access to the service:

i) is not already the subject of a regime in respect of which a decision under section 44N that the regime is an effective access regime is in force (including as a result of an extension under section 44NB); or

ii) is the subject of a regime to which a decision under section 44N that the regime is an effective access regime is in force (including as a result of an extension under section 44NB), but I believe that, since the decision under s 44N was published, there have been substantial modifications of the access regime or of the relevant principles set out in the Competition Principles Agreement.

The shipping channel service is not subject to any access regime that has been the subject of a decision under section 44N. The question of substantial modification does not arise.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(e).

f) Is access contrary to the public interest?

Paragraph (f) of subsection 44H(4) provides that I cannot declare a service unless I am satisfied that access (or increased access) would not be contrary to the public interest.

In considering this criterion, I had regard to the potential costs and benefits that may arise from declaring access to the shipping channel service. I note that this criterion does not require that I am affirmatively satisfied that access is in the public interest.

In considering whether increased access would be contrary to the public interest, I found the following to be material:

i) there was no persuasive evidence that the costs and uncertainties of access regulation at the Port of Newcastle are greater than those usually resulting from an access declaration, and which go beyond what is contemplated by Part IIIA and its negotiate-arbitrate model;

ii) price-monitoring regulation is not an effective substitute for access regulation, and does not perform the role that Part IIIA intended or else it could be declared effective regulation under subsection 44N;

iii) investment decisions on significant infrastructure are made with the full knowledge that other parties may seek to declare the services provided by that infrastructure under Part IIIA; and

iv) there was no persuasive evidence that access regulation would have material impacts on the Hunter Valley coal chain or Capacity Framework Arrangements.

On the basis of these findings, I have found that there is no basis for concluding that increased access would be contrary to the public interest. Accordingly, I have concluded that increased access would not be contrary to the public interest.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(f).

Objectives of Part IIIA of the CCA

In light of my finding on the criterion in paragraph (a) of subsection 44H(4), I consider that a decision not to declare the service would be consistent with the objects of Part IIIA of the CCA.

Economical to develop another facility that could provide part of the service

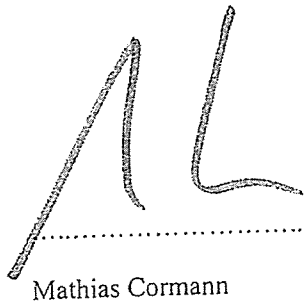
Subsection 44H(2) provides that, in deciding whether to declare a service or not, I must consider whether it would be economical for anyone to develop another facility that could provide part of the service.

I agree with, and have accepted, the NCC's conclusion that it may be possible that berthing facilities might be developed in conjunction with the construction of additional coal terminal facilities which could provide part of the service.

However, I also agree with the NCC that there is sufficient uncertainty about the timeframe on which these facilities might be built and whether they would be profitable that it cannot be concluded at this point in time that it would be economical for anyone to develop another facility to provide part of the service.

Conclusion

I am not satisfied that increased access to the shipping channel service would promote a material increase in competition in any market, as required by paragraph (a) of subsection 44H(4) of the CCA. Accordingly, I have decided not to declare the service.



Mathias Cormann

Acting Treasurer

Dated: 8 /11 /2016