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Lodgment and Details

Document Lodged:	Expert Report
File Number:	ACT 2 of 2020
File Title:	Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020
Registry:	VICTORIA – AUSTRALIAN COMPETITION TRIBUNAL

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Dated: 28/06/2021 9:15 AM

Important information

This Notice has been inserted as the first page of the document which has been accepted for electronic filing. It is now taken to be part of that document for the purposes of the proceeding in the Tribunal and contains important information for all parties to that proceeding. It must be included in the document served on each of those parties.

Synergies
ECONOMIC CONSULTING

Expert Report of Euan Morton

Public Benefits of Collective Bargaining at Port of Newcastle

25 June 2021

Synergies Economic Consulting Pty Ltd
www.synergies.com.au

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Figures and Tables

1 Introduction

1.1 Preliminaries

1. My name is Euan Pye Morton of Level 3, 10 Felix St, Brisbane, Queensland.

2. I hold bachelor degrees in Commerce, Law (Honours) and Economics (First Class Honours). I was admitted as a Solicitor to the Supreme Court of Queensland in 1991.

3. From 2004 to the present, I have been a Principal of Synergies Economic Consulting (Synergies). In my role as Principal of Synergies, I advise on a range of economic issues relating to infrastructure and economic policy. I have particular expertise in advising on access to transport infrastructure in the resources industry, including access pricing. My CV is attached as Appendix A to this report.

1.2 Instructions and assumptions

4. I have been engaged by Clifford Chance on behalf of the New South Wales Minerals Council (NSWMC) to assist in relation to ACT 2 of 2020 – Application by Port of Newcastle Operations Pty Limited, being a review by the Australian Competition Tribunal (ACT) of a determination made by the Australian Competition and Consumer Commission (ACCC) to authorise the NSWMC and other mining companies to negotiate collectively with Port of Newcastle Operations Pty Limited (PNO) in relation to the terms and conditions of access, including price, to the Port.

5. At the end of 2019 PNO invited coal producers, vessel agents, vessel operators and FOB coal consignees to enter into bilateral long term discounted pricing arrangements (or deeds). The deed offered to producers (the Producer Deed) includes discounted navigation service charges and wharfage prices set by PNO. It is the terms and conditions of this Producer Deed that the Applicants seek to collectively negotiate with PNO.[1]

6. In this context, I have been instructed to provide a report on:

[1] ACCC (2020); Determination – Application for authorisation AA1000473 lodged by NSW Minerals Council and mining companies; 27 August 2020; Paragraph 1.20.

a. my view on the report prepared by Dr Rhonda Smith, particularly in relation to the types of public benefits and public detriments that may be expected to accrue from collective bargaining arrangements; and

b. my view of how PNO may be expected to act in setting prices and negotiating access, given its economic circumstances and incentives. In addressing this issue, I consider whether the terms of the Producer Deed provide an opportunity for PNO to exert market power, consistent with its incentives, and whether this could lead to inefficient outcomes.

My instructions are attached as Appendix D.

7. My report is structured in order to sequentially address these questions.

8. Under my direction, Synergies has previously prepared a range of reports in relation to negotiations between coal producers and PNO for access to services at the Port of Newcastle (listed in full in Appendix B), including:

a. for Glencore Coal Pty Ltd (Glencore), a report prepared in 2015 in relation to its application for the declaration of channel services at the Port of Newcastle;

b. also for Glencore, a series of reports to the ACCC during 2018 in relation to an arbitration between Glencore and PNO in relation to the charges to apply for Glencore's use of the (then) declared channel service at the Port of Newcastle;

c. also for Glencore, a series of reports to the National Competition Council (NCC) over the period 2018-2019 in relation to PNO's application for the declaration of channel services at the Port of Newcastle to be revoked; and

d. for the NSWMC, a report to the NCC in 2020 in relation to the NSWMC's application to the NCC for declaration of channel related services at the Port of Newcastle.

9. The reports referred to in Paragraph 8(a), (c) and (d) address in detail a number of issues relevant to responding to my instructions. I have attached these reports to this report and referred to them where applicable in this report. A list of further materials supplied to me for the purpose of preparing my report are shown in Appendix C. Other materials that I have relied upon are identified in footnotes.

10. I acknowledge that my opinions are based wholly or substantially on my specialised knowledge arising from my training, study or experience. I acknowledge that I have read the Federal Court's Expert Evidence Practice Note and the Harmonised Expert Witness Code of Conduct and agree to be bound by them. I have made all the inquiries which I believe are desirable and no matters of significance which I regard as relevant have, to my knowledge, been withheld.

2 Review of report of Dr Rhonda Smith

11. I have reviewed the report of Dr Rhonda Smith.

12. I concur with Dr Smith's conclusions on the market(s) relevant to a consideration of the authorisation application, in particular that there is a relevant market for access to or supply of port services in the Port of Newcastle for the export of coal [Dr Smith ¶24]. I also agree that there are other markets which may be affected, albeit to a lesser extent, by the conduct for which access is sought. I consider that these will include the markets that were identified as relevant markets (other than the market for the service) in relation to the assessments of the declaration of services at the Port of Newcastle[2], with the most relevant of these being the market for the export of thermal coal in the Asia Pacific region, and the market for thermal coal tenements in the Newcastle catchment area [Synergies 2018a s3.2.1-3.2.2 and Synergies 2018b s2.2.1].

13. I agree with Dr Smith's assessment of the economic principles relevant to identifying public benefits, as well as identifying when a benefit is private rather than public, and when a benefit is both private and public. In particular, I agree that conduct that has the effect of promoting economic welfare will result in both a private and public benefit [Dr Smith ¶32], and that conduct that improves economic efficiency is welfare enhancing and will generate a public benefit [Dr Smith ¶42]. In this regard, I consider that economic efficiency will include consideration of transactional efficiency, productive efficiency, allocative efficiency and dynamic efficiency.

14. I also agree with Dr Smith's assessment of the economic principles that apply in relation to collective bargaining conduct and her assessment of the public benefits and public detriments that would be likely to result from collective bargaining conduct in general, and in particular from the collective bargaining conduct proposed by the mining companies in relation to Port of Newcastle. I support her view that the proposed conduct is likely to result in:

    a. transaction costs savings [Dr Smith ¶70-75];

    b. more efficient contractual outcomes, with collective bargaining: helping to address the imbalance of bargaining power for users negotiating with a monopoly service provider which in turn should produce more efficient outcomes [Dr Smith ¶78]; allowing mining companies to be better

[2] NCC, Declaration of the shipping channel service at the Port of Newcastle, Final recommendation, November 2015; NCC, Revocation of the declaration of the shipping channel service at the Port of Newcastle, Recommendation, July 2019; NCC, Application for declaration of certain services at the Port of Newcastle, Recommendation, December 2020.

informed in their negotiations thereby providing a better basis for decision making by both parties [Dr Smith ¶80, 86]; ultimately providing a positive incentive for investment by all parties (including PNO) as well as greater ability to invest [Dr Smith ¶85]; and

c. there is little, if any, public detriment likely to result from collective negotiation of these matters [Dr Smith ¶98].

3 PNO's incentives

15. PNO is a commercial entity, with an incentive to maximise profits when setting access charges. In order to properly appreciate the scope for inefficient outcomes to occur in the absence of the proposed collective bargaining conduct, an understanding of PNO's profit maximising incentive, and the behaviours that most effectively reflect this incentive, is critical.

16. In this regard, as I discuss in this section:

    a. Notwithstanding that PNO is heavily reliant on coal throughput for its revenue and profit, PNO's profits will be most effectively maximised through increasing prices and accepting any likely consequential impact on existing coal volumes. Moreover, existing constraints on PNO's ability to significantly increase prices are weak; and

    b. PNO is preparing for a significant decline in coal trade through Newcastle, and is actively seeking to develop a container terminal in order to provide the port with a 'life after coal', despite the ongoing debate around the economic efficiency of such investment at the present time.

3.1 PNO's pricing incentives

17. The shipping channel is a bottleneck which all coal producers in the Newcastle catchment must use in order to gain access to export coal markets – that is, the shipping channel is an essential facility such that the service provided by the facility is a natural monopoly. This accords with the Tribunal's 2016 determination which indicated that:[3]

> …the Service providing access to the shipping lanes is a natural monopoly and PNO exerts monopoly power; the Service is a necessary input for effective competition in the dependent coal export market as there is no practical and realistically commercial alternative…

18. It is a well-known economic result that a monopolist will increase prices whenever demand is inelastic, and that the profit maximising price will depend on the elasticity of demand and marginal cost.[4] Intuitively, if demand is inelastic,

[3] Australian Competition Tribunal (2016), *Application by Glencore Coal Pty Ltd* [2016] ACompT 6, p.23

[4] For a discussion of monopoly behaviour over time, see Dennis W. Carlton and Jeffrey M. Perloff (2005), Modern Industrial Organization, p.94.

then irrespective of costs, that means that a percentage price increase will always exceed the percentage decrease in demand, so that the percentage change in revenue will be positive. Put another way, a monopolist always has an incentive to price on the elastic part of the demand curve because the profit maximising price is not reached until demand reduces. Although the simple monopoly textbook model may not exactly apply, the basic principle of increasing prices if demand is inelastic should not be controversial. [Synergies 2018a s2.3.1 and Synergies 2019a s2.5.1]

19. PNO has previously claimed in submissions to the NCC that its reliance on coal volumes and the existence of spare capacity meant that it was incentivised to encourage growth in order to benefit from increased volume and revenue.[5] I agree that, at any given price, PNO will have a preference for, and will benefit from, increased volume. However, standard economic theory shows that it will achieve a greater benefit by increasing its price (at least until it begins to restrict volume), as coal demand has only a limited responsiveness to port prices. [Synergies 2018a s2.3.2 and Synergies 2019a s2.5.1] Moreover, as PNO has the ability to offer lower port charges to new or prospective mines, it has the ability to ameliorate the impact of price increases to existing customers (whose investment in their coal mines is sunk) on future volumes.

20. Using extensive quantitative analysis and reliance on standard, well accepted economic principles, Synergies' previous reports demonstrated that PNO's profit maximising incentive will be most effectively met by raising access prices (and accepting any likely consequential impact on volume) rather than by maintaining lower prices in order to attract additional volume [Synergies 2018a s2.3.3 and Synergies 2019a s2.5.1]:

    a. Synergies has previously examined PNO's profit incentives by modelling revenue and volume scenarios under different port access price levels of: (1) no increase in prices, (2) a $1.50/t price increase; and (3) a $3/t increase.[6] The results showed that, even factoring in the potential loss of volumes under low coal price scenarios, each access price increase would be expected to strongly increase revenues;

    b. PNO's cost structure is likely to be substantially fixed over a wide volume range, meaning that it is reasonable to assume that, over the foreseeable

[5] Port of Newcastle Operations (2020), Submission on the NSWMC application for a declaration recommendation in relation to services at the Port of Newcastle, 26 August, p.4.

[6] Synergies (2018a), p.29.

volume range, a change in PNO revenue will be fully reflected (or almost fully reflected) as a change in profit;

c. This demonstrated that a $3/t access price increase would have a strongly positive impact on PNO profits (even factoring in potential declines in volume). Synergies did not seek to quantify the ultimate binding constraint on PNO in terms of the highest profit maximising access price that could theoretically prevail. Recognising this, in a subsequent report, Synergies considered increases of up to $15/t and found that only under a coal price assumption of $75/t would profit start to decline with an access price increase of $12.50.[7] I acknowledge that this analysis is not precise, and that the profit maximising price for the service will vary over time as coal prices, exchange rates and production costs change. Nevertheless, this approach provided an indication of the likely magnitude of price increases that could be applied in order to maximise PNO's profits.

21. The discussion above assumes that a transparent, uniform price is applied for access to the channel service by coal companies, as has historically been PNO's practice. However, in 2019, PNO invited coal producers, vessel agents, vessel operators and FOB coal consignees to enter into bilateral long term discounted pricing arrangements (or deeds). As a result, PNO will be able to bilaterally negotiate with each user and is able to agree and modify (when required) access terms as per the user's circumstances. This raises the possibility of PNO applying price discrimination between different coal users.[8]

22. A monopolist that is able to price discriminate is able to set different prices for different users in order to extract the maximum possible economic surplus from them while minimising the negative impact on demand. [Synergies 2018a s2.3.2 and Synergies 2020 s.3.1] This reflects that the value from investing in coal mining derived by a coal producer is specific to each user (for instance, due to coal miners not having uniform costs of production, transportation cost would vary depending on the location of their mine, and quality or grade of coal produced could vary between mines (as is the case for the Hunter Valley coal producers). [Synergies 2020 s3.2] In particular, the demand from new users (who are yet to invest in mine development) will be significantly more sensitive to port

[7] Synergies (2019a), p.20.

[8] Item 5 of the Annexure to the Producer Deed includes provisions for non-discriminatory pricing, however questions have been raised as to the efficacy of this provision, see ACCC Statement of Facts, Issues and Contentions ¶81.1, New South Wales Minerals Council's Statement of Facts, Issues and Contentions, ¶85. This is discussed further in section 4.2.5.

charges than will the demand from existing users, whose investment in coal mining facilities and infrastructure are sunk. [Synergies 2018a s2.3.3 and Synergies 2019b s.2.2] As a result, price increases are more likely to discourage volumes from new users (who are yet to invest in mine development) than from existing users. If PNO is able to price discriminate, it could raise prices for existing users (whose demand is not sensitive to price) but offer discounts to new mine projects so as not to discourage their development. That is, key concern relates to the port's ability to ensure that its pricing framework for any new mine does not impede that mine's development.

23. Existing constraints on PNO's ability to significantly increase prices are generally accepted to be weak [Synergies 2018a s.2.3.4]. Since the revocation of the previous declaration of PNO's channel service under Part IIIA of the *Competition and Consumer Act 2010*, there is no regulatory oversight of PNO's pricing, and consistent with the NSWMC understanding, I am not aware of any present intention of the NSW Government to put in place any form of regulatory oversight for access charges at the port.[9] While PNO has proposed the development of long term discounted pricing arrangements (or deeds), as I discuss in section 4.2, the Producer Deed as currently offered does not provide pricing certainty or act as an effective constraint on price increases that PNO may apply.

24. In the absence of an effective constraint on the price increases that PNO may apply (for example through a clear commitment in the Producer Deed) market participants will necessarily have regard to the risk that, in future, significant price increases may be imposed. In these circumstances, it is inevitable that potential investors will base their investment decisions on conservatively high estimates of potential PNO charges, given its pricing incentives and constraints, as described in this section. [Synergies 2018a s.2.3.5]

3.2 PNO's incentive to diversify trade

25. The Port of Newcastle is the world's largest coal port, exporting over 165 million tonnes of coal in 2019, with coal exports representing over 96% of all commodities handled at the Port of Newcastle.[10] However, since the 2014 privatisation of Port of Newcastle, the long term outlook for thermal coal has become increasingly pessimistic, with climate change policies and reduced costs

[9] NSWMC's Statement of Facts, Issues and Contentions, ¶52

[10] See Port of Newcastle 2019 Trade Report, available at https://www.portofnewcastle.com.au/wp-content/uploads/2020/05/Port-of-Newcastle-Annual-Trade-Report-2019.pdf [accessed 22 June 2021].

of renewable energy driving rapid transformation away from the use of coal for electricity generation in many global economies.[11]

26. Reflecting this, PNO is preparing for a significant decline in coal trade through Newcastle, and is actively seeking to diversify its trade to provide the port with a 'life after coal'. This is a key factor driving PNO's proposed development of a container terminal at the Port,[12] notwithstanding the ongoing debate around the economic efficiency of such investment at the present time, given the timing required for development of additional container terminal capacity in NSW together with the alternate options available for creating such additional capacity.[13] In this regard, a report prepared by KPMG on behalf of NSW Ports concludes that new container terminal capacity is not needed in NSW for several decades at least, and that premature development of a new terminal would increase costs across the entire NSW supply chain.[14]

[11] IEA (2020), World Energy Outlook 2020, available at https://www.iea.org/reports/world-energy-outlook-2020?mode=overview [accessed 24 June 2021].

[12] See for example Sky News (2021), Federal court to rule on restrictions blocking a Port of Newcastle container terminal, 13 March 2021. See https://www.skynews.com.au/details/_6239743863001 [accessed 24 June 2021].

[13] See for example FreightWaves (2019), Port Report: State government sticks with decision to cripple the Port of Newcastle, 12 July 2019. See https://www.freightwaves.com/news/state-government-sticks-with-decision-to-cripple-the-port-of-newcastle [accessed 22 June 2021].

[14] KPMG (2019), Quay Conclusions – Finding the best choices for additional port capacity in NSW, February 2019, p.72.

4 PNO's behaviours reflect its incentives

4.1 PNO's past pricing practices

27. In the previous section, I discussed PNO's incentives as a commercial (profit maximising) monopolist and identified the behaviours that I considered would most effectively reflect these incentives given its economic circumstances. As I discuss in this section, evidence available to me indicates that to date PNO has demonstrated a willingness to exercise its market power for its commercial benefit.

28. PNO publishes on its website a schedule of service charges that it has powers to levy under Part 5 of the *Ports and Maritime Administration Act 1995* (NSW) (PAMA Act), including a navigation service charge and a wharfage charge. Under the PAMA Act, PNO can set these charges without Ministerial approval, and is not required to consult or negotiate with users in relation to these charges. PNO varies these charges from time to time, usually annually from 1 January each year.

29. PNO has operated the Port of Newcastle since May 2014, under a 98-year lease from the State of NSW. An examination of PNO's pricing schedules since assuming operation of the port[15] shows that PNO has substantially increased port access charges for coal vessels through the application of annual price indexation (broadly reflecting CPI) combined with a number of large one-off price increases as follows:

    a. from the beginning of 2015, PNO introduced differential charges between coal and non-coal vessels, and increased navigation services charges for coal vessels by between 40% and 60% (depending upon vessel type); and

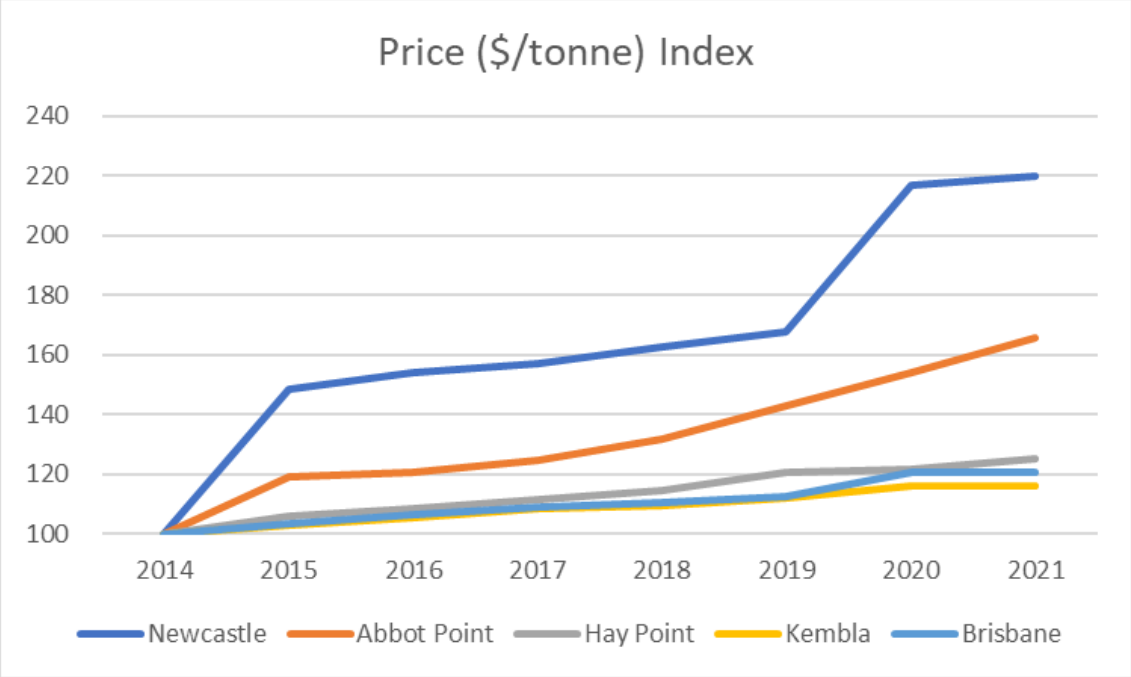
    b. from the beginning of 2020, PNO increased the navigation services charge for coal vessels by a further 33.5%.

[15] PNO's current port pricing schedules is available on PNO's website, see https://www.portofnewcastle.com.au/wp-content/uploads/2020/12/Schedule-of-Charges-2021-FINAL-.pdf. Previous port pricing schedules available via Wayback Machine web archiving service.

30. In total, since assuming operation of the port, PNO has increased port access charges by up to 120%,[16] while CPI has increased by only 11.9% over this same period.[17]

31. Further, PNO's price increases over this time have far exceeded those that have been applied by other Australian coal ports, as shown in Figure 1.

Figure 1 Price ($/t) index for Australian coal ports



Source: Synergies Economic Consulting

Note: Price index calculated for Panamax vessel; Comparator ports include all Australian coal export ports with published prices, Port of Gladstone not included as prices are not published

32. These price increases have not been associated with any increase in productivity, efficiency or service provided by PNO, and nor were they imposed for the purpose of funding any further investment in the services provided at the port.[18]

33. In my opinion, PNO's past behaviour of applying repeated significant real price increases, unrelated to changes in service levels or requirements for further investment in the services, is consistent with the behaviour that I would expect from a commercial (profit maximising) monopolist in its position (as described

[16] Synergies Economic Consulting Port Price Benchmarking Model, price change calculated for Panamax vessel

[17] Australian Bureau of Statistics, Consumer Price Index Australia; % change from Mar 2014 to Mar 2021; see https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/mar-2021 [Accessed 24 June 2021]

[18] New South Wales Minerals Council's Statement of Facts, Issues and Contentions, ¶45

in section 3) and reflects an exercise of market power for PNO's commercial benefit.

4.2 Behaviour permitted under the proposed Producer Deed

34. In the previous sections, I have discussed PNO's incentives as a commercial (profit maximising) monopolist, identified the behaviours that I considered would most effectively reflect these incentives given its economic circumstances, and shown how PNO's past actions are consistent with these behaviours, reflecting an exercise of market power.

35. As an alternative to its published schedule of charges, at the end of 2019, PNO invited coal producers and other port users to enter into bilateral long-term discounted pricing arrangements (or deeds), with the proposed Producer Deed offering navigation services charges and wharfage charges at a discount to PNO's published charges. I presume that the intent of these long term deeds is to provide users with greater certainty and confidence as to their ongoing port charges.

36. I have reviewed the terms of PNO's proposed Producer Deed and, in my opinion, the proposed deed offers only limited certainty and confidence as to ongoing port charges and provides considerable opportunity for PNO to continue to exercise market power in the setting of port charges. This section explains the reasons for my view.

4.2.1 Price adjustment provisions do not provide pricing certainty

37. The Producer Deed includes provisions governing prices in its Annexure as follows:

    a. Item 4 provides for Schedule 2 to include the initial specification of the Producer Specific Charges, being the navigation services charge and wharfage charge; and

    b. Item 7 sets out how the Producer Specific Charges will vary over the term of the Deed, through the following adjustments:

        i. Item 7(a) provides for an annual adjustment whereby each Producer Specific Charge will be increased by the greater of CPI or 4%; and

        ii. Item 7(b) provides that, in addition to the annual adjustment, a further increase may be applied where the increase is Material

(being an increase of more than 5%) and the increased Producer Specific Charges are consistent with the Pricing Principles (as specified in Clause 4.2 of Schedule 3).

38. While Item 7(a) provides for a defined price path over the term of the deed, this is in effect negated by Item 7(b) which permits PNO to adjust prices to a level consistent with the Pricing Principles. To the extent that PNO assesses that the Pricing Principles would support a price materially higher than the 'discounted' prices specified in the deed, then this provision would enable PNO to immediately increase the prices to that level. In the event of a dispute, an arbitrator must apply the Pricing Principles.

39. Although the Pricing Principles largely address similar matters to those that the ACCC must take into account resolving a pricing dispute under Clause 44X of Part IIIA of the *Competition and Consumer Act 2010* (CCA) (including the pricing principles specified in Clause 44ZZCA), the Pricing Principles do not address all of the matters included in the CCA,[19] and in any case the drafting varies from that in the CCA with the result that different interpretations are possible, and, indeed, likely.

40. Even if the Pricing Principles were fully consistent with the relevant provisions of the CCA, which they are not, the matters that the ACCC must consider under Clause 44X are specified at a high level only, with a significant range of prices that may be claimed as consistent with these principles. This is evidenced by the various proposals and determinations in relation to the access dispute between PNO and Glencore in relation to the provision of channel services:

Table 1 Port charges considered in PNO/Glencore arbitration (2018 $s)

	Navigation Service Charge $/GT	Wharfage Charge $/tonne
PNO submitted position	$1.3643	$0.0746
Glencore submitted position	$0.4139	$0.0746
ACCC determination	$0.6075	$0.0746
ACT determination	$1.0058	$0.0746
ACT re-determination	TBA	TBA

Source: ACCC Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd, p.7; Australian Competition Tribunal (2019), *Application by Port of Newcastle Operations Pty Ltd* [2019] ACompT 1, p.132.

[19] The Pricing Principles do not include a principle equivalent to Clause 44X(e) of the CCA, which requires that consideration of the value to the provider of extensions (including expansions of capacity and expansions of geographical reach) whose cost is borne by someone else.

41. Importantly, leaving aside the inconsistency between the Pricing Principles and Clause 44X of the CCA, the determination of a price for Port of Newcastle channel services consistent with the requirements of Clause 44X of the CCA is not yet resolved, with an appeal of the ACT determination to the Full Federal Court resulting in an order that the ACT determination be set aside and reconsidered by the ACT, particularly in relation to the treatment of user funded assets.[20]

42. In any case, there is not sufficient specificity in the articulation of the Pricing Principles to give coal producers confidence that PNO's interpretation of the Pricing Principles will adhere to established regulatory interpretation.

43. As a result, I consider that the price adjustment provisions in the Producer Deed, as currently drafted, establishes a large and uncertain range within which PNO may set prices within the term of the Deed.

4.2.2 Pricing Principles could enable PNO to set prices above an efficient price

44. The concept of what price reflects an efficient price has been considered extensively in economic regulation. While it is not possible to precisely define a single efficient price for a service, it is possible to identify boundaries beyond which prices are clearly inefficient. In general terms, the maximum efficient price is considered to be the price that would by charged by a hypothetical new entrant providing an equivalent service, although the hypothetical new entrant's price may need to be adjusted to reflect actual circumstances in which the service is provided. Economic regulation (including the requirements of Clause 44X of the CCA together with the body of regulatory precedent developed in the application of these requirements) is designed to constrain the application of clearly inefficient prices.

45. As noted above, the Pricing Principles included in the Deed largely address similar matters as Clause 44X and 44ZZCA of the CCA, but vary in their drafting. A particular issue is that the Pricing Principles include specific requirements regarding the recovery of PNO's costs (in 4.2(b)(i)-(iii)) that are not included in the CCA:

    a. Through Clause 4.2(b)-(d) of the deed's Pricing Principles, PNO will have an opportunity to recover (from all users of the service) the efficient cost of the service provided at the Port of Newcastle, which recovery shall

[20] Federal Court of Australia (2020), *Glencore Coal Assets Australia Pty Ltd v Australian Competition Tribunal [2020] FACF 145*

include a return on and of its Initial Capital Base, and any updates thereof, including efficient additional capital investments.

b. The Initial Capital Base is defined in the Pricing Principles as 'the value established by reference to the depreciated optimised replacement cost as at 31 December 2014 of the assets used in the provision of all of the services at the Port of Newcastle and, unless otherwise agreed, without deduction for user contributions'.

46. I consider that these provisions could have the effect of allowing PNO to set prices above an efficient price for the reasons described below.

No specification of cost allocation principles

47. The Pricing Principles require, through Clause 4.2(b)(iii) that PNO have the ability to recover costs that include the return over the Leasehold Period of the total value of the assets comprising its Initial Capital Base and any updates thereof, including efficient additional capital investments. PNO's definition of the Initial Capital Base includes assets used in the provision of all of the services at the Port of Newcastle (emphasis added), not just those services which are provided to mining companies. Further, the inclusion of efficient additional capital investments relates to all capital investments undertaken (including potentially investments that are not in any way relevant to the provision of services to the coal producers). The Pricing Principles do not limit capital investments to those undertaken by PNO and it is not inconceivable that this could be interpreted to include user funded investments in the provision of port services (as discussed below).

48. While the service that PNO provides to coal mining companies is limited to navigation and (some) wharfage services, PNO provides more extensive services to other users. For example, PNO provides a number of common user wharves, whereas the wharves used by coal producers are all privately owned. Further, in the event that PNO develops a container terminal as planned, the extent to which the assets will be provided by PNO or a terminal operator is not yet known.

49. However, notwithstanding that there is the potential for PNO to incur significant costs for the purpose of providing services that are not required by the coal producers, PNO's Pricing Principles do not limit in any way the allocation of costs to coal services.

50. This is of particular concern given PNO's stated desire to develop a container terminal at the Port, notwithstanding the ongoing debate around the economic

efficiency of such investment at the present time, as discussed in section 3.2. I acknowledge that a commercial entity with a profit maximising incentive would not normally have an incentive to invest in a development project that is not economically viable. However, the ability for PNO to fund such investment in part through higher charges for coal users has potential to distort this incentive. This is particularly the case given the limited expected life of PNO's coal trade, with the NSWMC reporting PNO to have publicly stated that coal industry operations in the Hunter Valley have a 15-year timeframe.[21] The potential impact of such an investment on port charges to coal users could be substantial – for example, if the development of a container terminal caused the inclusion of an additional $2 billion in the asset base used to determine charges for coal users, this could increase navigation service charges by more than $0.80/GT[22], and could double the initial navigation service charge proposed in the Producer Deed.

51. Floor and ceiling pricing limits (respectively based on the incremental cost and the stand alone cost of providing the required service) are a feature of many access regimes, and are designed to exclude any prices that are clearly inefficient and to prevent inefficient cross subsidy between services. These concepts are described as follows:

> … the stand-alone cost of any service or group of services of an enterprise is the cost of providing that service (at the existing or "test" demand level) or group of services by themselves, without any other service that is provided by the enterprise. A closely related concept is that of "incremental cost". The incremental cost of a service or group of services is the additional cost of providing that service or group of services over and above the cost of providing all the remaining services.[23]

52. Charging prices that are above the stand alone cost of providing a service results in economic inefficiency. Further, if charges for one user (or group of users) are above the stand alone cost of their services, and charges for another user (or group of users) are below incremental cost, then this results in inefficient cross

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[21] NSWMC's Statement of Facts, Issues and Contentions, ¶4(c)

[22] The inclusion of an additional $912m of user funded assets through the ACT's determination of the PNO/Glencore access dispute resulted in the navigation services charge for coal vessels increasing by $0.3983/GT (2018 $s) (see Australian Competition Tribunal (2019), *Application by Port of Newcastle Operations Pty Ltd* [2019] ACompT 1). Assuming the same relativities were to apply, the inclusion of an additional $2 billion in the asset based used for determining charges for coal vessels could increase the navigation services charge by $0.87/GT.

[23] G Faulhaber (1975); Cross-Subsidization: Pricing in Public Enterprises, American Economic Review, 65, 1975, pp.966-977. (This was cited as a seminal paper on productive efficiency by the ACCC in its August 2020 submission for the NSWMC's declaration application).

subsidisation between these users (or groups of users), which results in allocative and productive inefficiency.[24] In its arbitration of the PNO/Glencore access dispute, the ACCC confirmed that prices should not exceed stand-alone cost.[25]

53. By defining the Initial Capital Base and capital investment as that required for the provision of all services at Port of Newcastle, and not constraining the extent to which costs can be allocated to coal users to no greater than stand-alone cost, Clauses 4.2(b)-(d) of the Pricing Principles clearly permit inefficient pricing and cross-subsidisation between different groups of users to occur. While the Pricing Principles include provision (at Clause 4.2(k)) that prices should allow multi-part pricing and price discrimination where it aids efficiency, it is not clear whether this could prevent these inefficient pricing outcomes from occurring.

Allows for future depreciation of 'perpetual' assets

54. The Pricing Principles require, through Clause 4.2(b)(iii) that PNO have the ability to recover costs that include the return over the Leasehold Period of the total value of the assets comprising its Initial Capital Base and any updates thereof, including efficient additional capital investments (emphasis added). The Initial Capital Base is defined as the depreciated optimised replacement cost of the relevant assets, as at 2014.

55. While I consider that it would normally be uncontroversial that the efficient price for infrastructure services should provide for the return of the value of the assets over their useful life, this issue is complicated in the case of PNO by the large proportion of assets that have a 'perpetual' physical life. Provided that they are appropriately maintained, PNO's channels and breakwater assets can continue to be provided in perpetuity.

56. In its submissions to the ACCC for the purpose of the PNO/Glencore arbitration, PNO claimed that the perpetual nature of these assets meant that no depreciation should be recognised in the depreciated optimised replacement cost of these assets (which is the defined basis for valuing the Initial Capital Base).[26]

57. I consider that it is reasonable for PNO to take the view that, either:

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[24] G Faulhaber (1975); Cross-Subsidization: Pricing in Public Enterprises, American Economic Review, 65, 1975, pp.966-977.

[25] ACCC (2018); Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; 18 September 2018, p.172-173.

[26] ACCC (2018); Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; 18 September 2018; p.138.

a. these assets have a perpetual life, in which case it would be appropriate for PNO to not depreciate the assets; or

b. these assets have a finite economic life, in which case it would be appropriate for PNO to depreciate these assets over their finite useful life.

58. However, if PNO were to take the view that the assets had a perpetual life for the purpose of assessing the Initial Capital Base (thereby maximising the value of the Initial Capital Base by not recognising asset depreciation), but then subsequently adopt the view that the assets have a finite life and commence depreciating the assets after the Initial Capital Base has been set, then in my opinion this would act to inflate the price for the service, such that it will exceed an efficient price.

59. My view is consistent with the findings of the ACCC in relation to the PNO/Glencore arbitration, where the ACCC concluded that, in relation to the requirement that PNO reasonably recover its efficient cost, while in the case of perpetual assets the service provider does not receive an annual allowance for depreciation, it does receive an annual return on capital where the value of that annual return is higher in the case of perpetual assets as compared with depreciated assets. The ACCC considered that this would sufficiently ensure that the legitimate business interest of PNO would be met.[27]

No recognition of user contributions

60. PNO's definition of the Initial Capital Base specifies that, unless otherwise agreed, this value should be determined <u>without deduction for user contributions</u> (emphasis added). However, it is my opinion that, in the circumstances of the Port of Newcastle, where users substantially and transparently funded the initial development of assets, a price that includes return on and of those assets as if they were funded by the infrastructure provider is inefficient.

61. It is uncontentious that users have contributed an estimated 52.5% of PNO's channel assets and 61.3% of riverwalls and revetments, with an assessed value of $912 million (2018 $s).[28] The issue of how these user contributions should be reflected in efficient prices was a key issue of contention in the PNO/Glencore

[27] ACCC (2018); Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; 18 September 2018; p.186

[28] ACCC (2018); Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; 18 September 2018; p.137.

arbitration. The ACCC concluded that these user funded assets should be excluded from the asset based used for the determination of PNO's prices.[29] While this view was overturned by the ACT in its redetermination of the arbitration,[30] upon appeal, the Full Federal Court has concluded that the ACT erred in its decision and has required the decision be set aside and remitted back to the ACT for determination according to the law, including requiring it to give appropriate consideration to user funded assets.[31]

62. In doing so, the Full Federal Court has highlighted:

> … it may not be consistent with an economic understanding of efficiency for a provider to be able to charge the hypothetical price that would cover costs in a competitive market in a real world where those costs were being borne by others. In such a case, the value of the cost of capacity may be included in both the measure of costs in a hypothetical competitive market as well as being borne by other parties. It may be factored into market behaviour twice thereby leading to inefficiencies. They would be the same kind of inefficiencies that would flow if the provider was able to charge more than the competitive measure of the costs of providing the capacity. [32]
>
> …
>
> regard to the statutory object of promoting the economically efficient operation of, use and investment in the Port as the relevant infrastructure requires regard to whether part of the capacity has been provided by the contributions of users.[33]

63. Further, the Pricing Principles are unclear as to whether future user contributions could be incorporated into updates of the Initial Capital Base under Clause 4.2(b)(i).

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[29] ACCC (2018); Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; 18 September 2018; p.130.

[30] Australian Competition Tribunal (2019), *Application by Port of Newcastle Operations Pty Ltd* [2019] ACompT 1

[31] Federal Court of Australia (2020), *Glencore Coal Assets Australia Pty Ltd v Australian Competition Tribunal [2020] FACF 145*

[32] Federal Court of Australia (2020), *Glencore Coal Assets Australia Pty Ltd v Australian Competition Tribunal [2020] FACF 145*, ¶259

[33] Federal Court of Australia (2020), *Glencore Coal Assets Australia Pty Ltd v Australian Competition Tribunal [2020] FACF 145*, ¶291

64. By requiring that the value of the Initial Capital Base be determined without deduction for user contributions, I consider that the Pricing Principles provide for the determination of prices above an efficient level.

4.2.3 High cost to resolve dispute on Pricing Principles

65. The large and uncertain range within which PNO may set prices within the term of the Deed will provide PNO the opportunity to set a high price at the upper end of this range consistent with its interpretation of the Pricing Principles, with Producers' only option to challenge this via the Deed's Dispute Resolution Process set out in Schedule 4 of the Annexure, which provides for mediation followed, if required by arbitration. In resolving a pricing dispute, a mediator must take into account, and an arbitrator must apply, the Pricing Principles.

66. Where pricing principles are specified at a high level, with a wide variation in the prices that may be claimed to be consistent with those pricing principles, arbitration can be a risky, time consuming and expensive process. In this regard, I note that the ACCC's arbitration of a dispute PNO and Glencore in relation port charges remains ultimately unresolved, notwithstanding the ACCC was originally notified of the dispute on 4 November 2016.[34] While this arbitration has been delayed as the result of associated legal actions and appeals which may not be available in the event of a dispute under the Deed, it does provide an indication of the time that can be taken to resolve such a complex dispute. It also highlights the risks the parties face in an environment where there is uncertainty surrounding the basis of future price adjustments.

67. The Pricing Principles included in the Producer Deed do not reflect the outcomes of the ACCC's arbitration of the PNO/Glencore dispute, which resulted in a determination of the methodology and values to be used in setting a price for channel related services for coal users (most of which are no longer in dispute) consistent with the requirements of Clause 44X of the CCA. However, PNO requires these same issues to be re-prosecuted in individual arbitrations under each bilaterally negotiated Deed.

68. In my opinion, the large and uncertain range within which prices may be set in compliance with the Pricing Principles will increase the likelihood that pricing disputes will arise, which will only be able to be resolved via arbitration. Further, PNO's unwillingness to accept the ACCC's prior arbitral decisions on the

[34] ACCC (2018); Final Determination: Statement of Reasons – Access dispute between Glencore coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd; 18 September 2018; p.6.

methodologies and values to be used in setting a price for channel related services, together with its requirement that disputes on these issues be re-prosecuted in individual arbitrations under each Deed, is likely to result in very high transaction costs to resolve pricing disputes. These high transaction costs are likely to provide a disincentive for producers to dispute PNO's pricing changes, particularly for smaller producers with limited resources. The role collective bargaining by coal producers can play in reducing these transaction costs and thereby result in a public benefit is addressed in Section 5 of this statement.

4.2.4 Annual adjustment may not be cost-reflective

69. In the absence of PNO adjusting prices to reflect the Pricing Principles, Item 7 of the Annexure to the Deed provides that Producer Specific Charges will increase by the greater of CPI or 4%.

70. A price increase of 4% is materially higher than current inflation which, over the twelve months to March 2021, rose by 1.1%.[35] It is also materially higher than the RBA's long term inflation target of 2-3%.

71. Given the extent to which the required 4% annual price increase exceeds current and anticipated CPI, it is unclear whether this adjustment reasonably reflects anticipated changes in PNO's costs. Such an adjustment may be reasonable if the starting Producer Specific Charge is set at a discount to the full economic cost of service provision. However, in the event that Producer Specific Charges are increased during the term of the Deed to reflect the Pricing Principles, subsequent application of price indexation above the anticipated change in PNO's costs will result in increasingly inefficient prices.

4.2.5 Constraints on ability to price discriminate

72. Item 5 of the Annexure to the Deed includes provisions for non-discriminatory pricing. In particular, Item 5 includes a representation by PNO that:

    a. the pricing terms of the deed (Items 4 and 7) do not adversely discriminate against the Producer by comparison with Producer Specific Charges applicable to like circumstances to other Producers who have

[35] Australian Bureau of Statistics, Consumer Price Index Australia; see https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/mar-2021 [Accessed 24 June 2021]

entered into materially similar deeds, including as to the period of the Initial Term; and

b. PNO will not enter into bilateral arrangements with other producers concerning Producer Specific Charges to apply over the Initial Term, or give effect to variations to such charges under Item 7 which are materially different to those under the deed.

73. While the Deed includes these constraints on price differentiation, they are unlikely to be completely effective in preventing price discrimination emerging over time, as the non-discrimination provision does not apply in relation to Deeds entered into with a different Initial Term, and there is no obligation on PNO to retain this provision in future deeds. Therefore, I consider it likely that the use of bilaterally negotiated Producer Deeds will enable PNO to implement price discrimination, particularly between existing users and new coal developments, which will enable it to reduce the volume impact associated with price increases.[36]

74. However, this provision is likely to inhibit the ability of mining companies to negotiate changes in these pricing related provisions of the deed via bilateral negotiations. In my opinion, PNO will be less willing to vary provisions of the deed in one negotiation if similar changes are required to also be negotiated in all other Producer Deeds. This will particularly be the case if different and potentially conflicting changes are sought by different coal producers.

75. Further, in the event that the Deed is accepted by one Producer, PNO will be bound by its representation in that Deed not to vary from the pricing arrangements in Deeds subsequently negotiated with other Producers.

76. As a result, I consider that the constraints on price discrimination contained in the deed are likely to reduce the potential for effective bilateral negotiations.

[36] While I consider that PNO has an ability under the deed to price discriminate, I do not expect that it would be able to perfectly price discriminate in part due to the existence of some constraints on price differentiation, with the result that price discrimination would not be sufficient to achieve allocative efficiency. However, price discrimination as between existing and new users is feasible and can be used to minimise the impact of price increases for existing users on coal volumes from new mines being shipped through the port.

5 Implications

77. In the previous sections, I have discussed PNO's incentives as a commercial (profit maximising) monopolist, identified the behaviours that I considered would most effectively reflect these incentives given its economic circumstances, and shown not only how PNO's past behaviour is consistent with these behaviours, but also how PNO's proposed Producer Deed is ineffective in constraining these behaviours. In the event that PNO's proposed Producer Deed were to be implemented in its current form, for the reasons discussed in section 4.2, I consider that this would be likely to result in a range of inefficient outcomes, including:

    a. Producer Specific Prices set under the Deed are likely to exceed an efficient price, which will in turn reduce allocative efficiency, as described by Dr Smith [Dr Smith ¶39]. The efficiency losses associated with inefficient port pricing were discussed in some detail in my prior Synergies report [Synergies 2018a, s4.2];

    b. Where port prices currently or potentially exceed an efficient price (including as the result of the ineffectiveness of the Deed in providing an effective constraint on PNO's charges) the incentives for efficient investment by coal producers will be undermined. Substantial economic benefits are generated by additional investment in mining projects, as discussed in detail in my prior Synergies report [Synergies 2018a, s.4.3];

    c. Where port prices exceed an efficient price, this may result in some reduction in NSW coal production volumes. Synergies has previously shown that a fall in production from the coal sector will have a magnified effect on Gross State Product/Gross Regional Product, with a $100m fall in coal mining production (which is equivalent to a volume reduction of 1.3mtpa[37]) resulting in a $130.8m reduction in GSP/GRP. This is estimated to cause a corresponding fall in net employment of 472 people, and a reduction in household consumption of $51.1m [Synergies 2018a, p.78];

    d. To the extent that the Deed permits PNO to recover the cost of an investment in a new container terminal from coal users and this encourages PNO to accelerate the development of a container terminal, the Deed would promote inefficient investment by PNO;

[37] I have assumed a coal price of AU$70 per tonne in preparing this estimate.

e. The large and uncertain range within which prices may be set in compliance with the Pricing Principles will increase the likelihood that pricing disputes will arise, which will only be able to be resolved via arbitration; and

f. PNO's unwillingness to accept the ACCC's prior arbitral decisions on the methodologies and values to be used in setting a price for channel related services, together with its requirement that disputes on these issues be re-prosecuted in individual arbitrations under each Deed is likely to result in high transaction costs to resolve pricing disputes.

78. Further, I consider that the requirements in Item 5 of the Annexure to the Deed in relation to non-discriminatory pricing are likely to inhibit the ability of mining companies to negotiate changes in these provisions via bilateral negotiations, as PNO will be less willing to vary provisions if similar changes are required to also be negotiated in all other Producer Deeds. Further, in the event that the Deed is accepted by one Producer, PNO will be bound by its representation in that Deed not to vary from the pricing arrangements in Deeds subsequently negotiated with other Producers.

79. The extent of economic inefficiency likely to arise from the Producer Deed in its current form provides an indication of the scope for public benefits to be achieved from collective bargaining as identified by Dr Smith [Dr Smith ¶70-86], including as the result of transaction cost savings and more efficient contractual outcomes. While I am unable to predict the extent to which collective bargaining by mining companies will actually achieve more efficient outcomes, I consider that collective bargaining will significantly reduce the transaction costs associated with negotiating the Deed and, more importantly, present the best opportunities for the parties to negotiate a balanced contract that will prevent the emergence of future disputes by better articulating the circumstances triggering future price adjustments, and in that event, quantifying the impact on future prices. In the event that future disputes occur, collective bargaining will significantly reduce the transaction costs associated with resolving disputes that arise.

A Curriculum Vitae

Euan Morton

In brief

Euan Morton is a Principal of Synergies Economic Consulting and is a leading advisor on transport pricing and regulation. Euan's astute advice is repeatedly sought by clients due to his understanding of their interests and industries, his desire to advance those interests and his reputation for quick, effective and innovative solutions.

Euan's expertise and reputation is not limited to the transport industry. In 2015, Euan was appointed to an expert panel advising the COAG Energy Council on governance arrangements in Australia's energy markets. He previously served on an expert panel for the Ministerial Council on Energy in 2005 advising on network pricing in the energy industry Euan is also an Independent Expert under the National Electricity Rules. Euan is also a leading advisor in the water industry, most recently advising on governance arrangements for the Murray Darling Basin.

Skills and Capabilities

Pricing

Economic regulation advice

Competition policy

Economic policy advice

Expert statements and testimony

Qualifications

Bachelor of Economics (1st Class Honours), University of Queensland, 1994

Admission as a Solicitor, Supreme Court of Queensland, 1991

Bachelor of Law (with Honours), University of Queensland, 1988

Bachelor of Commerce, University of Queensland, 1986

Relevant experience – port access and pricing

NSW Minerals Council (NSWMC): prepared a report to support NSWMC's declaration application for the Port of Newcastle. It considered the implications of PNO's recent conduct to seek to negotiate bilaterally with coal producers and its actions to refuse to collectively negotiate with coal producers.

Dalrymple Bay Coal Terminal (DBCT) User Group: prepared a submission to the QCA on behalf of a group of DBCT Users in relation to the pricing methodology to be used for a proposed expansion of Dalrymple Bay Coal Terminal, addressing whether the criteria for a socialised pricing approach had been met.

Department of Infrastructure and Transport (SA): assisted with preparation of documentation necessary for the SA Government to apply for the recertification of the SA Port Access Regime by the National Competition Council (NCC).

Glencore: prepared a report evaluating the extent to which Port of Newcastle shipping channels meet the criteria for declaration under the National Access Regime, in the context of the Port of Newcastle's application for revocation of declaration.

Glencore: provided expert advice to support Glencore in the progress of the ACCC's arbitration of the dispute between Glencore and Port of Newcastle in relation to charges for use of the shipping channel, including application of the building block model for price setting.

Allens Linklater: assisted in the preparation of a series of expert reports in relation to the likely availability and cost of access to rail and port capacity for a proposed coal mine.

Queensland Commission of Audit – led the drafting of chapters on service provision and ownership for the transport and water sectors for the Commission. This included the chapters relating to the ownership and structure of the port sector in Queensland.

Sugar Terminals Limited – assisted with the negotiation of an option for the lease of its land based, wharf and jetty infrastructure at the Port of Lucinda, Port of Mackay, Port of Bundaberg and Cairns Port.

Sugar Terminals Limited – advised on the distinction between repairs and maintenance and capital costs from an accounting, economic and commercial perspective. This work extended to a detailed consideration of the incentive impacts of alternative treatments of operating and maintenance costs.

Sugar Terminals Limited – advised on the pricing arrangements for the use of its terminal infrastructure for other commodities, including a detailed review of the risk, commodity value and other factors affecting the pricing arrangements

Sugar Terminals Limited – advised on its negotiating strategy for the rental of its wharf at Cairns to the Royal Australian Navy (RAN). Our advice enabled STL to conclude its negotiations at a significant premium to the original ADF (approximately 300% higher)

Sugar Terminals Limited – advised on the pricing structures to be applied to the use of port infrastructure under different scenarios

Sugar Terminals Limited – advised on the valuation of port assets for pricing purposes

Sugar Terminals Limited – undertook an extensive review of the WACC. Our assessment of the issues was sufficiently rigorous to ensure that favourable WACC assessment ceased to be a contentious issue for the purposes of the rental negotiation under the sub-lease arrangement

CBH - Provided testimony to the Australian Competition Tribunal in relation to the public benefit from the co-ordination of logistics for the grain supply chain in Western Australia

CBH - advised on the economics of grain transport in Western Australia and the competition consequences of reforming a grain supply logistics chain through improving contractual interfaces and its implications for competition in the related transport and downstream grain marketing industries.

CBH - managed regulatory asset valuations for CBH's port terminals in conjunction with their ACCC access undertakings, including advising on the regulatory principles for conducting a DORC valuation, drafting the terms of reference for the asset valuation, supervising the asset valuation consultancy and providing expert input into the technical decisions that a regulator would make regarding the valuation

CBH - prepared a submission to the ACCC for Notification of conduct relating to the bundling of its handling and storage services with transportation for the purposes

CBH - developed ringfencing arrangements to address concerns regarding anti-competitive or inappropriate transmission of marketing information as part of the reform of the WA grain logistics chain

CBH - advised on the economic and commercial issues associated with developing an auction system for the allocation of port capacity in peak periods and advised on the arrangements that should be established to make the auction process efficacious

CBH - estimated an appropriate Weighted Average Cost of Capital (WACC) to apply when pricing access to its port terminal services by wheat producers;

CBH - assessed the operating costs for the CBH terminals, as well as quantifying a share of the head office costs that would be attributed to the terminal

CBH - advised on the adverse economic implications of failing to pursue network pricing in the WA grain supply chain in terms of the inefficient modal shift it would promote (shifting grain from rail to road)

Viterra – advised on its port pricing strategy and the factors that would be relevant to the substantiation of its prices in a regulatory process

Corrs Chambers Westgarth – advised on competition issues associated with the authorisation application by AWB and GrainCorp Operations to create and operate a joint venture to improve co-ordination in the movement of export grain.

Dalrymple Bay Coal Terminal – advised on the its strategy for seeking regulatory approval of a major capacity expansion, valued at over $1 billion, so as to minimise the risk of capex recognition and accelerate recovery of capex from users.

Dalrymple Bay Coal Terminal – prepared regulatory submissions for Dalrymple Bay Coal Terminal Management in conjunction with its successful regulatory submission pertaining to its 2010 access undertaking

Dalrymple Bay Coal Terminal – analysed expansion paths for DBCT and associated marginal and average cost in light of export coal market developments. This analysis also required an understanding of the interaction of the entire

coal chain and possible limitations this might place on achieving desired throughput

Dalrymple Bay Coal Terminal – identification and treatment of asymmetric risk associated with the provision of coal unloading, handling and loading services for regulatory purposes. This provided the perspective of users to a consideration of the regulatory treatment of asymmetric risk

Dalrymple Bay Coal Terminal – advised users of a port facility as to the likelihood of stranding risk in relation to potential expansions of the port infrastructure. This work included the development of a monte carlo simulation model to enable quantification of the stranding risk according to a range of input assumptions

Adani Abbot Point Coal Terminal – advised on the price review arrangements for the Terminal under the relevant contracts. This work involved applying the regulatory principles outlined in the contract to arrive at a price and to assist with negotiations with users

Adani Abbot Point Coal Terminal – prepared expert testimony for a pricing dispute between Adani Abbot Point Coal Terminal and users of the terminal. The expert statement addressed all of the issues relating to the assessment of a cost of service model being applied to a coal terminal, including capital expenditure, the cost of capital, operating and rehabilitation costs.

WICET – undertook a detailed study of the factors relevant to adopting a pricing structure and capacity accountability framework for WICET based on characteristics of usage as opposed to the traditional tonnage based port pricing approach. This enabled a pricing structure to be developed which incentivised the efficient utilisation of terminal capacity

Port Kembla Coal Terminal – assisted in advising Port Kembla Coal Terminal on the pricing issues associated with an expansion of the coal from 17mtpa to 26 mtpa.

Port Waratah Coal Services – advised on the pricing of terminal access, including the specification of capacity entitlements for terminal services and the manner in which those capacity entitlements should be priced. This work extended to the preparation of worked examples to explain the pricing structure

Australian Amalgamated Terminals – prepared an expert report for AAT in relation to the proposed declaration of its vehicle importation service at Fishermans Island

Port of Brisbane – reviewed proposed pricing policy related to ongoing capital expenditure and pricing structures designed to incentivise port productivity and efficiency.

Port of Brisbane – advised on regulatory issues surrounding the classification of port assets in the context of investing in a new transport corridor to enable the future construction of a freight-only rail line to the port.

Port of Brisbane – advised on channel valuation approaches are likely to be acceptable to an economic regulator, including advising on a number of detailed issues to inform the basis of the channel valuation (including, for example, the assumptions for the extent of dredging, the treatment of spoil, land reclamation issues etc).

Port of Brisbane – advised on the pricing approaches for use of its infrastructure, including determining the maximum allowable revenue for its services in a manner consistent with regulatory practice

Port of Brisbane – advised on the regulatory treatment of pre-development costs and pricing principles to be adopted for its future pricing arrangements

Port of Brisbane – advised on channel valuation approaches are likely to be acceptable to an economic regulator, including advising on a number of detailed issues to inform the basis of the channel valuation (including, for example, the assumptions for the extent of dredging, the treatment of spoil, land reclamation issues etc)

Port of Brisbane – provided advice on the costs of providing container services within a multi-user Multimodal Terminal at a port. The services provided by the terminal included container movements and container storage activities

Port of Townsville – advised on the commercial and regulatory issues associated with a major expansion of the port to accommodate projected coal throughput

Port of Townsville – advised on asset valuation approaches for regulatory purposes for all of its maritime and non-maritime infrastructure

Port of Townsville – advised on the reform of POTL's pricing strategy in order to transition to a commercial return on investment.

Port of Townsville – provided economic advice in relation to pricing of port services and performed a cost benefit analysis on the possible imposition of price regulation under the Queensland Competition Authority Act in regard to the

Townsville Port Authority – the resulting submission succeeded in demonstrating that there was no public benefit arising from referring the port for price control and a referral was not made

Ports North – undertook a strategic review of Ports North's current pricing practices having regard to all relevant legislative and regulatory issues

North Queensland Bulk Ports – advised on the regulatory approach to the treatment of contributed assets and assessed the status of financial contributions made by customers.

North Queensland Bulk Ports – advised on the competition and regulatory consequences of its proposal to impose certain conditions on the tender of a series of coal terminal development opportunities at Abbot Point.

North Queensland Bulk Ports – advised on the valuation of strategic port land, including undertaking a valuation of strategic port land using discounted cash flow based on projected demand and comparative supply chain costs and option valuation analysis

Ports Corporation Queensland – undertook a detailed assessment of the market power possessed by various ports controlled by a port authority which extended to landlord, tool and comprehensive ports;

Ports Corporation Queensland – advised on the competition and regulatory consequences of its proposal to impose certain conditions on the tender of a series of coal terminal development opportunities at Abbot Point

Ports Corporation Queensland – developed port charges that were consistent with regulatory benchmarks for Ports Corporation of Queensland in a pricing dispute with Xstrata concerning the Abbot Point Coal Terminal. Our work enabled PCQ to settle the pricing dispute on its preferred terms which was at a significant premium to Xstrata's original position. This was an intensive engagement and involved developing a detailed regulatory pricing proposal that met established regulatory standards, including:

- advised on a DORC valuation – we drafted terms of reference for the asset valuation, supervised the asset valuation consultancy and provided expert input into the technical decisions that a regulator would make regarding the valuation;
- the cost of capital – quantifying the cost of capital for the terminal in a manner consistent with regulatory benchmarks;
- the regulatory treatment of contributed assets;
- operating cost – an assessment of operating costs for the terminal, as well as quantifying a share of the head office costs that would be attributed to the terminal; and
- pricing structure.

Ports Corporation Queensland – completed an assessment of the case for economic regulation as required by Clause 4.1 of CIRA for the Ports Corporation of Queensland, including a detailed assessment of the market power possessed by the Ports of Weipa, Dalrymple Bay and Abbot Point. The submission was provided to Queensland Transport and was incorporated into a Queensland Government Report

Ports Corporation Queensland – advised a port on the regulatory treatment of contributed assets for its access negotiation strategy

Ports Corporation Queensland – benefits and costs of the Northern Missing Link (NML) - this work involved an assessment of the benefits of the NML in the context of the logistics chain as a whole comprehending the impacts across the whole of the Central Queensland coal system. Amongst the enhanced opportunities afforded by integrating the Newlands and Goonyella systems, the study identified and assessed the insurance benefits, congestion benefits (both in relation to the port and rail systems) and additional throughput benefits likely to arise from the NML.

Ports Corporation Queensland – undertook an analysis of the economic value of strategic port land and its application to commercial rental policies. This advice also included an assessment of options to maximise the returns from strategic port land in the face of constraints from economic regulation

Ports Corporation Queensland – performed a discounted cash flow valuation of strategic port land, taking into account demand, differential supply chain costs and real options values

Ports Corporation Queensland – advised on regulatory issues to assist in negotiations with users

Ports Corporation Queensland – advised on the pricing issues associated with the use of PCQ's port based infrastructure in Weipa, including asset valuation issues for infrastructure and channels and the regulatory approach to

contributed assets. Our advice assisted in the resolution of the dispute and the development of a new pricing agreement

Ports Corporation Queensland – advised on the regulatory approach to the treatment of contributed assets and financial contributions made by customers

Ports Corporation Queensland – advised on market definition and market power issues in connection with the provision of terminal services to a third party for the purposes of successfully defending a claimed breach of section 46 of the Trade Practices Act.

Ports Corporation Queensland – evaluated the commercial and financial feasibility of the conversion of a terminal to handle coal

Ports Corporation Queensland – prepared submissions in response to the Queensland Government's review of the Queensland Competition Authority Act 1987

Ports Corporation Queensland – undertook financial analysis of a proposed a business case for a new trade. This work included an assessment of returns against the risk of asset stranding

Ports Corporation Queensland – advised on the due diligence issues associated with a possible investment in a bulk storage facility

Ports Corporation Queensland – advised on planning decision making in the coal logistics chain which included advising on different planning models for infrastructure having regard to the experience in other sectors (including the various electricity transmission planning arrangements in place in Australia).

South Australian Department of Transport, Energy and Infrastructure – undertook a comprehensive port charges benchmarking exercise for the South Australian Department of Transport for a range of commodities in order to inform its proposed pricing approach for the Port Bonython facility

South Australian Department of Transport, Energy and Infrastructure – prepared an expert statement for the South Australian Department of Transport, Energy and Infrastructure in relation to a pricing dispute at the Port Bonython facility between the State and Santos. This expert statement involved undertaking an investigation of the appropriate charge to apply for wharfage dues at the facility, based on the terms of the initial agreement and economic pricing principles, including the development of a cost of service model to assess the likely charge that would be applied by an economic regulator.

Sydney Ports Corporation – estimated the economic impact of the Sydney Ports Corporation on the NSW economy

NSW Ports - advised a review of port charges at Port Botany and Port Kembla, including analysing constraints on pricing, assessing internal returns by segment, benchmarking of port charges, analysing port charges in the context of supply chain costs and surveying international port pricing practices in order to derive desirable options for price change

NSW Ports - Port Botany DORC - advised NSW Ports on a range of issues associated with its channel assets, with the objective of minimising future regulatory risk

NSW Ports - Port Kembla DORC - reviewed Arup's draft valuation report for Port Kembla, to identify any potential issues or concerns in terms of the application of standard regulatory valuation approaches.

Undertook regulatory due diligence for the successful bidder for the Port Kembla and Port Botany leases

FMG – prepared an expert report for FMG for its appeal to the Australian Competition Tribunal on the public issues involved in the declaration of services provided by rail infrastructure owned by Rio Tinto Iron Ore and BHP Billiton Iron Ore in the Pilbara region of Western Australia.

FMG – prepared a port access regime for Anderson Point that satisfied the State of Western Australia to enable FMG's commitments under State Agreements to be fulfilled

Murchison Metals – advised on the matters to be addressed in a port operator agreement

Murchison Metals – advised Murchison Metals Limited on port related access issues, including, likely regulatory requirements for the owner of the proposed Oakajee port in Western Australia and the optimal institutional and governance arrangements for the port

Murchison Metals – examined the costs and benefits of vertical integration of the supply chain for the proposed Jack Hills mine development (ie rail and port infrastructure) in Western Australia having regard to matters such as operational efficiency, financing costs, ease and speed of expansion and minimising the risk of opportunistic behaviour. This work also included a consideration of differing access and regulatory models and the differing impacts of those models on the

static and dynamic efficiency of the relevant logistics chain

Oakajee Port and Rail – advised on proposed pricing and regulatory approaches in conjunction with West Australian government proposals for the funding and charging of infrastructure at the proposed Oakajee port.

Oakajee Port and Rail – developed key principles for an access regime and associated logistics chain governance arrangements for the winning tender bid to develop 'greenfields' rail and port infrastructure for the Mid-West iron province in Western Australia

Oakajee Port and Rail – advised on the terms of its proposed port access regime with particular reference to the issues likely to emerge in the Government's assessment of the regime, including compliance with the Competition Principles Agreement

Oakajee Port and Rail – estimated the economic impact of the proposed port development at Oakajee

Australian Premium Iron Joint Venture – advised Australian Premium Iron Joint Venture on proposed pricing arrangements and charging structures at Anketell Pt

Port of Dampier – undertook a demand and pricing study and developed a pricing strategy to complement its study of market demand for services at the Port of Dampier in the context of the proposed major expansion of the port facility.

API Management – developed access pricing strategies for bulk commodity transport infrastructure. This involved developing/reviewing pricing objectives, service definition, the basis for pricing, and pricing strategies.

GIP – provided advice on economic regulatory issues associated with the Port of Brisbane, in the context of the due diligence process associated with the sale of GIP's equity stake in the port.

GIP – provided a comprehensive due diligence report for a bidder for the Port of Newcastle assets

Brookfield Infrastructure – prepared demand forecasts for Pacific National's intermodal rail business and undertook a detailed assessment of the supply chain for each major Australian port, including having regard to future expansion possibilities and the impact of bottlenecks. As part of this study, we also undertook a detailed assessment of rail vs road pricing for the intermodal business based on whole of supply chain costs.

Brookfield Infrastructure – undertook extensive due diligence work on rail and port regulation across Australia for Brookfield in conjunction with its proposed acquisition of Asciano

Brookfield Infrastructure – prepared advice for a client on the likely competitive impacts of a potential acquisition of Abbot Point Coal Terminal as part of the ACCC's mergers and acquisitions process

Brookfield Infrastructure – advised Brookfield in conjunction with its intended acquisition of Abbot Point Coal Terminal. This work included a detailed due diligence report that satisfied lender's due diligence requirements and the preparation of a report that satisfied the ACCC that the acquisition would not lead to a substantial lessening of competition (given Brookfield's ownership of the Dalrymple Bay Coal Terminal).

APLNG – assisted APLNG in its negotiations with the Gladstone Ports Corporation regarding future contractual arrangements at the port, in particular conducting a review of the proposed Port Services Agreement with an emphasis on the proposed Harbour Due Pricing Framework

Gladstone Port Corporation Users – advised the users of the RG Tanna coal terminal on channel charges

DBCT User Group – advised the users at the Dalrymple Bay Coal Terminal on costing approaches for the characterisation and allocation of capital and maintenance costs

DBCT User Group – assisted the Dalrymple Bay coal Terminal User Group in their negotiations with the lessee of the Dalrymple Bay Coal Terminal on general regulatory issues including on the costs of providing terminal services, the strategy for engagement with the regulator and on the likely outcomes of the regulatory process

DBCT User Group – advised on technical issues in relation to the valuation of assets for regulatory purposes – this work included managing an asset valuation process for the DBCT User Group and resolving the technical issues associated with optimisation and replacement cost issues

DBCT User Group – estimated the cost of capital for the Dalrymple Bay Coal Terminal;

DBCT User Group – developed and modelled a take or pay pricing structure for the Dalrymple Bay Coal Terminal

DBCT User Group – advised on capacity allocation and sharing approaches and prepared submissions to the ACCC in support of an authorisation application for the capacity allocation system; and

DBCT User Group – undertook a detailed study of the factors relevant to adopting a pricing structure based on characteristics of usage as opposed to the traditional tonnage based port pricing approach for a major coal terminal

DBCT User Group – developed pricing structures for use of the terminal. This advice resulted in the adoption of a cost reflective pricing structure that encourages users to efficiently utilise port capacity

DBCT User Group – advised on the appropriate form of contractual and incentive structures to be adopted and the advantages and disadvantages of alternative contractual and incentive structures

DBCT User Group – advised coal producers serviced by Dalrymple Bay Coal Terminal on the trade practices issues associated with seeking continued authorisation of a queue management system and assisting with the preparation of submissions to the ACCC

DBCT User Group – undertook a benchmarking study of port pricing arrangements for coal ports internationally for DBCT User Group

DBCT User Group – advised on the form of regulation to be applied. This work also involved a consideration of the advantages and disadvantages of applying differing forms of regulation from a user's perspective. In the case of DBCT, the most significant issues related to:

- minimising the risk that future investment in the terminal would be held up due to perceived stranding risk;
- developing a take or pay framework that provided incentives for users to minimise the gaming associated with contracting for future tonnages;
- other impacts, such as demurrage and the cost of capital.
- developing and modelling a take or pay pricing structure for the Dalrymple Bay Coal Terminal;

Anglo Coal Australia – infrastructure capacity procurement and contracting strategy - Developed a clear strategy for the expansion of Anglo's coal supply chain capacity. This was of particular importance given the capacity constraints that had been experienced through the Dalrymple Bay coal chain (and which were expected to continue) and the significant changes that may have arisen as a consequence of the change of ownership of key rail and port assets.

Anglo Coal Australia – prepared a submission on behalf of Anglo Coal Australia in relation to the proposed capacity allocation system for Dalrymple Bay Coal Terminal, again, this submission considered the issues associated with the economics of congestion in port relationships

Anglo Coal Australia – rail haulage procurement – advised on the key issues to be addressed in negotiating a rail haulage contract and assisted in the development of a strategy to procure rail haulage services

Anglo Coal Australia – real options – applied real options analysis to quantify optimal supply chain capacity procurement

Rio Tinto Coal Australia – prepared a submission on behalf of Rio Tinto Coal Australia in relation to the competition issues associated with a capacity allocation system at Port Waratah. This submission explicitly addressed the economics of congestion and the valuation of congestion relief enabled by the property rights changes proposed. The submission was crucial to gaining ACCC authorisation for the capacity allocation system

BHP Energy Coal – advised on port related issues associated with the assignment of capacity at a port. This work included a discussion of alternative capacity assignment mechanisms and assessed desirable approaches from the perspective of a new entrant into a system;

Aquila coal – provided expert testimony to support Aquila in a dispute with its joint venture partner regarding economic issues surrounding the availability of rail and port access for a proposed coal mine in central Queensland. This work involved assessing the supply chain constraints and availability of supply chain capacity for the mine to ship coal through coal terminals at Abbot Pt and Dalrymple Bay

Dalrymple Bay Coal Chain – chaired the Project Team charged with developing the "Long Term Solution" (LTS) for the management and governance of the coal chain, the objective of which was to overcome supply chain co-ordination failures. The appointment was made by a representative group of producers and service providers, tasked to implement the LTS. It considered This included assessment of issues relating to master planning, contractual alignment, capacity assessment, accountability for capacity consumption, dispute resolution and governance. This process resulted in the development of a set of agreed principles to guide the implementation of the LTS. Following the development of the LTS, I was appointed to chair the implementation of the LTS.

Dalrymple Bay Coal Chain – advised the Dalrymple Bay Coal Chain on the incentive structures (including pricing and

deemed capacity consumption) for the efficient utilisation of coal chain capacity (from a whole of coal chain perspective)

Surat Basin Coal Chain – advised Xstrata Coal on the issues that are will need to be addressed in the development of a supply chain co-ordination model for the Surat Basin

Surat Basin Coal Chain – assisted in the development of co-ordination and governance arrangements for the Surat Basin Coal Chain (SBCC), encompassing mines, railway, above rail operators, the coal terminals and the port. We advised contractual alignment in supply chains and the need for coordination mechanisms to optimise supply chain capacity. This included advice in relation to governance mechanisms designed to achieve optimal allocation and utilisation of supply chain capacity, the development of a set of common system operating assumptions which would underpin the confirmation and management of supply chain capacity and articulating the operating assumptions for Gladstone Ports Corporation and WICET

National Transport Commission – led the review of export coal supply chains for the National Transport Commission with a view to defining the proper role of government in these supply chains.

National Transport Commission – prepared an export coal chain study for the National Transport Commission as part of its development of its national transport strategy

Mackay Whitsunday Regional Economic Development Corporation – reviewed port planning arrangements for the Mackay region for the Mackay Whitsunday Regional Economic Development Corporation

Queensland Competition Authority – advised the QCA on the factors affecting the timeliness of regulatory decisions and benchmarking the QCA's decision making relative to other regulators in Australia;

Essential Services Commission (VIC) – assisted the ESC with its review of port pricing regulatory arrangements for the provision of port related services provided by Melbourne Ports Corporation.

Essential Services Commission (VIC) – advised ESC on competition impacts of port and associated land use planning arrangements and instruments in Victoria

Essential Services Commission (VIC) – advised the Essential Services Commission of Victoria on port related planning issues, with particular reference to the consistency of Victorian planning environment with the relevant COAG agreements

Essential Services Commission (VIC) – assisted the Commission prepare for its work in administering the Pricing Order associated with the privatisation of the Port of Melbourne

Essential Services Commission (VIC) – assisted with the Commission's 5 yearly review of regulatory arrangements applying to the Port of Melbourne, involving the drafting of the published report on behalf of the Commission

Essential Services Commission of South Australia (ESCOSA) – advised ESCOSA on access pricing approaches for the use of all rail and port infrastructure in South Australia that was subject to ESCOSA's jurisdiction. This work included a detailed review and evaluation of the range of approaches and methodologies that may be taken to the pricing of access for rail and port services and the suitability of those approaches for the particular services under consideration

TransNet (South Africa) – undertook an international benchmarking study of coal and iron ore transport charges on behalf of Transnet (South Africa)

Sumisho – performed a price and service quality benchmarking review of major Australian commodity ports as part of a due diligence exercise for a prospective purchaser of a coal mine

Qube – advised Qube on the competition and commercial implications of Qube's proposed acquisition of Asciano's port assets.

B Previous Synergies Reports

Report	Date	Title	Synopsis
Synergies 2015	1 September 2015	Potential for increase in navigation services charges at Port of Newcastle	Initial report to support Glencore's declaration application. Synergies advised on the approximate level of annual revenues, s, that PNO could potentially seek if it aimed to earn a commercial return on its investment.
Synergies 2018a	8 August 2018	Port of Newcastle - Assessment of revocation application by Port of Newcastle Operations	Initial report to support Glencore's response to PNO's revocation application. Synergies was engaged to assess the application by PNO in respect of the defined service against the declaration criteria set out in s 44CA(a) and (d) of the CCA.
Synergies 2018b	5 October 2018	Port of Newcastle - Response to submissions and documents provided by Port of Newcastle Operations	Response to additional submissions by PNO in support of its revocation application, including: - PNO's response to our assessment of the market definition for coal tenements - PNO's claims concerning the irrelevance of port charges to upstream market outcomes; and - PNO's claims about our assessment of the public benefit criterion.
Synergies 2019a	4 February 2019	Port of Newcastle - Assessment of revocation application by Port of Newcastle Operations Pty Ltd	Response to NCC's preliminary view on revocation application. The report set out where we considered the NCC did not have sufficient regard for the competitive harm and public interest losses resulting from revocation.
Synergies 2019b	26 April 2019	Revocation of declaration of the shipping channel service at the Port of Newcastle - Response to NERA report	Response to NERA report with further information in support of PNO's revocation application, including: - NERA's analysis about PNO's incentives to increase prices - NERA's views about the effect of declaration of competition in the coal tenements market - NERA's assessment of our earlier pricing analysis
Synergies 2020	July 2020	Port of Newcastle Operations ability and incentive to exercise market power and its impact on competition in Newcastle catchment coal tenements market	Report to support NSWMC's declaration application. It considered the implications of PNO's recent conduct to seek to negotiate bilaterally with coal producers and its actions to refuse to collectively negotiate with coal producers.

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01 September 2015

Anthony Pitt
Glencore Coal Assets Australia Pty Ltd
Level 38 Gateway Building
1 Macquarie Place
SYDNEY NSW 2000

Dear Anthony

POTENTIAL FOR INCREASE IN NAVIGATION SERVICES CHARGES AT PORT OF NEWCASTLE

Following significant increases in the Navigational Services Charge by Port of Newcastle (PON) from January 2015, Glencore applied to the NCC for declaration of the shipping channel service. At the end of July, the NCC released its draft decision to not declare the service, on the basis that port charges are not material enough to materially influence competition.

Glencore's concern is that, without regulatory oversight, PON has the potential to implement further substantial price increases, which would place unsustainable cost pressures on the coal industry in the foreseeable commercial environment. In this context, you have requested that Synergies advise you of the approximate level of annual revenues, and resulting increase to current annual revenues, that PON could potentially seek if it aimed to earn a commercial return on its investment in the Port of Newcastle (noting that the acquisition cost does not provide a proper basis for regulatory price setting).

In performing this assessment, we have adopted a standard building block methodology for assessing target annual revenues, relying on publicly available information to inform the buildup of costs, including PON's successful bid price for the PON package. While this is inevitably imprecise, our analysis indicates that, in order to earn a commercial return on its

investment[1], PON may seek additional increases in navigation services charges beyond those implemented in January 2015 in its first year of ownership and in the range of 70-84% in future years.

If PON were to seek full recovery of its published value of its trade assets of $2.398bn, this would indicate that it may seek additional increases in navigation services of up to 211% in subsequent years.

Attachment A sets out the methodology and assumptions that we have used in this analysis.

Yours sincerely

Euan Morton
Principal

[1] On the assumption that the target rate of return is estimated in accordance with IPART's standard WACCC methodology and that PON applies an average 50 year remaining economic life to its port investment in order to ensure that it is substantially recovered within the remaining expected life of the Hunter Valley coal reserves.

A Assessment methodology and results

A.1 Results

PON started trading on 30 May 2014 at which time it took over responsibility for port operations from Newcastle Port Corporation (NPC). PON has to date only published financial results for the half year 1 June to 31 December 2014 and commodity results for the full 2014 calendar year. Given this lack of historical comparative information, Synergies has estimated PON's expected annual revenue for the current financial year, i.e. 2015/16, based on this published information and information provided to Glencore by PON (shown in Appendix B). Synergies has estimated the expected annual revenue associated with PON's trade assets for this financial year to be approximately $111m. This amount includes the price increase that was brought into effect 1 January 2015 but ignores any future price increases. Further details on how this result was established is given below.

Synergies has modelled a number of scenarios for the determination of possible Annual Allowable Revenue (AAR) levels that PON may seek given the combination of a number of varying assumptions related to the opening asset value and the life applied to the channel assets:

- Opening asset value as at 31 December 2014 of $2.398b (PON's state value of trade assets),
- Opening asset value as at 31 December 2014 of $1.75b (PON's purchase price for the lease)[2],
- Channel life as at 31 December 2014 of 98 years to align with the long term leasing arrangements,
- Channel depreciated over an economic life reflecting the potential life of the coal resource, and therefore reflecting a remaining average life as at 31 December 2014 of 50 years,[3] and
- Channel life assessed having an infinite life and therefore no depreciation.

The Annual Allowable Revenue (AAR) for 2015/16 based on our analysis for these scenarios is given in **Table 1**, which also shows estimated current revenue for comparison. This table also shows the potential increase in charges assuming that the charging component that is most likely to increase is the Navigational Service Charge.

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[2] Synergies has made no adjustment to the value of the stated purchase price of $1.75b for the timing difference between the purchase date and the start of the asset roll forward at 1 December 2014.

[3] We note ARTC applies a remaining economic life to its assets in the order of 30 years. We have assumed PON would seek to recover the majority of its asset life over a similar timeframe, but then allow a longer period for recovery of the remaining asset value due to ongoing use by non-coal trades. On this basis, we assumed an average remaining economic life of the channel of 50 years.

Table 1 2015/16 Annual Allowable Revenues

	Scenario Description	2015/16 AAR	2015/16 Allowable NSC charge[1]	% increase from current NSC
Base case	Current estimated revenue	$111,201,486	$84,121,301	
Scenario 1	Asset Value at PON's stated trade asset value of $2.398b Channel life at 98 years	$268,566,009	$241,485,325	187%
Scenario 2	Asset Value at PON's stated trade asset value of $2.398b All asset lives at maximum of 50 years	$288,438,024	$261,357,840	211%
Scenario 3	Asset Value at PON's purchase price of $1.75b Channel life at 98 years	$170,404,974	$143,324,790	70%
Scenario 4	Asset Value at PON's purchase price of $1.75b All asset lives at maximum of 50 years	$181,911,882	$154,831,698	84%

1 Allowable NSC charge is determined by deducting current revenue from other charges from the total assessed ARR for 2015/16. This assumes that price increases would most likely to be applied to the NSC charge component, which is largely paid by the coal industry.

Source: Synergies

This analysis indicates that, in order for PON to achieve a commercial return on its invested capital, significant further increases in port charges can be expected beyond those implemented in January 2015. While we cannot comment on the timing for such price increases, to earn a commercial return on PON's purchase price, we estimate that PON will seek further cumulative price increases in the range of 70-84%. If PON were instead to seek a return on its stated value of trade assets, these cumulative price increases could be in the range of 187-211%.

A.2 Methodology

We have calculated the expected AAR for PON based on a standard building block approach using information that is publicly available.

As with most capital intensive businesses, the majority of the AAR would be made up of the return of and on the asset base. In a regulatory process, the regulatory asset base (RAB) would be based on the regulator's assessment of the optimised level of asset required to provide the required level of service, valued based on the replacement cost of the asset. However, in the absence of regulation, we have assumed that the asset base could reflect either

- PON's investment in trade related assets at Port of Newcastle, using an allocation of the $1.75b PON paid for the long-term lease of the Port assets, or

- its published value of trade assets. In this regard, in PON's letter to Glencore dated 19th December 2014, PON state that an evaluation of the Trade Assets[4] has been undertaken based on "methodology commonly used by regulators" and has been valued at $2.398b[5].

A.2.1 Annual Allowable Revenue (AAR)

The building block components and the methodology used for determining AAR are,

$$AAR = ROA + Depreciation - Inflation + Opex$$

where,

ROA is the annual return on the trade asset base (TAB) calculated as the opening TAB asset value for the relevant year multiplied by WACC (nominal, pre-tax),

Opex is the efficient level of operating costs and maintenance costs for the relevant year,

Depreciation is annual depreciation of the TAB,

Inflation is the annual amount of inflation of the TAB based on a forecast CPI of 2.5%.

A.2.2 Trade Asset Base (TAB)

The TAB is rolled forward each year based on,

$$OAV_t = CAV_{t-1} + Capex_t + Inflation_t - Depreciation_t$$

where,

OAV_t is the opening asset value for year t,

CAV_{t-1} is the closing asset value for year t-1,

$Capex_t$ is the amount of capital expenditure that is commissioned in year t (all Capex is assumed to be commissioned mid year),

$Inflation_t$ is the amount of inflation for year t on the OAV_t and $Capex_t$ using CPI of 2.5%,

[4] PON in their 2014 Annual Trade Report have defined Trade Assets are those assets which generate revenue for the Company excluding those assets which are associated with property leasing activities.

[5] Port of Newcastle's 2014 Annual Trade Report

$Depreciation_t$ is the amount of depreciation for year t on the OAV_t and $Capex_t$ and applied on a straight line basis.

A.3 Modelling Assumptions

Our primary source of information in developing the expected level of AAR has been PON's 2014 Annual Trade Report which contains financial information for the first half of the 2015 financial year, i.e. 1 June to 31 December 2014. The financial information on trade revenue collected provided in this report is relevant to the period prior to PON's recent changes to their pricing arrangements which took effect from 1 January 2015.

Other sources of information that were publicly available and were used in our analysis are set out below where applicable.

A.3.1 Opening TAB Value

The opening TAB value for the base case has been based on the PON sale price of $1.75b to show the amount of revenue PON would expect in order to provide an adequate return on the investment. This purchase price was inclusive of land assets associated with leasing arrangements that has been explicitly removed from the Trade Assets and Trade Revenue reported by PON and subsequently used in Synergies build up of AAR. As we have assessed revenue excluding land rentals, we have also identified and removed from the purchase price an estimated amount associated with these land assets in determining the Opening TAB value. Detail on the approach taken in relation to identifying asset categories is given in the following section. This removal of leased land assets results in an Opening TAB value of $1.389b.

We have also performed analysis of a second scenario where the opening TAB value reflects PON's valuation of Trade Assets of $2.398b. Though it is not explicitly stated in PON's Annual Trade Report, we have assumed this valuation is current at 31st December 2014 and has been used as the Opening TAB Value for our analysis.

A.3.2 Asset Categories

Detail on the breakup of PON's Trade Assets into asset categories or remaining lives have not been released by PON. In order to better reflect an expected level of AAR for PON, it is important to identify asset categories within the TAB and assign appropriate remaining lives to each category. We have done this based on publicly available information presented in Newcastle Port Corporation's (NPC) 2013-14 Annual Report. This report was prepared by NPC when it was responsible for the now leased assets i.e. prior to when the leasing arrangements with PON were finalised.

On 1 January 2014, in preparation for the sale and lease of a majority of its assets, NPC transferred all relevant assets to two subsidiaries, Port of Newcastle Lessor Pty Ltd and Port of Newcastle Operations Pty Ltd. These assets were later acquired by PON.

NPC's Annual Report details the amount of assets transferred to the subsidiary, which total $1.255b[6]. It also identifies a breakup of this total into a number of asset categories including, land and buildings, roads, wharves and jetties, breakwaters/dredged assets, plant, rail and construction in progress.[7]

This value is clearly much lower than that developed by PON, but the report does provide information on the breakup of the assets into asset categories. Given the lack of alternative information, Synergies has assumed the relative breakup of assets into asset categories presented in NPC's report is an appropriate proxy to apply to PON's valuation of assets. The breakup of the Opening TAB value for the $2.398b and $1.75b asset values discussed above are both based on this information. The percentage breakup to apply for each asset category used to split the $2.398b asset bundle has been determined excluding the amount associated with land leasing arrangements. In applying this to the $1.75b total asset value, we have first deducted an amount for leased land (estimated at 95% of total landholdings, with land value as per NPC's Annual Report) to arrive at a total opening TAB value of $1.389b. The resultant breakup of both Opening TAB values into asset categories are given in Table 2.

Table 2 Breakup of $2.398b Opening TAB Value into Asset Categories

Asset Category	% split applied	Split of $2.398b opening TAB value into asset categories	Split of $1.389b opening TAB value into asset categories
Berths, Wharves and Jetties	9.10%	$218,230,019	$126,366,276
Roads	1.23%	$29,381,555	$17,013,415
Breakwaters	2.35%	$56,305,480	$32,603,737
Land not assoc with leasing and Buildings	2.13%	$51,038,613	$29,533,953
Plant	2.27%	$54,400,549	$31,500,684
Rail	0.43%	$10,198,091	$5,905,213
Land assoc with leasing	0%	$0	$0
Channel	82.50%	$1,978,445,693	$1,145,620,670
Total Opening TAB Value		**$2,398,000,000**	**$1,389,000,000**

Source: Synergies

[6] NPC's 2013-14 Annual Report, p31

[7] The asset value for the channel is captured in the breakwaters/dredged asset category. Synergies has sought to separately identify the channel in its own asset category and has allocated $737.4m of the breakwaters/dredged assets (totalling $758.386m) as channel specific based on Note 19(a) of the Financial Statements that states that of the asset revaluation reserve amount, $737.4m was specific to the valuation of the channel.

A.3.3 Asset Lives

Asset Lives are needed to calculated depreciation of the TAB. NPC's Annual Report states straight line depreciation rates for each category of fixed assets in the following ranges[8] :

Buildings	2 – 7%
Roads	1.7 – 14%
Wharves and jetties	2.5 – 10%
Breakwaters	1%
Plant	2.5 – 85%

Given the lack of alternative information, Synergies have used the average of these ranges to apply to the relevant asset categories when calculating depreciation in the modelling.

Synergies has assessed a scenario that assumes an infinite life is assigned to the channel assets, and hence no depreciation of the channel is recorded. This results in a depreciation estimate similar to that reported in the Trade Report.

However, we consider that it is more likely that investors will seek both a return on and a return of their investment over time. In this regard, a plausible assumption of an economic life of 98 years could be applied to the channel assets in line with the life of the leasing arrangements, and have included this as a scenario in our modelling.

It is also plausible that PON will seek to recover the majority of its investment during the remaining economic life of the major port user, being the export coal industry. ARTC bases the remaining economic life of its assets on an estimate of the Hunter Valley coal reserves having a remaining life of approximately 30 years. Applying a remaining average life assumption of 50 years would provide that 60% of the port value was depreciated within this same timeframe. The remaining port value could then be depreciated over the longer term use of the residual trade assets.

A.3.4 Weighted Average Cost of Capital (WACC)

Synergies has assessed an indicative WACC based on the methodologies adopted by IPART. IPART has been selected as the relevant regulator on the basis that Port of Newcastle is subject to state based price monitoring in NSW.

The parameters of the WACC estimate are set out in Table 3.

[8] NPC's 2013-14 Annual Report, p11

Table 3 WACC parameters

Parameter	Value	Notes
Risk free rate	3.86%	The mid-point estimate of IPART's long-term average of the risk-free rate and the contemporaneous estimate produced by Synergies.
Debt margin	2.54%	The debt margin as provided by the Bloomberg BVAL service for 10 year BBB rated corporate bonds.
Debt raising costs	0.125%	Debt-raising costs as applied by IPART.
Gearing (debt to debt plus equity)	60%	Gearing assumption based on IPART transport WACC and DBCT gearing.
Market risk premium	7.4%	The mid-point estimate of the long-term IPART estimate of the MRP along with a contemporaneous measure calculated using dividend discount models.
Gamma	0.25	Gamma as set by IPART.
Tax	30%	Australian corporate tax rate.
Asset beta [a]	0.5	Asset beta set equal to the asset beta for DBCT as determined by the QCA.
Equity beta [a]	1.24	The asset beta transformed with 60% gearing using the Monkhouse formula.
Cost of debt	6.52%	
Cost of equity	13.08%	
Post tax nominal (vanilla) WACC	9.15%	
Pre tax nominal WACC	10.66%	

a: IPART's assumed transport equity beta is 0.90, however this is primarily applicable to public transport and we believe this is too low based on PON's assumed gearing of 60%.

Source: Synergies calculations

A.3.5 Opex

Synergies has included both direct and indirect operating expenses in the build up of anticipated AAR based on PON's Trade Report, which reports Operations Expenses – Trade Assets and Allocated Overheads – Trade Assets as separate cost categories.

Operations Expense – Trade Assets have been defined by PON as those expenses that are made up of salary and wages, repairs and maintenance, external services, fuel and security and that these costs relate to dredging, survey, repairs, maintenance and other minor costs that are directly related to Trade Assets.

Synergies assumes that 100% of these direct costs would be sought to be captured in PON's build up of its annual required revenue. Allocated Overheads – Trade Assets have been defined by PON as indirect costs including transition costs (costs not directly related to income earning operations or capital projects) and have been allocated based on relative revenue. Synergies assumes that this allocation of overheads to Trade Assets would be sought to be recouped by PON in its build up of annual required revenue.

Opex has been based on the six months of operating expenditure of $17.236m given in PON's Annual Trade Report. This year to date expenditure amount has been assumed to be representative of the full year's anticipated expenditure profile such that the full amount of opex expected to be spent for FY2015 is $34.472m. Synergies' analysis assumes that the current operating conditions remain constant over time and as such, forecast operating expenditure for future years has been assumed consistent with this amount in real terms and escalated at CPI each year. One unknown in this context is future maintenance dredging requirements.

A.3.6 Capex

Given our base assumption in this analysis is that current operating conditions and volume remain constant into the future, there is no allowance for growth capex in future years. A minimal annual spend for asset renewals of $10m per annum (FY2016 $) indexed by CPI each year has been included in the analysis. All renewals capex is assumed to have a 30 year life.

A.3.7 Volume

Changes in costs and revenues due to volumetric variation over time have not been contemplated in the modelling as the base assumption that volumes remain consistent with current operating conditions has been adopted for this analysis.

A.3.8 Estimated Current and Future Revenue

PON began trading on 30 May 2014. It has provided six months' worth of trade revenue for 1 June to 31 December 2014 in its 2014 Annual Trade Report where it reported its trade revenue from port charges (including navigation services charge, wharfage, site occupation, security and utilities) at $43.65m. This half year result related to the period prior to the price increase introduced by PON as of 1 January 2015.

In PON's letter to Glencore dated 19 December 2014, PON state that, based on the weighted average size vessel, the increase to navigation service charges (NSC) for coal vessels will be approximately 12.7 cents per tonne of coal and that all other charges will incur a price increase of 3.9% in 2015 and 2016.

Based on this information and the reported amount of coal exported through the port in the 2014 calendar year given in PON's Annual Trade Report of 159,035,923 tonnes, we estimate that, over a full year, this will result in addition revenue collected by PON of approximately $21m. Based on this, we have estimated the total 2015/16 annual trade revenue as $111m.

Table 4 below details Synergies method and assumptions applied for estimating this annual revenue amount.

Table 4 Estimation of PON's future revenue

	Half year result 1 January to 31 December 2014	Assumed full year result 2014/15 exclusive of price increase	$ increase due to price increase at 1/1/15[1]	Estimated total full year revenue 2014/15	Estimated 2015/16 annual revenue[4]
Port Charges	**$000**	**$000**	**$000**	**$000**	**$000**
NSC	30,936	61,872	20,198[2]	82,070	84,121
Wharfage	10,292	20,584	803[3]	21,387	21,921
Site Occupation	1,769	3,538	138	3,676	3,768
Security	609	1,218	48	1,266	1,297
Utilities	44	88	3	91	94
Trade Revenue	**43,650**	**87,300**	**21,189**	**108,489**	**111,201**

	Half year result 1 January to 31 December 2014	Assumed full year result 2014/15 exclusive of price increase	$ increase due to price increase at 1/1/15[1]	Estimated total full year revenue 2014/15	Estimated 2015/16 annual revenue[4]
2014 calendar year coal volume[5]		159,035,923	tonnes		
$ increase per nt coal		$ 0.127	$/t		
% increase for all charges other than NSC		3.9%			

Notes:

1. This price increase was brought into effect mid financial year at 1 January 2015, but for the purposes of estimating future full year revenue results the increase has been applied as per a full financial year.
2. The increase to the NSC has been calculated as 159,035,923t multiplied by $0.127/t.
3. The increase to wharfage, site occupation, security and utilities charges has been calculated by applying the 3.9% increase to the 2014/15 annual revenue for each charge.
4. 2014/15 estimated annual revenue has been escalated by 2.5% to give annual revenue estimate for 2015/16.
5. This reported level of coal tonnage through the port is for the 2014 calendar year. For the purposes of calculating approximately annual revenue amounts in has been assumed that this 12 months of throughput is also indicative of the throughput expected for the 2014/15 year.

B PON letter to Glencore

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Ref: A617869

19 December 2014

Mr Anthony Pitt
Glencore
PO Box R1543,
Royal Exchange NSW 1225

Dear Anthony

Thanks for your letter of 15 December 2014 regarding the changes to Port of Newcastle (PON) pricing to apply from 1 January, 2015.

Our letter of 26 November advised you of the increase in the wharfage charge which we invoice Glencore and enclosed our schedule of charges. I note your interest in the Navigation Services Charge (NSC) that we charge to the shipping lines and I will address the changes we have made below.

Pricing Realignment

In addition to the capital cost incurred by Port of Newcastle in acquiring port assets, including the channel, there are a number of other factors that have necessitated this realignment.

The previous pricing was well below market rates and had not been subject to annual price review. From July 1995 to July 2014 the NSC only increased by 1.2%. The NSC for a vessel up to 50,000 Gross Tonnes (GT) was 42.4 cents per GT in 1995 and is only 42.9 cents per GT now (exclusive of GST). If inflation alone, in accordance with the Consumer Price Index (CPI), had been applied each year across this period, NSC would have increased by 73%.

Given regular cost increases incurred in operating the port (including the channel licence, dredging, survey, vessel scheduling, and the maintenance of navigation aids and the breakwaters) this was an unsustainable position and restricted ability to maintain existing infrastructure and invest in new port infrastructure.

The historic pricing level does not reflect the intrinsic value of assets leased or licensed by PON from the State which are more than the assets owned by the former Newcastle Port Corporation or the costs involved in maintaining port assets and services. The most significant additional asset licensed to PON is the channel.

The intrinsic value of our trade assets (which includes the channel), revenue earned and costs incurred are now transparent and publicly disclosed on our website. The link is:

http://www.portofnewcastle.com.au/Company-Information.

The valuation of Trade Assets was independently prepared by a leading international professional services firm and was based on methodology commonly used by regulators. This will allow you to understand our current financial position.

Navigation Services Charge for Coal and Non Coal Vessels

In your letter you reference changes to charges for non-coal vessels being impacted in a similar way to coal vessels. This is incorrect. From 1 January 2015 there will be a separate NSC for coal vessels and non coal vessels.

- The maximum NSC for coal vessels will be uncapped and charged at a flat $0.69 per Gross Tonnage (GT), exclusive of GST.
- The NSC for non coal vessels will be $0.4459 per GT for the first 50,000 GT plus $1.0033 per GT thereafter (exclusive of GST).

The change to the pricing structure reflects the operational characteristics of the port. Non-coal ships are generally far smaller and with less draft than coal ships and use less of the channel. We are conscious of the need to charge fairly for the use of the channel which is our most valuable trade asset. Maintenance dredging is undertaken to preserve design depth which is utilised by many of the coal vessels which require all of the depth available in the channel. With coal ships using by far the largest and most costly parts of the channel in terms of both the intrinsic value and operating costs there should be a different charge to be fair on non-coal trades.

Under the current pricing arrangements non-coal commodities pay significantly more NSC per tonne of cargo than coal and this does not properly reflect the maintenance cost and intrinsic value of the assets used.

You reference the removal of the cap on NSC. Coal ships use the largest and most costly part of the channel to create and maintain, they therefore should pay a fair share. These vessels carry the largest cargo loads and are able to deliver strong economies of scale for the cargo owner. The intrinsic value and maintenance cost of the channel becomes significantly higher the deeper the dredging required. Coal ships also travel further up the channel to K10 with coal ships being the sole users of berths from K4 to K10.

Competitive Position of Exporters

In determining the pricing strategy, we have been mindful of our competitive position and of the competitive position of exporters through the port. Our new pricing is in line with the market, and all ship-based charges are less than our nearest comparative port, Port Kembla, which operates in the same regulatory and statutory pricing environment and is also privately owned. We understand Glencore is an exporter through Port Kembla and will therefore understand this comparison.

PON has a far larger and more valuable channel than Port Kembla and a significant ongoing need to dredge with our own trailing suction dredge operating 12 hours per day 7 days per week. Even with these significant additional costs our new NSC pricing is around 10% less per GT than is being paid by ships calling to receive your coal at Port Kembla.

I note your comments regarding how the changes we have made to the NSC that we charge to the shipping lines will flow back to Glencore. You have a much better understanding of how your commercial arrangements with your customers work but I would make the following points. NSC is a minimal part of the price paid for coal by the overseas buyer. We estimate that the NSC is about 0.5% of the delivered cost of coal to overseas buyers, and is effectively the same as the towage cost.

We have also benchmarked the new NSC relative to the Australian dollar price of coal over the past 20 years and the new charge sits comfortably within the range of this charge which further demonstrates that the new charge is reasonable in an historic context given the various coal price cycles that have occurred in this time.

The impact of the NSC increase will depend on the size of the vessel. In the year to 30 June 2014, the weighted average coal ship was 58,000 GT and had 92,500 tonnes of coal on board. Based on the weighted average size vessel the NSC increase will be approximately 19 cents per GT, exclusive of GST, or approximately 12.7 cents per tonne of coal. By comparison, fluctuations in exchange rates, fuel prices and vessel charter rates are likely to have a far more significant impact on the customer's cost structure.

I understand that price increases are never welcome however this realignment was necessary to reflect the costs in owning and maintaining the channel and associated infrastructure, and to fairly reflect the operations of the port and the different port users.

Apart from the navigation services charge for coal vessels, the pricing increase for 2015 is 3.9%. We understand the need for pricing certainty and therefore commit that the pricing increase for 2016 will be 3.9%.

Yours sincerely

Jeff Coleman
CHIEF EXECUTIVE OFFICER

Port of Newcastle

Assessment of revocation application by Port of Newcastle Operations

Prepared on behalf of Glencore Coal Ltd

8 August 2018

Synergies Economic Consulting Pty Ltd
www.synergies.com.au

Executive Summary

Synergies is assisting Glencore in its response to the NCC on the application submitted by PNO to the NCC on 2 July 2018 for the declaration made by the Australian Competition Tribunal on 16 June 2016 in relation to the use of the defined service ('Service' which largely comprises the shipping channels) at the Port of Newcastle to be revoked pursuant to s 44J of the *Competition and Consumer Act 2010* (Cth) (CCA).

Synergies has been instructed by Glencore to provide a report that assesses the application by PNO in respect of the Service against the declaration criteria set out in s 44CA(a) and (d) of the CCA and considers whether the declaration remains consistent with the objects of Part IIIA, as set out in s 44AA of the CCA.

Criterion (a) and (d) are forward looking tests and require consideration of the likely outcomes under two scenarios – the expected future where access is provided on reasonable terms and conditions as a result of declaration, or the expected future without declaration.

Revocation and the extent to which such a decision is consistent with the objects of Part IIIA requires an assessment as to whether it will promote efficient use of, and investment in, infrastructure and competition in upstream and downstream markets. It also requires an assessment as to how revocation encourages a consistent approach to access regulation in each industry more broadly.

Synergies notes that, in the context of Glencore's original application to the NCC in 2015 to declare the Service, there was general industry support for the Service to be declared. PNO is a privately owned monopoly, with a clear incentive to increase prices to maximise profits. Apart from the declaration, there are no effective constraints on the extent to which PNO may increase prices. While there is uncertainty about how prices will be determined, the pace of price increases and the exact final level, it is reasonable to conclude that there are likely to be very high price increases over time. In this sense, nothing has materially changed in the period since the Service was declared that would negate or dismiss Glencore's original concerns about PNO's effectively unfettered pricing behaviour and the need to establish the legitimate rights of port users to secure access to the shipping channel Service on reasonable terms and conditions.

In this context, Criterion (a) requires that:

> (a) that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of 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;

We have formed a view that revocation of the declaration is likely to lead to a material loss of competition in at least one of the dependent markets, namely the market for coal tenements (i.e. mining authorities). This market is critical for ensuring future coal reserves are well placed to meet demand. Any loss of competition in this market is likely to result in adverse effects including weakened incentives for investment and lower coal resource values. Given our view that criterion (a) is satisfied in relation to the coal tenements market, and in view of the time specified by the NCC as available to make submissions in response to PNO's application, we have not undertaken a detailed assessment of the remaining identified markets and are unable to conclude that there would be no competition effects in these other markets as a result of revocation of the declaration.

Criterion (d) requires that:

> (d) that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote the public interest.

We consider that continued declaration of the Service will promote the public interest, having regard both to the incentives that it will create for increased efficiency, particularly in the use of and investment in supply chain infrastructure (including rail, coal handling terminals and port) and to enhanced growth in the NSW and Australian economies resulting from enhanced incentives for investment in coal production. Moreover, revocation will lead to a public detriment and is not in the public interest where it undermines public confidence in the regulatory arrangements for preventing infrastructure owners being able to unreasonably exercise their market power.

Pursuant to s 44AA of the CCA, the objects of Part IIIA are to:[1]

> (a) promote the economically efficient operation of, and use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
>
> (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

We hold the view that the existing declaration, and the ability to have access disputes arbitrated by the ACCC, provides a meaningful constraint on PNO's ability to increase prices for the Service in order to maximise profits. Ultimately, we consider that revocation of the declaration is not consistent with the objects of Part IIIA as it will lead

[1] See s 44AA of the CCA

to reduced efficiency in the operation, use of and investment in supply chain infrastructure, and will cause a reduction in competition in dependent markets, with the effect being material in at least the coal tenements market.

Further, the current ACCC arbitration process between PNO and Glencore, once finalised, will be likely to provide a framework and guiding principles that will encourage and lead to consistent access principles in the coal export industry - provided the declaration is not revoked.

Finally, we note that PNO has not sought to argue that there has been any change to the economic position at the Port in respect of the nature of the Service since it was declared in June 2016 and therefore this report has been limited accordingly.

Contents

Figures and Tables

1 Introduction

1.1 Background and instructions

Synergies Economic Consulting (Synergies) is assisting Glencore Coal Pty Ltd (Glencore) in its response to the National Competition Council (NCC) on the application submitted by Port of Newcastle Pty Limited (PNO) to the NCC on 2 July 2018 for the declaration made by the Australian Competition Tribunal on 16 June 2016 of the declared Service at the Port of Newcastle to be revoked pursuant to s 44J of the *Competition and Consumer Act 2010* (Cth) (CCA).

The declared Service is specified as follows:

> The provision of the right to access and use the shipping channels (including berths next to the wharves as part of the channels) at the Port, by virtue of which vessels may enter the Port precinct and load and unload at relevant terminals located within the Port precinct and then depart the Port precinct.

and is declared for the period to 7 July 2031.

In support of its application, PNO contends that two of the declaration criteria established in s 44CA – criterion (a) and (d) - are no longer satisfied with respect to the Service.

Synergies has been instructed by Glencore to provide a report that assesses whether revocation of the Service is consistent with the objects of Part IIIA of the CCA, and assesses the Service against the declaration criteria set out in s 44CA(a) and (d) of the CCA, as follows:

'Criterion (a)'

> (a) that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of 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; and

and 'Criterion (d)':

> (e) that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote the public interest.

1.2 Report structure

Synergies has adopted the following structure for this report:

- Section 2 presents an assessment of the future with and without declaration, which forms the basis for our assessment of both criterion (a) and (d);
- Section 3 presents Synergies' assessment of the Service against criterion (a), including the following matters:
  - an overview of our approach to assessing the impact of the declaration on competition;
  - identification of the relevant dependent markets; and
  - assessment of the impact on competition in the dependent markets.
- Section 4 addresses criterion (d), identifying:
  - the public benefit associated with declaration of the Service; and
  - the additional public detriments that will result from revocation of the Service.
- Section 5 examines whether revocation is consistent with the objects of Part IIIA, in terms of whether revocation:
  - promotes the economically efficient operation of, and use of and investment in the infrastructure by which access to the Service is provided, thereby promoting effective upstream and downstream competition; and
  - provides a framework that encourages a consistent approach to access regulation in each industry.

2 Comparison of future with and without declaration

2.1 Approach to assessing future with and without declaration

Criterion (a) and (d) were recently amended by the *Competition and Consumer Amendment (Competition Policy Review) Act 2017* (Clth), which came into effect in November 2017. Under the previous criterion (a), in accordance with which the Service was previously assessed, the relevant question was whether 'access (or increased access) to the Service would promote a material increase in competition in at least one market other than the market for the Service, whether or not in Australia', when compared to the situation where no access to the Service was provided.

However, the amended criterion (a), as set out in s 44CA of the CCA, is directed at whether 'access (or increased access) to the Service, on reasonable terms and conditions as a result of declaration would promote a material increase in competition in at least one market other than the market for the Service, whether or not in Australia.'[2] The amended criterion (d) similarly focuses on the impact of access, on reasonable terms and conditions as a result of declaration.

The amended criteria require two scenarios to be considered – one in which a declaration is made and access (or increased access) to the Service is available on reasonable terms and conditions and the other in which no declaration is made. This also needs to be assessed in a practical, real world context, which in this case is that the declaration of the Service is in existence. This is consistent with the manner in which the Queensland Competition Authority and industry stakeholders are approaching the review of Service declarations for Aurizon Network, Dalrymple Bay Coal Terminal and Queensland Rail under the *Queensland Competition Authority Act 1997* (Qld).

In Synergies' view, continued declaration will ensure that users have a right of access to the Service on reasonable terms and conditions. In contrast, in the absence of declaration, there is no effective commercial, contractual or regulatory fetter on PNO's ability to impose further significant price increases on coal producers dependent on the port for the export of their coal. This reflects that:

1. PNO has a commercial objective to maximise profits when setting access charges;
2. notwithstanding that PNO is heavily reliant on coal throughput for its revenue and profit, PNO's profits will be most effectively maximised through increasing prices and accepting the likely consequential impact on existing coal volumes.

[2] See s 44CA(1)(a)) of the CCA

3. existing constraints (other than declaration) on PNO's ability to substantially increase prices are generally accepted to be weak.

Therefore, absent the declaration, as explained below, decisions about future coal production and investment in the coalfields in the Hunter Valley, Newcastle, Western and Gunnedah basins ('Newcastle catchment') will be impacted by the high probability that PNO would implement large increases in charges for use of the Service.

The basis for this conclusion is set out below.

2.2 Future with ongoing declaration (the current situation)

Where declaration of the Service continues, market participants will be assured that access to the port will be made available on reasonable terms and conditions for the term of the declaration (to July 2031), with this right supported by a legal right of access and opportunity to seek arbitration in the event of a dispute.

This means that, if they consider that PNO's terms and conditions of access, including price, are unreasonable, they have an opportunity to negotiate access with PNO, and have recourse to arbitration if required. This will ensure that the resulting terms and conditions, including price, are reasonable. Reasonable terms and conditions for access to the Service will include prices that are aligned with the efficient cost of providing the Service and a term of access consistent with the nature of relevant contracts in this industry relating to coal export. The presence of declaration will also provide a strong ongoing regulatory constraint on PNO further increasing prices beyond the level of the reasonable price.

PNO has submitted that there is no reason to believe that terms and conditions will vary materially as between the future with declaration and the future without.[3] PNO's basis for this view includes:

- that PNO currently provides open access to the Service and will continue to do so regardless of whether the Service is declared; and
- PNO contends that its prices are already set at a reasonable level, on the basis that generated revenues are less than its assessed 'building block' revenue, and that current charges are substantially lower in real terms than they were throughout the 1990s.

[3] PNO (2018), Application for Revocation of Declaration, 2 July 2018, p.17

In contrast, Synergies understands that Glencore considers that reasonable terms and conditions will involve charges that are substantially lower than PNO's current tariffs. This reflects that:

- while charges (in real terms) may be lower than they were throughout the 1990s, the massive expansion of the coal industry from 2000-2013 means that port revenue has more than doubled in real terms.[4] However, the cost to the port of providing the Service will have remained largely stable, given that all channel expansion costs have been directly funded by the coal terminals – Port Waratah Coal Services (PWCS) and Newcastle Coal Infrastructure Group (NCIG);[5]
- for the period prior to privatisation of the port in 2014, the Newcastle Port Corporation (NPC) reported a positive return on assets as shown in Table 1 below, and there is no indication that NPC considered that prices were materially below the full cost (including a risk adjusted return on capital) for providing the Service; and

Table 1 Newcastle Port Corporation – return on assets (%) – historical annual reports

2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
6.4	8.4	8.0	10.8	8.2	12.4	11.4	6.7	4.8	6.1	6.1	7.5	8.0

Source: Newcastle Port Corporation annual reports

- while PNO purchased the Port of Newcastle in 2014 for $1.75bn (which in itself was a price that exceeded the expectations of Government and analysts[6]), it then proceeded to revalue its trade assets (substantially comprising the channel and related assets) to $2.398bn.[7] Based on an engineering review of the DORC value of the channel and related assets, we understand that Glencore considers this value to be significantly overstated, particularly given the extent of channel dredging that has been either funded or directly undertaken by users. As a result, no confidence can be placed on the reasonableness of PNO's application of a building block model for establishing charges.

[4] Based on annual reports, total Port of Newcastle revenue in 2000-01 was $37.6m, increasing to $99.5m by 2012-13.

[5] See NCIG (2008), Presentation to Sydney Mining Club, p.24. See also Boskalis (2012), Project Sheet, NCIG Berths 8 and 9 dredging project, available from https://australia.boskalis.com/uploads/media/Australia_-_Newcastle.pdf [accessed 7 August 2018]

[6] See, for example: https://www.theherald.com.au/story/2319086/newcastle-port-lease-deal-done/; http://www.abc.net.au/news/2014-04-30/nsw-government-sells-port-of-newcastle-for-1.75-billion/5421800; https://www.afr.com/business/banking-and-finance/investment-banking/hastings-wins-port-of-newcastle-in-175bn-deal-20140430-imxxn

[7] Port of Newcastle (2014), Annual trade report, p.3

Having regard to these issues, Synergies understands that Glencore considers that a reasonable access price for the Service is likely be more reflective of the tariffs applicable prior to PNO's price increase of January 2015, when it increased charges to coal vessels by, on average, more than 40%.

Furthermore, and importantly, where users have negotiated an agreement with PNO, this is likely to provide predictability over the way in which prices will vary over the term of that agreement. Under an agreement, prices would be expected to vary in accordance with the well understood building block framework, with the key factors influencing price being port throughput, asset value and WACC.

The NSW Minerals Council, which represents the minerals industry in NSW, including explorers and producers of minerals and coal in NSW, supports the contention that reasonable prices are likely to be well below the prices currently applied by PNO. In its submission to the NCC in 2015 it noted that:[8]

> Comparing the counterfactuals with and without regulated access, it is therefore clear that regulated access creates the conditions for improved competition from what it would be otherwise.

The expectation that declaration will lead to reduced prices was also identified by Shipping Australia Limited in the originating declaration process. It stated that:[9]

> The recent coal tariff restructure by PoN resulted in a 61% increase in the navigation service charge…this cannot be justified against any increased cost base and seems to be clear evidence of price gouging by the new private operator…SAL strongly believes that the declaration will provide a clear mechanism to facilitate and enforce fair and reasonable priced access to shipping channels.

Synergies acknowledges that the reasonable price may not be Glencore's (or PNO's) subjective view of what is reasonable. Importantly, however, there is an arbitration process currently afoot[10] that will unambiguously resolve what is a reasonable charge for the provision of the Service for coal users. While Synergies understands that the ACCC is required under the CCA to publish some details of the arbitration determination, even where aspects of the outcome of this arbitration remain confidential

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8 NSW Minerals Council (2015), Submission in support of Glencore's application for declaration of shipping channel services at Port of Newcastle under Part IIIA of the Competition and Consumer Act, June 2015, p.7

9 Shipping Australia Limited (2015), Letter to the National Competition Council re Declaration of Shipping Channel Services at the Port of Newcastle – Glencore Application, June 2015, p.2

10 The ACCC is currently arbitrating a dispute between Glencore Coal and PNO in relation to the reasonable terms and conditions of access to the declared service.

between the parties to the dispute, PNO will have full knowledge of the pricing outcome that is likely to occur if other parties also seek to negotiate for access to the Service.

Therefore, where the Service remains declared, even if other users do not avail themselves of the right to negotiate with recourse to arbitration, PNO's clear understanding of what is a reasonable price for access will be expected to have the effect of constraining PNO from subsequent significant increases in price over and above this established reasonable price. This reflects that further significant price increases are most likely to trigger users seeking negotiated access, and then gaining that access on reasonable terms and conditions as judged in the context of Part IIIA.

Continued declaration would further provide a 'level playing field' for coal producers, such that all market participants would have access to such an arbitrated outcome in the event that private negotiations fail to reach a mutually acceptable resolution. However, in the event that the declaration is revoked, this benefit will be limited to Glencore (on the expectation that its agreement will be finalised in the near future and, in any case, prior to a decision on revocation). The benefits of ongoing declaration of a Service in providing protection to *all* current and future users of the Service has been highlighted by the DBCT User Group as part of the Queensland Competition Authority's (QCA) current review of third party access arrangements at the Dalrymple Bay Coal Terminal.[11]

2.3 Future if declaration is revoked (the counter factual)

As discussed above, in considering the counter factual, this test is not intended to be assessed simply based on the terms and conditions upon which PNO currently offers access to the Service. Rather, consistent with the accepted need for criterion (a) to be forward looking, this must be assessed based on how these offered terms and conditions may change over time, given PNO's commercial incentives and constraints in an unregulated environment.

To apply this 'without' test, a clear understanding of PNO's incentives and constraints is necessary in order to predict how it may behave in the future without declaration.

2.3.1 PNO's commercial incentives

The shipping channel is a bottleneck which all coal producers in the Newcastle catchment must use in order to gain access to export coal markets – that is, the shipping

[11] Dalrymple Bay Coal Terminal User Group (2018), Declaration review regarding Dalrymple Bay Coal Terminal – Submission to the Queensland Competition Authority, 30 May 2018, p.77

channel is an essential facility such that the Service provided by the facility is a natural monopoly. This accords with the Tribunal's 2016 determination which indicated that:[12]

> …the Service providing access to the shipping lanes is a natural monopoly and PNO exerts monopoly power; the Service is a necessary input for effective competition in the dependent coal export market as there is no practical and realistically commercial alternative…

PNO states that it is not relevantly vertically integrated into any dependent market, which means that it has no incentive to constrain third party access for the purpose of advantaging any related entity.[13]

While we understand that this claim of lack of vertical integration is untested having regard to the change in PNO's shareholders since the matter was considered by the NCC in 2015, even in the absence of vertical integration, it does not automatically follow that, as submitted by PNO, it has incentives to maintain volumes, protect competition and not price coal producers out of the market.[14] Rather, PNO has a commercial incentive to maximise its profits. As the owner of a natural monopoly facility and in the absence of another constraint, this means that PNO has a clear incentive to use its market power to charge a price that extracts monopoly rents from users of the facility (as Glencore submits it has already begun doing). The extent to which PNO will be able to use its market power to increase prices will depend on the responsiveness of demand and the threat of more stringent regulation.

It is a well-known economic result that a monopolist will increase prices whenever demand is inelastic and the profit maximising price will depend on the elasticity of demand and marginal cost. Intuitively, if demand is inelastic, then irrespective of costs, that means that a percentage price increase will always exceed the percentage decrease in demand, so that the percentage change in revenue will be positive. Hence, the monopolist will always have an incentive to increase prices when demand is inelastic.

This can be seen in the equation for setting the profit maximising price

> Price = Marginal Cost) /(1 + 1 / absolute value of elasticity of demand)

[12] Australian Competition Tribunal (2016), *Application by Glencore Coal Pty Ltd* [2016] ACompT 6, p.23

[13] PNO (2018), p.33

[14] PNO (2018), p.20

Appendix A shows the derivation of the profit maximising price for a monopolist, as well as the profit maximising prices when the monopolist can price discriminate for different customer types.

The ACCC's Chairman Rod Sims in a 2016 address to the Ports Australia Conference noted:[15]

> …inevitably there are situations where the conditions for effective competition are absent; such as where firms have a legislated or natural monopoly. Many of Australia's key infrastructure assets, including ports, exhibit such monopoly characteristics.
>
> Where this is the case, appropriate regulation is needed to act as a constraint on pricing. And it's not difficult to understand why. If you were the commercial owner of monopoly infrastructure without any effective constraint on your pricing, what would you do? Of course you would use the situation to earn high returns over time. To do otherwise would be doing a disservice to your board and your shareholders.
>
> Why allow a monopolist such discretion?

2.3.2 What behaviours will most effectively maximise PNO's profits

PNO has highlighted its reliance on coal volumes and the existence of spare capacity as evidence that its incentives and strategy are to encourage growth to benefit from increased volumes and revenues.[16] It states that this is consistent with the NCC's observation that if:[17]

> a service provider has no vertical interests in a dependent market(s), and its facility has excess capacity, then it may be profit maximising for the service provider to promote competition in the dependent market(s), reduce margins and prices in the dependent market(s) and increase incremental demand for the service provided by the facility.

This is an overly simplistic and erroneous view, as an objective of profit maximisation does not necessarily align with an objective of volume maximisation for a profit maximising monopolist. This can be seen by a review of standard economic theory. Where an otherwise unconstrained monopolist applies a single price for all users (as is

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15 ACCC (2016), Keynote address to the Ports Australia Conference Melbourne, Ports: What measure of regulation? A copy is available at https://www.accc.gov.au/speech/ports-what-measure-of-regulation

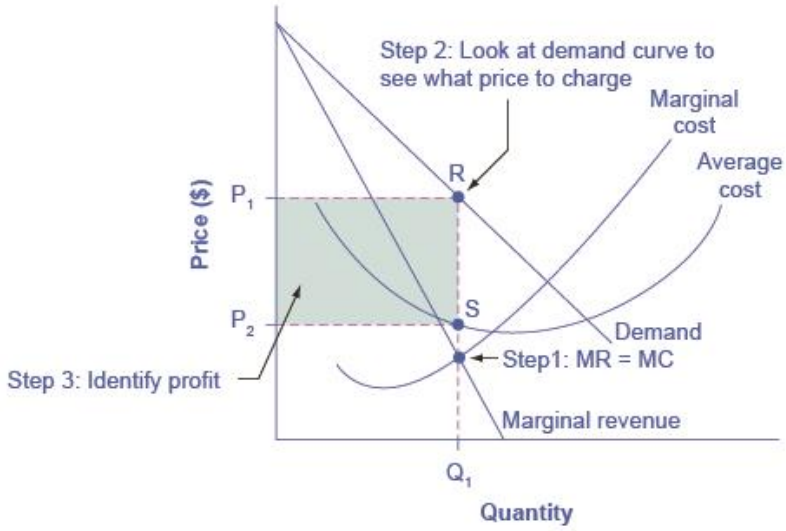
16 PNO (2018), p.34

17 NCC (2018), Declaration of Services – A guide to declaration under Part IIIA of the Competition and Consumer Act 2010, April 2018, version 6, paragraph 3.31, p.34

the case for PNO in relation to coal users), it is a standard result that, for the given demand at each price, there is a profit maximising incentive to restrict output to achieve a higher price. While a monopolist would prefer an increase in demand at each price point, it remains the case that for a given demand schedule, it will have an incentive to increase its price (notwithstanding that this will restrict output), consistent with the limited responsiveness of demand to price. Intuitively, a profit maximising monopolist will simply not know it has maximised profit until there is at least some demand response to its price rises.

This can be seen in Figure 1, where the monopolist's profit is illustrated by the green-shaded rectangle. If the monopolist were to increase quantity, the width of the green-shaded rectangle would increase. At the higher quantity though, the price charged on all units must decrease. In other words, the height of the green rectangle must decrease. At the point where marginal revenue equals marginal cost, the trade off between the height and width of the rectangle (i.e. the profit) is optimised. At quantities to the right of this point, prices can be increased (from P_2), and thus quantity decreased, to increase profit. The key question for a monopolist is whether the price effect or quantity effect will dominate the impact on profit. This will depend on the responsiveness of demand to changes in price as well as marginal cost.

Figure 1 Trade off between price and quantity for a monopolist



Source: Principles of Economics (Taylor and Greenlaw)

The profit maximising price occurs where marginal revenue is equal to marginal cost.[18]

[18] Appendix A shows the derivation for the profit maximising price for a monopolist and also shows the profit maximising prices when the monopolist can price discriminate across different customers.

Applied to the context of PNO, even substantial increases in charges are not likely to induce a material reduction in volume from existing mines, with the result that the price effect will far outweigh any quantity effects. This is because, at current prices, demand for the Service is likely to be price inelastic, i.e. the percentage reduction in demand is likely to be less than the percentage increase in prices over a very large price range, and, in the absence of some other constraint, PNO would always have an incentive to increase prices until demand was not inelastic. Further, a monopolist may seek to mitigate the demand risk through price discrimination, for example through providing price rebates to vulnerable demand. The incentive to increase port prices will be particularly pronounced when coal prices are high, and thus coal miners' margins are relatively wide. Consequently, the only real constraint on prices is the threat and potential impact of more stringent regulation, as discussed in section 2.3.4.

While it is acknowledged that not all products handled at the Port of Newcastle have the same capacity to pay port charges, and that large price increases may have a more significant impact on volumes of products other than coal, PNO already applies different charges to coal and other products. Notably, while PNO's 2015 price review substantially increased the price for coal vessels, the impact for other products was only modest. Therefore, as a result of its ability to price discriminate, increasing prices for coal vessels will not affect its ability to remain competitive for other trades, such as in relation to its proposed development of a new container terminal at the Port of Newcastle.

2.3.3 Effectiveness of alternate strategies in maximising PNO's profit

In order to understand the implication of PNO's profit maximising objective, we have assessed the impact of alternate strategies that PNO may adopt in terms of their effectiveness at improving PNO profit. In order to do so, we have first considered:

- the potential volume impact of PNO's pricing decisions; and
- the potential cost impact to PNO of volume changes.

Potential volume impact of pricing decisions

For existing coal producers, the key driver of volume is how the coal price compares to their marginal cost of production. Marginal cost refers to the minimum operating cash cost of producing additional coal from operating mines. Where supply is balanced with demand, the price will be determined by the highest marginal cost supplier of the total required volume (where this is provided at least overall cost).

Wood Mackenzie prepares international cost curves for all producers in the seaborne thermal and coking coal markets. These coal cost curves are based on a calculation of total cash costs for each mine, incorporating mining, coal preparation, transport and port costs, as well as overheads and royalties and levies.

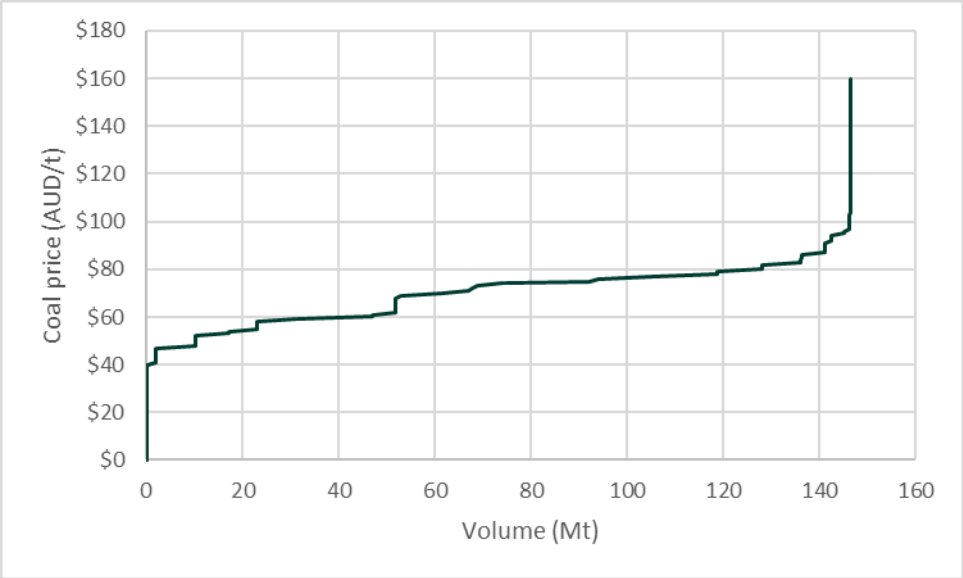
In theory, no other costs are relevant for existing producers, as their initial fixed investment costs are deemed sunk. However, this situation is different for new projects, as the initial investment costs are not yet sunk. Therefore, the relevant costs for new projects also include recovery of capital expenditure and a required rate of return on capital. Where supply from operating mines is inadequate to meet demand, the price will need to be sufficient to provide an incentive for new mine development. Therefore, the price will be expected to reflect the operating cash cost, capital expenditure and required rate of return on capital, on a levelised (annuitized) basis, for the highest cost supplier of the total required volume (where this is provided at least overall cost).

As discussed below, coal that is exported via Port of Newcastle competes in the global seaborne coal markets. In purchasing coal, buyers will take account of the cost of transporting the coal from the point of sale to the point of its ultimate consumption – this includes PNO's channel charges. Any increase in the charges imposed by PNO will be expected to commensurately reduce the price paid for the coal. As a result, for coal producers, changes in PNO's channel charges will have a similar impact as a direct change in input costs, and will influence:

- the margins achieved from existing projects (noting that there is substantial sunk investment in existing projects);
- the volume from existing projects, but only where the input cost increase is sufficient to move the mine to the position where it is at or above the marginal cost price (or decrease is sufficient to move the mine to a position where it is below the marginal cost price) – noting that there may be incentives for mines to maintain production even when suffering a cash loss, given the existence of fixed costs, together with the costs of stopping and restarting production; and
- the viability of new projects, and hence incremental volume growth.

The potential impact on Newcastle coal exports can be assessed based on an examination of cost curves, as developed by Wood Mackenzie. Figure 2 shows the cost curve for all thermal coal exported through Port of Newcastle.

Figure 2 Port of Newcastle thermal coal supply curve – existing projects (2018, AU$/t)



Source: Wood Mackenzie, Synergies analysis

The data in Figure 2 shows that, where thermal coal prices are above AU$80/t, most existing mines that operate through the Port of Newcastle are able to operate such that marginal cost is materially less than price.[19] As a result, there is unlikely to be any loss in volume for a modest increase in input costs. However, the effect on profitability will be more severe if the coal price decreases below AU$80/t. For example, at prices of AU$65/t, as was observed at times over the last five years, many mines would be under intense cost pressure. A number of these would only be able to continue operating with negative cash margins, and they would consider options for reducing volumes if this would allow them to reduce their cash losses. Note, however, that there are several factors which will serve to mitigate the impact on volumes from an increase in charges for the Service, such as:

- the impact of take or pay charges for rail and export coal terminal services – these costs (estimated to be on average AU$13.50/t for Newcastle exporters) are in essence fixed for mines – hence, they cease in a relevant sense to be cash costs; and
- abandoning a mine or ceasing operation (i.e. putting a mine into "care and maintenance") and subsequently re-commencing operations as prices improve is

[19] Price and cash cost data from Wood Mackenzie are expressed in US$. We have converted these values to AU$ using an exchange rate of 0.74 US$/AU$, which is consistent with the exchange rate at the end of July 2018. As we discuss below the cash cost curves include charges that are take or pay in nature, and as such, do not vary strictly with output in the short term.

not a costless exercise. Consequently, it is entirely rational for mines to continue operations despite short term losses, reducing output only to the extent that they are able to reduce variable cost.[20]

Potential cost impact of volume changes

Based on our understanding of the cost structure of ports, together with available evidence in relation to Port of Newcastle, we anticipate that PNO's cost structure for the Service is likely to be substantially fixed over a wide volume range. This reflects that:

- the largest cost is the capital cost of providing the channel and associated infrastructure, which is already sunk. PNO has previously submitted that it has channel capacity in excess of 328mtpa (compared to 2017 usage of 167mtpa) – indicating that there may be little foreseeable need to invest in new capacity;[21]
- operating costs, such as channel dredging and port management costs, are expected to be substantially fixed; and
- a number of the cost items that are likely to be more variable, for example the cost of managing vessel movements in the port, are largely borne by the harbour master service, provided by the Port Authority of NSW rather than by PNO.

Therefore, we consider that it is reasonable, for the purpose of this analysis, to assume that over the foreseeable volume range, a change in PNO revenue will be fully reflected as a change in profit.[22]

Given these anticipated changes in volume associated with a change in price, and the anticipated changes in cost associated with a change in volume, it is possible to assess the effect on PNO's profit from pursuing a strategy that focuses on volumes as compared to a strategy that focuses on price.

Strategy 1: maintaining price to encourage incremental volume

This strategy reflects the status quo, and we consider that the volume that is 'most likely' to arise from this strategy will reflect current forecast exports from the Port of Newcastle.

Using forecasts from Wood Mackenzie, Figure 3 shows that export volumes are expected to increase between now and 2021, and thereafter remain generally stable until 2030. As

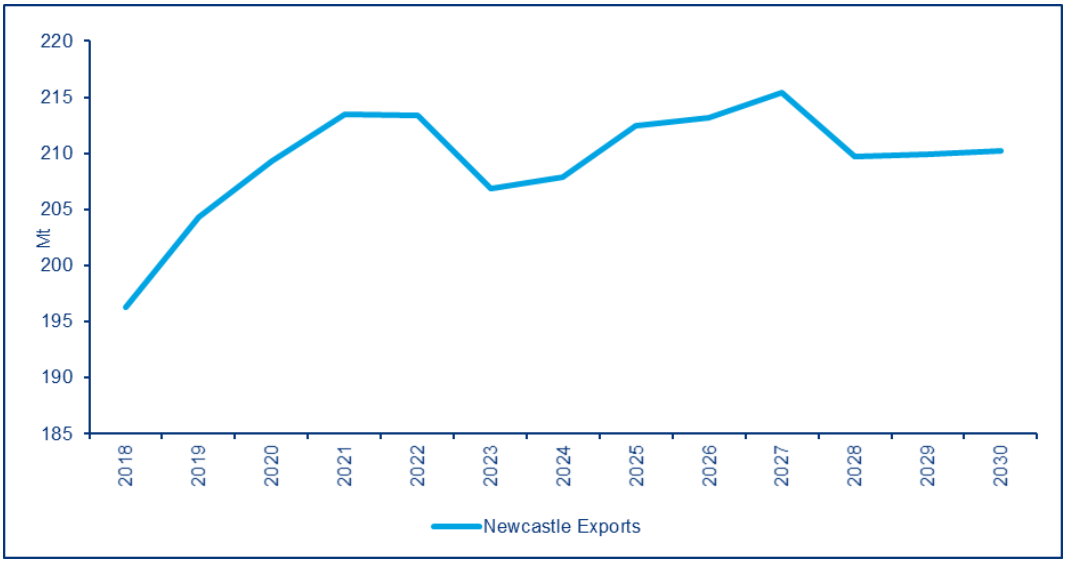
[20] Dixit, A.K. & R.S. Pindyck (1994), Investment under Uncertainty, Princeton University Press, Princeton, N.J., 1994

[21] PNO (2018), p.34

[22] Even though that may not be strictly the case in practice.

a result, it seems doubtful that maintaining current prices is expected to encourage significantly higher volume.

Figure 3 Predicted Newcastle export volumes



Source: Wood Mackenzie

Strategy 2: increasing price and accept consequential impact on volume

An alternate strategy would be for PNO to increase prices and accept the consequential impact on throughput volumes.

To assess the impact of this, it is necessary to first consider:

- the range of possible price increases that PNO may apply;
- the likely impact that such price increases may have on volume; and
- assess the likely impact that the combination of price and volume may have on PNO profit.

In considering these issues, we have assumed, for simplicity, that volume will reduce if the cash cost of production is higher than the expected sale price. However, as discussed above, there are several factors which will serve to mitigate the impact on volumes from an increase in charges for the Service. Further, as has been seen in the recent times, coal producers will quickly respond to reducing coal prices by aggressively reducing their cash costs to preserve margins. As a result, we consider that our approach will indicate the likely 'worst case' impact on volumes as a result in changes in the price for the Service.

In the absence of any regulatory constraint, it is difficult to estimate with any confidence the prices that PNO may contemplate. In order to estimate what charges PNO may consider, we have referred to the range of navigation service charge (NSC) scenarios that Synergies developed during the declaration assessment process in 2015. These scenarios identified the charges that could be presented as being consistent with a building block model based on publicly available information and a series of assumptions on potential asset lives and asset values.[23]

The 2015 analysis identified that PNO's 2015 channel charges (which were estimated to be equivalent to approximately $0.53/t) could potentially increase by a further 211% to $1.64/t, based on a building block model.[24] Using these scenarios as a guide, we have considered the impact on PNO's profit from an increase in charges of $1.00/t. However, recognising that there is no obligation on PNO to set charges with reference to a building block model (or to retain parameter values contained in it), we have also considered the impact on PNO's profit from a more extreme increase of $3/t.

Using cost curve data from Wood Mackenzie, it is possible to assess the extent to which such input cost increases will cause operating mines to move to the position where they are at or above the marginal cost price.

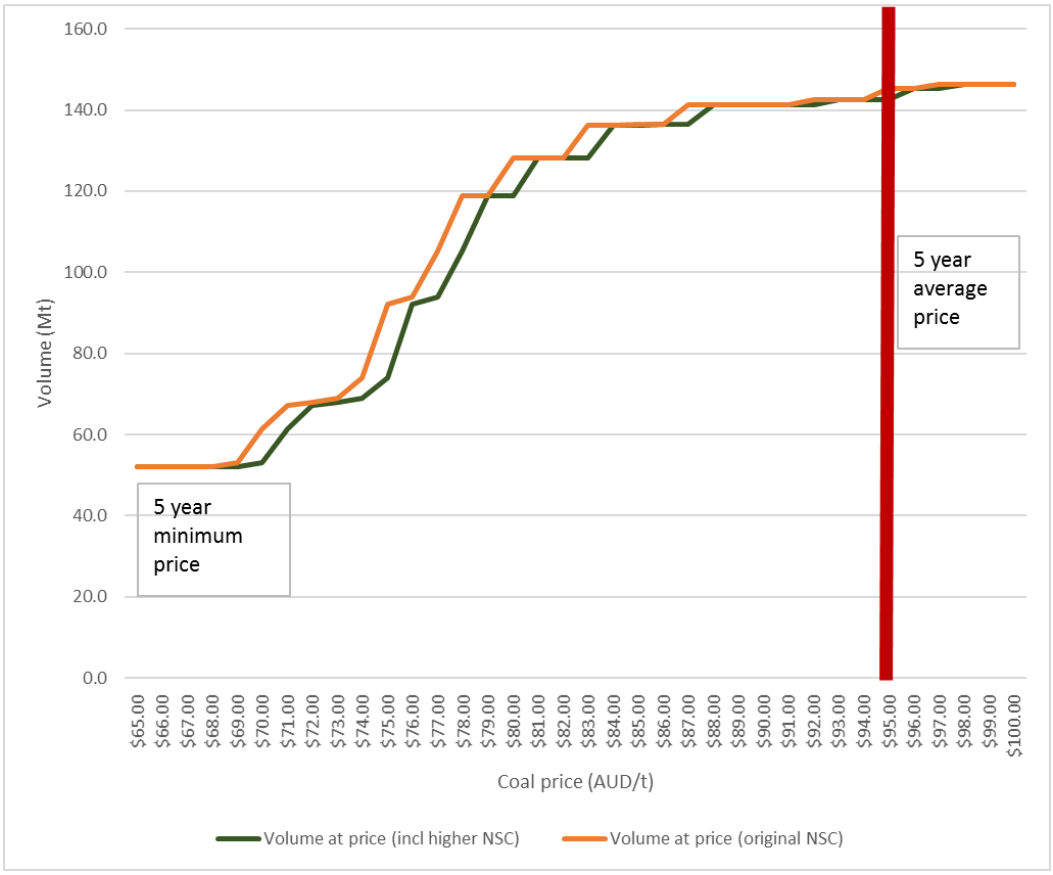
Figure 4 displays the potential sensitivity of volume from existing mines to a change in input costs over range of feasible coal prices. While coal prices remain the key determinant of volume, the change in input costs for mines exporting from Port of Newcastle will result in a change in their position on the international cost curve. In terms of establishing a feasible range of coal prices, it is noted that coal prices have exhibited substantial volatility over the last five years. The average thermal coal price over this timeframe was AU$95/t, although it was as low as AU$65/t in April 2016. We note that Wood Mackenzie forecasts a thermal coal price of AU$100/t in 2020, increasing modestly over the following decade.

In Figure 4, the impact of an increased port charge is demonstrated by the difference between the orange and green lines. The orange line illustrates expected volumes assuming that the port charge remains at its present level. Meanwhile the green line shows the potential volume response, at a range of coal prices, assuming the charge is increased by AU$1/t. Consequently, the gap between the two lines indicates the shortfall in volume that could arise from an increased port charge.

[23] Glencore (2015), Applicant's response to the draft recommendation not to declare the shipping channel service at the Port of Newcastle, 9 September, Annexure A.

[24] All references to the navigation services charge, or increases in the navigations services charge, are expressed in AU$.

Figure 4 Volume differential with a $1/t increase in PNO's access charge



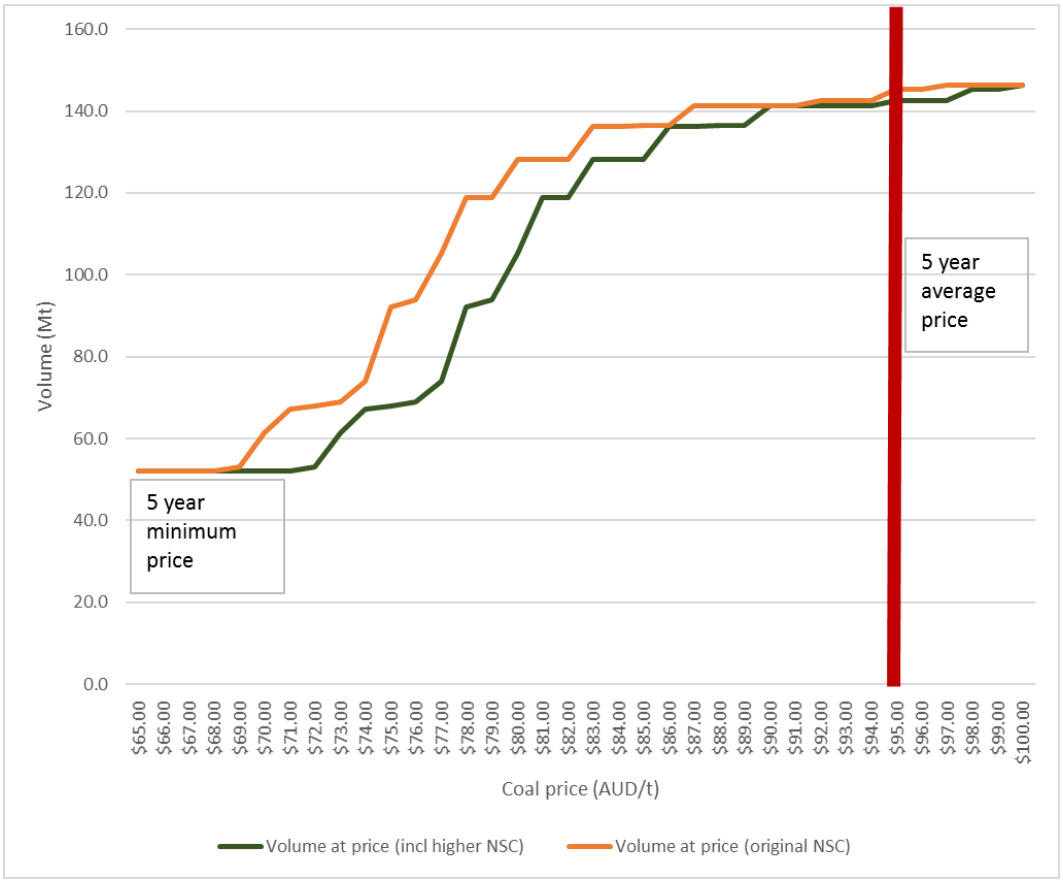
Source: Wood Mackenzie, Synergies analysis

Figure 4 clearly shows that, at higher coal prices, volume from existing mines is highly inelastic. The consequence of this is that, theoretically, PNO has the scope to increase prices substantially without discouraging throughput when coal prices are high. Having regard to the theoretical diagrams presented in the previous section, the positive price effect outweighs any negative quantity effect, such that this trade-off is unlikely to constrain profit if the coal price is sufficiently high. In effect, the only constraint on prices in such a circumstance is likely to be a regulatory one.

The effect of an increase in the port access charge is predicted to be more acute at lower coal prices. For example, if coal prices were to fall below AU$80/t, the difference in volume with and without the increased port access charge could be as high as 10mtpa on existing projects.

The volume differential with a AU$3/t increase in the access charge over the base case is displayed in Figure 5. The potential divergence in volume follows a similar pattern, although it is more pronounced.

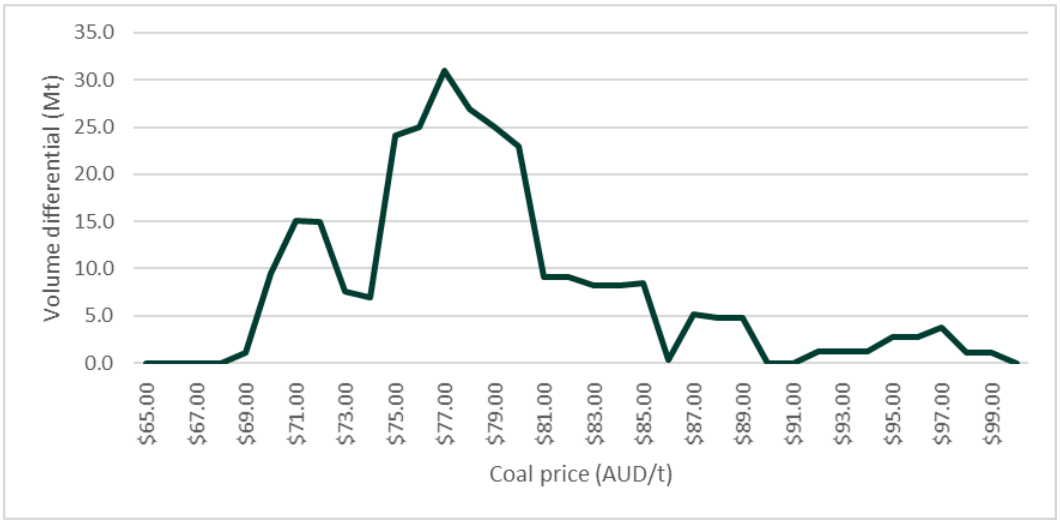
Figure 5 Volume differential with a $3/t increase in PNO's access charge



Source: Wood Mackenzie, Synergies analysis

Figure 6 shows the magnitude of the volume differential; that is, the difference between the orange and green lines in Figure 5. This shows that the change in volume is negligible at prices above the five year average of AU$95/t. However, at prices at the lower end of the five-year range, a higher port charge could prematurely induce volume contractions of 20 to 30mtpa.

Figure 6 Magnitude of volume differential with a $3/t increase in PNO's access charge



Source: Wood Mackenzie, Synergies analysis

This analysis, while not without limitations, verifies the expectation that in each case, even if an increase in port charges discouraged all expansion volumes, the increase in port charges will not be sufficient to undermine existing volume to an extent that PNO's profits would be materially adversely affected. Rather, the increase in port charges brings forward the point where cash costs exceed price, such that in the event of declining coal prices, mine operators are priced out of the market more quickly than would have been the case under a lower navigation services charge.

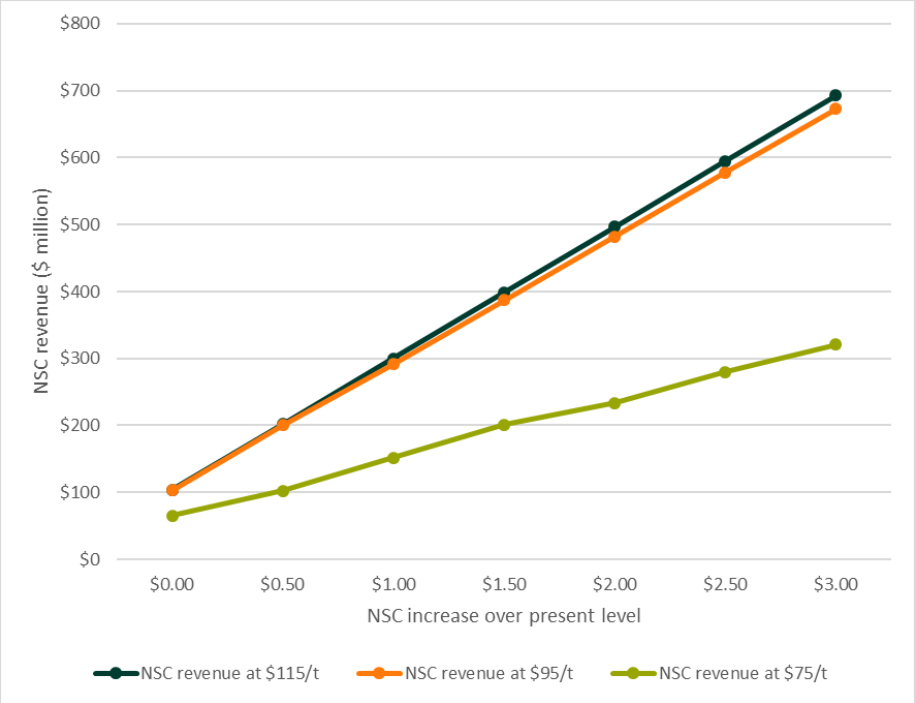
Profit impact of alternate pricing strategies

Figure 7 shows the profit impact for PNO of the alternate pricing strategies discussed above. These estimates have been calculated on the basis of three potential coal price scenarios:

- AU$95/t, which is the average price over the last five years;
- AU$115/t, which is AU$20 above the five-year average price; and
- AU$75/t, which is AU$20 below the five-year price (but still above the 5-year minimum).

Each coal price scenario is assigned a different line on the chart. Each line shows the change in PNO revenue under access charge increases that range from no increase to an increase of AU$3/t. As explained earlier, given the dominance of fixed costs, the revenue impact can be interpreted as a profit impact for PNO.

Figure 7 Profit maximising scenarios under various coal prices and port charge increases



Source: Synergies

Figure 7 shows that each of the identified port charge increases is expected to lead to an increase in profit, regardless of the prevailing coal price. The highest of the increases examined ($3/t) could lead to revenue of almost $700 million. It should be noted that the revenue scenarios for coal prices of AU$95/t and AU$115/t are almost identical, whereas the scenario which assumes a coal price of only AU$75/t results in significantly lower revenue for each port price increase. This is because of the similar volume under the former two scenarios, as the majority of mines remain profitable at these coal prices, whereas at a price of AU$75/t, the price increases may lead to a reduction in volume. However, the key point is that even with a price increase of $3/t over the current level, and assuming a coal price of AU$75/t, PNO's profits still increase despite the realisation of materially lower volumes.

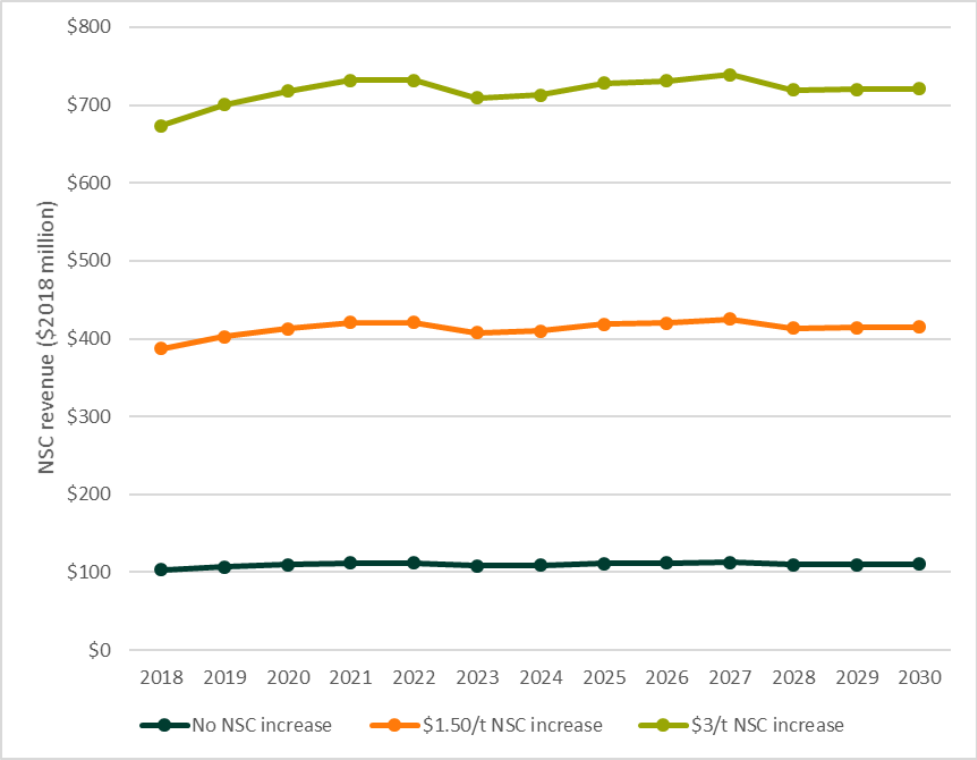
Figure 7 illustrates the profit incentives at a single point in time. However, a key question is how these revenue scenarios could develop over time. Possible revenue scenarios for 2018-2030, assuming a coal price of AU$95/t, are shown in Figure 8. These scenarios are as follows:

- no increase in port access charge, and volumes based on Wood Mackenzie forecast;
- a $1.50/t increase in port access charge, and volumes adjusted for impact of charge increase; and

- a $3/t increase in port access charge, and volumes adjusted for impact of charge increase.

Although long term forecasts are subject to considerable uncertainty, Wood Mackenzie predicts Newcastle exports to be approximately 210Mt in 2030, an increase of only 7% on the forecast 2018 volume of 196.3Mt. Consequently, a strategy of keeping port charges steady (as shown by the dark green line) to encourage future volume growth will have only a marginal effect on PNO revenue over the longer term. On the other hand, because of the insensitivity of volumes to price increases, it would foreseeably be possible for PNO to increase charges materially (as shown by the light green and orange lines) without jeopardising long-term revenue.

Figure 8 PNO revenue scenarios under different charge increases, 2018-2030



Note: Wood Mackenzie estimates the 2018 Newcastle export volume to be 196.3 Mt, of which 146.7Mt is attributable to thermal coal. For simplicity, we assume that volume changes for thermal and coking coal are consistent over time. A coal price of $95/t is assumed for all scenarios in this figure.

Source: Wood Mackenzie, Synergies analysis

Importantly, this analysis does not mean that the highest of the considered price increases is the profit maximising price. Given the relative insensitivity of volume from existing mines to changes in port charges, it is quite likely that further price increases beyond that shown in these scenarios would increase PNO's profits even further.

We also acknowledge that the profit increase may not be enduring, as the price increases are likely to undermine exploration and investment in mining projects, which is expected to cause a longer term decline in volumes. However, even if price increases were to result in a 25% reduction in long term volumes, as is possible with a $3/t price increase at a coal price of $75/t, Service revenue could still be increased from $65.3 million to $321.1 million, as per the light green line in Figure 7. Even if such price increases lead to a further 25% decline in long term volumes due to the reduction in incentives for exploration and mine development, PNO's revenue would still be $240.8 million – far higher than would be the case without the price increase.

Further, in the event that volumes were to start to decline more materially over the long term, it would remain open to PNO to adjust prices to limit the impact of volume decline, including through:

- a reduction to its navigation service charge if it considered that this may delay such volume decline (and hence maximise PNO's profitability); or
- introducing price discrimination, reducing the charge applied to relatively more elastic volume (e.g. through the application of a price discount or rebate), while maintaining the charge applied to inelastic volume.

2.3.4 What will constrain PNO's profit (price) maximising behaviour

PNO has submitted that it has contractual obligations to the State (as part of the lease transaction) which mean it does not have an incentive to diminish the long-term output of the Hunter Valley coal industry.[25] However, leaving aside whether the State would enforce such obligations, Synergies considers that this incentive will not act as a significant constraint on prices. Our previous analysis demonstrates that price adjustments in the order of up $3/t are possible without triggering any major reduction in volumes at current and forecast prices. Provided that PNO stays within this large band of possible price increases and does not price in a way that causes a substantial reduction in volumes, is it unlikely that PNO would ever conceivably be in breach of these obligations to the extent they are meaningful.

We consider that the threat of alternate regulatory oversight is also weak. As part of the original declaration proceedings, PNO (and NSW Treasury) both submitted that the ability of PNO to increase prices is constrained by legislative pricing monitoring arrangements, specifically the *Ports and Maritime Administration Act 1995* (NSW) (PAMA

[25] PNO (2018), p.35

Act), *Ports and Maritime Administration Regulations* 2012 (NSW) and the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW).[26] However, both the Tribunal and the NCC have previously acknowledged that the existing NSW monitoring regime provides effectively no constraint on pricing practices, and as such, the regime would be highly unlikely to meet the requirements for certification under the National Access Regime.

Further, we consider that the NSW Government is subject to a clear conflict of interest in this matter. The price monitoring framework established under the PAMA Act was put in place in preparation for the NSW Government's program for port privatisations, including Port Botany, Port Kembla and Port of Newcastle. By providing such a light handed price monitoring arrangement, the NSW Government established a regulatory arrangement that was likely to maximise the prices that it would achieve for these assets. Indeed, as noted above, the price achieved for Port of Newcastle was well above analysts' expectations at that time.

This may explain why no action was taken against PNO following price increases in excess of 40%—increases that are completely unprecedented in the context of privatised assets in Australia. Given the absence of a response by the NSW Government and the lack of transparency concerning the specifics of the transaction and the charging structures agreed as part of that transaction, coal producers can have no confidence in the integrity of the NSW Government's imposition of regulatory constraints in respect of this issue.

Moreover, introducing price regulation shortly after such privatisations, however warranted, would be likely to undermine the assumptions that underpinned PNO's bid for the port. While we are not aware of whether this would have caused any specific consequences in relation to the Port of Newcastle transaction, it would certainly be likely to undermine the confidence of investors in relation to any future asset privatisations by the NSW Government. As a result, the NSW Government has a strong incentive to not introduce any more stringent arrangements for the regulation of prices at Port of Newcastle.

The ACCC's view is that price monitoring, in general, is not an effective constraint on monopoly power. For instance, using the existing airports monitoring regime as an example, the ACCC has previously stated that:[27]

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[26] PNO (2015), Submission in response to Glencore's application to the National Competition Council, 18 June 2015, p.14. see also NSW Treasury (2015), Glencore's application for Declaration of Shipping Channel Services at the Port of Newcastle, June 2015, p.5

[27] ACCC (2011), Submission to the Productivity Commission's inquiry into the economic regulation of airport services, March 2011, pp.4-6, p.18

> With regards to assisting the competitive process, monitoring has limitations in its scope to correct market failure when the causes extend beyond information asymmetry…
>
> …Although monitoring has played a role in problem identification, it is ineffective as a tool to address the problem it identifies…There is greater justification instead, to look to regulatory arrangements that respond appropriately to the risks that have been identified, and can facilitate market based outcomes…
>
> …monitoring does not present an effective constraint on monopolists' market power.

This is consistent with the Tribunal's 2016 decision to declare the Service which found that there were no direct regulatory constraints on PNO's pricing structures. It noted that coal miners supplying coal into the coal export market from mines in the Hunter Valley have no "real practical alternative" to using the Service, and in more profitable times, they are "vulnerable to charging changes imposed by PNO for access…".[28]

In practice, the effectiveness of a price monitoring process will depend upon the credibility of the threat of more heavy handed regulatory responses to the exercise of monopoly power. As we have seen no response from the NSW Government to PNO's conduct to date, we conclude there is no credible regulatory threat or constraint to that conduct other than Part IIIA of the CCA.

2.3.5 Conclusion

Before considering the competition effects of possible changes in the declaration status of the Service, Synergies considers that it is first important to establish the key factors that are likely to influence PNO's pricing behaviour in the absence of declaration, which can be summarised as:

1. PNO has a commercial objective to maximise profits when setting access charges;
2. notwithstanding that PNO is heavily reliant on coal throughput for its revenue and profit, as shown above, PNO's profits will be most effectively maximised through increasing prices and accepting any likely consequential impact on existing coal volumes.
3. existing constraints (other than declaration) on PNO's ability to significantly increase prices are generally accepted to be weak.

[28] Australian Competition Tribunal (2016), *Application by Glencore Coal Pty Ltd* [2016] ACompT 6, p.36

Therefore, in the absence of declaration, PNO has the incentive and ability to impose further significant price increases on coal users.

While PNO claims that it will apply a building block methodology in establishing charges for the Service[29], application by a monopolist of a building block methodology does not provide any confidence in the resulting prices being reasonable, if there is no constraint or review on the manner in which it derives the inputs to that model. As shown by Synergies' previous analysis[30], price increases of over 200% could be conceivably be argued under a building block methodology based on PNO's published asset valuation. Further, there is also no constraint on PNO subsequently changing these parameter values in order to 'legitimise' additional price increases. Moreover, in the absence of declaration, there is no obligation on PNO to apply a building block methodology, and no constraint on it applying a different methodology at a future point in time.

Finally, regardless of the price increases that PNO would actually apply in the short term, market participants will necessarily have regard to the risk that, in future, significant price increases may be imposed. That is, particularly when making a decision whether to invest in exploration or development, coal producers will base their decision on the price that they anticipate that PNO may apply. In an environment where there is no meaningful regulatory constraint on PNO's ability to increase prices, and where PNO has previously shown a willingness to sharply increase prices without any change in the cost or nature of the Service provided, there is a very high probability of further substantial price increases from current levels. As a result, it is inevitable that potential investors will base their investment decisions on conservatively high estimates of potential PNO charges, given its pricing incentives and constraints, as described in this section.

[29] PNO (2018), p.17

[30] Glencore (2015), Applicant's response to the draft recommendation not to declare the shipping channel service at the Port of Newcastle, Annexure A, 9 September.

3 Assessment of Criterion (a)

3.1 Approach to assessing impact on competition

It is necessary to assess criterion (a) on a forward looking basis. This involves a comparison of the future state of competition in the relevant market with declared access to the Service and the future state of the competition without such declared access.

In assessing an application for declaration of a service, the NCC usually first considers whether the relevant markets are currently workably competitive, on the basis that declaration is unlikely to promote competition in a market that is already workably competitive. Where a market is not workably competitive, the NCC then considers whether declaration will promote competition in that market.

The NCC, in its guidance, indicates that in order to recommend revocation, the NCC must reach the view that if an application for declaration were being brought today, it would not meet one or more of the declaration criteria.[31]

In the current case where the Service is already declared, it is necessary to compare the future state of competition in the status quo with continuing declaration and the future state of competition where declaration is revoked. In this context, an assessment that there is currently workable competition in relevant markets is not determinative, as declaration may have driven the dependent markets to a state of workable competition. This is relevant as one needs to consider how competition is likely to evolve without declaration and then assess whether declaration will promote competition in the future.

3.2 Identification of the relevant markets

Criterion (a) requires that the markets, other than the market for the Service, in which competition is to be promoted, be identified.

Synergies notes that PNO's application for revocation has accepted that criterion (a) should be assessed in terms of the impact on the same markets considered for the purposes of the original declaration application:

1. a coal export market;
2. markets for the acquisition and disposal of exploration and/or mining authorities (referred to in this report as a 'coal tenements market');

[31] NCC (2018), Declaration of Services – A guide to declaration under Part IIIA of the Competition and Consumer Act 2010, April 2018, p.47

3. markets for the provision of infrastructure connected with mining operations, including rail, road, power and water (referred to in this report as an 'infrastructure services market');

4. markets for services such as geological drilling services, construction, operation and maintenance (referred to in this report as a 'specialist services market'); and

5. a market for the provision of shipping services including shipping agents and vessel operators, of which ships exporting coal from the Port of Newcastle are part (referred to in this report as a 'shipping market').[32]

PNO has submitted that there is no evidence that increased access, on reasonable terms and conditions as a result of the declaration of the Service, would promote a material increase in competition in the coal export market, and as such, there is no basis to conclude that increased access would have a material effect on competition in any of the markets that are a derivative of the coal export market.[33]

Synergies disagrees with this presumption and considers that there is a need to independently analyse and assess the impact on competition in each of the dependent markets. Importantly, PNO's presumption does not acknowledge the impact of access to the Service, on reasonable terms and conditions, on those dependent markets which rely primarily upon the prospects for ongoing future growth in export coal production from the Newcastle catchment area, rather than on continuing production from established mines. In this regard, Synergies considers that the most significant loss of competition that would result from revocation of the declaration will occur in the coal tenements market. Given the timeframe available for this report as determined by the NCC timetable, this market has been the focus of our review.

Each of the five dependent markets, put forward by Glencore in its originating application and previously accepted by PNO, the NCC and the Tribunal, have been defined in varying degrees of detail in the regulatory proceedings so far. However, we consider that in order to more closely examine the competition impacts in these markets, a more detailed description of their respective characteristics is required, having regard to the generally accepted dimensions of market definition, including product, function and geography (and sometimes temporal attributes, depending on the type of asset and prevailing market conditions). However, consistent with the ACCC approach in its Merger Guidelines, the product and geographic aspects are usually the most important

[32] PNO (2018), p.16

[33] PNO (2018), p.37

from a competition perspective.[34] These market definition dimensions are presented below.

The NCC has previously indicated that, in competition law matters, it considers market definitions using a 'purposive' approach. It also noted that the particular purpose of the market definition in the consideration of applications for declaration is to enable examination of the effect of access or increased access as a result of declaration on competition in a dependent market.[35] We have adopted this approach as a basis for further defining the relevant markets.

3.2.1 Coal export market

The scope of the dependent coal export market was examined more closely than other dependent markets as part of the original declaration application process.[36] A brief overview, with some additional commentary on the main distinguishing characteristics that are considered relevant to conducting a competition analysis, is presented below.

The Hunter Valley Coal Industry and associated export supply chain is the largest coal export operation in the world. Spread over 250km, the coalfields in the Newcastle catchment area (including the Hunter Valley, Newcastle, Western and Gunnedah basins) produce over 170 million tonnes of saleable coal per year. This is around 90% of New South Wales production and 40% of Australia's black coal production.[37]

A map of the Hunter Valley Coal Chain network is presented below.

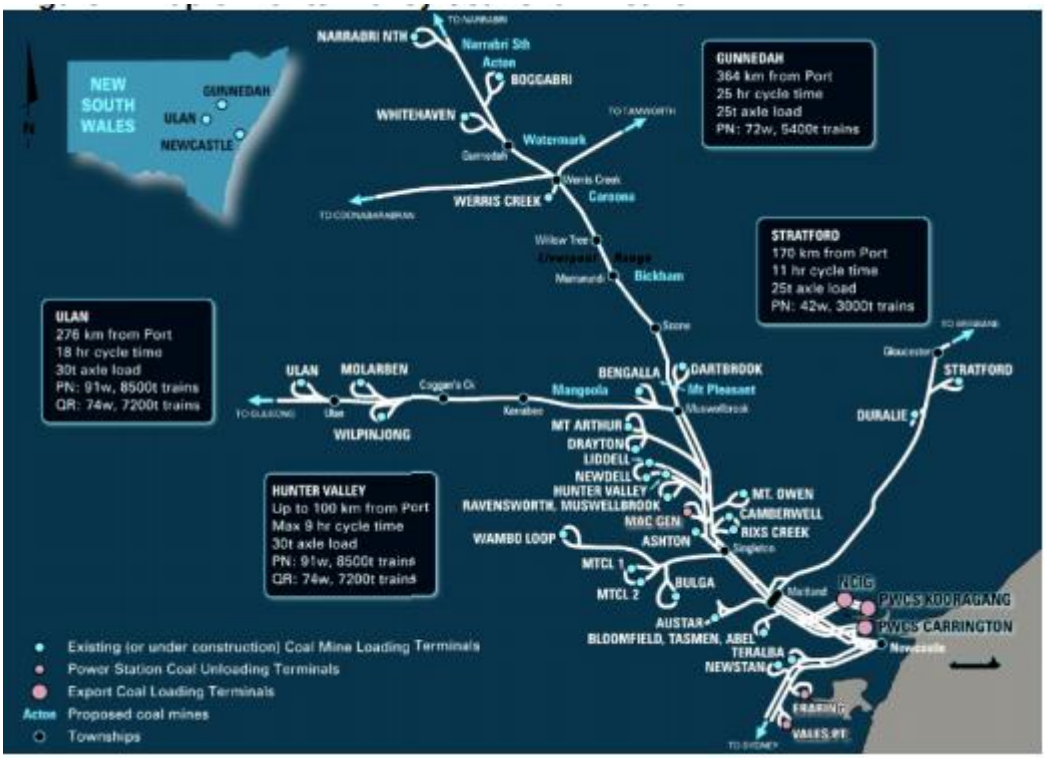
[34] ACCC (2008), Merger Guidelines, amended in November 2017, p.13

[35] NCC (2018), Declaration of Services, A guide to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth), April 2018, p.29

[36] See section 8.4 of Glencore's application to the NCC dated May 2015. A copy is available at http://ncc.gov.au/images/uploads/DEPONAp-001.pdf

[37] Glencore (2015), Application for a declaration recommendation in relation to the Port of Newcastle, May 2015, p.3

Figure 9 Hunter Valley Coal Chain network



Source: Glencore (2015), Application for a declaration recommendation in relation to the Port of Newcastle, p.4, previously sourced from HVCCC

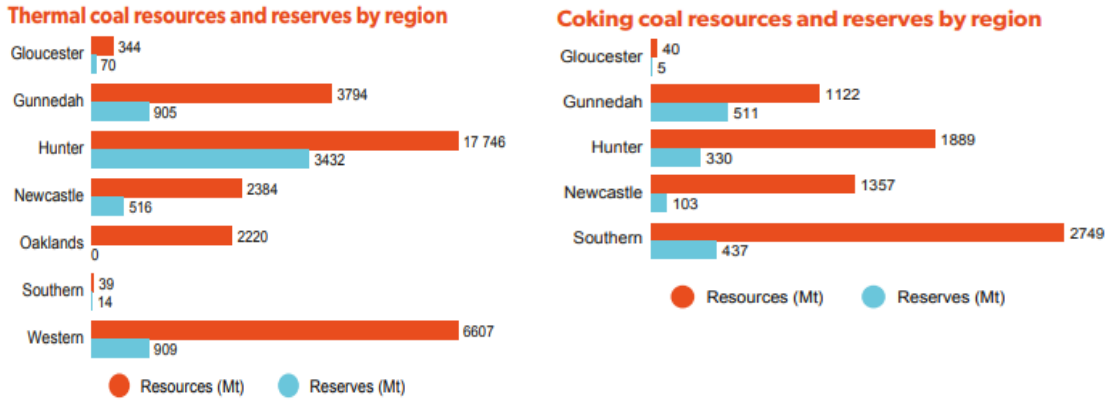
In relation to the **product dimension** for the coal export market, Synergies considers that, given their substantially different properties and uses, there are separate markets for thermal and metallurgical (coking) coal:

- thermal coal is used to provide base load energy to produce steam for power generation, heating and industrial applications such as cement manufacture;
- metallurgical coal is used in steel production. It is used either to produce coke, which is then fed into the top of the blast furnace along with the iron ore, or for pulverised coal injection (PCI), where the coal is injected directly into the base of the blast furnace.

The thermal and coking coal markets operate largely independently, although some degree of substitution between thermal coals and lower ranked coking coals is possible.

The NSW coalfields primarily operate in the thermal coal market. This is illustrated in Figure 10 below which shows that NSW's thermal coal resources and reserves are significantly greater than coking coal (with coking coal reserves primarily located in the southern basin, which exports through Port Kembla).

Figure 10 Thermal and Metallurgical coal resources and reserves by region in NSW (million tonnes)



Source: NSW Department of Planning and Environment, November 2017

Reflecting this, most of the coal mines exporting through the Port of Newcastle are either wholly or predominantly thermal coal mines, with 85-90% of Newcastle coal exports being thermal coal.[38]

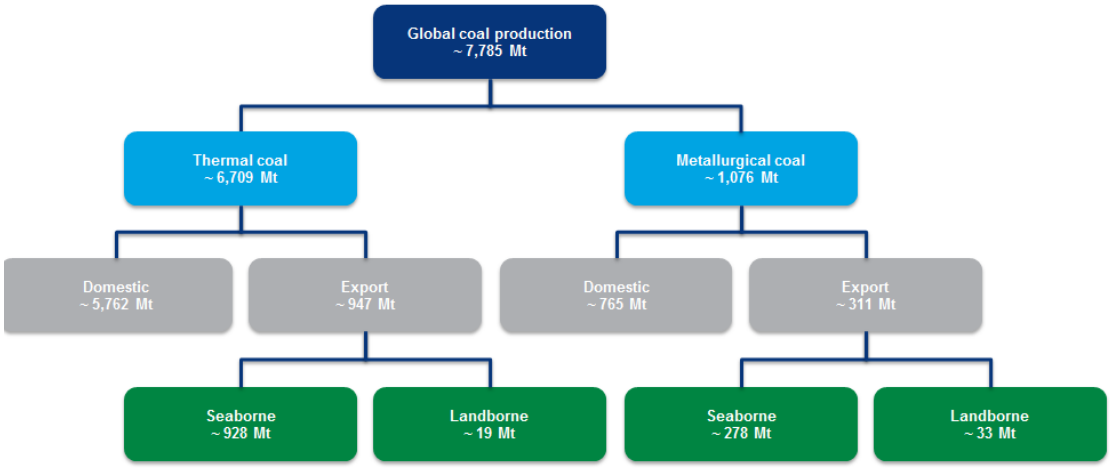
Therefore, while we consider that there are two relevant coal export markets, we consider that the most significant of these is the thermal coal market. While, in its revocation application, PNO has not specifically defined the product dimension of the export coal market, we note that in its discussion on the export coal market it has similarly acknowledged the differences between coking and thermal coal, and has focussed its attention on the thermal coal market. Therefore there appears to be agreement on this matter.

The **functional dimension** for the coal export markets is the sale of coal products for export.

[38] The Centre for International Economics (2014), The contribution of mining to the New South Wales economy – prepared for the NSW Minerals Taskforce, September 2014, p.14

The **geographic dimension** of the coal export markets is often regarded as being global in nature. However, it is useful to consider in more detail what is meant by this. Figure 11 categorises the global coal market according to a number of key characteristics:

Figure 11 2016 estimated global coal production by market and end-use



Source: Wood Mackenzie

As can be seen from this figure, most coal is used in the country in which it is mined. China, the US, and India in particular – the world's three largest coal producers – consume the majority of their coal domestically. Of the two methods of cross border trade, landborne and seaborne, the seaborne market is far more significant in terms of size – landborne coal trade is confined to just a few key areas: Russia, China and Eastern Europe. Despite its relatively small proportion of global coal production, the Australian coal industry is a major participant in the seaborne export coal markets.[39]

The Reserve Bank of Australia (RBA) has examined coal markets and has identified that the global market for traded coal can be viewed as consisting of two broad geographical markets, which have historically been somewhat separate because of the effect of transport costs:

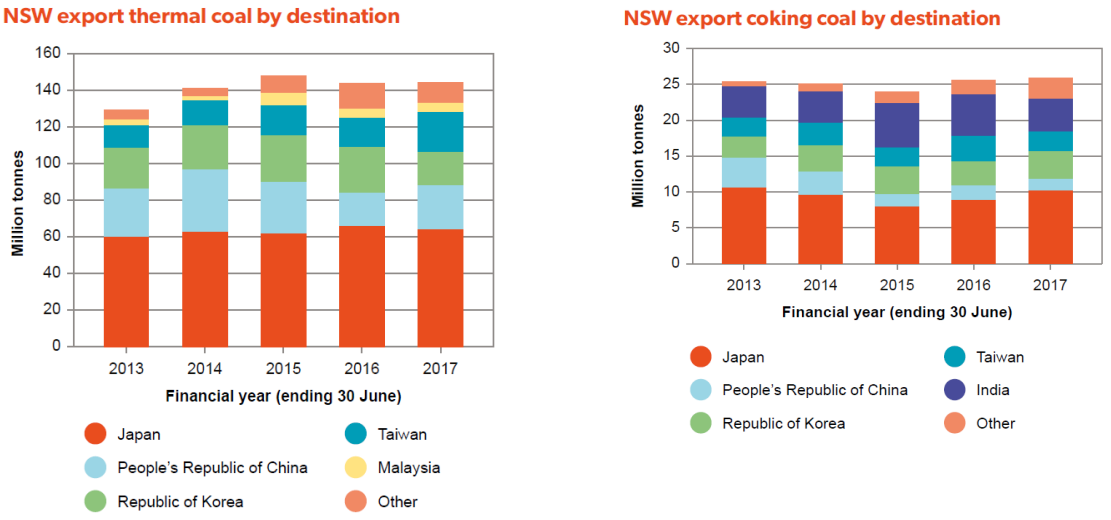
1. the Atlantic market, which consists of exports from the Americas and Russia to countries in Europe; and

2. the Asia-Pacific market, which largely consists of coal trade from Australia and Indonesia to countries in Asia and the Pacific, including China, Japan and Korea. Wood Mackenzie estimates that the Pacific market accounts for approximately 75% of seaborne coal trade.

[39] Based on advice provided to Synergies by Wood Mackenzie

Figure 12 shows the destination of NSW thermal and metallurgical coal exports between 2013 and 2017. It shows that the vast majority of NSW coal exports are directed to the Asia-Pacific market.

Figure 12 NSW exports of thermal and metallurgical coal by destination, 2013 to 2017



Source: NSW Department of Planning and Environment (2017), Thermal coal opportunities in New South Wales, November 2017; Coking coal opportunities in New South Wales, November 2017.

The RBA further noted that these large markets have historically been quite separate, with only Russia and South Africa tending to supply both depending on price differentials across the markets. However, more recently, lower costs of freight, subdued demand from importers and an increase in the volume of traded coal from both traditional and non-traditional suppliers have all worked to increase the links between these two markets.[40] As a result, there is some degree of competition between these markets, with the result that a price increase in one geographic zone will cause supply from the other zone to be diverted into that market, meaning that the market prices in the two geographic regions evolve similarly.[41] Notwithstanding that the prices between the two geographic zones are linked, we consider it remains unclear as to whether they are so linked that a common market is likely on a longer term forward looking basis.

[40] Reserve Bank of Australia, Statement on Monetary Policy, February 2013. See http://www.rba.gov.au/publications/smp/2013/feb/box-a.html

[41] International Energy Agency, Medium-Term Coal Market Report 2016, p.55-56. The IEA report plotted steam coal prices for three different regions, - the ARA CIF in north-west Europe, Richards Bay in South Africa and Newcastle for the period 2002-16. All three price indexes were well co-integrated, and highly correlated despite regional differences.

From this, we conclude that the relevant geographic zone of the coal export markets is most likely to be limited to the Asia-Pacific region. However, in the context of our analysis in section 3.2.2 below, we do not consider that it is necessary to be definitive on this issue.

3.2.2 Coal tenement market

The NCC, the Tribunal and PNO have each previously accepted a separate dependent market(s) for the acquisition and disposal of exploration and/or mining authorities. The product, functional and geographic dimension of this market were not examined in detail in the originating declaration proceedings.

Synergies considers that this market is best defined as the market for prospecting, exploring and developing coal deposits within the Newcastle catchment area (at its broadest level), and that it is likely that is this comprised of smaller regional markets in the areas of the Hunter Valley/Western Basins and the Gunnedah Basin.

The basis for this market definition is described below.

Coal tenement rights

Investment in exploration is necessary for developing coal reserves to meet future expected demand. In NSW, between half and three quarters of investment is spent on existing deposits ('brownfield'), as opposed to new deposits ('greenfield').[42]

In Australia, mineral resources are owned by the Crown, regardless of who owns surface rights to the land. A tenement refers to a claim, created by a lease or licence that gives its holder the right to explore for resources or to undertake production.[43] Generally, the process for allocating rights begins with an exploration licence, which permits the holder to explore for resources on a specified area of land.[44]

Tenements are typically mutually exclusive in so far as two parties cannot hold licences to explore the same piece of land. Tenements are usually time-limited. This enables jurisdictions to maximise resource rents (where the State government receives a payment from the explorer in return for allowing it to exploit a natural resource which is owned by the State) by incentivising explorers to progress works and ensuring that

[42] The Centre for International Economics (2014), The contribution of mining to the New South Wales economy – prepared for the NSW Minerals Taskforce, September 2014, p.16

[43] This is consistent with FMG's definition used in its application to the NCC for declaration of a service provided by the Mt Newman Railway Line. See NCC (2005), Draft recommendation on Application by Fortescue Metals Group Limited for declaration of a service provided by the Mount Newman Railway Line, November 2005, p.77

[44] Productivity Commission (2015), Examining Barriers to More Efficient Gas Markets, March 2015, p.56

deposits are not hoarded. At expiration, a company may choose to renew its licence rights, surrender its licence (and therefore the right to further explore that area) or apply for a production licence if coal has been discovered.

The ability to prospect and explore for coal in New South Wales is governed by the *Mining Act 1992* (NSW) ('the Mining Act'). Before exploring for coal, an explorer must first obtain an Authority under the Act. There are specific permits for coal exploration. Exploration authorities include an exploration licence and an assessment lease. These authorities are approved and regulated by the NSW Department of Industry, Resources and Energy. An exploration licence gives the licence holder the exclusive right to explore for specific minerals within a designated area, but does not permit mining. These licences can be granted for periods up to six years,[45] and can be renewed for a further term of up to six years.[46] Exploration licences are generally required to be reduced by 50% (of the project area) on each renewal.[47] An assessment lease (or also known as retention leases) enables explorers to maintain an interest in areas of land containing mineral resources where extraction is not yet commercially viable.

The design of the rights to explore deposits and prove coal resources and the method by which those rights are allocated can affect efficiency in that market. Since 2014, the NSW Government, in response to concerns about the lack of transparency and corruption in the allocation of exploration licences, has initiated a range of reforms, including the introduction of a competitive selection process for the granting of exploration licences (as opposed to the pre-existing direct allocation of licences by the Government to selected parties). In explaining its rationale for these reforms, the NSW Government highlighted its aim of 'promoting competition in the sector for access to and commercialisation of coal assets'.[48]

Following the initial allocation of coal tenement rights, subsequent transactions can take several forms:

- disposal and acquisition of shares in the corporate entity that has the licence to explore a tenement;

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45 See *Mining Act 1992* (NSW), section 27

46 See *Mining Act 1992* (NSW), section 114

47 See https://www.resourcesandgeoscience.nsw.gov.au/miners-and-explorers/applications-and-approvals/environmental-assessment/exploration

48 NSW Government, media release, Strategic Statement on NSW Coal, August 2014. A copy is available at https://resourcesandgeoscience.nsw.gov.au/__data/assets/pdf_file/0006/521637/Strategic-statement-on-NSW-coal.pdf

- transfer of a licence, noting that under NSW legislation, exploration licences and retention leases can be traded, although this requires the approval by the NSW Government before a transfer can occur; or
- creation of a joint venture where the entity that has a licence to mine the tenement shares the future proceeds of subsequent mining with another entity, in return for capital to construct the mining infrastructure.

The Productivity Commission examined the tenement regime in relation to Australia's gas and energy resources sector and noted that the ability to transfer resource rights was an economically desirable aspect of the system as it enables the rights to be transferred to those who value them most highly, facilitating allocative (and dynamic) efficiency. In the case of retention leases, the ability to transfer rights can also help ensure that companies most adept at developing resources obtain the rights to do so (promoting productivity efficiency).[49] These efficiencies would be reduced if there was a material reduction in competition in the market for tenements.

Further defining the coal tenements market

Synergies considers that the relevant **product dimension** for the market for coal tenements should appropriately be described as the rights to explore a specific coal deposit, with different markets existing for predominantly thermal and predominantly coking coal deposits. As described above, in NSW, with the exception of the Illawarra district, the coal reserves are predominantly thermal coal, and similarly the coal tenements market will be essentially a thermal coal tenements market.

We have considered whether it is necessary to further specify the product dimension to be proven[50] deposits. In examining this issue, we have had regard to the NCC's view in the FMG matter where it said:[51]

> It is unlikely that an iron ore deposit would be subject to transactions where the extent and value of that deposit have not been proven, at least to a level where there is a reasonable prospect that the deposit will prove to be economically exploitable.

In the context of coal exploration, we understand that the NSW Government undertakes initial drilling of exploration areas prior to their release, in order to initially prove the

[49] Productivity Commission (2015), Examining Barriers to More Efficient Gas Markets – Commission research paper, March 2015, p.57

[50] 'Proving' is used in this context to describe the proves of ascertaining (or "proving up") the nature and extent of a deposit. This is consistent with NCC Draft Recommendation on FMG's application to declare a rail service, p.78

[51] NCC (2005), Draft recommendation on Application by Fortescue Metals Group Limited for declaration of a service provided by the Mount Newman Railway Line, November 2005, p.79

existence of resource. Companies will then conduct further exploration to better define and more fully prove the resource.

In considering what level of 'proving' is required, we consider that the tenements market should include all tenements released by the NSW Government for further exploration. We consider that prescribing the product market to more comprehensively proven tenements would unnecessarily limit the tenements market to only where further exploration expenditure has occurred and, as such, limits the market to the sale of tenements that have been explored, rather than to the release of tenements for exploration.

We have reached a view that the market should not be restricted to fully proven deposits. As part of the NSW Government's recent reforms affecting the coal mining and exploration industry, it is reasonable to expect their stated objectives pertaining to promoting competition in the industry would include competition for new licences to explore where reserves are known to exist but have not yet been fully proven.

Synergies considers that the **functional dimension** for the coal tenements market is separate from mining and marketing activities. Exploration and development of coal tenements is part of the production chain, and vertical integration efficiencies do not appear to preclude a separate functional market for these exploration activities. This is consistent with the nature of transactions that take place for coal tenements, where explorers may develop the tenement themselves, and/or sell to another party that has greater capacity to develop a mine.[52] This separate functional market is therefore appropriately described as prospecting, exploring and developing activities. This prescription is also consistent with the NCC's approach to defining the market for iron ore tenements in the Pilbara.[53]

The next question then becomes defining the **geographic dimension** for the coal tenements market. The geographic market is the area of effective competition in which sellers and buyers operate.

The Tribunal has previously noted that what is relevant as a starting point, are actual sales patterns, the location of customers and the place where sales takes place and any geographic boundaries that limit trade.[54] Under the NSW regulatory regime, there is a competitive selection process for coal tenements where the NSW Government is the sole

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[52] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, p.252; Productivity Commission (2015), p.57

[53] NCC (2005), Draft recommendation on Application by Fortescue Metals Group Limited for declaration of a service provided by the Mount Newman Railway Line, November 2005, p.81

[54] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, p.233

issuer (i.e. the seller) of mining exploration tenements across the state (although these tenements may then be traded). These permits to explore do not apply to deposits outside of NSW. Furthermore, the permits apply to exploration of a specific mineral deposit and a particular location in NSW. In other words, they cannot be used to explore for other mineral deposits at other intra-state locations. In effect this means that, irrespective of the options that buyers of exploration rights might have, the sellers of those rights are restricted in terms of the locations for the rights.

While the NCC's final decision on the originating application for declaration of the Service at the Port of Newcastle did not seek to define the tenements market in any detail, the NCC noted that it considered it likely that the tenements market would extend beyond the Newcastle catchment area, although not necessarily beyond Australia.[55] This was based on the view that parties seeking coal mining authorities may be able to consider different locations, for instance coal mining regions located in the Newcastle catchment area or coal mining regions in Queensland, thus expanding the field of substitutes.[56]

Synergies has reviewed the NCC's 2015 position in the context of the revocation application and considers that a more detailed assessment of the geographical limitations of the market is required before any such findings could reasonably be made. In particular, we note that the NCC's final recommendation considered substitutability only from the perspective of buyers of tenements and not sellers of tenements where potential monopsony (buyer) power is an issue. We also note that the NCC's final recommendation did not consider in any detail the aspects of this market, such as the differences in coal types or quality (i.e. thermal coal is predominantly mined in NSW while coking coal is predominantly mined in Queensland) and it did not consider the extent to which access to and cost of logistics infrastructure influences the extent to which buyers will see tenements in different regions as direct substitutes (noting that the most substantial thermal coal deposits in Queensland are located in the Surat and Galilee basins, which have limited, if any, existing available transport infrastructure).

Synergies considers that the relevant tenements market is confined at its maximum to a regional market where coal exports would necessarily go through the Port of Newcastle. This follows from considering the relevant market by application of a hypothetical monopsony test and asking the question whether a hypothetical monopsonist buyer of tenements, linked to supply through the Port of Newcastle, can profitably lower the price

[55] NCC (2015), Declaration of the shipping channel service at the Port of Newcastle – Final Recommendation, November 2015, p.32

[56] NCC (2015), Declaration of the shipping channel service at the Port of Newcastle – Final Recommendation, November 2015, p.32

for mining authorities by the imposition of a small but significant non-transitory decrease in price.

In applying this test there is a need to consider the options of sellers of the mining authorities as well as the scope for other buyers to be willing to enter the market and buy the relevant authorities thereby defeating the attempt to exercise monopsony power. In this case seller substitution takes the place of buyer substitution in the standard Hypothetical Monopolist Test, while other buyers take the place of substitution on the supply side which can be implemented as part of the test or at a subsequent stage.

Consider the market from the perspective of a hypothetical monopsonist, that is, a single buyer of mining authorities linked to supply through the Port of Newcastle. As the tenements are specific to defined locations in NSW, and, if developed, would have no option but to export via the Port of Newcastle, the seller would not have options to supply tenements except to that single buyer. Therefore, it follows that a monopsony buyer of tenements linked to the Port of Newcastle catchment could profitably reduce the prices paid for those tenements.

Importantly, this differs from the situation that led to the Tribunal's conclusion in relation to the FMG matter that a monopsony buyer of iron ore tenements linked to a specific rail line could not profitably decrease the price paid for tenements because sellers would easily find an alternate purchaser.[57] At the time of that decision, there was no third party access available to existing rail lines, and there was therefore likely to be no perceived advantage in being in close proximity to an existing rail line.[58] As the Tribunal noted, the declaration application under consideration related only to the BHP Billiton rail lines, and that many of the Pilbara tenements would have effective substitutes available to them in the form of alternative rail lines (including both existing and planned rail lines).[59] This contrasts with the tenements in the Newcastle catchment area, which have access to no existing or planned substitute to the Port of Newcastle.

While considerations of limited options for sellers of authorities constrains the geographic scope of the market to the broader Newcastle catchment area, Synergies considers that the market for coal tenements in the Newcastle catchment may be further defined into key regional markets.

Figure 13 below shows that there are three distinct areas within the broader Newcastle catchment where coal exploration licences have been issued by the NSW Government.

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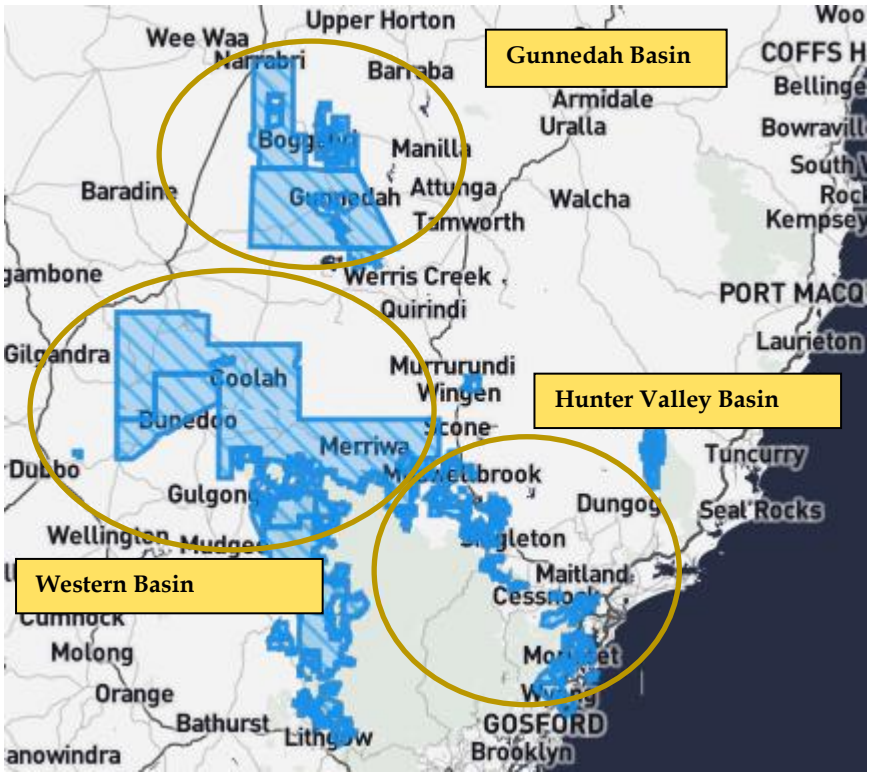
[57] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, p.258

[58] Dalrymple Bay Coal Terminal User Group (2018), Declaration review regarding Dalrymple Bay Coal Terminal – Submission to the Queensland Competition Authority, 30 May 2018, p.46

[59] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, p.250

1. the Hunter Valley and Newcastle Basins;
2. the Gunnedah Basin; and
3. the Western Basin.

Figure 13 Coal exploration licences in Newcastle catchment area (2018)

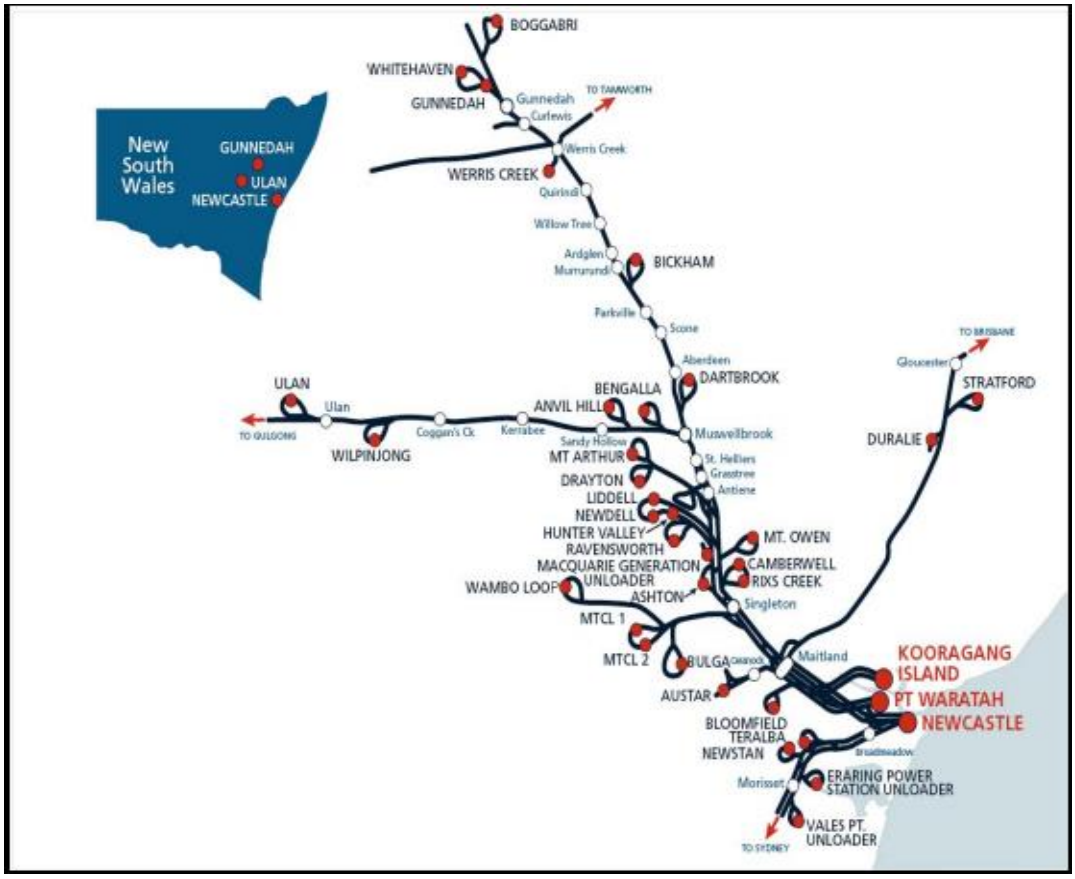


Source: http://commonground.nsw.gov.au/#!/title-map/Coal/Exploration%20Licence/Standard/7/-31.87755764334002/149.8480224609375

While there are other sites of coal exploration identified in this map (i.e. south towards Lithgow), the three regions identified above broadly align to the location of the Australian Rail Track Corporation (ARTC)'s 'Zone 1', 'Zone 2' and 'Zone 3' mines (see Figure 14 below). This rail network connects the coalfields and reserves to the Port of Newcastle ensuring that tenements have access to an effective logistics option.[60]

[60] While mines elsewhere in the Western Basin may also have access to a rail network, this is the NSW Country Regional Network, which is of significantly lower standard, and in many cases requires trains to transit the Sydney metropolitan area. This is a much less efficient option, with commensurately higher transport costs involved.

Figure 14 ARTC geographic zones for Hunter Valley Coal Network (2018)



Source: ACCC (2010), Australian Rail Track Corporation Limited Hunter Valley Coal Network Access Undertaking – Draft Decision 5 March 2010, p.60.

From a demand perspective, it is necessary to consider the extent to which tenements within each of the regional markets in the Newcastle catchment area are considered to be close substitutes. Where there is a high level of substitutability for coal tenements at different locations, then it is reasonable the NCC might conclude that the areas are in the same market. Conversely, where coal tenements in different locations are not highly substitutable, then it is reasonable to argue that different geographic markets should be recognised.[61]

We have conducted a review of the tenement owners of NSW coal exploration licences across the Hunter Valley, Gunnedah and Western basins. The results are summarised in Table 2 below. A more detailed listing is presented in Appendix B.

[61] NCC (2018), p.29

Table 2 Coal exploration licences in NSW – July 2018

	Hunter Valley Basin	Western Basin	Gunnedah Basin
Number of permits	66	19	20
Number of companies	15	7	5
Top permit holders	Glencore (15)	Glencore (4)	Whitehaven (9)
	Yancoal (14)	Yancoal (3)	Idemitsu (2)
	Centennial (8)	Peabody (2)	Yancoal (2)
	Australia Pacific Coal (4)	KEPCO Korea (2)	Laneway Resources (1)
	Korea Resources (4)	Bickham Coal Co (2)	Shenhua Group (1)

Note: Permits have been identified, wherever possible, to parent companies.
Source: NSW Department of Planning and Environment at www.commonground.nsw.gov.au [accessed on 30 July 2018]

The table shows licence holders of exploration rights in NSW comprise a mix of owners of existing coal mines and explorers who do not have an existing operation. It also shows that while there is crossover of title ownership between the Hunter Valley and Western Basins, there is very little crossover of title ownership between these two basins and the Gunnedah Basin.

Based on the Tribunal's identified starting point of actual sales patterns and location of customers, it appears that the Gunnedah Basin may be a separate market to the Hunter Valley/Western Basins. We consider that this apparent limited demand substitutability can be explained by a number of key differences between the regions:

- the exploration permits relate to different geological basins. This has implications for the type and quality of coal reserves, which will impact on the potential price for coal and mining costs; and
- their relative proximity to port, as shown in Table 3 and the volume of coal transported from the basin to port, both of which in turn have important implications for the cost for transporting coal from site to port in the event that these exploration sites are commissioned as mining operations.[62]

[62] The NSW Department of Planning and Environment notes that the granting of an exploration licence does not give any right to mine, nor does it guarantee a mining lease will be granted with the exploration licence area. See https://www.resourcesandgeoscience.nsw.gov.au/miners-and-explorers/applications-and-approvals/mining-and-exploration-in-nsw/coal-and-mineral-titles for further details.

Table 3 Geographic areas of coal tenements – proximity to Port of Newcastle

Geographic area	Average distance from Port of Newcastle	Distinguishing features
Hunter Valley Basin	0 – 100 km	lowest cost structure due to close proximity to port and high traffic volumes leading to high economies of scale
Western Basin	275 km	average cost structure due to moderate proximity to port and moderate traffic volumes
Gunnedah Basin	365 km	highest average cost structure given it is long distance from port and small traffic volumes, leading to limited economies of scale

Source: Synergies, based on distances identified in Figure 9 as published by the HVCCC.

Given the differences in these factors for each of the NSW coal basins identified above, tenements in the Gunnedah basin appear to systematically attract different potential buyers compared to tenements in the Hunter Valley and Western Basins (although all are still required to have regard to the cost of access through the Port of Newcastle).

Further, over time the deposits which are being explored and developed have a tendency to be further away from the port, such that infrastructure costs would be anticipated to become more and more important to the prospect of tenements being developed into producing mines, and hence to the valuation of those tenements. This has similarly been recognised by the DBCT User Group which recently argued that the market for coal tenements in Queensland is most appropriately limited to the Hay Point catchment rather than a broader Bowen Basin market.[63]

On the basis of this analysis, Synergies submits that, at its maximum scope, the coal tenements market that connects to the Port of Newcastle is confined to the broader Newcastle catchment area. However, the geographic market may be more accurately described as comprising regional catchment markets, focussed around the Hunter Valley and Western Basins and the Gunnedah Basin.

3.2.3 Other dependent markets

As part of the consideration of the original declaration, PNO, the NCC and the Tribunal accepted three of Glencore's other dependent markets:

- *Infrastructure services market*: markets for the provision of infrastructure connected with mining operations, including export coal terminals, rail (infrastructure and haulage), road, power and water;
- *Specialist services market*: markets for services such as geological drilling services, construction, operation and maintenance; and

[63] Dalrymple Bay Coal Terminal User Group (2018), Declaration review regarding Dalrymple Bay Coal Terminal, Submission to the Queensland Competition Authority, 30 May 2018, p.43

- *Shipping market*: a market for the provision of shipping services including shipping agents and vessel operators, of which exporting coal from the Port of the Newcastle are part.

Glencore's application identified an additional dependent market for financing of coal projects, but this was not accepted by the NCC or Tribunal as comprising a separate market for the purposes of Part IIIA.

The activities in these agreed markets occur in connection with, or derive from, the primary activity of the production and sale of coal. A brief overview of these markets is presented below. Given the timeframe available for this submission, we have not undertaken a detailed investigation of the product, functional and geographic dimensions of these markets, as we consider that our assessment of the impact on competition in the coal tenements market is sufficient to satisfy criterion (a). Further definition of these markets should be undertaken.

Infrastructure services market

The Hunter Valley Coal Chain relies upon a significant amount of investment into the infrastructure that supports coal development and export from the Port of Newcastle. The coal terminals (PWCS and NCIG), ARTC rail track and rail haulage providers are reliant upon commercially viable development projects and export operations.

In its submission, Glencore has provided details of mining operations in the Hunter Valley, including numbers of producers and mines, and of related infrastructure services, such as rail services and the port terminals identified above.

We note that the NCC has previously considered this market to be localised to the Hunter Valley, given that coal in the region is what is being transported and loaded onto ships for export at Newcastle. Infrastructure services in other geographic locations (for example above and below rail assets, port loading terminals) will not be substitutable. The NCC further noted that this was consistent with publicly available material relied upon by PNO.[64] We therefore consider that the geographic dimension of this market is the Newcastle catchment area.

Specialist services market

The mining specialist industry provides construction, drilling, geological and technology services that help downstream mining companies to build infrastructure and engage in exploration and production at mining sites. There are numerous industry

[64] NCC (2015), Final Recommendation on Declaration of the shipping channel service at the Port of Newcastle, November 2015, p.32

participants ranging from small operators (e.g. with one or two drilling rigs) to very large operators (who may have over 20 rigs that can be deployed). Some firms offer specialised services for coal deposits, while other firms, depending on the size of the geological workforce, may provide services in relation to exploration of other mineral deposits. Glencore noted in its 2015 submission to the NCC the market is labour intensive and fragmented with many small operators concentrating their activities within a certain geographic location or product segment.[65]

As the NCC previously noted in the original declaration proceedings, providers of specialist services may be able to work in different mining regions around Australia,[66] suggesting that the market, or least some products within in, may have a national focus.

Commercial shipping market

The commercial shipping market covers shipping agents and vessel operators calling at the terminals at the Port of Newcastle. The NCC earlier accepted that there were separate markets for bulk and containerised shipping services and the relevant market is for bulk shipping services (but not solely coal bulk shipping services). Further, the NCC considered that there may be some limits to substitution (in particular ports may have limitations on ship sizes), but did not reach a final view.[67]

3.3 Impact on competition in dependent markets

The degree to which competition in each of the dependent markets is affected by a revocation of the declaration is likely to vary across the various dependent markets reflects:

- the extent to which there are entities in those markets who are not affected by the prospect of higher port charges at the Port of Newcastle;
- the potential market influence of the entities that are affected;
- the extent to which their competitiveness is affected; and
- entry and exit barriers.

Market definition is crucial to understanding the scope of the impact on competition of declaration (to identify the dependent markets) as well as the intensity of the impact

[65] Glencore (2015), Application for a declaration recommendation in relation to the Port of Newcastle, May 2015, p.26

[66] NCC (2015), Final Recommendation on Declaration of the shipping channel service at the Port of Newcastle, November 2015, p.32

[67] NCC (2015), Final Recommendation on Declaration of the shipping channel service at the Port of Newcastle, November 2015, p.31

(whether declaration is likely to result in a material increase in competition or not). Where the markets are broadly defined, for example from a global geographic perspective, the effects on competition are most likely to be more limited then when the markets are confined to regional areas within NSW.

Coal sourced from the Newcastle catchment area is a major source of supply in seaborne markets in the Asia Pacific – the Asia Pacific seaborne coal thermal market is one market dependent on the Service. However, there are several of the other dependent markets that are highly reliant on the production of coal from the Newcastle catchment area, and in turn, the Service. At least one of these dependent markets – the coal tenements market – is a local market where coal supply must be transported via the Port of Newcastle. The market for the provision of infrastructure to support mining operations in the Newcastle catchment area is also likely to be a local market, as recognised by the NCC.[68]

In considering this issue, we consider that it is important to recognise that a distinction needs to be made between a reduction in competition in the relevant coal export markets and the impact on competitiveness of coal exports sourced from the Newcastle catchment area.

The competitiveness of coal exports can deteriorate and cause flow-on competition reducing effects in other dependent markets, without there being a material reduction in competition in the relevant coal export market. This is because competition in some dependent markets will depend on the strength of demand for services and other inputs and reduced competitiveness of coal will, in time, have an adverse impact on these markets.

Therefore, in order to assess the potential impact on competition in the dependent market, we have first considered the impact that the declaration will have on the competitiveness of coal exports sourced from the Newcastle catchment area. We have then considered the implications, first in relevant coal export markets, and then in the coal tenements markets, where it is considered there is likely to be a material impact on competition over the longer term sufficient to meet criterion (a).

As noted above, given our view that criterion (a) is satisfied in relation to the coal tenements market and in view of the time constraints, we have yet not undertaken a detailed assessment of the remaining identified markets. As a result, we are unable to presently conclude that there would be no competition effects in these markets as a result of revocation of the declaration. Further analysis of these markets should be undertaken.

[68] NCC (2015), Final recommendation on Declaration of the shipping channel service at the Port of Newcastle, November 2015, p. 32

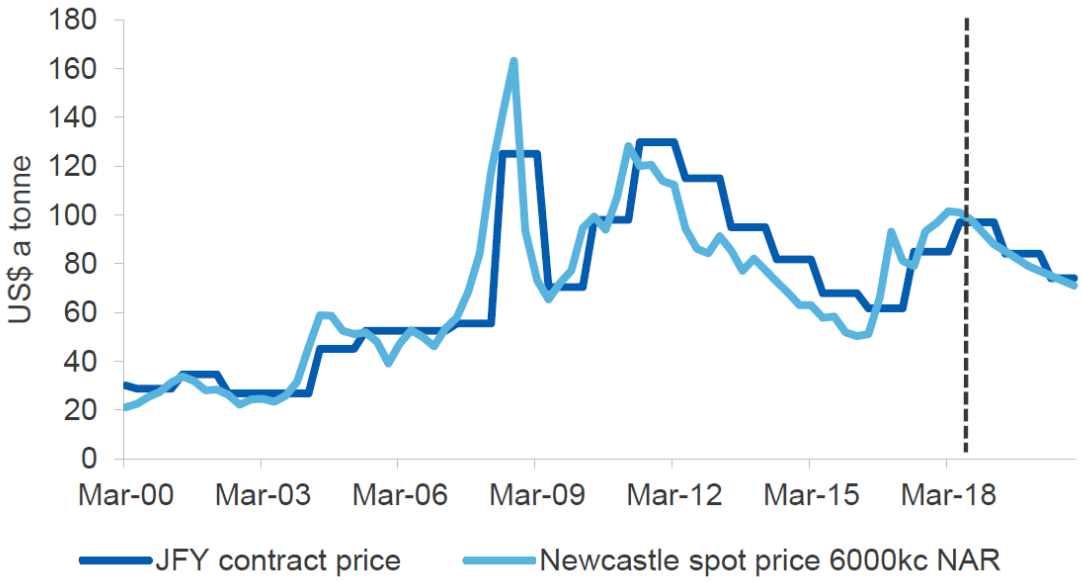
3.3.1 Impact on competitiveness of coal producers in Newcastle catchment area

This section discusses conditions in the thermal coal export market and the impact that revocation of the declaration is likely to have on the competitiveness of coal exports from the Newcastle catchment area in that market.

Seaborne thermal coal market

We concur with PNO's assessment that the seaborne thermal coal market (however described geographically) is cyclical and volatile. Since the initial regulatory proceedings in 2015, conditions in the seaborne thermal coal market have improved, with prices having recovered from their previous lows, as shown in Figure 15.

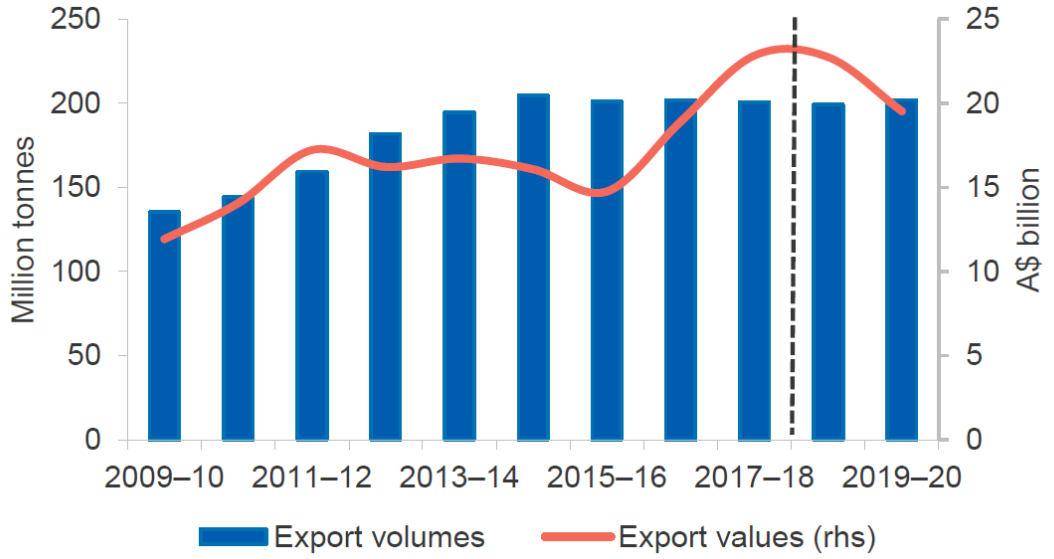
Figure 15 Benchmark thermal coal prices



Source: Office of Chief Economist, Resources & Energy Quarterly, June 2018

However, while export coal prices have increased materially since 2014, Australian thermal coal exports have not grown commensurately over this period, as shown by Figure 16.

Figure 16 Australia's thermal coal exports



Source: Office of Chief Economist, Resources & Energy Quarterly, June 2018

There has been some recent investment in additional coal production capacity, both in the Newcastle catchment area and elsewhere in Australia, as a result of these recent price increases. However this has been limited, largely reflecting the cautious outlook of investors together with the view that the factors influencing the thermal coal price may be transitory in nature.[69]

However, on the basis of these recent trends, it is reasonable to assume that circumstances where existing mines have been operating with low, or even negative, margins have passed, at least for the time being.

Nevertheless, as discussed in section 2.3, revocation of the declaration will result in a high likelihood of further significant price increases at the Port of Newcastle, particularly given the that there is no credible threat of regulation, as discussed in section 2.3.4. Even if PNO does not immediately raise prices following revocation of the declaration, market participants will necessarily factor in the high likelihood of future significant price increases.

This will have substantial impact on the decision of existing miners and/or potential new entrants as to whether to invest in new or expanded mining projects in the Newcastle catchment area. The impact will be particularly significant for smaller or more marginal coal producers who, unlike some of the larger miners, may not be able to absorb the increased exposure to increased cost and risk.

[69] Office of Chief Economist (2018), Resources and Energy Quarterly, June 2018, p.36

Investment pipeline

PNO suggests that there are healthy growth and investment prospects for the Newcastle catchment coal sector, and in support of this, cites a number of proposals for new and expanded coal mines in the Hunter Valley.[70] However, we are concerned that this may overstate the strength of the coal mining investment pipeline in NSW. Notwithstanding that coal prices have increased significantly since 2016, investment in coal production and exploration have remained weak.

With the exception of MACH Energy's development of the Mt Pleasant mine, the majority of PNO's identified proposals for increased coal production relate to previously committed mine developments (e.g. Whitehaven's Maules Creek project) or minor expansions of existing mines aimed at 'sweating' the existing assets in order to maximise production while prices remain high.

Reflecting this, of the 19 current proposals to expand coal mines listed by PNO, Wood Mackenzie forecasts that two thirds of these will be producing at or near PNO's cited expanded volume in 2018. Further, this additional production has largely been based on established proven reserves. Limited exploration expenditure, as discussed in section 3.3.3 below, means that the pipeline for further mine development is becoming increasingly uncertain.

A recent study into the competitiveness of Australia's coal sector by National Energy Resources Australia (NERA) identified that Australia now performs poorly in the exploration and development phase of the industry value chain, when compared with international peers. Specifically, NERA noted that:[71]

> Development is a key weakness for the Australian coal industry. Capital costs for projects built over the last 5 years averaged US$7.2/t, the highest in the world, and almost 50% above average. While excessive demand during the boom saw significant cost inflation and project delays, this does not fully explain Australia's poor performance; instead, structural factors; such as the high cost of labour, are a major cause of this weakness. In the past two years, construction and labour costs have been falling; however, they are still among the highest in the world, and further labour cost reductions are unlikely to provide the step change in costs required. The country's current poor development capability is a severe barrier to investment.

Accordingly, NERA identifies international cost competitiveness as a major concern for further exploration and development of Australia's coal reserves. In the absence of a

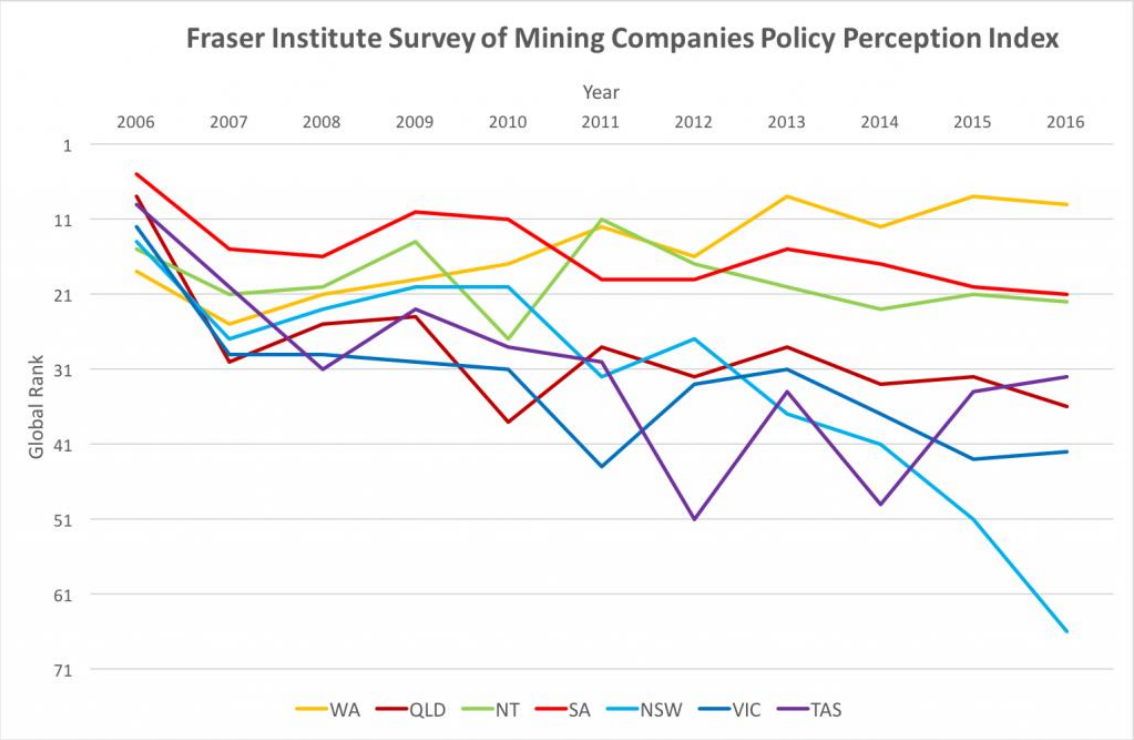
[70] PNO (2018), p.24

[71] National Energy Resources Australia (2016), Coal Industry Competitiveness Assessment, December 2016, p.13

significant cost advantage over international competitors, the viability of developing new and expanded coal projects is now far more marginal than has historically been the case. Commitment to further investments in coal production will be subject to final decisions regarding project viability, and will depend on the level of investor confidence in the NSW coal sector.

A measure of industry confidence in the mining sector, known as the annual Fraser Institute of Survey of Mining Companies, presents a policy perception index and ranks countries and states according to the extent to which public policy factors encourage or discourage investment.[72] The results of the Fraser Institute's 2016 survey for Australia are presented below.

Figure 17 Policy perception index – Fraser Institute – Australia (2016)



Source: Australian Institute of Geoscientists (2017)

The figure shows between 2006 and 2016, the comparative attractiveness of NSW (along with Victoria) has sharply declined, in contrast to other states which have largely retained their comparative global ranking. This suggests that mining companies see government policy in NSW has having been discouraging of investment. A decision to

[72] The Fraser Institute is a think-tank organisation based in Canada and has conducted annual surveys of mining and exploration companies since 1997 and assesses how mineral endowments and public policy factors such as taxation and regulation affect exploration investment. More information is available at https://www.fraserinstitute.org/

revoke the declaration will be seen as a further disincentive to coal mining investment in NSW.

Absent the declaration, the way in which increased costs and risks associated with new investment in coal mining projects would likely unfold, as previously outlined in Glencore's 2015 application, still prevail today. In particular:

- faced with a lack of certainty around long term access to essential port infrastructure, combined with strong expectations of future significant price increases, financiers will build conservative assumptions into their financial models, which in turn will impact on the bankability of a project;
- uncertainty about port prices is likely to lead to:
  - reduced investor confidence and commitment to support new coal mining projects in the Newcastle catchment, which may increase the costs associating with obtaining finance; and
  - some pathways to securing financing no longer being available or only available at significantly higher cost (commensurate with the increased cost and increased exposure to risk) and on terms more favourable to the financier;
- the consequences of such a tighter investment environment will particularly impact smaller and more marginal coal producers, and result in them being unwilling or unable to enter the coal export market, as they are less well placed to withstand the consequences of a lack of investor confidence and a reduction in, or increased cost of, available financing for their projects; and
- the presence or absence of smaller coal producers is particularly significant, as it tends to be those smaller companies who carry out the more marginal coal projects which do not attract the attention of the major producers, because for example they are smaller in scale and do not provide sufficient scale for major producers to generate an acceptable return.

In considering these risks it is important to recognise that while there is uncertainty about the final price outcome, there is sufficient certainty that the access price will be substantially higher than the current price if the Service is not declared for it to influence reasonable future expectations of mine profitability. This is because of the profit maximising incentive and ability that PNO will clearly have if the Service is not declared.

The importance of smaller producers and more marginal coal projects to the investment pipeline in the Newcastle catchment area is clearly evident from the list, as identified by

PNO, of proposals to develop coal mines in the Newcastle catchment area.[73] As shown in Table 4, these development proposals are largely either from new coal producers, or in the Gunnedah Basin, which is generally accepted to be a more marginal development area given the significantly higher transport cost to port.

Table 4 Current proposals to develop coal mines

Mine	Operator	Forecast exports at full production	Comment
Mount Pleasant	MACH Energy	8 mtpa	Small company, new producer – MACH Energy was formed to develop Mt Pleasant, and the mine remains MACH Energy's only coal asset
Vickery	Whitehaven	8.3 mtpa	Moderate size company – Whitehaven commenced operations in 1999, and remained a relatively small producer until quite recently. Whitehaven has primarily grown organically through new mine development Project is located in the Gunnedah basin – high marginal freight costs
Dartbrook	Australian Pacific Coal	4 mtpa	Small company, new producer – Australian Pacific Coal does not have any producing coal assets. Dartbrook is its only NSW project.
Watermark	Shenhua	6 mtpa	New producer – if the project proceeds, Shenhua will be a new entrant to the Australian mining industry Project is located in the Gunnedah basin – high marginal freight costs
Wallarah 2	Korea Resources Sojitz Corp	4 mtpa	Small producers – Korea Resources only other Australian coal interest is a share in Centennial Coal's Springvale project near Lithgow. Sojitz has interests in some small Queensland project's, Wallarah 2 is its only NSW project.
Mitchell Flat	Glencore	TBA	
Bylong	KEPCO	4.6 mtpa	New producer – Bylong is KEPCO's only Australian coal asset
Ferndale	Whitehaven	3 mtpa	Moderate size company – Whitehaven commenced operations in 1999, and remained a relatively small producer until quite recently. Whitehaven has primarily grown organically through new mine development Project is located in the Gunnedah basin – high marginal freight costs

Source: PNO, Company and project websites

Given that smaller coal producers and those holding tenements with relatively higher marginal costs are likely to be the most substantially affected by the higher costs and

[73] PNO (2018), p.24

risks associated with increased access charges for use of the Service, the investment pipeline appears particularly vulnerable to a revocation of the declaration.

Based on this review of the risks that revocation of the declaration poses to the investment pipeline, Synergies concludes that:

- there is a high probability (and in turn a reasonable expectation amongst those affected) that revocation will lead to reduced investor confidence and a higher cost of capital for new coal mining projects in the Newcastle catchment area, which in turn would be reflected in a commensurately lower investment in coal exploration and development of new and expanded coal projects;
- smaller coal producers or producers with relatively high marginal costs would likely be most affected, with the majority of identified new projects in the Newcastle catchment area falling into these categories; and
- as a consequence of the generally lower investment in coal exploration and development, together with the adverse impacts on smaller coal producers, there would be a consolidation of the number of coal firms involved in coal production that in turn would limit the scope for effective competition in local, dependent markets.

Materiality of port charges to coal producer's decisions on output and investment

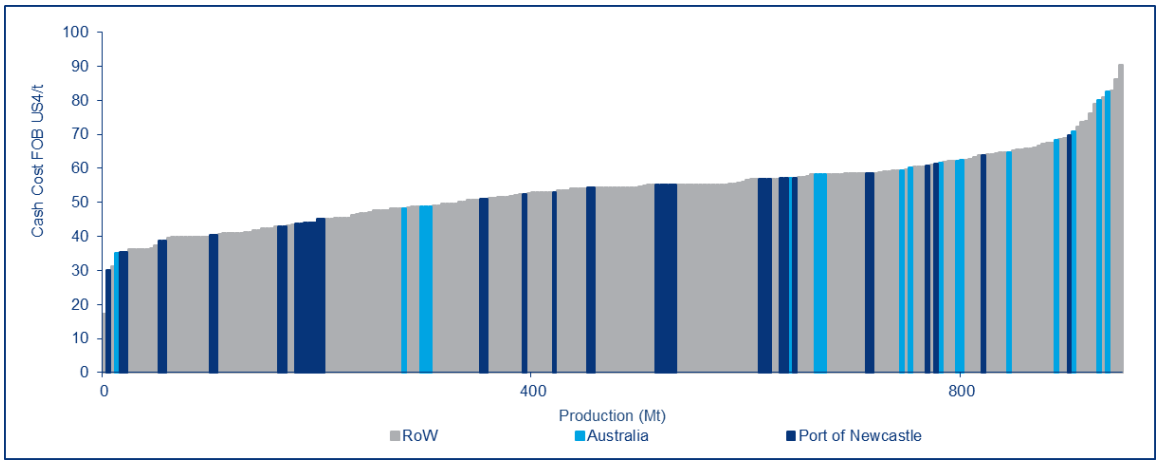
PNO has sought to illustrate the costs, and therefore the margin, faced by a Newcastle coal producer in order to demonstrate the limited relevance of PNO's charges to their decisions.[74] However, in doing so, it has estimated the producer cash costs as being AU$43/t, giving a producer margin of AU$45 at current prices.

From an examination of the cost curves provided by Wood Mackenzie, as shown in Figure 18, PNO's illustration appears to approximate the cost structure of the lowest cost Newcastle coal producer (whose cash costs Wood Mackenzie has estimated as being just over US$30, or just over AU$40/t). If we were to instead consider the situation faced by the producer of the marginal volume, being the highest cost current Newcastle producer (which is the most relevant miner when assessing the impact of higher access charges) Wood Mackenzie reports cash costs of just under US$70/t, or just under AU$95/t. At PNO's identified thermal coal spot price of AU$88/t, the marginal Newcastle producer will have a negative cash margin. At the medium term (2020) forecast coal price of

[74] PNO (2018), p.26

US$74/t,[75] the marginal Newcastle producer will have a positive cash margin of US$4/t. Noting NERA's estimate that capital costs for Australian projects built over the last 5 years averaged US$7.2/t,[76] this may still be insufficient for the marginal Newcastle producer to recover all costs, including capital costs.

Figure 18 Current global seaborne Energy Adjusted (6,322) Thermal Coal FOB supply curve (2018, US$/t, nominal)



Source: Wood Mackenzie

Further, if we consider planned projects, it is important to recognise that the lowest cost and most easily accessed resources are usually developed first. Therefore, as a general rule, the undeveloped resources are likely to be more marginal, in terms of either coal quality or cost of production, than many existing mines.

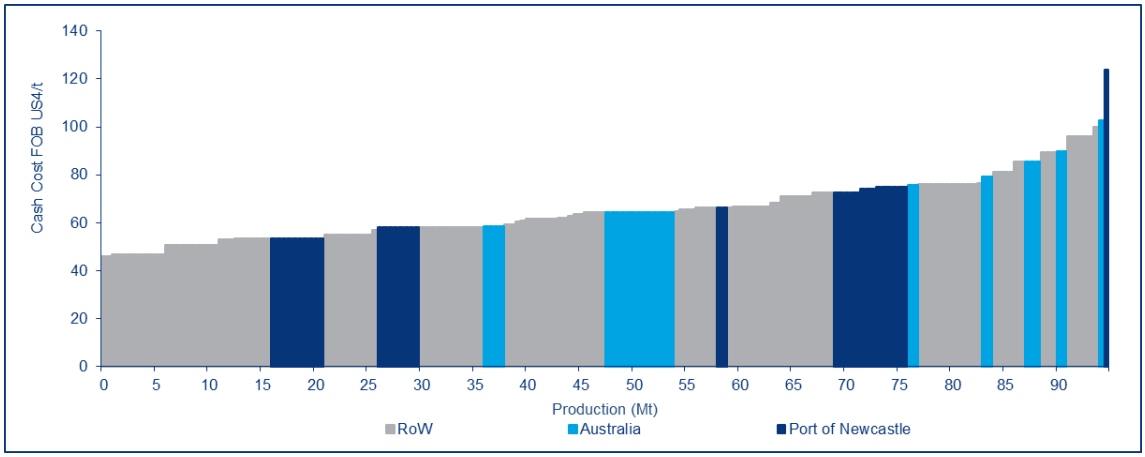
Wood Mackenzie also maintains cost curves for known, but yet to be developed, projects. Wood Mackenzie estimates that, in 2025, the cash cost for several of these projects will range from US$70-75/t or AU$95-100/t (2018$s) as shown in Figure 19. Given a coal price forecast in 2025 of US$75/t (2018$s),[77] these projects would have a cash margin of less than $US5/t to contribute to the capital costs of the projects, which is less than NERA's estimate of capital costs of US$7.2/t. In this context, the perceived risk of a change in input cost of up to $2/t would appear likely to have a material impact on whether or not these projects will be considered viable.

[75] Office of Chief Economist (2018), Resources Quarterly, June 2018, p.36

[76] National Energy Resources Australia (2016), Coal Industry Competitiveness Assessment, December 2016, p.14

[77] Wood Mackenzie forecast for 'FOB Newcastle @ 6,000 kcal/kg NAR, market'

Figure 19 Global Seaborne Energy Adjusted (6,322) New Thermal Coal Projects FOB supply curve (2018, US$/t, nominal) in 2025



Source: Wood Mackenzie

PNO has claimed that port charges, and any uncertainty about future port charges absent declaration, are 'dwarfed' by other factors that participants in the dependent markets must manage, and which will not be affected by declaration.[78] PNO identified these other factors as including: (i) highly volatile market conditions in the global coal export market; (ii) changing landside and sea freight costs; and (iii) changing mine operating costs.[79]

We note that the risks identified by PNO are general market risks that are faced by coal producers regardless of location and will be faced irrespective of whether investing in the Newcastle catchment area or elsewhere. However, it is the increased risk that arises as a result of the uncertainty over future port price increases that is the valid consideration when assessing the impact of revocation of the declaration.

In this regard, it should be noted that a number of the risks to input costs identified by PNO (e.g. shipping rates, labour costs) may be correlated with demand (and therefore with price), such that higher costs are incurred when demand (and prices) are high. To the extent that some costs are correlated with higher coal export prices, the risks are diminished.

The risk caused by PNO's ability to increase prices absent the declaration will be specific to coal exporters in the Newcastle catchment area and is not correlated with demand (and therefore price). To reiterate, the critical issue is that, in the face of significant industry wide risks, an additional risk specific to the Newcastle catchment area will detract from the attractiveness of investing in that area, in comparison to other projects.

[78] PNO (2018), p.29

[79] PNO (2018), p.29

3.3.2 Impact on competition in the coal export markets

As discussed in section 3.2, it is not necessarily the case that there is a single world coal market for the purposes of analysing impacts on competition. Synergies considers that it is likely that there are separate product markets for thermal coal and metallurgical coal, separate seaborne and landborne markets and a separate Asia-Pacific market for thermal and metallurgical coal products.

We note that, when using the test of access versus no access rather than declaration versus no declaration, the Tribunal found that access 'would promote a material increase in competition in the market for the export of coal from the Hunter Valley'.[80] Although not specifically discussed, this implies that, on the assumption of complete withdrawal of coal supplied by the Newcastle catchment area from 'the market for the export of coal from the Hunter Valley' (that is, the no access scenario) the Tribunal concluded there would be a material reduction in competition. While the exact dimension of the export coal market was not discussed by the Tribunal, its decision suggests that export coal sourced from the Newcastle catchment area, in sufficient volumes, may be able to influence competition outcomes in that coal export market. However, this contention depends on there being a material change in export volumes sourced from the Newcastle catchment area.

The impact on competition in relevant export markets will therefore depend on the extent to which coal supply from the Newcastle catchment area will be affected. As explained in the foregoing sections, it is not possible to definitively establish that coal export volumes would be significantly adversely affected in relevant coal export markets such that there would be a reduction in competition, on the whole, in those markets.

However, we consider that marginal supply will be materially affected in the future such that the detrimental effects will be more significant in other dependent markets, most significantly those that rely upon continued investment in the development of coal resources (such as the coal tenements market). In the following section, we discuss the likely impacts on competition in the coal tenements market where we show the potential for the detrimental effects on competition to be sufficient to meet criterion (a).

3.3.3 Impact on competition in the coal tenements market

Synergies considers that the revocation of the declaration will result in investors in the coal sector in the Newcastle catchment facing a material risk of substantially higher port charges that will most likely reduce their incentive to invest in the exploration and

[80] Australian Competition Tribunal (2016), *Application by Glencore Coal Pty Ltd* [2016] ACompT 6, p.25

development of future coal reserves in the Newcastle catchment. We consider that this will be likely to have a material adverse impact on effective competition in the tenements market.

Extent of competition in the tenements market

In recent years there have been significant concerns raised about the extent of competition in the exploration tenements market in NSW. Prior to 2014, the NSW Government directly allocated tenements to companies, with the process often marred by corruption. For example, in 2015, the ACCC commenced proceedings in the Federal Court against eleven respondents for alleged bid rigging conduct in 2009 involving mining exploration licences in the Bylong Valley, NSW (in 2016, one of the parties admitted to breaching the competition law).[81] [82]

However, in 2014, the NSW Government commenced a major reform program aiming at improving transparency in the process by which licences are allocated and promoting competition in the sector for access to and commercialisation of the state's coal assets.[83] As a result, the NSW Government introduced changes to the Mining Act in 2017 to provide for competitive tendering for coal exploration permits. While the NSW Government is yet to release new exploration permits under this process, it is anticipated that the market will evolve similarly to that in Queensland, where the Queensland Government periodically releases exploration areas for tender. A competitive process is held for the allocation of those permits, with allocations based on established criteria including the bidder's technical credibility and planned exploration program.[84]

Within this same timeframe, actual investment in coal exploration in NSW has declined substantially, notwithstanding that the output of Newcastle coal mines has doubled in the last ten years. While coal prices have increased significantly since 2016, coal companies have largely used this price increase to restore profitability, and there has been only limited commensurate increase in investment in coal production (as discussed in section 3.3.1) and even less commensurate increase in coal exploration. It is only in 2018 that there have been reports that investment in coal exploration may have

[81] ACCC (2015), Media release – ACCC takes action for alleged cartel conduct in the NSW Government's Mount Penny coal exploration licence tender process, 25 May 2015

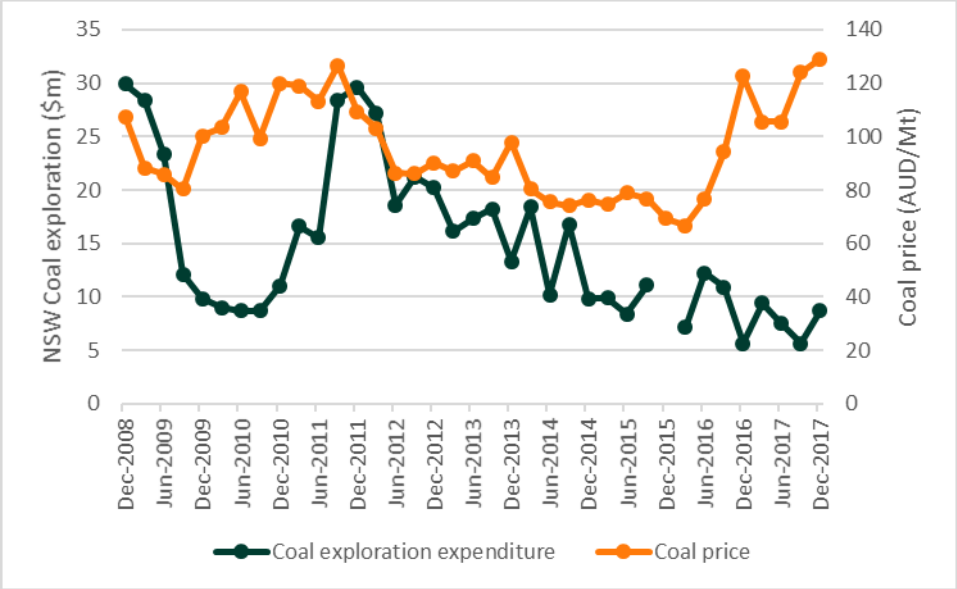
[82] ACCC (2016), Media release – Loyal Coal Pty Ltd admits breaching competition law in relation to Mount Penny coal exploration licence tender process, 5 April 2016

[83] NSW Government (2014), Strategic Statement on NSW Coal, August 2014, p.2

[84] See the Queensland Government's Mineral and Coal exploration guide at https://www.dnrme.qld.gov.au/__data/assets/pdf_file/0017/241190/mineral-coal-exploration-guideline.pdf

'bottomed out'.[85] This can be seen in Figure 20 below which shows the trend in coal exploration expenditure levels in NSW.

Figure 20 NSW coal exploration expenditure, coal price (AU$/t)

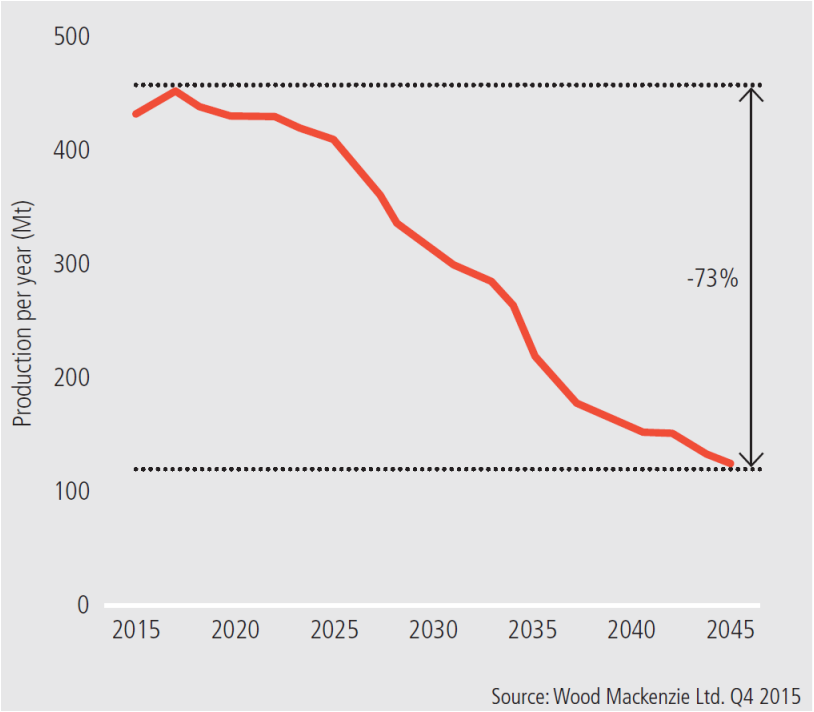


Note: December 2015 exploration expenditure data was not available for publication.
Source: Australian Bureau of Statistics, Catalogue 8412.0, Mineral and Petroleum Exploration, New South Wales

Because future supply of coal exports from the region will rely on the development of new reserves, it is important that appropriate incentives for investment in coal exploration are maintained. This can be seen from Figure 21, which shows the production outlook from operating coal mines in Australia, based on existing knowledge of available reserves.

[85] Office of Chief Economist (2018), Resources Quarterly, June 2018, p.39

Figure 21 Production outlook from operating mines in Australia



Source: National Energy Resources Australia (2016)

As discussed in section 3.3.1, Australia performs poorly in the coal resource exploration and development compared to its international peers, and the country's poor development capability already forms a severe barrier to investment. Revocation of the declaration will add to the lack of competitiveness in the exploration and development phase for coal producers in the Newcastle catchment area, and will directly impact on the exploration market, including the tenements market and the market for specialist services. As the Minerals Council of Australia has previously commented:[86]

> Private sector investment in exploration will not occur if the prospects of developing an operational mine are poor …

Impact of declaration on incentives for participation in the tenements market

Importantly, in the absence of the declaration, this loss of competitiveness will not be felt evenly across the industry. As was established in section 3.3.1, smaller coal producers will be at a comparative disadvantage to the major operators, as they are less well placed to withstand the consequences of a lack of investor confidence and a reduction in, or increased cost of, available financing for their projects.

[86] See Minerals Council of Australia, http://www.minerals.org.au/exploration

However, at the other end of the scale, the largest coal producer in the region – Glencore – will be at a comparative advantage relative to all other producers. As has previously been noted, the ACCC is currently arbitrating a dispute between PNO and Glencore on the terms on conditions of access. Upon resolution of this dispute, an agreement will be established which will stand for its defined term regardless of the future status of the declaration. Therefore, Glencore will not be subject to the same risk of port price increases as will other coal producers, leading to a distinct advantage over other coal producers in future mine development.

We note that the only new mine currently under development in the Hunter Valley, Mt Pleasant, is owned by MACH Energy, a small producer established to buy the Mt Pleasant tenement from Rio Tinto in 2015. Further, as shown in section 3.3.1, of the proposals to develop coal mines identified by PNO, in most cases the proponents are not existing major coal producers. However, these are exactly the types of companies that will be most disadvantaged through the revocation of the Port of Newcastle declaration. The comparative disadvantage for smaller companies, and the relative advantage for Glencore, is likely to lead to further consolidation within the sector.

We also consider that a revocation of the declaration will not impact evenly across the geographic regions within the Newcastle catchment area. While interest in bidding for tenements for development purposes as a whole will be reduced (because such tenements are marginal by their very nature), the level of interest in tenements that are located in the most marginal areas is likely to be more severely affected, as this is where the impact of increased cost and risk associated with port access is most likely to result in mine viability being compromised.

As was discussed in section 3.2.2, while we consider the maximum geographic scope of the coal tenements market to be the broader Newcastle catchment area, we also consider that the geographic market may be more accurately described as comprising two regional catchment markets, focused around the Hunter Valley/Western Basins and the Gunnedah Basin.

In particular, we consider the reduction in incentive for bidders to participate and vigorously compete in the tenements market is likely to be felt most significantly in the Gunnedah Basin for two reasons:

- the location of these deposits means that the transport costs that would be associated with mine development are significantly higher than for other tenements in the Newcastle catchment area, with the result that they are likely to be perceived as more marginal deposits; and

- based on a review of the ownership of tenements in this region as set out in Appendix B, these tenements are most typically purchased by smaller producers.

Resulting impact of declaration on competition in the tenement markets

The potential effect on competition in the tenements market depends on the extent to which revocation of the declaration will lead to a reduced incentive for expenditure on exploration and development, and the extent to which there are less independent operators interested in the tenements market.

The reasoning of the Tribunal in relation to the FMG matter sets out some relevant factors to consider as follows:[87]

> The two bases upon which it could be said that competition will increase are first, access to rail would encourage tenement holders to incur further expenditure in exploration and so improve what is known about the resource or second, if the quantity of tenements sold increases. Either outcome would result in an increase in competition, because it could produce a better quality or a greater quantity of traded tenements.

There is an important additional consideration relevant to declaration of the relevant Service of the Port of Newcastle that relates to consolidation of buying power in the market for tenements. As explained in section 3.2.2**,** the relevant market for tenements is constrained at its maximum to the region linked to supplying coal through the Port of Newcastle. This reflects the fact that the sellers of these tenements have to ultimately sell to buyers who will eventually use the tenements for the supply of coal through the Port of Newcastle. In this case a monopsony buyer of these tenements could buy at a price lower than would be realised in a workably competitive tenements market.

Also, as noted above, there is already concern about the effectiveness of existing competition in the coal tenements market (in relation to the initial allocation of exploration permits), with the NSW Government recently reforming its permit allocation process in order to promote competition for access to coal exploration areas. The prospect of competitive bidding for new authorities has the potential to improve competition in the tenements market but this potential is unlikely to be realised if higher port charges lead to materially lower interest in exploration and development and a limited number of bidders willing to vigorously compete in this market.

In summary, the prospect of materially higher port charges will impact adversely on investment exploration and development incentives and deter marginal producers and

[87] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, pp. 258-259

investment in marginal resources. This is likely to lead to less rivalry and greater concentration in the market for tenements with potential uncompetitive impacts on the quantity, quality and price of traded tenements.

We consider that revocation of the Port of Newcastle declaration will impact on companies' incentives to participate in the tenements market in several ways:

- first, the higher cost and risk profile that emerges for the industry from the unregulated port monopolist means that the prospective economic viability of new mines deteriorates. This is significant because tenements will typically hold less attractive resources than existing coal production areas, even before the uncertainty surrounding future port charges emerged;
- second, as a consequence, there will be a reduction in the number of parties who are willing to bid on tenements, either at initial allocation or for subsequent sale, and less rivalrous behaviour amongst those that do bid. In particular:
  - small companies, as well as those with a relatively lower risk appetite, are less likely to be vigorous and effective competitors for the acquisition of these tenements;
  - the reduction in interest in tenements is likely to be felt most strongly in regions that are likely to have the highest incremental costs;
  - the combination of these factors is likely to particularly affect the tenements market in the Gunnedah basin, which is subject to the highest incremental transport cost and where tenements are generally held by smaller companies;
  - in terms of likely consolidation of the ownership of tenements, Glencore will have a particular advantage, as the only producer who will have long term certainty of access and price at Port of Newcastle;
- third, owners of tenements will have less incentive to invest in the exploration of their tenement, either for the purpose of developing the tenement itself or obtaining more information about the tenement to improve its prospective value. Again:
  - this impact is likely to be particularly strong in the Gunnedah basin, where the tenements are usually considered to be more marginal in nature and where they are generally held by smaller companies;
- fourth, there is a material risk that the sellers of tenements will face less competition amongst buyers when selling their tenements, thereby impacting adversely on price and activity in the tenements market. However, although the extent of trading in tenements may be less, suggesting a smaller market, there will be lost value from an economic efficiency perspective;

- fifth, the NSW Government, as the originating seller of tenements (typically for more marginal deposits than those already held), faces the risk of less competition in the bidding for licences and a materially lower price than could be achieved in a workably competitive tenements market unaffected by the prospect of being undermined by future port price increases.

Collectively these effects mean there would be lower and less competitive prices for tenements and lower quality and quantity of traded tenements reflecting a material reduction in competition in the tenements market.

3.4 Conclusion on Criterion (a)

In Synergies' view, criterion (a) is satisfied on the basis that removing the existing declaration will result in a return to access based on unreasonable (or at the least, comparatively adverse) terms and conditions where users of the Service will face the prospect of substantially higher access prices as a result of PNO's unconstrained ability and incentive to adjust prices to maximise profit and impose price levels that far exceed efficient economic cost.

We consider that there is a material risk that this will reduce the incentive for exploration expenditure as well as leading to concentration on the buyer side of the market for tenements. The reduced exploration expenditure would likely reduce the incentive to improve the quality of traded tenements and separately less effective competition in buying tenements would likely occur and reduce the price for tenements below a competitive price for the seller. In addition, the quantity of traded tenements would also be likely to be reduced reflecting the impacts on quality and price. The effects are likely to be particularly significant in the Gunnedah Basin, where average costs are already relatively higher than elsewhere in the Newcastle catchment area (i.e. Hunter Valley and Western basins).

These outcomes would in turn have the effect of materially reducing competition in the accepted dependent market for coal tenements, thereby satisfying criterion (a).

4 Assessment of Criterion (d)

4.1 Approach to assessing public benefit

Criterion (d), as recently amended, requires that 'access (or increased access) to the service, on reasonable conditions as a result of declaration of the service would promote the public interest.'

This varies from the public interest assessment that was conducted in the original declaration assessment, as the previous version of this criterion (criterion (f)) required only that access (or increased access) to the service would not be contrary to the public interest.

'Public interest' is not a term defined in the CCA. The NCC has, however, previously identified that the central question associated with this criterion is whether the declaration is likely to generate overall gains to the community.[88] The NCC and the Minister may have regard to a very wide range of matters when considering this criterion.[89] The NCC has also indicated that issues of economic efficiency and competition to be important in the context of promoting the public interest.[90]

In approaching this assessment, we have also had regard to mandatory public interest considerations pursuant to s 44CA(3) of the CCA, in which the NCC must consider:

- the effect that declaring the service would have on investment in:
  - infrastructure services; and
  - markets that depend on access to the service; and
- the administrative and compliance costs that would be incurred by the provider of the service if the service is declared.[91]

We note that PNO contends that criterion (d) is not satisfied because it asserts that there is no basis to presume that the terms and conditions upon which it offers access will vary materially as between the future with declaration and the future without declaration. As a result, it concludes that there is no evidence that declaration will have a positive

[88] NCC (2018), p.42

[89] Treasurer 2016-17, House of Representatives, Competition and Consumer Amendment (Competition Policy Review) Bill 2017 – Explanatory Memorandum, p.103

[90] NCC (2018) p.45

[91] NCC (2018), p.43

impact in markets that depend on access to the Service and that, in contrast, continued declaration will impose significant administrative and compliance costs on PNO.[92]

Synergies disagrees with PNO's position on the basis that, by providing an effective constraint on PNO increasing its prices to capture monopoly rents, declaration will promote the efficient use of infrastructure and create improved conditions for investment in exploration and development of coal reserves.

The additional benefits associated with improved access based on reasonable terms and conditions (compared to access on PNO's imposed terms) and which have not already been identified in criterion (a) fall into two broad categories as follows:

- the gains arising from increased productive, allocative and dynamic efficiency in markets other than the coal tenements market (which has already been considered in relation to criterion (a)); and
- the additional economic growth in the NSW and Australian economies associated with increased mining production (i.e. where increased investment attractiveness because of the declaration leads to deposits being proven and ultimately mined).

Having regard to the fact that the Service is already declared, we have also specifically considered whether there are any public detriments that are likely to arise from revocation of the declaration. Revoking the declaration will be detrimental to the public interest where:

- there is no other credible constraint on PNO engaging in monopoly pricing which would mean that the application of the Part IIIIA regulatory framework is redundant;
- revocation of the declaration will cause a reduction in the value of investments made by coal producers who legitimately expected that PNO's ability to engage in monopoly pricing would be constrained; and
- it establishes a precedent for undeclared ports, across Australia, to raise prices where they perceive the threat of regulation is similarly weak.

4.2 Promoting economic efficiency

The NCC, in its declaration guidance, considers issues of promoting economic efficiency and promoting competition to be important in the context of promoting the public

[92] PNO (2018), p.41

interest.[93] The NCC notes that, where access promotes workable or effective competition, it is also likely to result in efficiency gains. However, it also recognises that access may lead to efficiency losses in certain circumstances.

While PNO's application submits that criterion (d) is not met because there is no public benefit associated with access, PNO's application fails to acknowledge any circumstance in which the existence of the declaration results in a loss of economic efficiency or competition in any of the relevant dependent markets.

Using the NCC's guidance, our assessment of criterion (a) concluded that revocation of the declaration is likely to lead to a material loss of competition in the coal tenements market, which will result in allocative efficiency losses in that market, noting that time constraints have prevented a more detailed examination of other dependent markets.

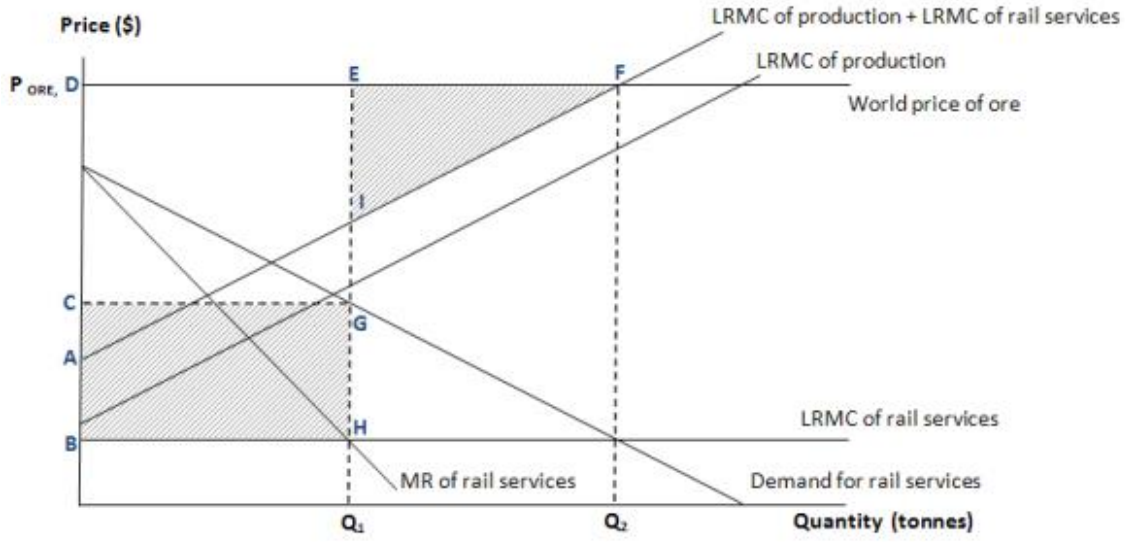
However, allocative economic efficiency losses can also occur in the other dependent markets without there being a material adverse impact on competition in those markets. This is because allocative economic efficiency effects arise wherever the pattern and associated value of economic activity differs between a status quo factual position and a counter factual position following a policy or parameter change (in this case, where the counter factual results in materially higher access prices where declaration is revoked).

Furthermore, these effects are not necessarily dependent on there being a material reduction in workable competition in any dependent market. For example, where coal exported from the Newcastle catchment is less competitive in relevant export markets and volumes decline, there could be an efficiency loss for coal mines where the access prices exceed the efficient costs of supply through the Port of Newcastle.

This can be demonstrated using the figure below, which we have reproduced from previous analysis presented by the ACCC to the PC's 2013 review of the national access regime.

[93] NCC (2018), p.45

Figure 22 Efficiency losses as a result of monopoly pricing



Source: ACCC (2013), Productivity Commission Review of the National Access Regime - ACCC submission to issues paper, February 2013, p.77

In presenting this diagram, the ACCC used the example of a miner exporting its output into a global market to show that there can be efficiency losses without there being a material reduction in workable competition, by noting that:[94]

> Even if the railway operator is able to expropriate some or all of the miner's rents (the area ADF) without affecting the miners' marginal costs of supply (for example, by imposing a two-part tariff for rail services), there may still be negative efficiency consequences from the expropriation of the miner's economic rents. Mining exploration is inherently risky as many prospects will be found not to be viable after substantial exploration and initial development expenditures have been incurred. The economic rents made on commercially viable mines allow miners to recover losses on prospects that prove unviable and to achieve at least a commercially-acceptable risk-adjusted rate of return across their entire operations (including losses on unviable prospects). Expropriation of these economic rents may discourage investments in prospecting for, and developing, new mines—with negative implications for allocative and dynamic efficiency, productivity and export earnings, and, in turn, for community welfare.

Synergies considers that declaration will clearly promote enhanced efficiency in the provision of supply chain infrastructure in the present circumstances. As was established in section 2.3, absent the declaration PNO has a strong incentive to increase

[94] ACCC (2013), Productivity Commission Review of the National Access Regime – ACCC submission to issues paper, February 2013, p.77

prices, even where this will constrain output. Although demand for the Service is inelastic at current price levels, increased port prices will increase the cash costs of coal producers in the Newcastle catchment area, and at times of low coal prices, this is likely to lead to some loss in coal throughput. Further, as has then been discussed in section 3.3.1, the strong expectation of higher port charges is likely to undermine the incentive of coal producers to invest in new and expanded coal production, with a particularly strong impact on small coal producers and marginal production areas. This is because, small producers, unlike some of the larger miners, may not be able to absorb the increased exposure to cost and risk. As a result, it is likely that, over time, Newcastle coal exports will be lower than would be the case where the Service is declared.

Declaration, by leading to higher throughput volumes, will therefore generate more efficient use of, and investment in, the Hunter Valley Coal Chain infrastructure, including rail infrastructure, coal terminal infrastructure and port infrastructure. By maximising throughput, the productive efficiency of the existing supply chain infrastructure will be increased (particularly where there is existing spare capacity), as the supply chain responds to increasing demand. These are incremental efficiency effects not considered in the competition assessment for the tenements market.

We can similarly consider the markets for services supplying coal mines in the Newcastle catchment area such as geological and drilling services, construction, operation and maintenance. If there is a longer term decline in mining exploration, investment and production as a result of access charges that reflect the application of monopoly power, and the factors of production in those markets are allocated to other sectors and regions, then there would be allocative efficiency losses (those resources will be applied to less valuable activities) and also associated productive efficiency losses reflecting adjustment and transactions costs.

Economic regulation aims to achieve the efficiency benefits of a single infrastructure operator while preventing the allocative and dynamic efficiency losses that result from a monopolist's use of its market power. This is consistent with the ACCC's view about the purpose of economic regulation, which is to prevent efficiency losses arising from a monopolist's market position.[95]

PNO's ability to charge higher prices absent the declaration is likely to distort price signals for investment and dampen incentives for innovation in dependent markets, irrespective of the impact on competition, and is therefore not in the public interest.

[95] ACCC (2013), Productivity Commission Review of the National Access Regime – ACCC submission to issues paper, February 2013, p.5

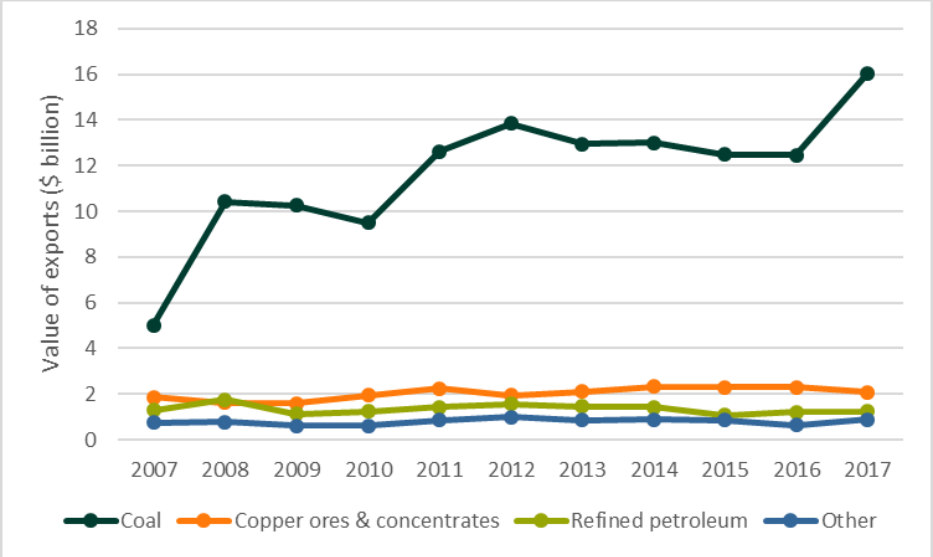
4.3 Economic benefit of increased investment in mining

In its originating application for declaration, Glencore identified public benefits associated with increased access to the Service on reasonable terms and conditions in terms of the resulting economic growth and efficiencies that were anticipated from stimulated investment in mining development.[96] These continue to be valid reasons, consistent with maintaining the declaration.

As we have established in our examination of criterion (a), continued declaration, giving rise to the continued ability of users to access the Service on reasonable terms and conditions over the long term, is expected to increase the competitiveness of the Newcastle catchment region for exploration and investment in coal mining. By facilitating such investment, this will lead to enhanced growth, with associated benefits for the NSW economy and the Australian economy, more broadly.

Coal comprises the largest export from the NSW minerals and fuels sector, accounting for 80% of the total value of mineral and fuel exports in 2017. This is shown in Figure 23 below.

Figure 23 Value of exports ($bn), NSW minerals and fuels sector



Source: Department of Foreign Affairs and Trade

The NSW Government has publicly stated that 'a strong mining industry generates employment in regional NSW, drives investment in regional communities and increases

[96] Glencore (2015), Application for a declaration recommendation in relation to the Port of Newcastle, May 2015, p.32

export growth.'[97] It further indicates that coal's 'most significant' contribution to the economy comes from exports, valued at $13.2b in 2015-16 and was 'easily the State's biggest single export earner and makes NSW one of the world's major exporters of coal.'[98]

The Centre for International Economics (CIE) has previously assessed the economic benefit generated by the NSW mining industry, including employment and valued added[99] in NSW. The results are re-produced in the table below.

Table 5 Mining value added 2012-13

	NSW	Central West	Illawarra	Hunter region	New England and North West
	$b	$b	$b	$b	$b
Value added					
Coal	9.6	1.4	0.9	6.3	0.3
Other metal ore	1.6	0.8	0.0	0.0	0.0
Other mining	1.4	0.2	0.1	0.4	0.1
Total	**12.5**	**2.4**	**1.0**	**6.6**	**0.4**
Employment (FTE terms)					
Coal	27 988	4 183	2 734	18 312	897
Other metal ore	7 934	4 033	7	125	0
Other mining	7 861	902	391	2 055	342
Total	**43 782**	**9 118**	**3 132**	**20 492**	**1 239**

[a] Employment has been calculated in Full time equivalent terms, based on 40 hours per week per FTE.

Source: The Centre for International Economics (2014), The contribution of mining to the New South Wales economy – prepared for the NSW Minerals Taskforce, September 2014, p.2

As shown in the table above, the CIE estimated that, in 2012-13 the direct contribution of the NSW coal mining industry was around $9.6bn per annum (accounting for 2.2%[100] of the total industry value added in the NSW economy). At a regional level, coal mining

[97] See https://www.industry.nsw.gov.au/invest-in-nsw/industry-opportunities/mining-and-resources/coal/coal-in-nsw

[98] See https://www.industry.nsw.gov.au/invest-in-nsw/industry-opportunities/mining-and-resources/coal/coal-in-nsw

[99] Value add measures the value of output generated by factors of production (labour and capital) as measured in the income to those factors of production.

[100] The Centre for International Economics (2014), The contribution of mining to the New South Wales economy – prepared for the NSW Minerals Taskforce, September 2014, p.21

was a significant contributor to the regional economies within the broader Newcastle catchment area, as follows:

- Hunter region – 16.6% of the total industry value add;
- Central West – 11.7% of the total industry value add; and
- New England and North West – 3.3% of the total industry value add.

Although this assessment was undertaken in 2014, overall coal production within the Newcastle catchment remains at a similar level. This, combined with increases in the export coal price since the study was undertaken, would be likely to suggest that these estimates are a reasonable (possibly conservative) estimate of the economic value of coal mining within the NSW economy.

As established in section 3.3.1, revocation of the declaration will lead to a loss in investor confidence, and poorer prospects for investment in coal exploration and mine development. Continued declaration will avoid this loss in investment attractiveness and create an improved environment for investment in new and expanded coal mining projects.

While the CIE assessment above provides a useful benchmark for the overall value that the coal mining sector adds to the NSW economy, in order to understand the public benefit associated with the declaration, it is necessary to consider the economic benefit of incremental investment in coal mining. This can be seen through the economic impact assessments prepared for recent mine developments. A summary of economic benefits for a sample of recent NSW mining proposals, including economic value added as well as direct and indirect employment, is shown in Table 6.

Table 6 Economic impact assessments for recent NSW mine proposals

Project	Mine Size	Details of economic benefits
Mt Arthur Coal Open Cut Modification (2012)	32mtpa	9,071 direct and indirect jobs (2,715 for the regional economy) $2.6 billion in annual direct and indirect regional value added (approximately $81 million per mtpa)
Mount Owen Continued Operations Project (2014)	14mtpa	1,200 direct and indirect jobs (1,091 employed in the Hunter region) Increase to Hunter economy of $1.3 billion over the life of the project ($1.9 billion for NSW as a whole)
Bylong Coal Project (2015)	6.5mtpa	1,496 direct and indirect jobs (830 local jobs) $492 million ($75 million per mtpa) annual direct and indirect value-added ($378 million in the local area)
Wallarah 2 Coal Project (2013)	5mtpa	$507 million in annual direct and indirect value added (approximately $100 million per mtpa). 1,711 direct and indirect jobs
Airly Mine Extension Project (2014)	1.8mtpa	155 full time equivalent jobs $259 million injection (net present value) into the local, regional, state and national economies.
Rocky Hill Coal Project (2016)	2mtpa	$89.5 million in net benefits to NSW of the life of the mine (including $63.4 million royalties payable to the NSW Government) 73 full time equivalent employees during ongoing operations

Source: Gillespie Economics, Deloitte Access Economics, Golder Associates, Umwelt, Hansen Bailey

These assessments clearly demonstrate the economic gains associated with investments in new and expanded coal mining projects in NSW.

In the absence of declaration, as established in section 2, PNO's profit maximising incentive will drive it towards continuing to increase port charges, even where this creates a risk of reducing current or future port throughput. On this basis, it is reasonable to assume that PNO will likely increase prices over the long term, which will cause some reduction in volume throughput at Port of Newcastle. This will have consequential impacts on the NSW and Australian economy. In its 2014 assessment of the value of mining to the NSW economy, the CIE also assessed the impact of a fall in production from the coal mining sector, shown in the table below.

Table 7 Impacts of a fall in production

Simulation – for each sector, a fall in the value of production of $100 million is modelled	NSW	Central West	Illawarra	Hunter region	New England and North West
Coal sector					
Gross State Product/ Gross Regional Product ($m)	-130.8	-19.5	-12.8	-85.6	-4.2
Industrial factor income ($m)	**-107.9**	**-16.1**	**-10.5**	**-70.6**	**-3.5**
Industrial factor income for mining industry ($m)	**-48.0**	**-7.2**	**-4.7**	**-31.4**	**-1.5**
Household consumption ($m)	-51.1	-7.6	-5.0	-33.4	-1.6
Net employment (FTE)	-472	-70	-46	-309	-15
Government revenue ($m)	-22.9	-3.4	-2.2	-15.0	-0.7

Source: The Centre for International Economics (2014), The contribution of mining to the New South Wales economy – prepared for the NSW Minerals Taskforce, September 2014, p.37

This demonstrates that a fall in production from the coal sector will have a magnified effect on Gross State Product/Gross Regional Product, with a $100m fall in coal mining production (which is equivalent to a volume reduction of 1.3mtpa[101]) resulting in a $130.8m reduction in GSP/GRP. This is estimated to cause a corresponding fall in net employment of 472 people, and a reduction in household consumption of $51.1m.

4.3.1 Tax paid to NSW and Commonwealth Government

Coal production generates a range of taxes paid to both the NSW and Commonwealth Governments, including both royalties (to the NSW Government) and general taxes including payroll tax, land tax, company tax and, for those people employed in the coal sector, personal tax.

These payments are a component of the 'value added' or broader economic benefit described in section 4.3 above. However, we consider that it is useful to specifically identify these payments, as higher royalties and tax payments are able to be used by the NSW and/or Federal Governments to provide an increased level and/or quality of services to the community. Provided royalties and taxes are not set at a level that disincentivises investment, the collection of these revenues is in the public interest.

The increase in royalty and taxation revenue that is collected by the NSW and Commonwealth governments as a consequence of increased investment in exploration and development of coal mines will result in incremental public benefits as the additional revenues can be used to fund welfare enhancing services.

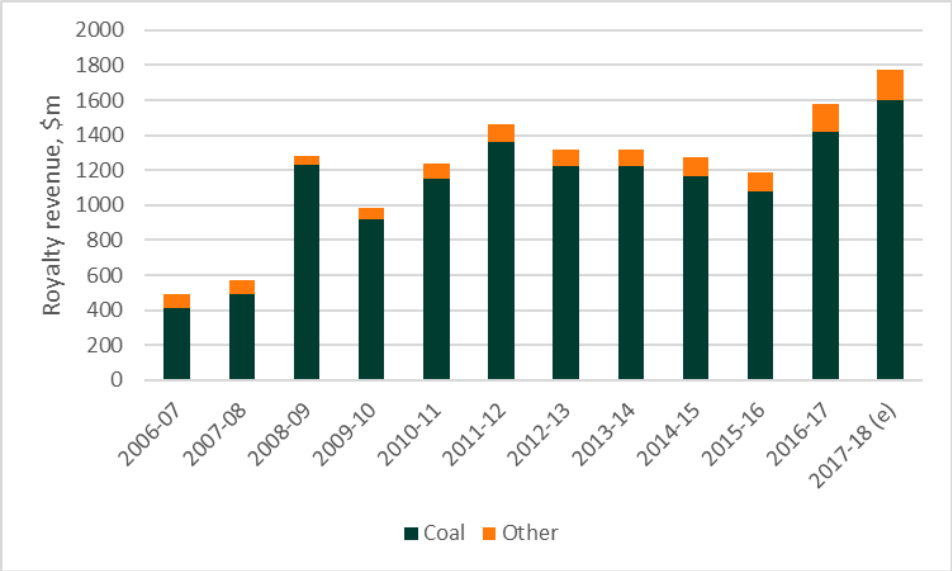
[101] We have assumed a 2014 coal price of AU$70 per tonne in preparing this estimate.

Royalties and resource rents

Royalties are based on the principle that a payment to government for the exploitation of a natural resource, such as coal, should be derived from the economic rent which the resource produces. An economic rent is the excess of the return to a factor of production above the amount that is required to sustain the current use of the factor.[102]

NSW mining royalty revenue since 2006 is shown in Figure 24. Royalty revenue generated by the NSW coal sector is significant. Although royalty revenue was not identified by mineral for 2016-17 and 2017-18, the share of coal royalties as a proportion of total revenue has been above 90% for the last 10 years, and there is no evidence to suggest that this share would have changed dramatically in the last two years. Therefore, conservatively assuming a 90% share of total royalty revenue, coal royalties were at least $1.4 billion in 2016-17, and are predicted to increase to at least $1.6 billion for 2017-18. As the large majority of NSW coal exports utilise the Port of Newcastle, the Newcastle catchment mines will account for most of the coal royalties collected by the NSW Government.

Figure 24 Royalty Revenue – NSW minerals sector



Note: A 90% share is assumed for coal royalties in 2016-17 and 2017-18, consistent with historical trends
Source: https://www.resourcesandenergy.nsw.gov.au/miners-and-explorers/enforcement/royalties, NSW Budget papers

While the above royalty collections relate to the entirety of the NSW coal industry, the impact on royalty collections from incremental changes to coal production, facilitated by

[102] Ken Henry (2009), Australia's future tax system – Report to the Treasurer, December 2009, p.171

improved incentives for exploration and development of coal resources, can readily be estimated. The NSW Government applies royalties based on the following rates:[103]

- 8.2% of value of open cut coal
- 7.2% of value of underground coal
- 6.2% of value of deep underground coal

Assuming an average royalty rate of 7.5%, each incremental 1mtpa of thermal coal (at the medium term forecast price of approximately AU$100) will raise approximately $7.5m per annum of additional royalty revenue for the NSW Government.

In addition, the sale of coal tenements by the NSW government also raises a form of resource rent which is based on the expected value of the underlying resource. An increase in competition for tenements (which we have previously identified under criterion (a), potentially including an increase in the willingness of participants to pay for these tenements, will result in public benefits where higher 'resource rent' payments to the NSW Government can be used to fund social welfare enhancing programs which benefit the broader community. Increased incentives to conduct exploration to further prove these reserves will increase the opportunity for future mine developments and, hence, royalty collections.

Other tax payments

In addition to royalties, coal production contributes substantially to tax collections in the form of company tax, personal income tax and, to a lesser degree other state based taxes such as payroll tax and land tax.

It follows that where there are the appropriate incentives to invest in the exploration and development of new coal projects, any future incremental production will promote the public interest where operations generate additional taxation income for governments.

4.4 Transfer of economic rents

As was established in section 2.3, absent the declaration PNO has a strong incentive to increase prices, earning monopoly rents through the provision of the Service. Such a material transfer in economic rents from miners to PNO is also contrary to the public

[103] See https://www.resourcesandenergy.nsw.gov.au/miners-and-explorers/enforcement/royalties/royalty-rates [viewed 3 August 2018]

interest, irrespective of any efficiency losses that might arise. Without these rents, miners will be less willing to undertake exploration activities.

As the ACCC Chairman has previously commented:[104]

> It concerns me when the argument is made that economic regulation is not required for such assets because any monopolistic pricing amounts to a pure transfer of economic rents between parties within the supply chain…This seems to suggest that policy makers should pay no attention to the ability of a bottleneck monopolist to extract rents from upstream or downstream firms in a commodity export supply chain. I take a different view…The threat of expropriation of rents by a monopoly service provider in such a situation does not merely result in a pure transfer. Rather, the threat of such expropriation can limit future investment and innovation by the upstream firms. What miner would invest in reducing its extraction costs if it knew that the lower extraction costs would simply be met by higher transportation charges? More generally, what miner would invest in its mines knowing that the benefits of that investment could be expropriated by a monopoly somewhere else in the supply chain?...Monopolies, therefore, generally require effective economic regulation.

Continued declaration in the current circumstances will avoid the transfer of economic rents from coal producers to PNO and advance the public interest.

4.5 Mandatory considerations

4.5.1 No impact on investment in infrastructure services

PNO has claimed that declaration of the Service may have a chilling effect on investment in infrastructure services as declaration may curb the returns that would otherwise be achieved by those investing in infrastructure services.[105]

We acknowledge that concerns have often been raised about the potential chilling effect on investment that regulation may cause, on the basis that regulators may err through underestimating the risks associated with infrastructure investment, and hence the returns that investors expect for such investments. However, we believe that in this instance, there is little prospect of regulation constraining investment in the Service.

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[104] ACCC (2015), Speech to Infrastructure Partnerships Australia Conference, Sydney – Competition key to restoring Australia's productivity. A copy is available at https://www.accc.gov.au/speech/competition-key-to-restoring-australia%E2%80%99s-productivity

[105] PNO (2018), p.41

This reflects that the concerns over investment typically relate to services where regulators hold a deterministic price setting role (i.e. through determining maximum allowable revenues and/or specific access charges). This is not the case under declaration which provides for a negotiate-arbitrate framework. While a price is determined and imposed in the event of an arbitration, the continued declaration does not of itself create this outcome. It is only where negotiations fail that arbitration is triggered. Parties to a dispute are able to continue private negotiations throughout the arbitration up until such time that the arbitrator makes a final decision. Because of the scope that still exists under declaration for parties to reach a commercial solution, it has lower risk of regulatory error compared with a more heavy handed regulatory model of direct price regulation. The Sydney Airport declaration process[106] is an example of where declaration facilitated the commercial resolution of an access dispute.

However, in the particular case of PNO, there is little prospect that an arbitration outcome, even an adverse one, will affect investment relevant to the coal industry. Historic practice at the Port of Newcastle has been that users directly undertake the investments required to expand the capacity of the channel and related assets. This approach has been used for all of the channel extensions that were required to support the coal industry expansion since the 1990s, with all channel dredging directly provided by PWCS and NCIG.[107] Further, PNO anticipates that this funding approach will continue to be used for future expansions, for example direct dredging would have been required for the previously proposed PWCS T4 project.[108]

In any case, we note that PNO has modelled capacity of 328mtpa[109] (as opposed to current throughput of around 170mtpa), which indicates that PNO may have significant

[106] In October 2002, Virgin Blue Airlines applied for declaration of airside services at Sydney Airport. The application sought declaration under Part IIIA of two services (1) airside services (take off and land using the runways and movement between the terminals) and (2) domestic terminal services. Virgin Blue withdrew its application for declaration of the domestic terminal service in December 2002 following commercial agreement with Sydney Airport Corporation Limited (SACL) on terminal access. For the airside service, the NCC made a recommendation (to which the Minister agreed) not to declare the services. Virgin Blue sought review of the decision and the Tribunal overturned the Minister's decision and determined that the services be declared to December 2010. The Federal Court upheld the Tribunal's determination in 2006. In 2007, Virgin Blue notified the ACCC of an access dispute with Sydney Airport, though the notification was withdrawn following a successful commercial settlement.

[107] See NCIG (2008), Presentation to Sydney Mining Club, p.24. See also Boskalis (2012), Project Sheet, NCIG Berths 8 and 9 dredging project, available from https://australia.boskalis.com/uploads/media/Australia_-_Newcastle.pdf [accessed 7 August 2018]

[108] On 31 May 2018, PWCS issued a public statement indicating that it had advised the Port of Newcastle that it intends to allow the Terminal 4 Agreement for Lease to lapse when it expires in August 2019. This means that Port Waratah does not intend to proceed with the Terminal 4 development. See https://pwcs.com.au/news/latest-news/port-waratah-terminal-4-announcement/. Prior to that announcement, PWCS had indicated that that the T4 project included the provision of a fourth berth to upgrade shiploading capacity and dredging to provide access to the berth. See https://pwcs.com.au/news/news-archive/port-waratahs-project-145-open-for-business/

[109] PNO (2018), p.34

excess channel capacity. This suggests that little or no investment is likely to be required over the medium term, except to provide direct access to new terminal facilities which, as noted above, are expected to be financed by users.

As a result, there is no expectation that PNO will need to invest its own funds in order to provide capacity for future demand for the Service for the foreseeable future. In this context, the more significant risk to investment becomes whether continued declaration may affect the incentives for users to invest in extensions to the channel to provide access to new terminal facilities, such as the PWCS T4 facility.

In Glencore's view, PNO's stated value of trade assets of $2.398bn, does not appear to have recognised the substantial contribution that users have previously made to the development of the channel asset.[110] Therefore, in the absence of declaration, we consider that there is a material risk that PNO will not acknowledge the contributions made by users (or terminals) to the development of the channel asset, and will seek to incorporate a return on such investments in its channel usage charges. Access on reasonable terms and conditions, as facilitated by declaration, will ensure that users are not charged twice for such investments. As a result, we consider that it is likely that declaration will improve the incentive for users to invest in future required channel works, as they will be confident that they will not be charged twice for these works.

4.5.2 Compliance costs

PNO has submitted that the declaration of the Service has led to it incurring significant administrative and compliance costs and that it will continue to incur these costs if the declaration is not revoked.[111] PNO's application does not provide detailed information about the nature or scale of these costs but simply notes them to be 'significant'. PNO further notes that Aurizon's recent submission to the QCA estimates their cost of access regulation at $15m per annum.[112]

Synergies considers that while there is a degree of administrative and compliance costs that will be incurred as a result of declaration (and which will extend beyond the owner of the declared Service, to include the access seeker as well as the regulator), Aurizon Network is unlikely to be a relevant comparator for PNO and that, in PNO's particular circumstances, there is no reason for these costs to be significant in the future in the event that the declaration is not revoked.

[110] Port of Newcastle (2014), Annual trade report, p.3

[111] PNO (2018), p.41

[112] PNO (2018), p.41

Aurizon Network is subject to a regulatory regime that requires it to develop and maintain an access undertaking establishing how it will provide access to its declared services, including the specification of a range of reference tariffs. Further, these arrangements are required to be fully re-evaluated on a regular basis. Moreover, in addition to the access undertaking, there are a range of instruments that Aurizon Network is required to develop and maintain, including a range of standard agreements, system rules, capacity assessments, network condition assessments and so on.

In contrast, as a result of declaration, PNO is simply required to negotiate with users for access to its Service. In the event that negotiations fail, and recourse to arbitration is required, we acknowledge that this can be administratively expensive. In this regard, it is likely that PNO will have borne substantial costs associated with the current arbitration between PNO and Glencore. However, any subsequent arbitrations (if they occur) are likely to be materially less costly, given that the ACCC will have reached a clear position on the reasonable approach to many of the issues. As a result, the costs associated with the Glencore arbitration are likely to be largely one off costs, and, in a forward looking sense, to the extent they have been incurred are now sunk.

Perhaps most importantly, in the event that the terms of the current arbitration were publicly known and PNO offered all users similar terms of access, there is a high likelihood that PNO would be able to avoid future arbitrations.

Accordingly, in future negotiations, it would be reasonable to expect that the costs can be managed and minimised by PNO, particularly as the methodology for a reasonable access charge for coal users will have been established. Further, to the extent that additional costs are incurred as a result of declaration, we would expect that an arbitrator would recognise the reasonable level of these costs as part of the efficient cost of providing the Service and would allow these costs to be recovered in a reasonable price.

The NCC's guidance expressly indicates that any service provider opposing an application for declaration should provide clear evidence why the protections under the CCA would not adequately deal with the issues addressed by the CCA. This would include, for example, explaining why potential costs, either generally or in the context of the particular service to which access is sought, would not be taken into account by the ACCC in setting prices in an arbitration in appropriate circumstances.[113] PNO's application for revocation does not demonstrate this.

[113] NCC (2018), p.45

4.6 Public detriments associated with revocation of the declaration

We believe that, absent the declaration, the integrity of Part IIIA will be undermined and the public interest will be diminished. Without a credible threat of regulation, PNO will have substantial ability and incentive to increase prices. Users of the Service will not have any established rights to access the channel Service on reasonable terms and conditions, and nor will they have any expectation of ever being able to negotiate and obtain access on such terms. While we acknowledge that Part IIIA was not established as a mechanism for resolving what are essentially price disputes, we consider that that the revocation of regulation under Part IIIA in circumstances where there is such a strong expectation of monopoly pricing in the absence of such regulation, is clearly contrary to the public interest.

The public detriments associated with revocation fall into four broad categories:

- efficiency losses in all dependent markets (previously discussed in section 4.4);
- the loss of any credible constraint on PNO's prices for the Service;
- losses incurred by businesses who have invested on the basis of the declaration being in place; and
- losses associated with negative precedent effects.

Importantly, these public detriments resulting from revocation of the declaration are *additional* to the public benefits associated with continuing the declaration, as described above.

4.6.1 No other credible constraint on monopoly pricing

As has been established in section 2.3.2, notwithstanding that PNO is heavily reliant on coal throughput for its revenue and profit, PNO's profits will be most effectively maximised through increasing prices and accepting the likely consequential impact on existing coal volumes. Further, absent the declaration, there has been shown to be no effective commercial, contractual or regulatory fetter on PNO's ability to impose further significant price increases on coal users. The Service declaration that is currently in place provides the only credible means of restraining PNO from such price increases.

While we acknowledge that the Part IIIA framework is established as an access regime, and is not designed primarily as a price regulation mechanism, as noted by the ACCC,

it has the capacity to deal with both access and pricing issues.[114] Further, there are numerous examples of access regulation frameworks being applied to infrastructure services, notwithstanding that they are not vertically integrated (and hence do not have an incentive to deny access based on favouring part of the vertically integrated business), recognising that there is potential for these businesses to misuse their market power leading to negative impacts on competition and/or economic efficiency. Examples include:

- ARTC Hunter Valley access undertaking and Interstate access undertakings, regulated under Part IIIA;
- WA Rail Access Regime, insofar that it applies to the vertically separated rail network held by Arc Infrastructure;
- Dalrymple Bay Coal Terminal and Queensland Rail, regulated under the *Queensland Competition Authority Act* (1997) (Qld) (QCA Act); and
- numerous gas pipelines, regulated under the National Gas Law (NGL).

We have examined the history of revocation of declaration matters pursuant to Part IIIA. We have also examined revocation matters under the NGL for the regulation of national gas pipelines in Australia dating back to the beginning of 2005.

In preparing this analysis, we recognise that gas pipeline infrastructure is subject to an 'upfront' declaration process which is different to that applied to the services provided by other infrastructure assets, such as PNO channels (including rail infrastructure, ports, airports).

The initial national gas pipelines access regime (provided in the former *Natural Gas Pipelines Access Code*) established the concept of covered and non-covered pipelines. The Code provided for pipelines to be covered from the access regime's commencement by their inclusion in Schedule A to the Code. By this mechanism, the Code automatically covered twenty-two transmission pipelines and fourteen distribution networks.[115]

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[114] ACCC (2017), Guidelines relating to deferral of arbitrations and backdating of determinations under Part IIIA of the Competition and Consumer Act 2010, August 2017. The Guideline notes that the ACCC may conduct arbitrations on both price and non-price issues and that there may be instances where the ACCC may be given an undertaking that only deals with price.

[115] There are covered and uncovered pipelines. Covered pipelines are subject to economic regulation. Some pipelines are not covered as they are subject to greenfields exemptions. Pipelines that are covered are subject to either full or light regulation. Light regulated pipelines must have an access regime, disclose certain information and provide reports to the regulator. They are not subject to price or revenue regulation. Fully regulated pipelines must submit an access arrangement to the Australian Energy Regulator for approval.

However, the regime provided for pipeline owners to apply to the NCC for revocation of coverage. The NCC's role in assessing revocation applications in relation to gas pipeline networks under the NGL[116] is similar to its role under Part IIIA of the CCA where the legislative criteria for assessing revocation is broadly consistent between both access regimes.

A summary of these cases is presented in the following table. A more detailed summary is presented at Appendix C.

[116] The *National Gas Access (WA) Act 2009* (WA) applies the NGL and the National Gas Rules in Western Australia except that the relevant regulator is the Economic Regulation Authority of Western Australia rather that the Australian Energy Regulator.

Table 8 Incidence of revocations of access regulation

Matter	Basis for revoking access regulation	Relevance
Access to infrastructure (revocation of declaration)[117]		
Declared sewerage transmission and interconnection services by Sydney Network Sewerage (2009)	Revoked due to certification of a state access regime. The NSW Premier was deemed to have made a decision not to declare the services. Services Sydney appealed the decision and the Tribunal handed down its decision to declare the services. In August 2009, the NSW Water Industry Access Regime was certified as effective for a period of 10 years. On 1 October 2009, the declaration was revoked on the basis that the declaration criteria were no longer satisfied due to a certified access regime being in place.	No state access regime in place NCC and Tribunal noted that the existing NSW monitoring regime would be unlikely to satisfy the threshold for certification
Access to gas pipelines (revocation of coverage)[118]		
Coverage of the Dawson Valley Pipeline (2014)	Revoked due to imminent threat of competition. The Minister was not satisfied criterion (a) was met. He found that the possibility of another pipeline being developed to offer similar services lessened the necessity for access to maintain or enhance competition	No prospect of the shipping channel services being duplicated at the Port of Newcastle
Coverage of the Wagga Wagga gas distribution system (2013)	Revoked with some ongoing regulatory constraint. The NCC had recommended that coverage not be revoked. The designated Minister's decision to revoke was made following the NSW Government's decision to continue with retail price regulation.	No existing regulatory constraint other than declaration is currently available at Newcastle
Coverage of the Tubridgi Pipeline and the Griffin Pipeline (2005)	Revoked due to lack of foreseeable demand. The Minister believed that there were no tangible benefits from continued coverage primarily because there was not enough evidence to conclude that there would be sufficient gas demand over the long term to require the services of the Tubridgi and Griffin Pipelines.	Demand outlook is strong at the Port of Newcastle
Coverage on the Moomba to Adelaide system (2005)	Revoked but with some prevailing market constraint. In making his decision to revoke, the Minister was not satisfied that the declaration would promote competition in the dependent markets. In reaching this decision, the Minister noted that although Epic Energy had monopoly market power, its ability and incentive to abuse this was constrained (due to substitution of other gas reserves).	No substitutability exists at the Port of Newcastle

Source: Information compiled from matters listed on the National Competition Council website at www.ncc.gov.au

The table above shows that there has been only one instance where revocation has occurred in relation to infrastructure matters under Part IIIA. For third party access to gas pipeline infrastructure, there has only been four instances since 2005 where

[117] There were three instances in which declaration was applied to airport infrastructure involving Sydney airport and Melbourne airport. These declarations expired. For more information, see Appendix C.

[118] According to the NCC's website, there are additional regulatory gas decisions which have been made since 2005. These are not listed in the table as they reflect exemptions relating to greenfield projects and/or changes from full regulation to light regulation coverage. Furthermore, we have examined the NCC's 'Past Applications Register' published on its website and note that there are numerous revocation decisions made between 1999 and 2004. Synergies has briefly examined these decisions and in the majority of these cases, the decision to revoke was made on the basis that the up-front declaration did not satisfy criterion (a) as there was either no ability for the infrastructure owner to exercise market power or there was no demand for third party access to the pipeline. These circumstances do not apply to the Port of Newcastle.

revocation has occurred (noting that, as identified earlier, gas pipelines were subject to 'upfront' declaration rather than being initially assessed against declaration criteria).

In the case of infrastructure, revocation did not proceed without the introduction of another regulatory constraint (i.e. certification of a state access regime). In the case of gas infrastructure, revocation did not proceed without there being changes in market circumstances which meant that commercial factors would effectively constrain access charges.

None of the circumstances in each of these matters exist at the Port of Newcastle today that would warrant revocation on similar grounds. While declaration (or coverage in the case of gas pipeline and networks) is intended to be a high threshold, equally, revocation is not a common occurrence (particularly after all appeal avenues for challenging the basis of the originating declaration have been exhausted).

4.6.2 Loss in value of investments made since declaration

Since the Service was declared in June 2016, numerous companies have committed to investments in the NSW coal sector, either through:

- acquiring an existing coal tenement or coal mine; and/or
- directly investing in new, extended or expanded coal production.

In each case, the investors will have assessed the value of those investments based on their expectations of the associated costs and revenues. These assessments will have been made in an environment where the Service was known to be declared under Part IIIA until mid 2031, and where there was therefore a reasonable expectation that PNO would be constrained from further significant increases in charges for the Service over that period.

However, as described above, absent the declaration, there will be no credible constraint on PNO increasing prices for the Service in a way that hypothecates margins that the investors had reasonably anticipated earning from coal production. This will reduce the value of the investments that these companies have made in the NSW coal mining sector.

4.6.3 Precedent implications

The pricing approach of most ports in Australia is one in which price increases have generally been in line with CPI adjustments. The recent pricing behaviour of PNO to aggressively increase its prices well above CPI in circumstances where that increase has not been associated with a significant investment has been the 'exception to the rule' and not generally aligned with the pricing practices at most other ports.

From a public interest perspective, revoking the declaration will set a poor precedent for undeclared ports across Australia, should it be perceived to allow clearly inefficient pricing behaviour to go unaddressed in an environment of a clearly deficient response from the relevant State Government to effectively constrain prices. Absent the declaration, port owners who are similarly incentivised to raise prices, will do so, with the full knowledge from this process that the threat of regulation under Part IIIA is weak (or, arguably, non-existent should the revocation proceed).

The constraint that potential regulation under Part IIIA provides for infrastructure businesses who hold market power will be undermined should the declaration be revoked. The mere act of revoking the declaration, notwithstanding that there has been no material change in market circumstances, and PNO continues to have the incentive and opportunity to set unreasonable terms and conditions, is likely to render any potential threat of Part IIIA to be, for all practical purposes, non-existent for firms that have market power, but are not vertically integrated. This lack of regulatory threat will be greater than in the situation where the Port of Newcastle was never first declared, as at that time there was an element of risk in terms of any untested applications for declaration. Revocation will confirm the risk of regulation for these firms is negligible.

This additional lack of confidence will create additional costs and risks which are likely to serve as further disincentives in the coal mining industry in NSW (and could, feasibly have spill over effects to other markets in other jurisdictions (and beyond ports).

Had the NSW Government responded to PNO's price increase of between 40-60% following the privatisation of the Port of Newcastle with a regulatory response, such as a referral to Independent Pricing and Regulatory Tribunal, it is very unlikely that the declaration process would have been initiated.

In this context, there is a clear public interest in maintaining the declaration as it signals to governments seeking to privatise assets to do so in a transparent regulatory environment, having regard to the future pricing arrangements that would be applied to the privatised asset.

4.7 Conclusion on Criterion (d)

Beyond the competition benefits identified in section 3, there are strong efficiency benefits associated with maintaining the declaration. Access (or increased) access to the Service, based on reasonable terms and conditions, will also ensure that disincentives to future investment in coal mining and exploration are not introduced, thereby risking the economic gains associated with such investment.

Further, we consider that there would be significant public detriment associated with a revocation of the declaration, when there has been no change in market circumstances, and when all of Glencore's (and other users) reasonable concerns about PNO's ability to set unreasonable terms and conditions have neither diminished nor been dispelled, that would warrant the current regulatory framework becoming redundant. Continued declaration would maintain the integrity of Part IIIA as a credible threat to monopoly behaviour that offends the objects of Part IIIA, while still providing for alternative regulatory approaches to be applied to other ports as appropriate (in which case the public interest in applying Part IIIA may not be strong).

For these reasons Synergies considers criterion (d) to be satisfied to warrant the declaration remaining in place.

5 Objects of Part IIIA

5.1 Introduction

Pursuant to s 44AA of the CCA, the objects of Part IIIA are to:[119]

(a) promote the economically efficient operation of, and use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and

(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

This is based on the premise that competition provides an incentive for firms to improve economic efficiency. In our view, revocation of the declaration is not consistent with the objects of Part IIIA as it will lead to reduced efficiency in the operation, use of and investment in supply chain infrastructure, and will cause a reduction in competition in dependent markets, with the effect being material in at least the coal tenements market.

5.1.1 Economically efficient operation of, and use of and investment in infrastructure thereby promoting effective competition

Objects clause (a) essentially describes the desired gains to the economy through the operation of Part IIIA and incorporates two limbs – Part IIIA is intended to promote the efficient use of infrastructure, *thereby* promoting effective competition. In order to be consistent with Objects clause (a), both limbs need to be achieved.

In this regard, the first component of this clause refers to the need to promote the economically efficient operation of, and use of and investment in the infrastructure by which services are provided.

As was established in section 2.3, absent the declaration PNO has a strong incentive to increase prices, even where this will constrain output. Although demand for the Service is inelastic at current price levels, increased port prices will increase the cash costs of coal producers in the Newcastle catchment area, and at times of low coal prices, this is likely to lead to some loss in coal throughput. Further, as has then been discussed in section 3.3.1, the strong expectation of higher port charges is likely to undermine the incentive of coal producers to invest in new and expanded coal production, with a particularly strong impact on small coal producers and marginal production areas. This is because, small producers, unlike some of the larger miners, may not be able to absorb the

[119] See s 44AA of the CCA

increased exposure to cost and risk. As a result, it is likely that, over time, Newcastle coal exports will be lower than would be the case where the Service is declared.

Revocation will therefore lead to lower throughput volumes than would be the case under continued declaration of the Service. These lower throughput volumes will result in less productively efficient use of the Hunter Valley Coal Chain infrastructure, including rail infrastructure, coal terminal infrastructure and port infrastructure.

Furthermore, revocation will introduce disincentives for investment in mining exploration and production, given the increased cost and risk of port access. This, too, will distort the incentives for efficient investment in infrastructure necessary to support increased volumes for the NSW coal sector, with resources likely to be diverted to other, lower value, uses.

Hence, revocation of the declaration will be inconsistent with this first limb of Objects clause (a).

The second limb of Objects clause (a) is for the promotion of the economically efficient operation of, use of and investment in infrastructure to have the effect of promoting effective competition in upstream or downstream markets.

As we have established in clause 3.3, revocation of the declaration is likely to reduce investor confidence in obtaining reasonable terms and conditions of access (and in particular having the ability to have those terms and conditions determined by the ACCC as part of an access arbitration if unable to agree terms and conditions with PNO) and therefore increase the costs of capital for new coal mining projects in the Newcastle catchment, which in turn will result in lower investment in coal exploration and development of new and expanded coal projects. This will lead to a loss of competition in the coal export market, and more significantly in the coal tenements market.

Revocation will therefore lead to a reduction in the number of parties who are willing to bid on tenements, either at initial allocation or for subsequent sale, and less rivalrous behaviour amongst those that do bid. A further consequence is that there will be less incentive for tenement holders to invest in exploration to prove up their reserves, given the lower likelihood of mine development being viable.

Collectively these effects mean there would be lower and less competitive prices for tenements and lower quality and quantity of traded tenements reflecting a material reduction in competition in the tenements market.

By reducing competition in dependent markets, and materially so in the coal tenements market, revocation of the declaration will also be inconsistent with the second limb of Objects clause (a).

Revocation of the declaration is clearly inconsistent with Objects clause (a), as it will undermine both the efficient use of infrastructure and competition in dependent markets.

5.1.2 Consistent approach to access regulation in each industry

The goal in applying any form of access regulation (that is not without some costs) is to ensure economic efficiency, through the mechanism of fostering competition, is maximised across all sectors in an industry by applying a consistent form of access regulation. This is the purpose of Objects clause (b).

Revocation in this instance is not consistent with the objects of Part IIIA where it undermines the effectiveness of Part IIIA as a credible regulatory constraint. Absent the declaration, the effectiveness of Part IIIA is diminished not only for ports, but for all infrastructure sectors where competition is not deemed to be a sufficient constraint on monopoly behaviour and no other regulatory tool is available or adequate to address issues of access.

Revocation for a particular port whose pricing behaviour continues to draw strong criticisms from users of the Service, and absent the declaration, will in all likelihood go unchecked, has to potential to render the threat of Part IIIA ineffective in other industries and markets where similar concerns may arise.

Further, the current ACCC arbitration process between PNO and Glencore, once finalised, will be likely to provide a framework and guiding principles that will encourage and lead to consistent access principles in the coal export industry - provided the declaration is not revoked.

Therefore, we consider that revocation of the declaration will also be inconsistent with Objects clause (b).

A. Profit maximising derivations

The purpose of this Appendix is to provide algebraic derivations of the profit maximising conditions for a monopolist both with and without price discrimination.

A.1 The profit maximising price for a monopolist

The profit maximising output and price combination can be obtained from the condition of maximising profits which is found by differentiating the expression for profit with respect to a change in output.

Thus

(1) $Profit = PQ - TC$

where P = price, Q = output and TC is total cost.

Differentiating (1) with respect to Q

(2) $\delta Profit/\delta Q = P + \delta P/\delta Q \times Q - \delta TC/\delta Q$

Using the definition of marginal cost (2) can be re-expressed as

(3) $\delta Profit/\delta Q = P + \delta P/\delta Q \times Q - MC$

where MC is marginal cost and $P + \delta P/\delta Q \times Q$ is MR or marginal revenue.

So setting marginal profit to zero

(4) $P = MC - \delta P/\delta Q \times Q$

Using the formula for the price elasticity of demand $\varepsilon_d = \delta Q/\delta P \times P/Q$, (4) can be re-expressed as

(5) $(P - MC)/P = -1/\varepsilon_d$

Where is ε_d is negative.

This mark up equation shows that prices can exceed marginal cost depending on the elasticity of demand. The lower is the elasticity of demand in absolute terms the higher is the price mark up.

Equation 5 can be re-arranged to define the profit maximising price as follows

(6) $P = MC/(1 + 1/\varepsilon_d)$

Or

(7) $(P - MC)/P = -1/\varepsilon_d$

Note that the elasticity of demand must be less than -1 otherwise marginal revenue will be negative. This follows by setting MR=MC and rearranging (6) as

$$(8)\ MR = P(1 + 1/\varepsilon_d)$$

Assuming a positive price, MR is negative if the elasticity of demand, ε_d, is inelastic (less than 1 in absolute terms).

The intuition is as follows. Total revenue is maximised where the elasticity of demand is -1. If the firm moves into the inelastic part of the demand curve prices decline by a greater percentage than quantity increases. Alternatively suppose the starting point is where demand is inelastic, then revenue can be increased until the elasticity of demand is -1 by increasing prices, as the percentage increase in prices will be greater than the percentage reduction in demand. So a monopolist will always have an incentive to increase prices if demand is inelastic, even if marginal cost is near zero. Furthermore, the profit maximising price depends on marginal costs as well as the elasticity of demand as shown in equation (6).

Consider the potential impacts on prices consider a price elasticity of demand of -1.01 and -1.5.

For a price elasticity of demand of -1.01 using (6) the price would be 100 times marginal cost.

For a price elasticity of demand of -1.5 using (6) the price would be 3 times marginal cost.

A.2 The profit maximising price for a monopolist that can price discriminate

Assume that there are two groups of customers and the monopolist can charge different prices to the two groups reflecting different responsiveness to price.

Also assume the monopolist's marginal cost is the same when supplying the product to the two groups.

Then

$$(1)\ Profit = (P_1 - MC)\,Q_1 + (P_2 - MC)\,Q_2$$

where 1 and 2 relate to the two groups.

Profits are maximised by maximising the profits for each group separately and the profit maximising prices can be found by differentiating the profit expression with respect to each output and setting marginal profit at zero.

This leads to the condition that the marginal revenues for each group will be equal and equal to marginal cost and the profit maximising prices as follows:

(2) $P_1 = \quad MC/(1 + 1/\varepsilon_{d1})$

(3) $P_2 = \quad MC/(1 + 1/\varepsilon_{d2})$

The results can be extended to more groups reflecting different demand elasticities.

For a reference see Carlton, D. W. and J. M. Perloff, (2000), Modern Industrial Organization, Third Edition, Addison Wesley, pp. 88-92 and 284-288.

B. Coal exploration licences – Newcastle catchment

Table 9 Ownership of coal exploration licences in NSW - July 2018

Title Holder	Parent company	No of titles
Gunnedah Basin		
Aston Coal 2 Pty Ltd	Whitehaven	2
Boggabri Coal Pty Limited	Idemitsu	2
CoalWorks (Vickery South) Pty Ltd	Whitehaven	1
Curlewis Coal & Coke Pty Limited	-	2
Goonbri Coal Company Pty Limited	-	1
Namoi Mining Pty Ltd	Yankuang Group Co Ltd	2
Narrabri Coal Pty Ltd	Whitehaven	1
Renison Coal Pty Ltd	Laneway Resources	1
Secretary of the Department of Planning and Environment	na	2
Shenhua Watermark Coal Pty Ltd	Shenhua Group (Chinese state-owned enterprise)	1
Whitehaven Coal Mining Limited	Whitehaven	5
Hunter Valley Basin		
AQC Dartbrook Pty Ltd	Australian Pacific Coal	4
Austar Coal Mine Pty Limited	Yancoal	1
Bloomfield Collieries Pty Ltd	Bloomfield Group	3
Callaghans Creek Holdings Pty Ltd		1
Centennial Mandalong Pty Limited	Centennial Coal	5
Centennial Mannering Pty Ltd	Centennial Coal	1
Centennial Myuna Pty Limited	Centennial Coal	1
Centennial Newstan Pty Limited	Centennial Coal	1
Coal & Allied Operations Pty Ltd	Yancoal (Yankuang) / Mistubishi	7
Construction Forestry Mining and Energy Union Mining and Energy Division	-	1
Cumnock No. 1 Colliery Pty Limited	Glencore	1
Dellworth Pty Limited	NuCoal Resources	
Donaldson Coal Pty Ltd	Yancoal	2
Enviro-Mining Pty Ltd	no longer in operation – went into voluntary administration	1
Glencore Newpac Pty Ltd	Glencore	1
Glendell Tenements Pty Limited	Glencore	2
Hunter Valley Energy Coal Pty Ltd	BHP Billiton Group	1
Kores Australia Pty Limited	Korea Resources Corporation	4

Title Holder	Parent company	No of titles
Mach Energy Australia Pty Ltd	Droxford International (Salim Group – Indonesian conglomerate)	1
Malabar Coal (Maxwell) Pty Ltd	Malabar Coal	1
Maxwell Ventures (Management) Pty Ltd	Malabar Coal	1
Monash Coal Pty Ltd	Yancoal (Yankuang)	2
Mount Thorley Operations Pty Limited	Yancoal Yankuang) (80%) / PSCO Australia Pty Ltd (20%)	1
Mt Arthur Coal Pty Limited	BHP Billiton Group	2
Mt Owen Pty Limited	Glencore	5
Muswellbrook Coal Company Ltd	Idemitsu	1
Newcastle Coal Company Pty Ltd	Noble Group	2
Saxonvale Coal Pty Limited	Glencore	5
Secretary of the Department of Planning and Environment	-	3
Spur Hill NO2 Pty Limited	Malabar Coal	1
United Collieries Pty Ltd	Glencore (95%) / CFMEU (5%)	1
Wambo Coal Pty Limited	Peabody	2
White Mining (NSW) Pty Limited	Yancoal (Yankuang)	1
Western Basin		
Bickham Coal Company Pty Limited	Bickham Coal Company	2
Kepco Bylong Australia Pty Ltd	Korea Electric Power Corporation (KEPCO Korea)	2
Loyal Coal Pty Ltd	Whitehaven	1
Mangoola Coal Operations Pty Limited	Glencore	1
Moolarben Coal Mines Pty Limited	Yancoal (Yankuang)	3
Phoenix Vision Coal Pty Ltd	Deregistered 9 August 2016	1
Ridgelands Coal Resources Pty Limited	Ridgelands Resources Group (Hong Kong)	1
Secretary of the Department of Planning and Environment	-	3
Ulan Coal Mines Ltd	Glencore	3
Wilpinjong Coal Pty Ltd	Peabody	2

Source: NSW Department of Planning and Environment at www.commonground.nsw.gov.au [accessed on 30 July 2018]

C. History of declaration applications

Table 10 History of declaration revocations and reasons

Application Date	Matter	Outcome	Additional information
Access to Infrastructure (Airports, Rail, Water)			
08/08/2014	Tiger Airways Australia Pty Ltd applied for declaration of the Domestic Terminal Service at Terminal 2.	Withdrawn	The declaration was withdrawn as there was an agreement on access to infrastructure at the airport.
27/09/2011	The Board of Airline Representatives of Australia Inc (BARA) made 2 applications for declaration of jet fuel services from Sydney Airport and Caltex Pipelines for the Caltex Pipelines and Sydney JUHI Facility.	Not declared	Minister stated that sections 44H(4)(a) and 44H(4)(f) were not satisfied by either application.
19/05/2010	Pacific National applied for declaration of the Blackwater, Goonyella, Moura and Newlands Coal Railway.	Withdrawn	Certification of state rail access regime.
22/03/2010	North Queensland Bio-Energy Corporation Ltd applied for declaration of the narrow-gauge cane tram network operated by Sucrogen Pty Ltd (Herbert River tramway network).	Not declared	NCC was not satisfied that the application met all of the declaration criteria in s 44G(2). It also is not satisfied that the cane railway is of national significance nor access would not be contrary to public interest.
14/11/2008	Third party access to Pilbara Railways - Following the NCC's recommendations and the Treasurers' decisions regarding the Mt Newman, Goldsworthy, Hamersley and Robe Railway services in the Pilbara, the Treasurers' four decisions were subject to reviews by the Australian Competition Tribunal.	Declared / not declared	Following the NCC's recommendations and the Treasurers' decisions regarding the Mt Newman, Goldsworthy, Hamersley and Robe Railway services in the Pilbara, the Treasurers' four decisions were subject to reviews by the Australian Competition Tribunal. Two of the Competition Tribunal's decisions were then the subject of appeals to the Full Court of the Federal Court and further appeals to the High Court. The High Court remitted the Hamersley and Robe River decisions back to the Tribunal to be re-determined. In doing so, the Tribunal set aside both the Hamersley declaration and the Robe River declaration, leaving only the services provided by the Goldsworthy railway declared.
18/01/2008	The Pilbara Infrastructure Pty Ltd applied for declaration of the Robe Railway.	Not declared	In the initial decision, declaration was implemented as the Minister deemed that they were satisfied with all the declaration criteria. In the first appeal, the tribunal deemed that it was uneconomical to develop another facility, so the declaration was reduced to a 10-year timeframe. The declaration was set aside by the Tribunal as it was deemed uneconomical for anyone to develop an alternative facility to the Robe line.

Application Date	Matter	Outcome	Additional information
17/11/2007	The Pilbara Infrastructure Pty Ltd applied for declaration of the Hamersley Railway.	Not declared	The Tribunal set aside the Minister's decision to declare the Hamersley Railway service.
17/11/2007	TPI applied for declaration of the Goldsworthy Railway.	Declared (expires 2028)	The NCC considered access to the Goldsworthy line was not contrary to public interest therefore there was no reason to exercise discretion against declaration.
03/05/2007	The Tasmanian Department of Infrastructure, Energy and Resources applied for declaration of the Tasmanian Railway Network.	Declared (expired 2017)	The NCC and designated Minister was satisfied that all the criteria in subsection 44G(2) of the act were satisfied by the application.
08/10/2004	Lakes R Us P/L applied for declaration of the water storage and transport services offered by Snowy Hydro Limited and State Water Corporation.	Not declared	The NCC and designated Minister determined that the application did not satisfy the criteria in that declaration would not promote competition in a dependent market and would be contrary to public interest.
15/06/2004	Fortescue Metals Group Pty Ltd applied for declaration of the services provided by Mt Newman and Goldsworthy Railway lines.	Not declared	The Minister was deemed to have made a decision not to declare the service and this was upheld by the Tribunal upon appeal. Access was not in the public interest and therefore the services should not be declared. This is because in any event as a matter of discretion they would not declare the service.
03/03/2004	On 3 March 2004, Services Sydney applied to the council for the declaration of the services of Sydney Network Sewerage.	**Revoked** - due to certification of access regime	The Premier was deemed to have made a decision not to declare the services. Service Sydney appealed the decision and the Tribunal handed down its decision to declare the services. In August 2009, the NSW Water Industry Access Regime was certified as effective for a period of 10 years. Following certification, the NCC reviewed the declaration and recommended to the Minister it be revoked. On 1 October 2009, the declaration was revoked on the basis that the declaration criteria were no longer satisfied due to certification of these access regime.
01/10/2002	Virgin Blue Airlines applied for declaration for the airside services at Sydney Airport. This included the use of runways and passenger terminals	Declared (expired in 2010)	The designated Minister determined that airside services should not be declared. Virgin Blue successfully appealed the decision to the Tribunal. Sydney Airport sought Judicial review of the Tribunal's decision but was unsuccessful.
06/11/1996	Australian Cargo Terminal Operators Pty Ltd (ACTO) applied for declaration of particular services at Sydney and Melbourne International Airports.	Declared Melbourne (expired 1998) Sydney (expired 2005)	The services for which declaration was sought were: • the service provided through the use of the freight aprons and hard stands to load and unload international aircraft at Sydney international airport (S1) and Melbourne international airport (M1) • the service provided by the use of an area at the airport to store equipment used to load/unload international aircraft; and to transfer freight from the loading/unloading equipment to/from

Application Date	Matter	Outcome	Additional information
			trucks at Sydney International Airport (S2) and Melbourne International Airport (M2), and • the service provided by use of an area to construct a cargo terminal at Sydney International Airport (S3) and Melbourne International Airport (M3). The NCC recommended (and the Treasurer accepted) that the services specified as S1, S2, M1 and M2 be declared and those specified as S3 and M3 should not. The Melbourne airport services (M1 and M2) were declared from 1 August 1997 until 9 June 1998. The FAC appealed the decision in relation. to Sydney airport. The Tribunal declared an amended scope of service for Sydney airport which came into effect on 1 March 2000 for 5 years.
24/04/1996	The Australian Union of Students applied for declaration of the 'Austudy Payroll Deduction Service'.	Not declared	The Minister was not satisfied that it would be uneconomical for anyone to develop another facility and that the DEETYA computer facility was not of national significance. It also deemed declaration would be contrary to the public interest.
Access to Gas Pipelines (2005+)			
15/05/2014	WestSide Corporation applied for revocation of coverage in the Dawson Valley Pipeline.	**Revoked**	The Minister was not satisfied criterion (a) was met. He found that the possibility of another pipeline being developed to offer similar services lessened the necessity for access to maintain or enhance competition.
01/05/2013	Envestra applied for revocation of coverage on the Wagga Wagga gas distribution system.	**Revoked** but NSW retail price regulation for gas remained	The NCC had recommended the declaration not be revoked. The designated Minister's decision to revoke was made following the NSW Government's decision to continue with retail price regulation.
28/11/2012	Kimberly-Clarke Pty Ltd applied for coverage of the South Eastern Pipeline System	No coverage	The Minister was not satisfied the criteria were met.
04/11/2005	BHP Petroleum applied for revocation of coverage of the Tubridgi Pipeline and the Griffin Pipeline.	**Revoked**	The Minister believed that there were no tangible benefits from continued coverage primarily because there was not enough evidence to conclude that there would be sufficient gas demand over the long term to require the services of the Tubridgi Pipeline.
16/03/2005	Molopo Australia Ltd applied for coverage of the Dawson Valley to Wallumbilla Pipeline.	No coverage	The Minister was not satisfied the criteria were met.
15/03/2005	Epic Energy applied for revocation of coverage on the Moomba to Adelaide system	**Revoked**	In making his decision to revoke, the Minister was not satisfied that the declaration would promote competition in the dependent markets. In reaching this decision, the Minister noted that although

Application Date	Matter	Outcome	Additional information
			Epic Energy had monopoly market power, its ability and incentive to abuse this was constrained (due to substitution of other gas reserves).

Source: NCC website at www.ncc.gov.au

Note: According to the NCC's website, there are additional regulatory gas decisions which have been made since 2005. These are not listed in the table as they reflect exemptions relating to greenfield projects and/or changes from full regulation to light regulation coverage. Furthermore, we have examined the NCC's 'Past Applications Register' published on its website and note that there are numerous revocation decisions made between 1999 and 2004. Synergies has briefly examined these decisions and in the majority of these cases, the decision to revoke was made on the basis that the up-front declaration did not satisfy criterion (a) as there was either no ability on the infrastructure owner to exercise market power or there was no demand for third party access to the pipeline. These circumstances do not apply to the Port of Newcastle.

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Port of Newcastle

Response to submissions and documents provided by Port of Newcastle Operations

Prepared on behalf of Glencore Coal Pty Ltd

5 October 2018

Synergies Economic Consulting Pty Ltd
www.synergies.com.au

Executive Summary

Synergies, acting on behalf of Glencore, has prepared this report to address additional submissions by PNO in relation to PNO's recent application for revocation of declaration of shipping channel services at the Port of Newcastle.[1]

The NCC sought further information from PNO on the following issues, which we have considered in this report include:

- investment incentives in new coal mining projects in the port's catchment areas with and without declaration;
- the effect of declaration on competition in the acquisition and disposal of exploration and/or mining authorities; and
- whether declaration of the shipping channel service at the Port of Newcastle promotes the public interest.

Reduced investment incentives and impact on competition in the market for coal mining authorities

PNO has submitted that declaration will have no discernible impact on competition in the acquisition and disposal of exploration and/or mining authorities, in part because the geographic dimension of the market is not limited to the Hunter Valley, such that any actions taken by PNO will not be material to this more broadly defined market for coal authorities.

In reaching its view that the geographic dimension of the market is not limited to the Hunter Valley, we consider that PNO, through its advisors, HoustonKemp, has misapplied the Hypothetical Monopsony Test[2]. In our assessment, we defined the hypothetical monopsonist as a buyer of tenements who is linked to Port of Newcastle export supply chain. This is the appropriate definition, given the purpose of the assessment is to consider the impact that declaration of the Port of Newcastle shipping channel will have on competition in dependent markets.

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[1] The declaration which is currently in place at the Port of Newcastle is pursuant to the Part IIIA of the *Competition and Consumer Act 2010* (Cth) (CCA). It provides a legislative right for access seekers (such as Glencore as well as all other channel users) to negotiate with PNO for access to the declared service on reasonable terms and further provides recourse to arbitration if negotiations are unsuccessful.

[2] The Hypothetical Monopsony Test is an application of the logic in the standard Hypothetical Monopolist Test, but assessing market power from the perspective of a monopsony. This means that seller substitution takes the place of buyer substitution in the standard Hypothetical Monopolist Test, while other buyers take the place of substitution on the supply side.

However, HoustonKemp argue that such a monopsonist could not profitably reduce the price of tenements in the Newcastle catchment area as other buyers would be attracted to the market. This is not correct and overlooks the key, fundamental issue in this analysis; the absence of any other existing or proposed port facility for the export of the coal means that a seller of coal tenements has no other option than to sell to the buyer linked to the Port of Newcastle. Therefore, this buyer (linked to the Port of Newcastle) could profitably reduce the prices paid for those tenements. The limited options for buyers to only export through the Port of Newcastle provides a maximum constraint on the geographic scope of the tenements market.

Therefore, Synergies maintains its views that the geographic scope of the coal tenements market is confined to the Newcastle catchment area (at its broadest level), and that based on an examination of the patterns of ownership, it is likely that it comprises smaller regional markets in the areas of the Hunter Valley/Western Basins and the Gunnedah Basin.[3]

PNO further claim that because the current level of port charges represents what they allege to be an immaterial cost for a coal mine operator or investor and that there is no basis to conclude that the terms of access would be materially different as a result of declaration, competition in the coal tenements market will be unaffected by the status of declaration as port charges have no discernible effect on the investment incentives or returns from investing in coal mines.[4] PNO has not provided any new evidence to support these claims, which we addressed in detail in our 8 August report.

Given these factors, PNO's pricing behaviour will have a material impact on competition in coal tenements market. Should revocation of the declaration occur, this is likely to lead to a material loss of competition in the market for coal tenements where there is a loss in investor confidence and reduced willingness to invest in coal exploration and mine development which is likely to lead to a reduction in the number of parties who are willing to bid on tenements and less rivalrous behaviour amongst those that bid.

Public interest

PNO has submitted that there is an insufficient basis for the NCC to be satisfied that access (or increased access), on reasonable terms and conditions as a result of the declaration of the Service, would promote the public interest.

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[3] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.40

[4] HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, p.2

PNO's claims in part rely on the low number of public submissions as evidence of there being a low level of public interest in maintaining the declaration. It is the substance of the issues raised in submissions that is the key consideration.

On a more substantive point, PNO also claim that Synergies mis-stated the public interest criterion test and applied it as a negative assessment rather than through the application of the positive test in which the designated Minister must now be positively satisfied that access (or increased access) to the Service would promote competition.

We have examined this claim, and again, we disagree with PNO. Our assessment that revocation would not promote the public interest is based on the application of the public interest to a future *with continued declaration* and a future *without declaration*. In other words:

- the status quo is the circumstance in which the declaration already exists;
- the counterfactual is the circumstance in which the declaration no longer exists.

Under this scenario, the starting point is not the absence of declaration. More appropriately, where the starting point is a circumstance of declaration existing, then the test of 'disbenefit' or the detriment that is likely to arise in the event that the declaration is removed, is the only practical application of the with and without test.

The additional information presented by PNO does not raise substantive new issues that would warrant the NCC or the Minister removing the current declaration from remaining in place.

We therefore maintain that the amended criterion (d) pursuant to s 44CA(1), based on the evidence presented in our earlier report, is satisfied.

Contents

1 Introduction

On 2 July 2018, the Port of Newcastle Operations Pty Limited (PNO) applied to the National Competition Council (NCC) for revocation of the declaration made by the Australian Competition Tribunal (the Tribunal) on 16 June 2016 for the use of the defined service (Service). The Service largely comprises the use shipping channels at the Port of Newcastle that are subject to the revocation application, pursuant to s 44J of the *Competition and Consumer Act 2010* (Cth) (CCA).

Synergies Economic Consulting (Synergies) is assisting Glencore Coal Pty Ltd (Glencore) in its response to the NCC on this revocation application. Synergies prepared a report on behalf of Glencore dated 8 August 2018 (available on the NCC's website) which concluded that continued declaration satisfies s 44CA(a) and (d) of the CCA and remains consistent with the objects of Part IIIA, as set out in s 44AA of the CCA.[5]

On 20 September 2018, the NCC published submissions and documents provided by PNO in response to the NCC's letter of 4 September 2018, in which it requested further information from PNO in relation to:

1. Investment incentives in new coal mining projects in the port's catchment areas with and without declaration.
2. The effect of declaration on competition in the acquisition and disposal of exploration and/or mining authorities.
3. Whether declaration of the Service would promote the public interest.
4. The effect of a proposed new container terminal at the Port on PNO's incentives to provide access to the declared service with and without declaration.
5. Containers imported and exported at the Port in 2017 and 2018.

Synergies has examined the information presented by PNO in response to the NCC's request for additional information in items 1-3 above, and our response is set out in this report. We have not examined information related to items 4-5 above, being the import and export of containers and the prospective container terminal development. This is because the relevance of it is not clear from the NCC's questions and PNO's response, and it appears to relate to matters affecting other dependent markets which were not covered in our earlier report to the NCC. In addition, our ability to comment is limited

[5] A copy of Synergies' report is available at the following link http://ncc.gov.au/application/consideration-of-possible-recommendation-to-revoke-declaration-of-service-a/2

because of the confidentiality restrictions that have prevented us seeing any underlying data and reports that we would have needed in order to do so.

This report is structured as follows:

- Section 2 addresses PNO's response to our assessment of the market definition for coal tenements, in which PNO argues for a broader geographic scope of the dependent market, which in turn, serves to diminish any perceived competition risks in relation to the Port of Newcastle;
- Section 3 responds to PNO's claims concerning the irrelevance of port charges to upstream market outcomes; and
- Section 4 responds to PNO's claims about our assessment of the public benefit criterion.

2 Market definition

Criterion (a) requires that the Minister must be satisfied that access (or increased access) on reasonable terms and conditions, as a result of declaration of the service would promote a material increase in competition in at least one dependent market.[6]

Synergies' report to the NCC of 8 August 2018 submitted that revocation of the declaration will result in investors in the coal sector in the Newcastle catchment facing a material risk of substantially higher port charges that will be likely to reduce their incentive to invest in the exploration and development of future coal reserves in the Newcastle catchment.[7] We considered that this would be likely to have a material adverse impact on effective competition in the tenements market.

PNO has presented submissions to submit that declaration will have no discernible impact on competition in the acquisition and disposal of exploration and/or mining authorities, in part because the geographic dimension of the market is not limited to the Hunter Valley, such that any actions taken by PNO will not be material to this more broadly defined market for coal authorities.[8]

We disagree with PNO's reasoning and outline our position below. Before considering this issues in detail, we briefly review the precedent on the market for mining authorities.

2.1 Market for coal mining authorities

The NCC, the Tribunal and PNO have each previously accepted a separate dependent market(s) for the acquisition and disposal of exploration and/or mining authorities. The product, functional and geographic dimension of this market were never examined in detail in the originating declaration proceedings as the focus was mainly on the dependent market for coal exports.

In our 8 August report, we identified the market characteristics associated with a separate dependent market for acquisition and disposal of exploration and/or mining authorities and presented evidence that revocation would be likely to have a material adverse impact on effective competition in the tenements market.

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6 See s. 44CA(1) of the CCA

7 Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.62

8 PNO (2018), Application for revocation and declaration Further submission in response to letter from the NCC dated 4 September 2018, 17 September 2018, p.3

2.2 Geographic dimension

2.2.1 Our previous submission on the geographic dimension of the tenement market

In our 8 August report, we presented evidence to support the view that the dependent market for prospecting, exploring and developing coal deposits is confined to the Newcastle catchment area (at its broadest level), and that it is likely that it comprises smaller regional markets in the areas of the Hunter Valley/Western Basins and the Gunnedah Basin.[9] We reached this conclusion on the basis of assessing the location of customers, sales and the geographic boundaries that limit trade.

A key factor in our consideration of the geographic boundaries of this market was our application of a Hypothetical Monopsony Test – this is an application of the logic in the standard Hypothetical Monopolist Test, but assessing market power from the perspective of a monopsony. This means that seller substitution takes the place of buyer substitution in the standard Hypothetical Monopolist Test, while other buyers take the place of substitution on the supply side.

In this instance, we defined the hypothetical monopsonist as a buyer of tenements who is linked to Port of Newcastle export supply chain. Linking the hypothetical monopsonist to the Port of Newcastle supply chain is appropriate, given the purpose of the assessment is to consider the impact that declaration of the Port of Newcastle shipping channel will have on competition in dependent markets.

We then considered the question of whether a hypothetical monopsonist buyer of tenements, linked to supply through the Port of Newcastle, could profitably lower the price for mining authorities by the imposition of a small but significant non-transitory decrease in price. In applying this test there is a need to consider the options available to sellers of the mining authorities, and in particular the scope for other buyers (who are not linked to the Port of Newcastle supply chain) to be willing to enter the market and buy the relevant authorities thereby defeating the attempt to exercise monopsony power.

It has previously been accepted by the NCC and the Tribunal that the Port of Newcastle is the only viable option for mines in the Newcastle catchment area to export coal.[10] Therefore, coal tenements in the Hunter, Western and Gunnedah basins – which are

[9] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.40

[10] Australian Competition Tribunal (2016), *Application by Glencore Coal Pty Ltd* [2016] ACompT 6, p.1

necessarily specific to these defined locations[11] - would, if developed, have no option but to export via the Port of Newcastle. In other words, it is inevitable that a buyer of a coal tenement in the catchment of the Port of Newcastle will be dependent upon that port for export volumes.

Therefore, under the Hypothetical Monopsonist Test, with the monopsonist buyer being the only party with control over supply through the Port of Newcastle, leaves a seller of these authorities with no practical alternative except to sell to that buyer. If other buyers entered the market to buy those authorities, they would ultimately have to onsell them to the buyer who controls supply through the Port of Newcastle. As a result, it follows that a monopsony buyer of tenements linked to the Port of Newcastle could profitably reduce the prices paid for those tenements, relative to the outcome of a competitive market on the buyer side.[12]

Synergies concluded that these limited options for buyers of authorities to only export through the Port of Newcastle (due to the absence of an alternative or substitute port) constrained the geographic scope of the market at its maximum to a regional market where coal exports would necessarily have to go through the Port of Newcastle.

2.2.2 PNO's claims regarding geographic dimension

PNO disagrees with the position described by Synergies, submitting that the geographical dimension of the market is not limited to the Hunter Valley but is much broader.

PNO argue that Synergies' reasons for distinguishing the circumstances at the Port of Newcastle from the Tribunal's previous assessment of a geographic scope for the iron ore tenements market in the Pilbara region is not valid.

PNO's advisors (HoustonKemp) also submit that:[13]

> The essential error in the reasoning put forward by Synergies makes is to assume away the prospect of alternative buyers of coal authorities – from outside the Hunter Valley – competing with its hypothetical, Hunter Valley-based monopsonist. Coal

[11] Under the NSW regime, there is a competitive selection process for coal tenements where the NSW Government is the sole issuer of mining exploration tenements across the state (although these tenements can be traded). These permits do not apply to deposits outside of NSW. This means that irrespective of the options for exploration rights buyers of those rights might have, the sellers of those rights are restricted in terms of the location for the rights.

[12] The application of this test is inherently hypothetical and the absence of a party in the position of the hypothetical monopsonist is irrelevant – the purpose of the exercise is to help inform the delineation of the market, in similar manner as when the standard hypothetical monopolist test is applied.

[13] HoustonKemp Economists (2018), Effect of declaration on competition for coal authorities, A report for Port of Newcastle Operations, 14 September 2018, p.6

> authorities have a fundamental value given expectations of the price of coal and the costs of its extraction. If a hypothetical monopsonist for coal authorities in the Hunter Valley were to attempt to force prices for coal authorities below their fundamental value, its position would quickly be competed away by buyers from outside the Hunter Valley seeking the potential arbitrage opportunity created by that action.

Synergies does not agree with PNO's reasoning on this issue. A critical aspect that PNO overlooks is that the buyer of the tenement must (given the absence of alternative ports), be linked into the coal supply chain that is connected to the Port of Newcastle. These issues are addressed in turn.

Tribunal decision in FMG decision

As the Tribunal noted in its consideration of the Fortescue Metals Group (FMG) matter, the declaration application under consideration related only to the BHP Billiton rail lines (and therefore the hypothetical monopsonist test was based on a monopsonist linked to the BHP Billiton rail lines), and that many of the Pilbara tenements would have effective substitutes available to them in the form of alternative rail lines (including both existing and planned rail lines).[14] The Tribunal's conclusion was that a monopsony buyer of iron ore tenements linked to a specific rail line could not profitably decrease the price paid for tenements because sellers would easily find an alternate purchaser (who could utilise an actual or planned rail line to convey iron ore to the relevant port).

This contrasts with tenements in the Newcastle catchment area, which do not have access to any existing or planned substitute to the Port of Newcastle. In this context, when asking the question whether a hypothetical monopsonist buyer of tenements could profitably lower the price for mining authorities, competition from alternative buyers of coal authorities who are not linked to the Hunter Valley supply chain, is not, as put forward by PNO, a relevant consideration. As noted above, buyers will not be willing to enter the coal tenements market if they are unable to access a port to export coal.

We also note that PNO claimed that the Tribunal, in the FMG case, found that the market for the purchase and sale of tenements 'extended beyond the Pilbara region'. The Tribunal's decision noted that the 'market is most likely Pilbara wide' and not as PNO has claimed, extending 'beyond the Pilbara region'.[15] The Tribunal stated:[16]

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[14] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, p.250

[15] HoustonKemp Economists (2018), Effect of declaration on competition for coal authorities, A report for Port of Newcastle Operations, 14 September 2018, p.5

[16] Australian Competition Tribunal (2010), *Fortescue Metals Group Limited* [2010] ACompT 2, 30 June 2010, p.258

> Most of the experts accept that the market for tenements is at least Pilbara-wide. Dr Fitzgerald supported a global market and pointed to the prevalence of international investors in joint venture arrangements. By the same token, many investors in tenements only participate in Australia. Further, as Mr Houston pointed out, differences in the scale and quality of resources, and different regulatory requirements and business environments, mean that businesses most likely characterise their operations on a region-by-region basis, rather than a global basis. We believe that the market is most likely Pilbara wide, and not global for the reasons given by Mr Houston.

Our definition of the geographic market for tenements is consistent with the region by region approach adopted as the most likely geographic market by the Tribunal.

Value of tenements

We also note that PNO maintains that "coal authorities have a fundamental value given expectations of the price of coal and the costs of its extraction".[17] We interpret this as a reference to the resource value or resource rent component that is associated with the authorities, and that PNO maintains that this is fixed in value.

We disagree with this view, as this resource value will fundamentally depend on what the seller can realise through the proceeds from the sale of coal. If the buyer side is a monopsony rather than a competitive market, then the resource value to the seller will be reduced. In effect, some the difference will be transferred to the buyer and some will be lost because there will be less investment in exploration and development. The resource value to the seller is reduced to the extent that the seller has no options other than to supply to the monopsony buyer.

As explained in our 8 August report, the underlying value of the tenements must fall in response to expectations of future rises in port charges being factored into valuations. Moreover, the uncertainty as to the extent of future rises in port charges will also impact valuations.

We therefore maintain our view that the relevant geographic dimension of the coal tenements market is bound at its broadest level by the Newcastle catchment area. Indeed, as discussed in our 8 August report, based on an analysis of the actual sales patterns and the identity of tenement holders, it is possible that smaller regional markets

[17] HoustonKemp Economists (2018), Effect of declaration on competition for coal authorities, A report for Port of Newcastle Operations, 14 September 2018, p.6

could to exist, encompassing the Hunter Valley and Western Basins and the Gunnedah Basin.[18]

2.3 Product dimension

In our previous report, Synergies considered that the relevant product dimension for the market for coal tenements should appropriately be described as the rights to explore a specific coal deposit, with different markets existing for predominantly thermal and predominantly coking coal deposits.[19] Our report noted that in NSW, with the exception of the Illawarra district, the coal reserves are predominantly thermal coal, and similarly the coal tenements market will be essentially a thermal coal tenements market.[20]

PNO contends that the product dimension of a market should not necessarily be distinguished according to different types and qualities of coal. It concluded that even if there were separate product markets for thermal and coking coal, this is not an important distinction in establishing a market definition since the fundamental value of authorities arises from expectations of the price of coal and the costs of its extraction.[21]

While we agree that defining a product dimension for coal tenements that distinguishes between thermal and coking coal is not a critical aspect of assessing the impact on competition in the relevant market with and without declaration, it is nevertheless sensible to restrict the market to the resources that the seller of tenements is selling.

2.4 Summary

After reviewing the additional information submitted by PNO, Synergies maintains its earlier view that the coal tenements market is confined at its maximum to the broader Newcastle catchment area and, based on actual sales and ownership patterns, that the geographic market may be even more constrained, and may comprise regional catchment markets, focussed around the Hunter Valley and Western Basins and the Gunnedah Basin.

Applying this definition, Synergies maintains its view, based on the evidence submitted in its earlier report (and explained further here in response to critiques by PNO and

[18] PNO and its advisor, HoustonKemp, do not appear to have considered this issue.

[19] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.42

[20] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.42

[21] HoustonKemp Economists (2018), Effect of declaration on competition for coal authorities, A report for Port of Newcastle Operations, 14 September 2018, p.8

HoustonKemp) that revocation of the declaration is likely to lead to a material loss of competition in at least one of the dependent markets, namely the market(s) for coal tenements (i.e. mining authorities). This will arise where there is a loss in investor confidence and reduced willingness to invest in coal exploration and mine development which is likely to lead to a reduction in the number of parties who are willing to bid on tenements and less rivalrous behaviour amongst those that bid. It follows that there would be lower and less competitive prices for tenements, and lower quality (in terms of the extent to which explorers have been willing to invest in the 'proving up' of deposits) and quantity of traded tenements, reflecting a material reduction in competition in the tenements market.

This market is critical to future coal production levels, as in the absence of ongoing development of new tenements, coal production will inevitably decline over time.

3 Incentive to invest in coal mines

PNO argue that because the current level of port charges represents what they allege to be an immaterial cost for a coal mine operator or investor, competition in the coal tenements market will be unaffected by the status of declaration as port charges have no discernible effect on the investment incentives or returns from investing in coal mines.[22] PNO submitted commissioned reports to support its position.[23]

3.1 Our previous consideration of the issue

PNO claims that Synergies has not answered or even 'traversed' the issue about the quantum of port charges in its earlier report.[24]

Contrary to this view, our previous report examined at length (at section 3.3.1 of our 8 August report) the cost curves and cost structures of different categories of coal producers in the Hunter Valley, and the materiality of port charges to production and investment decisions.

3.2 Commitments to apply building block processes are not an effective constraint

In arguing that there will be no discernible difference in the investment incentives for new coal mining projects with and without declaration, PNO and its advisors reassert PNO's previous claim that there is no basis to conclude that the terms of access would be materially different as PNO has already indicated that it will set charges according a building block approach as set in any arbitration relating to access.[25]

As we demonstrated in our 8 August report, PNO has a clear commercial incentive to maximise profits, notwithstanding that PNO is currently heavily reliant on coal throughput for its revenue and profit. PNO's profits will be most effectively maximised through substantially increasing prices and accepting the likely consequential impact on

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22 HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, p.2

23 See HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018. See also Resourcefulnaess Consulting (2018), Effect of port charges on incentives to invest in coal, September 2018.

24 PNO (2018), Application for revocation and declaration Further submission in response to letter from the NCC dated 4 September 2018, 17 September 2018, p.6. Indeed, to the extent that existing mines are relevant, it is the impact of higher charges on the marginal mine which needs to be the focus of any assessment.

25 See HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, pp.2-3

coal volumes, which as we have previously established is likely to be small as coal volumes from existing mines are insensitive to changes in port charges.[26]

Absent the declaration, while PNO states that it will set charges taking into account matters that are required to be considered in any arbitration, including the mandatory considerations in section 44X of the CCA,[27] there is no obligation on it to continue to do so.

Further, even where PNO does adopt a building block methodology for assessing charges (as per the approach typically adopted in regulatory arbitrations), the pricing outcomes can vary widely depending upon the underlying parameters and cost inputs. A building block methodology will not, by itself, constrain PNO from adopting input assumptions (such as the rate of return) that allow it to earn monopoly profits. As noted in our 8 August report, previous analysis prepared by Synergies identified that PNO could potentially increase its charges by more than 200% while still basing their derivation on a building block model.[28]

3.3 Lowest cost producers are not the relevant benchmark

In our 8 August report, we demonstrated that PNO's references to the immateriality of port charges to current (and expected) coal miner margins has been based on the cost structure of the lowest cost Newcastle coal project.

PNO (through its advisors HoustonKemp) again appears to continue to rely on the cost structure of the lowest cost existing Newcastle coal project while seeking to demonstrate that port charges are not material to a miner's production or expansion decisions.[29] It is true that for the lowest cost mines, higher port charges may not influence production decisions. However, the key considerations from a competition perspective relates to the impact on more marginal producers on the one hand, and on the other, the tenements market, and in turn, to planned and prospective mines.

[26] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, pp.20-21, pp.29-31

[27] HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, p.2

[28] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.23

[29] HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, p.3

3.4 Planned and prospective mines are critical rather than existing mines

When assessing the impact of higher port charges on the market for coal tenements and exploration, it is necessary to instead consider the cost structures and expected profit margins for *planned and prospective* coal projects which, as we discuss in our previous report, are likely to be more marginal, in terms of either coal quality or cost of production, than many existing mines. There is a key difference between existing and planned mines because the capital to create the mine is sunk for an existing mine but not for a planned mine.

The very fact that the capital that is necessary to make a mine operational is not sunk for *planned and prospective* coal mines is why the impact of the current and uncertain future port charges are potentially material for the (undeveloped) tenements. Tenements will only be explored and examined if current and prospective owners have confidence in the underlying commerciality of the development. The key issue, therefore is how unregulated port charges affect the willingness of tenement owners from exploring and developing their tenements and how the market for tenements is affected by unregulated port charges relative to where port charges are regulated.

Consequently, the key difference between existing and planned and prospective coal projects is that the latter class must expect to earn a margin significantly above cash costs to compensate for the capital costs of resource and mine development in order to proceed (these capital costs largely being sunk in respect of existing mines).

Based on WoodMackenzie's cost curves for planned projects and forecast coal prices, several of the currently planned Hunter Valley projects across all tenements (as opposed to only the most prospective) are marginal – the margin above cash costs is likely to be barely sufficient to recover their capital costs. In this context, the combination of higher port charges and the perceived risk of a significant increase in future port charges would be likely to have a material impact on whether or not these projects will be considered viable.[30]

[30] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, pp.59-60

3.5 Relative importance of port charges

PNO has repeated its previous claim that port charges, and any uncertainty about future port charges absent declaration, are dwarfed by other factors that reflect vastly greater sources of uncertainty which will not be affected by declaration.[31]

The risks identified by PNO are general market risks that are faced by coal producers regardless of location and will be faced irrespective of whether investing in the Newcastle catchment area or elsewhere. The key point is the marginal impact of the perceptions around higher future charges are specific only to the Newcastle catchment area.[32] Where a port that has the ability and incentive to recover rent from producers if their mines commence profitable operation, this can be expected to result in investment in new mines dependent on that port being stifled. Indeed, it is unlikely that the port will be maximising returns if this is not the outcome. In its submission to the NCC, the ACCC also highlighted the likely dampening effect of monopoly pricing on downstream investment.[33]

PNO, and its advisor HoustonKemp, have claimed that such 'hold-up' concerns are misplaced, as hold-up could only arise if PNO were able to increase the price of its service to each mine individually.[34] We disagree with this contention. As we discussed in detail in our 8 August report, once investment in mine development is sunk, export volumes from those mines are insensitive to changes in port charges, reflecting that the mine will continue to produce coal while it has a positive cash margin.[35] In this context, there is ample opportunity for PNO to expropriate profits from coal mines, once their investment in the mine development is sunk, without the need for price differentiation (although we accept that price differentiation would increase the ability for PNO to expropriate miner profits without reducing demand.

The inevitable consequence of a reduction in investment in exploration and examination of tenements will be a reduction in the value of tenements. Moreover, the higher risk

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[31] See HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, pp.2-4

[32] HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, p.4 refer to the historical context of port charges (prior to the privatisation of the port). This is irrelevant in the context of the expectations around the level of future charges, which will be the relevant consideration for the future investment by coal mining enterprises using the Port of Newcastle.

[33] ACCC (2018), Possible NCC recommendation to revoke declaration at the Port of Newcastle, 8 August 2018, p.5

[34] HoustonKemp Economists (2018), Effect of declaration on incentives to invest in coal mines, A report for Port of Newcastle Operations, 14 September 2018, p.3

[35] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, pp.20-21, pp.29-31

profile for tenements means that there can be expected to be fewer parties interested in securing tenements.

Accordingly, it is the prospect of higher charges and increased risk that arises as a result of the uncertainty over the extent of future port price increases at the Port of Newcastle that will adversely affect competition in the tenement market in the Newcastle catchment area, should the declaration be revoked.[36]

[36] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.61

4 Public interest

Criterion (d) as recently amended, requires that access (or increased access) to the service, on reasonable conditions as a result of declaration of the service would promote the public interest.[37]

'Public interest' is not a term defined in the CCA. The NCC had previously identified that the central question associated with this criterion is whether the declaration is likely to generate overall gains to the community. The NCC has also indicated that issues of economic efficiency and competition are important in the context of promoting the public interest.

Synergies' report of 8 August 2018 presented evidence to indicate that there are strong efficiency benefits with maintaining the declaration. Access (or increased) access to the Service, based on reasonable terms and conditions, would ensure that disincentives to future investment in coal mining and exploration are not introduced. Therefore, continued declaration will avoid risking the economic gains associated with such investment.[38]

We note that the NCC and the Minister may have regard to a very wide range of matters when considering this criterion. The NCC notes in its Guide to Declaration of Services at page 43 that "through the Competition Principles Agreement in 1995, the Council of Australian Governments agreed to the implementation by the Commonwealth of what became Part IIIA. Clause 1(3) reflects the matters that were considered relevant to the analysis of the public interest at that time. Those matters include: (a) ecologically sustainable development (b) social welfare and equity considerations, including community service obligations (c) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity (d) economic and regional development, including employment and investment growth (e) the interests of consumers generally or of a class of consumers (f) the competitiveness of Australian businesses, and (g) the efficient allocation of resources".

In this regard, our earlier report considered that there would also be significant public detriment associated with a revocation of the declaration where:

- there is no other credible constraint on PNO engaging in monopoly pricing which would mean that the application of the Part IIIIA regulatory framework is redundant;

[37] See s 44CA(1) of the CCA

[38] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.91

- revocation of the declaration will cause a reduction in the value of investments made by coal producers who legitimately expected that PNO's ability to engage in monopoly pricing would be constrained; and
- it establishes a precedent for undeclared ports, across Australia, to raise prices where they perceive the threat of regulation is similarly weak.[39]

We also considered revocation to be unwarranted when there has been no change in market circumstances, and when all of Glencore's (and other users) legitimate concerns about PNO's ability to set unreasonable terms and conditions have neither diminished nor been dispelled.[40]

In this context, continued declaration would maintain the integrity of Part IIIA as a credible threat to monopoly behaviour that offends the objects of Part IIIA, while still providing for alternative regulatory approaches to be applied to other ports as appropriate (in which case the public interest in applying Part IIIA may not be strong). For these reasons, Synergies considered criterion (d) to be satisfied to warrant the declaration remaining in place.

We also believe that the submissions to the NCC made by parties such as the Minerals Council of NSW suggest that declaration would promote the interests of the regional Hunter Valley community and the ACCC's submission should remind the NCC of the allocative efficiency arising from any arbitration determination by the ACCC.

The ACCC Arbitration Determination should provide some important guidance on efficiency issues and whether declaration would have any impact on investment. Given the ACCC's exhaustive arbitration process we believe they are best placed to provide evidence on these issues, particularly having regard to confidentiality limitations imposed on Glencore (and therefore us) in relation to that arbitration matter at this time. Once that ACCC Arbitration Determination becomes public we may wish to make further submissions to the NCC given its contents are relevant to this criterion.

[39] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.71

[40] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.92

4.1 PNO's claims

PNO has submitted that there is an insufficient basis for the NCC to be satisfied that access (or increased access), on reasonable terms and conditions as a result of the declaration of the Service, would promote the public interest.

PNO has relied upon what it claims to be the low number of submissions from the general public, and no submissions from the NSW State Government (and its agencies), as evidence of there being a low level of public interest in maintaining the declaration. Of the submissions the NCC received (including but not limited to Glencore, Yancoal and NCIG), PNO dismisses these as not being representative of the public but largely reflecting the private business interests of a small number of persons and category of stakeholders.[41]

Glencore has dealt with this issue in its submission and noted that actually there were a significant number of Port users who made submissions including the only two coal terminals at the Port, NCIG and Port Waratah and the Minerals Council of NSW whose members represent a considerable number of people employed in the coal mining industry in the Hunter Valley and which all expressed significant concerns as to any revocation. Glencore also noted that the only party that made a supporting submission of PNO was Ports Australia.

Indeed, having regard to the submissions to the NCC on matters relating to economic regulation of a component of the bulk commodity export supply chain, they should in fact enhance the legitimacy of the views of those that actually use and seek access to the service on terms that are efficient. It is entirely appropriate for users of the Port of Newcastle to express views about the public interest in declaration or continued declaration in the face of a revocation application.

Further, the absence of any state based submissions is neither surprising nor a particularly telling feature. The NSW Government made a deliberate decision to not implement an effective regulatory framework prior to its privatisation of the Port of Newcastle, most likely in order to maximise the price it would achieve for its sale. As a result, the NSW Government now has a substantial conflict between the public interest, and the interests of the new owner of the port who relied on this absence of an effective regulatory framework in its decision to purchase the port and almost immediately impose significant price increases to coal users.

[41] PNO (2018), Application for revocation and declaration Further submission in response to letter from the NCC dated 4 September 2018, 17 September 2018, p.4

On a more substantive point, PNO also claim that Synergies mis-states the public interest criterion test and applied it as a negative assessment rather than through the application of the positive test in which the designated Minister must now be positively satisfied that access (or increased access) to the Service would promote competition.[42]

In making this claim, we consider that PNO has fundamentally misinterpreted the counterfactual test that is to be applied where declaration is already in place. We address this particular issue in more detail below. In any event, the submissions that the NCC has received make it abundantly clear that, in the views of the shipping and mining industries, the declaration should not be revoked and that in any event if the matter was to be considered again, these industries would support declaration.

4.2 Application of public interest criterion

PNO claims that Synergies mis-states the public interest criterion. It claims that our previous statements that 'revocation would be contrary to the public interest' is incorrect in so far as declaration is now a positive test that requires demonstration that the public interest would be promoted rather than declaration not being contrary to the public interest or revocation being contrary to the public interest.

In our report of 8 August, we acknowledged criterion (d), as recently amended, requires that 'access (or increased access) to the service, on reasonable conditions as a result of declaration of the service would promote the public interest.'[43]

We also outlined our approach to how this test should be applied in the circumstance of a revocation application in which a service is already declared (as opposed to the more conventional case of a declaration application).[44] The amended criterion anticipates the consideration of two scenarios – one in which a declaration is made and access (or increased access) to the Service is available on reasonable terms and conditions and the other in which no declaration is made. However, this needs to be assessed in a practical, real world context, which in this case is that the declaration of the Service is in existence.

Our assessment that revocation would not promote the public interest is based on the application of the public interest to a future *with continued declaration* and a future *without declaration*. In other words:

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42 PNO (2018), Application for revocation and declaration Further submission in response to letter from the NCC dated 4 September 2018, 17 September 2018, p.5

43 Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.70

44 Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.33

- the status quo is the circumstance in which the declaration already exists;
- the counterfactual is the circumstance in which the declaration no longer exists.

Under this scenario, the starting point is not the absence of declaration such that the public interest benefits of declaration needs to be proven. More appropriately, where the starting point is a circumstance of declaration existing, then the test of 'disbenefit' or the detriment that is likely to arise in the event that the declaration is removed, is the only practical application of the with and without test.

This approach is consistent with the manner in which the Queensland Competition Authority and industry stakeholders are approaching the review of Service declarations for Aurizon Network, Dalrymple Bay Coal Terminal and Queensland Rail under the *Queensland Competition Authority Act 1997* (Qld).[45] We also note the ACCC's submission in relation to what is involved in 'promoting' competition and note that it does not disagree with our analysis.

Irrespective of where the onus lies in affirming the public interest, the substantive issue of the continued declaration promoting the public interest was made out in our 8 August submission.

However, if one insisted on specifying the status quo as the situation in which the declaration does not apply there would be a need to recognise that it would then be necessary to specify the likely impact on prices, investment and economic activity as these aspects would change relative to current conditions. Then the counterfactual would relate to how declaration would promote competition. But as explained, this re-specification of the scenarios is not necessary to assess the case for continued declaration.

4.3 PNO's claims to specific matters raised by Synergies

PNO also responded to some specific matters identified in our previous report. We address each of these issues below.

4.3.1 PNO's commercial incentives

PNO submits that Synergies did not provide supporting information in relation to its claim that declaration provides an effective constraint on PNO increasing its prices to

[45] Submissions are available at http://www.qca.org.au/Other-Sectors/Access/To/Infrastructure/DeclarationReviews/In-Progress/2020-Declaration-Review

capture monopoly rents and promotes the efficient use of infrastructure and improved conditions for investment in exploration and development of coal reserves.[46]

However, these issues were extensively canvassed in our earlier report[47] which was substantively focussed on demonstrating, through extensive quantitative analysis and reliance on standard, well accepted economic principles, that:

1. PNO has a commercial objective to maximise profits when setting access charges;
2. notwithstanding that PNO is currently heavily reliant on coal throughput for its revenue and profit, PNO's profits will be most effectively maximised through increasing prices and accepting the likely consequential impact on coal volumes (noting these impacts may predominantly arise from the absence of new mines or expansions to existing mines);
3. existing constraints (other than declaration) on PNO's ability to substantially increase prices are generally accepted to be weak.

Synergies' 8 August report identified the profit impact for PNO of alternate pricing strategies based on a number of different scenarios of feasible coal prices. Each scenario identified a change in PNO revenues[48] under access charge increases that ranged from no increase to an increase of AU$3/t. Synergies' analysis demonstrated that the highest increase ($3/t) could lead to revenue of almost $700 million, despite lower volumes. The analysis showed that PNO could increase charges materially, without jeopardising revenue.[49]

Therefore, absent the declaration, decisions about future coal production and investment in the coalfields in the Hunter Valley, Newcastle, Western and Gunnedah basins ('Newcastle catchment') will be impacted by the high probability that PNO would implement large increases in charges for use of the Service. We note the relevance of the ACCC Arbitration Determination to this issue which we believe supports our arguments, but cannot comment further due to confidentiality restrictions.

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46 PNO (2018), Application for revocation and declaration Further submission in response to letter from the NCC dated 4 September 2018, 17 September 2018, p.6

47 See sections 2.3 and 4.1 of our 8 August 2018 report.

48 Given the dominance of fixed costs, the revenue impact can be interpreted as a profit impact for PNO.

49 Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, pp.27-28

4.3.2 Loss of investor confidence and value in investments

PNO has argued that Synergies presented no evidence to support its claim about a loss of investor confidence and poorer prospects for investment in coal exploration and a potential loss of value in investments should revocation occur.[50]

While time series information about the market value of coal tenements is not publicly available (and in all likelihood does not exist in any systematic manner), our earlier report stepped through a reasoned logic as to why revocation will impact on companies' incentives to participate in the tenements market, with following key points:[51]

1. the higher cost and risk profile that emerges for the industry from an unregulated port monopolist means that the prospective economic viability of new mines deteriorates. This is significant because tenements will typically hold less attractive resources than existing coal production areas, even before the uncertainty surrounding future port charges emerged;

2. as a consequence, there will be a reduction in the number of parties who are willing to bid on tenements, either at initial allocation or for subsequent sale, and less rivalrous behaviour amongst those that do bid. In particular:
   - small companies, as well as those with a relatively lower risk appetite, are less likely to be vigorous and effective competitors for the acquisition of these tenements;
   - the reduction in interest in tenements is likely to be felt most strongly in regions that are likely to have the highest incremental costs;
   - the combination of these factors is likely to particularly affect the tenements market in the Gunnedah basin, which is subject to the highest incremental transport cost and where tenements are generally held by smaller companies;
   - in terms of likely consolidation of the ownership of tenements, Glencore will have a particular advantage, as the only producer who will have long term certainty of access and price at Port of Newcastle;

3. owners of tenements will have less incentive to invest in the exploration of their tenement, either for the purpose of developing the tenement itself or obtaining more information about the tenement to improve its prospective value. Again:

[50] PNO (2018), Application for revocation and declaration Further submission in response to letter from the NCC dated 4 September 2018, 17 September 2018, pp.6-7

[51] Synergies (2018), Port of Newcastle Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, p.68

- this impact is likely to be particularly strong in the Gunnedah basin, where the tenements are usually considered to be more marginal in nature and where they are generally held by smaller companies;

4. there is a material risk that the sellers of tenements will face less competition amongst buyers when selling their tenements, thereby impacting adversely on price and activity in the tenements market. However, although the extent of trading in tenements may be less, suggesting a smaller market, there will be lost value from an economic efficiency perspective. This loss of value arises as there would be lower and less competitive prices for tenements and lower quality and quantity of traded tenements.

The ACCC's submission also touches on these issues, but we believe of most relevance to whether or not a declaration and an ACCC arbitrated outcome would have any impact on investment is best canvassed when the ACCC Arbitration outcome becomes public.

4.4 Summary

We have reviewed the additional information presented by PNO in its response and accompanying submissions. None of the information presented by PNO constitutes a new argument or a material change in market circumstances that would warrant the NCC or the Minister removing the current declaration from remaining in place.

We therefore maintain that the amended criterion (d) pursuant to s 44CA(1), based on the evidence presented in our earlier report, is satisfied.

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Port of Newcastle

Assessment of revocation application by Port of Newcastle Operations Pty Ltd

Prepared on behalf of Glencore Coal Pty Ltd

4 February 2019

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Executive Summary

Synergies has been instructed by Glencore to provide a report which responds to the NCC's Statement of Preliminary Views ('NCC's preliminary view') on revocation of the declaration in relation to the use of the defined service ('Service' which largely comprises the shipping channels)at the Port of Newcastle that was released on 19 December 2018.

In support of its application for revocation of the declaration, PNO contends that two of the declaration criteria established in s 44CA of the *Competition and Consumer Act 2010* (Cth) (CCA) – criterion (a) and (d) – are no longer satisfied with respect to the Service.

The NCC's preliminary view accepts that criterion (a) and (d) are not satisfied. The Council considers that declaration would not have any appreciable effect in promoting the economically efficient operation of, use of, or investment in the infrastructure by which the Service is provided.[1] The NCC therefore proposes to recommend to the designated Minister that the declaration be revoked. [2]

We have reviewed the NCC's preliminary view on criterion (a) and (d), against our earlier evidence submitted to the NCC, as well as other stakeholder submissions and relevant regulatory precedent. We disagree with the NCC's assessment based on several key aspects (without limiting the other matters raised by Glencore in its previous and current submissions).

First, in relation to criterion (a), the NCC has not properly considered the manner in which and extent to which PNO will be incentivised to maximise profits in a future without declaration. As a consequence, the NCC has not adequately assessed the risk associated with the strong likelihood that substantially higher port charges will materially reduce the investment incentives for coal tenement buyers in the Newcastle catchment region and impact adversely on competition in the coal tenements market. The NCC's views are contrary to those expressed by the ACCC in its public commentary on the NCC's draft recommendation and its conclusion is contrary to the views expressed by the Queensland Competition Authority (QCA) in relation to its assessment of the continuation of the declaration of the Dalrymple Bay Coal Terminal (DBCT).

Further, we consider that the NCC has placed insufficient weight on the ACCC's recently published arbitration determination in the Glencore-PNO access dispute matter when assessing the risk that materially higher prices will most likely prevail in an unconstrained environment. While Synergies accepts that the ACCC's Determination is

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1 NCC (2018), Revocation of the declaration of the shipping channel service at the Port of Newcastle, Statement of Preliminary Views, 19 December 2018, p.80.

2 NCC (2018), p.80.

not a single definitive view of what constitutes 'reasonable' terms and conditions, the ACCC is the statutory body under the CCA tasked with making such determinations; and at the very least, the determination demonstrates that the mere availability of access to arbitration provides the very real prospect of lower, more cost reflective, prices being achieved in a future where the status quo of declaration applies relative to the situation where revocation applies. This is particularly the case given the NCC's acknowledgement that, in the absence of declaration, PNO is an unregulated bottleneck facility.

Second, the NCC's assessment of criterion (a) effectively means it does not recognise any additional public benefits under criterion (d). Where the NCC considers there is no material competition benefits in a future with declaration, the NCC concludes that there will be no derived efficiency gains or other public benefits either. The NCC's views are contrary to the submissions of the New South Wales (NSW) industry body, the NSW Minerals Council, and other coal exporters. More substantively, irrespective of competition impacts in dependent markets, continued declaration will facilitate increased investment and output from the Hunter Valley and this outcome advances the public interest in the context of the CCA objectives.

The inevitable consequence of higher port charges for the coal industry means that prospective bidders for coal tenements are less likely to purchase tenement rights or if they do so will pay lower prices because they assess that their expected returns will be lower in the face of rising costs (port charges) which cannot be mitigated. Most of the impact would be reflected in a transfer of resource rents from the sellers of coal tenements and ultimately the State of NSW to shareholders in the Port of Newcastle. There is also likely to be a reduction in coal output from the Hunter Valley relative to what would occur in the absence of the revocation over the longer term.

For these reasons, we do not consider that the NCC's preliminary view appropriately demonstrates why declaration does not satisfy the legislative criteria. Rather, the legislative criteria (following amendments) relevant to establishing declaration remain satisfied and that revocation is likely to lead to a material loss of competition in at least one of the dependent markets, namely the market for coal tenements. This market is critical for ensuring future coal reserves are well placed to meet demand. Any loss of competition in this market is likely to result in adverse effects including weakened incentives for investment and lower coal resource values. We also maintain that declaration is in the public interest.

Our assessment of criterion (a) and (d) is well aligned with recent regulatory precedent set by the QCA in its draft recommendation to continue declaration of the DBCT in

Queensland.[3] This decision is relevant as it considers the same legislative criteria and similar issues in similar dependent markets (i.e. coal tenements) to those being assessed by the NCC. While both regulatory decisions consider very similar issues, the regulators have reached very different conclusions. The QCA's conclusion to recommend ongoing declaration of DBCT is consistent with Synergies' arguments for ongoing declaration at the Port of Newcastle.

[3] See QCA (2018), Draft recommendation – Part C: DBCT declaration review, December 2018. The QCA released its Draft recommendation on 18 December 2018. A copy is available at http://www.qca.org.au/Other-Sectors/Access/To/Infrastructure/DeclarationReviews/In-Progress/2020-Declaration-Review

Contents

1 Introduction

1.1 Background and instructions

Synergies Economic Consulting (Synergies) is assisting Glencore Coal Pty Ltd (Glencore) in its response to the preliminary views of the National Competition Council (NCC) on the application submitted by Port of Newcastle Operations Pty Limited (PNO) to the NCC on 2 July 2018. The application is for the declaration made by the Australian Competition Tribunal on 16 June 2016 of the declared Service at the Port of Newcastle to be revoked pursuant to s 44J of the Competition and Consumer Act 2010 (Cth) (CCA).

The declared Service is specified as follows:

> The provision of the right to access and use the shipping channels (including berths next to the wharves as part of the channels) at the Port, by virtue of which vessels may enter the Port precinct and load and unload at relevant terminals located within the Port precinct and then depart the Port precinct.

and is declared for the period to 7 July 2031.

In support of its application, PNO submitted that two of the declaration criteria established in s 44CA – criterion (a) and (d) - were no longer satisfied with respect to the Service.

Synergies' reports of 8 August 2018 (2018a[4]) and 5 October 2018 (2018b[5]) to the NCC responded to PNO's initial application and its further claims by presenting evidence that demonstrated criterion (a) and (d) were satisfied. Synergies submitted that:

- revocation will lead to a material loss in competition in at least one dependent market, namely the coal tenements market (thereby satisfying criterion (a)); and
- there are public benefits associated with declaration and a range of public detriments should revocation occur (thereby satisfying criterion (d)).

The NCC released its Statement of Preliminary Views on 19 December 2018 which concluded that criterion (a) and (d) are not satisfied and therefore proposes to recommend to the designated Minister that the Declaration be revoked.[6]

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[4] A copy of this report is available at http://ncc.gov.au/images/uploads/Glencore_Coal_Pty_Ltd_-_Synergies_Report_-_8_August_2018.pdf

[5] A copy of this report is available at Annexure C of Glencore's submission at http://ncc.gov.au/images/uploads/Glencore_Coal_Pty_Ltd,_5_October_2018_(PDF,_2.17MB).pdf

[6] NCC (2018), pp.79-80.

Synergies disagrees with the NCC's preliminary view and maintains that continued declaration satisfies criterion (a) and (d) and is consistent with the objects of Part IIIA. This report sets out where we consider the NCC has not had sufficient regard for the competitive harm and public interest losses resulting from revocation.

Our response to the NCC's preliminary view also takes into account recent regulatory precedent set by the Queensland Competition Authority (QCA), which is, at present, reviewing the existing declaration of the Dalrymple Bay Coal Terminal (DBCT).[7] The QCA's draft recommendation to maintain the DBCT declaration is relevant as it considers many of the issues considered by the NCC. The QCA's draft recommendation and reasons are consistent with the arguments raised by Synergies in this and earlier reports.

1.2 Report structure

Synergies has adopted the following structure for this report:

- Section 2 - sets out our response to the NCC's preliminary view on criterion (a) in which we show that the NCC has not properly considered the extent to which PNO will be incentivised to increase prices in order to maximise profits, and therefore that revocation will reduce investment incentives for coal tenement buyers in the Newcastle catchment region;
- Section 3 - presents our response to the NCC's preliminary view on criterion (d) where we consider the NCC does not appropriately recognise the possibility that, in a future absent declaration, there can be adverse efficiency effects even if there were no adverse competition effects as the NCC contends; and
- Section 4 - discusses how continued declaration is consistent with the objects of Part IIIA.

[7] See QCA (2018), Draft recommendation – Part C: DBCT declaration review, December 2018. The QCA releases its Draft recommendation on 18 December 2018. A copy is available at http://www.qca.org.au/Other-Sectors/Access/To/Infrastructure/DeclarationReviews/In-Progress/2020-Declaration-Review

2 Response to NCC assessment of criterion (a)

2.1 Summary

This section presents Synergies' response to the NCC's preliminary view on criterion (a).

The NCC is not satisfied that increased access to the declared Service, on reasonable terms and conditions, as a result of a declaration would promote a material increase in competition in any dependent market.[8]

Synergies disagrees with the NCC's preliminary findings. Our earlier reports (2018a), (2018b) focussed on the competition losses that will arise in the dependent coal tenements market in the Newcastle catchment.

We maintain our view that by reducing competition materially in the coal tenements market, revocation of the declaration is inconsistent with the objects of Part IIIA and the broader objective of the CCA which is, in part, to enhance the welfare of Australians through the promotion of competition.[9]

The NCC's conclusions materially turn on its view that Service fees are a very small proportion of the cost of coal and that the commercially rational Service charge increases (without declaration) are unlikely to be a significant cost component.[10] Synergies considers that the NCC's assessment has not properly considered the manner in which and extent to which PNO will be incentivised to increase prices in order to maximise profits absent the declaration remaining in place. As a result, the NCC has not considered the strong likelihood that *substantially* higher port charges will materially reduce the investment incentives for coal tenement buyers in the Newcastle catchment region.

Similar to investors in the residential housing market, prospective bidders for coal tenements are less likely to purchase tenement rights when they assess that their expected returns will be materially lower in the face of rising costs which cannot be mitigated. This in turn most likely means a material loss in competition in the coal tenements markets and less efficient outcomes for existing tenement holders where coal resource values are reduced. Much of the impact would be reflected in a transfer of resource rents from the sellers of coal tenements and ultimately the State of NSW to

[8] NCC (2018), p.64.

[9] The object of the CCA is set out in Part I, section 2.

[10] NCC (2018), p.42.

shareholders in the Port of Newcastle.[11] There is also likely to be a reduction in investment and coal production relative to what would occur in the absence of the revocation over the longer term.

This view is consistent with recent findings of the Queensland Competition Authority (QCA) in respect of the impact of declaration of the Dalrymple Bay Coal Terminal (DBCT) on competition in the coal tenements market in central Queensland. The QCA conducted a detailed and thorough review to provide advice and assistance on criterion (a). As a result, the QCA considers that:[12]

> Criterion (a) is satisfied.
>
> DBCT Management has an ability and incentive to exercise market power, such that in the absence of declaration, efficient entry to the coal tenements market would be discouraged and there will be a material impact on competition in that market.
>
> Access (or increased access) to the DBCT service on reasonable terms and conditions as a result of declaration would promote a material increase in competition in the coal tenements market.

A summary of the contrasting positions of the NCC and the QCA on criterion (a) is presented in the table below.

Table 1 Criterion (a) assessment NCC vs QCA

Factor	NCC (PoN revocation)	QCA (DBCT declaration review)
That access (or increased access) promotes a material increase in competition in at least one market, other than the market for the service	Criterion (a) is not satisfied for PoN	Criterion (a) is satisfied for DBCT
Pricing objective	Insufficient constraint on incentive of PNO to earn monopoly profits	Insufficient constraint on incentive of DBCT to maximise its profits
Constraints on ability and incentive to exercise market power: with or without declaration		
• Countervailing power of users	Users of the port are not an effective constraint as they have no effective alternative to the Service	There is a substantial cost difference in exporting coal through other coal terminals compared to DBCT; therefore both existing and new entrants would have no countervailing power in a future without declaration

[11] Such a material transfer in economic rents from miners to PNO is contrary to the public interest. Without these rents, miners will be less willing to undertake exploration activities. See section 4.4 of Synergies' 8 August 2018 report. This issue is discussed in section 3.5 of this report.

[12] QCA (2018), p.5.

Factor	NCC (PoN revocation)	QCA (DBCT declaration review)
• Competition from other facilities	The presence of Port Botany places some constraint on PNO, but only for users for which it may be commercially viable (only for containerised freight)	Other coal export terminals are not close substitutes and hence would not act as a competitive constraint on DBCT
• Lease arrangements	Lease arrangements may allow for some influence by the State but are costly and would not adequately limit any effects on competition from PNO's actions	The lease arrangement does not appear to be a mechanism that would constrain DBCT from exercising market power in a future without declaration
• Vertical integration	PNO is not vertically integrated into any dependent market therefore has no incentive to discriminate in favour of any related operation(s) in dependent markets	Despite DBCT not being vertically integrated it would still have the ability and incentive to exert market power
• Threat of declaration or regulation	The existing regulatory framework (PAMA Act and regulations) promotes transparency but does not provide an adequate regulatory constraint	The threat of declaration would not act as a constraint against DBCT from exercising market power in a manner such that it would adversely affect competition conditions
Key finding	The NCC found that PNO has the ability and incentive to earn monopoly profits and did not identify any adequate constraints on PNO exercising market power	The QCA's view was that as a result of no constraints being identified DBCT would have the ability and incentive to exercise market power
Competition assessment of future with and without declaration in the coal tenements market		
• Significance of charge	The NCC considered that current port charges were less than 1% of forecast thermal coal price, and 'commercially realistic' price increases would be small	The QCA found that coal handling charges were currently 2-3% of forecast metallurgical coal price and, absent declaration, for new users this may rise to 8-12%
• Investment incentives	The NCC does not consider the difference in uncertainty resulting from whether the Service is declared relative to revocation to be sufficient to have a material effect on the decision whether to invest or participate in the coal tenements market	The QCA considers that the absence of the declaration will likely have a material and adverse impact on efficient investment in the coal tenements market due to the fact that the risk and uncertainty as a result of no declaration would create a barrier to efficient entry into the market (see 'impact on coal tenements dependent market for more discussion)
• Coal resource values	The NCC noted the possibility that revoking the declaration would have the effect of a reduction in the resource values, however, this would have been already taken into account by investors as such the drop in value is likely to be minimal	Existing users would have materially more favourable access conditions than potential DBCT users in a future without declaration because existing users are protected from significantly higher access charges by existing user agreements. This would have the potential effect of discouraging future users from participants in the coal tenements market resulting in an adverse effect on competition
• Impact on coal tenements dependent market	The NCC considered that 'commercially realistic' increases in port charges would have an immaterial effect on overall supply chain costs and thus the absence of the declaration will have no material effect on competition in the coal tenements market	The QCA found that the absence of the declaration would result in a material reduction in competition in the coal tenements market due to the ability of DBCT to: - set asymmetric terms and conditions between existing users and new entrants (coal handling

Factor	NCC (PoN revocation)	QCA (DBCT declaration review)
		charge for existing users would be far smaller than for potential users) - set prices at five-year intervals making potential DBCT users' mining operations unbankable, discouraging new entry - price discriminate between existing and potential users

Source: Synergies, based on the NCC's Preliminary View and the QCA's Draft Recommendation

While both regulatory decisions consider very similar issues, the regulators have reached very different conclusions, which appear to turn on the following factors:

- the regulator's view on the materiality of potential price increases; and
- the regulator's view on the likelihood that pricing risks for critical infrastructure may influence investment decisions in a market other than the market for the service that is being considered for declaration.

We discuss these factors in more detail in section 2.5. Despite acknowledging there is little constraint on PNO's market power, the NCC considers that PNO will most likely charge a 'commercially realistic' price (without indicating what that might be or why PNO would voluntarily charge a price below that which maximises profit) and that, even in the absence of declaration, Service charges are 'unlikely to be a significant cost component' (again, without assessing what a 'commercially realistic' price might be). Furthermore, the NCC assumes that existing and potential market participants share its benign view. The mere presence of the Glencore-PNO access dispute as well as stakeholder submissions from other coal exporters submitted to the NCC as part of this process (e.g. Yancoal, NCIG) suggests such views are not widely held by those who will be affected by such charges.

2.2 Background

Criterion (a) as set out in subsection 44CA(1) of the CCA prescribes that:

> (a) access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of 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.

This criterion is forward looking, requiring two scenarios to be considered – one in which a declaration is made and access (or increased access) to the Service is available on reasonable terms and conditions and the other in which no declaration is made.

The dependent markets that had been previously identified and accepted by the NCC were:[13]

(a) a coal export market (the coal export market);

(b) markets for the acquisition and disposal of exploration and/or mining authorities (the tenements market);

(c) markets for the provision of infrastructure connected with mining operations, including rail, road, power and water (the infrastructure market);

(d) markets for services such as geological and drilling services, construction, operation and maintenance (the specialist services market); and

(e) 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 (the bulk shipping market).

In its preliminary view, the NCC considered it appropriate to have regard to a 'container port market' as an additional discrete dependent market.[14] Synergies accepts this view and considers it uncontentious for the purpose of assessing PNO's application for revocation.

Synergies' assessment of the competition losses associated with revocation was not based on the identified separate market for container port services. We have not made any assessment of the impact of revocation on competition in this market given the limited time available to respond to the preliminary decision.

Synergies, however, notes recent comments by the CEO of PNO that it will seek to develop the container operations at the Port through the relationships of its 50% shareholder China Merchants. China Merchants has shipping container vessels in its shipping arm.[15] This has not been analysed by the NCC even though it was raised by the NCC.

2.3 Synergies' previous views on criterion (a)

Synergies (2018a) considered a future with and without declaration and submitted that:[16]

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[13] NCC (2018), p.32.

[14] NCC (2018), p.34.

[15] Fairplay (2018), Australia's Newcastle port faces the coal conundrum, 13 April 2018. See https://fairplay.ihs.com/bulk/article/4297541/australia%E2%80%99s-newcastle-port-faces-the-coal-conundrum [accessed 1 February 2019]

[16] Refer to section 2 of Synergies' report (2018a).

- in a future without declaration, there will be no effective commercial, contractual or regulatory constraint on PNO's ability to impose significant Service charge increases for coal producers;
- investors in the coal sector in the Newcastle catchment, facing a material risk of substantially higher port charges, will have a reduced incentive to invest in coal exploration and future reserves (i.e. the coal tenements market);
- investors in the coal tenements market in the Newcastle catchment often tend to be those smaller companies who are focussed on more marginal tenements (which do not attract the attention of the major producers); they have higher marginal costs and are less able to reduce their exposure to higher access charges;
- in the face of higher costs and expectations of materially lower returns, these smaller coal producers are less likely to purchase tenements and invest in coal exploration, thus lowering coal resource values as they become generally less attractive; and
- under these conditions, revocation is likely to lead to a material loss of competition in at least one of the dependent markets, namely the market for coal tenements, thus satisfying criterion (a).

Synergies (2018a) further noted that it was unable to conclude that there would be no competition effects in the other dependent markets without conducting a full assessment of each market (this was not possible due to reporting time constraints).

Synergies (2018a) also noted that the competitiveness of Newcastle's coal exporters can deteriorate and cause flow-on competition reducing effects in other dependent markets, without there being a material reduction in competition in the relevant coal export market.[17] This follows from the distinction between 'competitiveness' of a supplier (or group of suppliers) and 'competition in a market'. Even though competition in the relevant coal export market may not be materially affected by Service charge increases, the competitive constraints from other suppliers in the coal export market can mean that the competitiveness (profitability) of Newcastle's coal exporters may be adversely affected with flow-on adverse competitive effects to other dependent markets.

[17] Synergies (2018a), p.52.

2.4 NCC's preliminary view

The NCC reached a different view. It concluded that increased access, on reasonable terms and conditions, as a result of declaration will not promote a material increase in competition, in any upstream or downstream market directly.[18]

While accepting evidence that PNO has market power and that there will be insufficient constraint on its pricing behaviour in a future absent declaration, the NCC still contended that PNO would set 'commercially realistic prices', without a supporting rationale and meaningful explanation for what that meant, and accepted PNO's claims that the magnitude of Service charges, with or without declaration, would be insufficient to materially impact volumes traded through the Port, investment incentives, or otherwise competition in any dependant market.[19]

Given these reasons, the NCC's preliminary conclusion is that criterion (a) is not satisfied.

2.5 Synergies' response to the NCC's preliminary view

Synergies disagrees with the NCC's preliminary view that competition will be unaffected by a change in the status of declaration, particularly in the coal tenements market, and our supporting reasons are set out below.

In assessing criterion (a) and considering the two future scenarios (i.e. with and without declaration):

1. the NCC first considered PNO's ability and incentives to exercise market power by imposing higher prices for the Service;
2. it then considered whether such conduct would materially affect competition in any of the relevant dependent markets.

While the NCC acknowledges that that PNO has the ability and incentive to exercise market power, it has taken the view that 'commercially realistic' price increases are likely to mean that port charges remain a small component of costs. The NCC has not indicated what a 'commercially realistic' price might be, nor has it provided any justification for this view, especially in light of its finding that, in the absence of declaration, PNO will be an unregulated bottleneck facility. We discuss this in more detail in section 2.5.1 below.

[18] NCC (2018), p.64.

[19] NCC (2018), p.64.

Further, we disagree with the NCC that such conduct, in a future without declaration, will not have any influence on the decisions of coal producers, particularly in relation to investment in coal tenements. Revocation will result in a material loss of competition in the dependent coal tenements market, for the reasons set out in section 2.5.2 below.

2.5.1 Future with and without declaration

PNO's ability and incentive to exercise market power

The NCC reached several key conclusions in respect of PNO's incentives and, absent the declaration, its ability to exercise its market power by increasing prices for the Service, which we have summarised as follows:[20]

(a) the Port of Newcastle occupies a strategic bottleneck and has the ability and incentive to earn monopoly profits;

(b) current users of the port are not an effective constraint on PNO's market power because:
   (i) users have no alternative to using the Service;
   (ii) they have limited ability to pass on price increases; and
   (iii) demand for shipping channel Services is price inelastic.

(c) other potential constraints are not sufficient to constrain PNO's market power:
   (i) PNO does not have an incentive to discriminate in favour of any particular operation that would result in reduced volumes;
   (ii) the existing regulatory framework (PAMA Act and regulations) promotes transparency but does not constrain charges, and is not an effective substitute for access regulation;
   (iii) lease arrangements may allow for some influence by the State but are costly and would not limit any effects on competition from PNO's actions; and

(d) given the lack of constraints on PNO's market power, terms and conditions of access are likely to be more favourable to users in a future with declaration.

Synergies agrees with the NCC's conclusions that PNO has market power and has a commercial incentive to use its market power in order to earn monopoly profits.

[20] NCC (2018), pp.25-29.

Relevance of market power to assessment of criterion (a)

The NCC has noted: "The market power of the service provider is relevant to the assessment of criterion (a) insofar as it is part of the Council's assessment of the ability and incentive of the service provider to adversely affect competition in a dependent market."[21] We consider that the NCC's reference to an incentive to adversely affect competition in a dependent market is not a necessary requirement. The service provider does not need to have an incentive to affect competition, but rather only needs to have the incentive to maximise profit, with a consequential impact on competition.

Synergies has previously established[22] and the NCC appears to have accepted, that PNO has a clear incentive to use its market power to charge a price that extracts monopoly rents from users of the facility (as Glencore has previously submitted that PNO had already begun doing[23]). As is discussed in further detail below, the extent to which PNO will be able to use its market power to increase prices will depend on the limited responsiveness of demand to price increases and the threat of more stringent regulation. Neither of these pose credible constraints on PNO's exercise of market power in a future without declaration.

Further, as noted above, PNO is acutely aware that the coal sector has only a limited life and is actively planning for the development of additional trades. This is a key factor driving PNO's proposed development of a container terminal at the Port.[24] PNO's commercial imperative to foster the development of additional trades to provide a 'life after coal', together with the container vessels shipping business of its 50% shareholder China Merchants, further complicates any assessment of PNO's incentives. PNO has many opportunities to provide advantages to its shareholder, including reduced wharfage or reductions in other port related charges.

Applying this correct interpretation to criterion (a), PNO's pursuit of these commercial objectives has the clear potential to have consequential impacts on competition in dependent markets.

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21 NCC (2018), p.31.

22 See section 2.3.1 of Synergies 8 August 2018 report.

23 Glencore (2018), Submission to the National Competition Council in response to the application by Port of Newcastle Pty Ltd for revocation of declaration of the shipping channel service at the Port of Newcastle, 8 August 2018, p.16.

24 Newcastle Herald (2017), Life after coal, 20 December 2017. See https://www.theherald.com.au/story/5132103/life-after-coal-leadership-needed-for-a-fair-transition/ [accessed 1 February 2019]

Potential outcomes of PNO's exercise of market power absent declaration

While the NCC accepts that PNO has market power, the NCC's assessment about the manner in which and extent to which PNO will exercise this power absent the declaration appears to assume that PNO will adopt a very restrained approach, although the NCC does not support this assumption with an attempt to identify what that price might be or provide a credible commercial rationale for why PNO would apply it. In this regard, the NCC considers that:[25]

- the commercially rational price increases which may be imposed by PNO in the future without declaration remain unlikely to be a significant cost component or driver of profitability in the coal export market; and
- it is more likely that PNO will be incentivised to maximise the volume of coal passing through the Port, rather than set prices at a level that materially reduces coal throughput.

We disagree with both of these conclusions, for the reasons set out below.

In considering the future without declaration, the NCC has stated that it considers that Service charge increases to commercially realistic levels would remain a small proportion of costs.[26] This appears to reflect the NCC's view that estimates of the potential Service charge calculated under a building block methodology, such as PNO's submission to the ACCC of $1.36/GT or Synergies' estimate of $1.64/GT, provide an indication of the prices that might be considered commercially feasible in the future without declaration.[27]

However, the NCC does not appear to have considered the extent to which higher price increases may also be commercially feasible. For example, the PNO submitted charge of $1.36/GT was developed for the purpose of an ACCC arbitration and, as noted by the NCC[28], the actuality and/or threat of arbitration increases the incentive and likelihood for PNO to provide 'reasonable terms and conditions'. Therefore, it cannot be assumed that this reflects the price that may be sought by PNO in the absence of the declaration. Further, absent the declaration, there is no requirement for PNO to calculate prices according to a building block methodology, and even if there was such a constraint, there

[25] NCC (2018), p.42.

[26] NCC (2018), p.54.

[27] NCC (2018), p.41-42.

[28] NCC (2018), p.30.

would be no limitation on the parameter values PNO could adopt which would justify increases in charges for the Service.

It is therefore important to consider what characterises a commercially feasible charge. In this regard, we note that the NCC has described a commercially realistic charge to be one that is set at a level that is not above the profit maximising level.[29] We agree with this view. However, we note that the NCC has not sought to make any assessment of what the profit maximising price might be, after having regard to the factors that would constrain PNO's market power.

Absent declaration, the only factor that will effectively constrain PNO's incentives to increase prices is the responsiveness of volumes; that is, price will increase towards a level at which demand is no longer inelastic such that volumes are materially affected. In this respect it is a basic economic condition that a monopolist will set prices based on the elastic part of the demand function that it faces.[30] Although the simple monopoly textbook model may not exactly apply, the basic principle of increasing prices if demand is inelastic should not be controversial – a monopolist will generally not know that it has maximised profit until it increases price to the point where demand is affected.

The main constraint may be the potential for regulatory intervention if very large price increases were sustained, but the nature of and prospect of such regulatory intervention is highly uncertain and most likely would entail a considerable time lag entailing economic damage in the meantime. Indeed, if the NCC's approach to date is maintained, then such a constraint is likely to be weak.

Synergies previously examined PNO's profit incentives by modelling revenue and volume scenarios under different port price levels of: (1) no increase in prices, (2) a $1.50/t price increase; and (3) a $3/t increase.[31] The results showed even if price increases were to result in a 25% reduction in long term volumes, as is possible with a $3/t price increase and assuming low coal prices, PNO's revenue could still be increased substantially (our modelling estimated a substantial increase in revenues from a baseline of $65.3 million to a projected revenue level of $321.1 million).

While our previous submission demonstrated that a $3/t price increase would have a strongly positive impact on PNO profits (even factoring in potential declines in volume), we had not sought to quantify the ultimate binding constraint on PNO in terms of the

[29] NCC (2018), p.42.

[30] For a discussion of monopoly behaviour over time, see Dennis W. Carlton and Jeffrey M. Perloff (2005), Modern Industrial Organization, p.94.

[31] Synergies (2018a), p.29.

highest profit maximising price that could theoretically prevail in a future absent declaration.

Given the NCC effectively equates a commercially realistic price to be somewhere below the profit maximising level, we have extended our previous assessment by considering much higher price increases in order to provide an indicative assessment of where the profit maximising price level might lie.

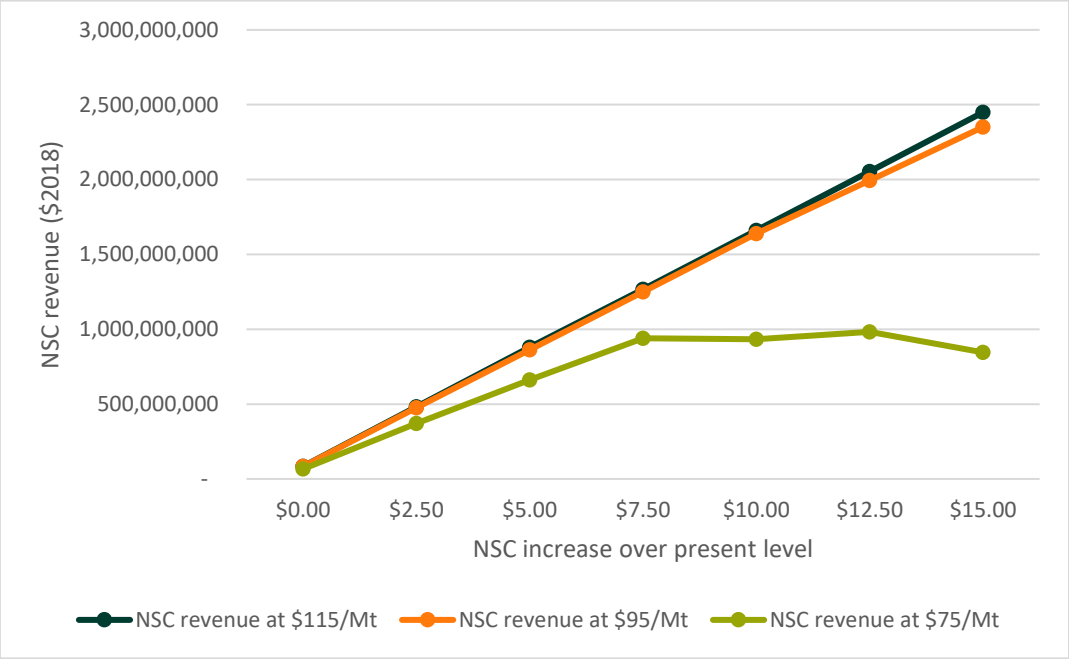
The conventional approach to assessing the profit maximising price is to apply relevant demand elasticities to equate marginal cost and marginal revenue for a series of prices. Here, we do not have information available that would enable this calculation to be performed. Instead, in order to obtain an estimate of the indicative magnitude of a profit maximising price, we have undertaken a high level assessment based on the Wood Mackenzie data utilised in our previous submissions.

The assumed incremental increase in the Navigation Service Charge (NSC) has been added to the total cash cost for each mine as measured by Wood Mackenzie. This allows us to ascertain the threshold coal price at which a given coal operation is expected to be priced out of the market. We have then added up the total coal volume (across all producers) that is expected to be produced at that price, in order to determine the relevant quantity for the revenue calculation. The estimated revenue from the NSC is then derived as this expected quantity multiplied by the total NSC (the base NSC of $0.53 plus the modelled increase).

Clearly, the profit maximising price for the Service will vary over time as coal prices, exchange rates and production change. Nevertheless, this approach, whilst static in nature, provides an indication of the likely magnitude of the profit maximising price for the Service.

Figure 1 shows that the point at which each of the identified NSC increases ranging between a $2.50/t increase up to a $15/t increase is expected to lead to an increase in revenue (which, for PNO, broadly equates to profit given an environment of mostly fixed costs), at prevailing coal prices of AU$75/t, AU$95t, and at AU$115/t.

Figure 1 Profit maximising scenarios under various coal prices and Navigation Service Charge (NSC) increases



Source: Synergies

The figure shows, under a low coal price assumption of AU$75/t, port charge increases only cease to be profitable at around $12.50/t, the point at which profits start to decline. At this price level, port charges are approximately 17 per cent of the coal price. At higher coal prices, the profit maximising port charge will be substantially higher again as is clearly shown in the figure.

It is not our intention to suggest that PNO will levy charges for the Service at the profit maximising price. Moreover, whilst the precise value of the profit maximising price may be debated, it is clearly significantly higher than the values we used in our earlier analysis and presumably significantly exceeds the "commercially realistic" price that has underpinned the NCC's analysis. In our view, it highlights that it is inappropriate to rely upon an unspecified "commercially realistic" price to underpin analysis of the adverse competition and public interest impacts of revocation of the declaration.

Notwithstanding that, in our 8 August report, we clearly demonstrated how PNO's profit objective is best achieved through increasing port charges, and accepting any consequential impact on volume,[32] the NCC has based its assessment on the presumption that PNO will set prices with the objective of avoiding any material loss in coal volumes. For example, the NCC states that "The Council notes that it is possible

[32] Synergies (2018a), p.16-32.

that reducing coal volumes through the Port may not diminish PNO's profitability if other users of the Service increase their volumes sufficiently to compensate for lost coal volumes. However, considering PNO's ongoing reliance on coal export revenues, the Council does not consider this likely."[33] The NCC does not appear to have considered the extent to which the profit impact of lost coal volumes will be compensated by the profit impact of higher prices for the remaining coal volumes.

In this regard, it seems as if the NCC does not recognise the standard economic proposition that profit maximisation for an entity with market power always means higher prices, from the exercise of that market power, with either some reduction in volume or in extreme cases no impact on volumes. This is a basic economic feature of a monopoly situation including where there is excess capacity. It means that PNO is very unlikely to maximise profit without there being a reduction in volume (as it is reductions in volume that ultimately constrain profit maximising price increases).

For these reasons, we consider that the NCC's reliance on Service charges remaining a small cost component in the absence of the declaration is not consistent with the behaviour that can be expected from a profit maximising monopolist, which is a characterisation of the commercial environment that the NCC accepts. Instead, the NCC appears to be relying on PNO 'doing the right thing', rather than acting in accordance with its commercial objectives. Considering a range of potential pricing outcomes that more accurately reflects PNO's commercial objectives is fundamental in an assessment of the degree of harm that may arise in dependent markets in a future without declaration.

We observe that the QCA, in its declaration review of DBCT, similarly concluded that DBCT Management has a profit maximising objective.[34] However, in considering the potential consequences of DBCT acting in accordance with its profit maximising objective, the QCA explicitly assessed the factors that will ultimately constrain DBCT's pricing – in this case the costs that users would incur if using the WICET facility. In this context, the QCA estimated that:[35]

- in a future with declaration (i.e. status quo):
  - the coal handling charges that apply when the DBCT service is declared would represent about 2 to 3 per cent of the forecast metallurgical coal prices until 2035;

[33] NCC (2018), p.42.

[34] QCA (2018), p.70.

[35] QCA (2018), pp.83-85.

  - for mines in the Goonyella system, the average supply chain cost to access WICET[36] is at least $26 per tonne, which is more than double the supply chain cost to access DBCT at $11 per tonne. This results in an estimated cost difference between accessing WICET and DBCT of at least $15 per tonne;

- in a future without declaration:
  - the coal handling charge at DBCT for potential entrants would likely go up from the current $5 per tonne (that incumbents would pay) by an additional at least $15 per tonne to at least $20 per tonne, such that the cost of accessing DBCT for entrants would be about the same as accessing WICET, all other things being equal;
  - a coal handling charge at this level for potential entrants would represent at least 8 to 12 per cent of the forecast metallurgical coal prices in a future without declaration;
  - this would be at least four times the 2 to 3 per cent of metallurgical coal price that existing users would pay as a coal handling charge.

The QCA then assessed the potential competition impacts with and without declaration, assuming such prices were applied, and found that declaration would promote competition in the coal tenements market.

We consider that the NCC should similarly make an explicit assessment of the range of prices that could potentially be applied by PNO given its commercial objectives and constraints, and then assess the potential competition impacts having regard to possible application of such prices. It is only against the backdrop of such an analysis can an assessment of future "commercially realistic" prices (absent declaration) be made. Synergies submits that this represents feasible and reasonable analysis that should be undertaken given the importance of the matter to the assessment of the revocation application and the national significance of the facility.

Application of access on 'reasonable' terms and conditions and relevance of ACCC arbitration determination

Synergies presented evidence (2018a) that where declaration of the Service continues, market participants will be assured that access to the port will be made available on reasonable terms and conditions for the term of the declaration (to July 2031), with this right supported by a legal right of access and opportunity to seek arbitration in the event

[36] WICET is not subject to the same access arrangements that apply to DBCT. Terms and conditions of access to WICET are set out in WICET's Terminal Access Policy.

of a dispute.[37] This was further acknowledged by Synergies (2018b), pre-dating the decision to, and public release of, the ACCC's Arbitration Determination, in which Synergies noted that the ACCC's decision should provide some important guidance on efficiency issues and whether declaration would have any impact on investment.[38]

The NCC's preliminary view does not consider it necessary or appropriate to form a concluded view as to whether the terms set in the ACCC Determination are 'reasonable terms and conditions as a result of declaration'.[39] The NCC further noted that the Determination '…reflects the ACCC's appraisal of reasonable terms and conditions for Glencore and PNO at a point in time and…[is] an example of the type of decision that can result from an arbitration…'.[40] In so doing, the NCC indicated that it has not treated the Determination as a definitive statement of what reasonable terms and conditions are.[41]

Synergies accepts the NCC's preliminary view that the ACCC's arbitration Determination does not represent the single definitive view of what constitutes 'reasonable' terms and conditions, particularly noting that aspects of the ACCC's Determination are subject to legal appeal by PNO (largely relating to whether or not PNO can include channel dredging expenditure by exporters or the coal terminals in its asset base) and Glencore (largely on the basis that the ACCC was led into error by accepting PNO's arguments on rock density and therefore dredging costs in the channel) and reasonable minds may differ on specific parameter estimates. However, we consider that the ACCC's Determination is important in providing all stakeholders with a guide as to what a reasonable price for the Service may be and how it may be determined having regard to the detailed assessment of the individual parameters that the ACCC undertook. Particularly important is the ACCC's view that the reasonable price for the Service is significantly lower than the price currently being applied by PNO.

In its approach to assessing criterion (a), Synergies considers that the NCC has placed insufficient weight on the ACCC's Determination in the context of considering the risk that PNO will exercise its market power to set prices that are above a reasonable level. Indeed, based on the Determination, it appears that PNO has already done so.

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37 Synergies (2018a), p.11.

38 Synergies (2018b), p.21. This report will be cited as "Synergies (2018b)" in all subsequent references contained in this current report.

39 NCC (2018), p.18.

40 NCC (2018), p.18.

41 NCC (2018), pp.18,19-20.

At the very least, the Determination demonstrates that the mere presence of declaration and access to arbitration provides the very real prospect of lower, more cost reflective, prices being achieved in a future where the status quo of declaration applies relative to the situation where revocation applies.

Extent of Glencore advantage due to arbitration outcome

Irrespective of the outcome of PNO's revocation application, Glencore will have the benefit of an arbitrated outcome on its Service charge, giving it certainty over the pricing methodology to be used to calculate the charge.

Synergies notes that the NCC is not satisfied that Glencore will gain a competitive advantage as a result of the ACCC's arbitrated terms. The NCC further considered that any advantage that did exist would remain in the future with and without declaration, and even if it did exist, the advantage is too small to make a material difference to the state of competition in any market. The NCC concluded that were this a material concern, more market participants would have sought rectification through arbitration.[42]

Synergies disagrees with the NCC's conclusions on this point. The view that the advantage that Glencore will only gain a small advantage (if any) from an arbitrated outcome in a future without declaration rests entirely on the NCC's benign view of the extent to which PNO will take advantage of its market power, discussed above. In particular, the NCC provides no credible commercial rationale why PNO would limit its price increases to the extent the NCC assumes.

Further, Synergies considers that the absence of more ACCC arbitrations from other coal producers in the Newcastle catchment is not a sufficient basis to indicate evidence that other market participants do not consider this to be a material concern. While no other party has applied for arbitration to date, this does not provide any guidance as to the future as the ACCC arbitration Determination was only handed down in late 2018.

Lodging a dispute with the ACCC for arbitration is not costless, and some producers may be willing to accept some price 'premium' in order to avoid this process, particularly while the outcome of the current dispute is not yet settled. For so long as the declaration remains in place, users have the option of seeking arbitration if the 'premium' becomes unacceptably high. Recognising this, we consider that PNO is less likely to seek further aggressive price increases while the declaration remains in place, as it will be acutely aware of the likely price reduction that will apply if users choose to seek arbitration.

[42] NCC (2018), p.56.

Conclusions

The NCC's preliminary view assumes PNO will adopt a very restrained approach in setting prices in a future without declaration. The NCC indicates that PNO will adopt a price that is 'commercially realistic' without any assessment of what that means or at which price level a commercially realistic price is expected to prevail. Our analysis suggests that PNO has the ability and incentive to increase prices significantly before the detrimental impact on volumes means that further price rises will not be profitable.

Despite clear and unequivocal evidence of PNO's profit maximising motive, the NCC has advocated that declaration be revoked. While Synergies accepts that the presence of market power is not, by itself, a sufficient determinative factor to meet the necessary threshold for criterion (a) to be satisfied, it does raise practical concerns for users of the declared Service that the only credible constraint that currently exists (as attested to in the recent ACCC arbitrated outcome in Glencore-PNO access dispute in which the ACCC has set a lower Service charge to that currently imposed by PNO) will be removed should the NCC's recommendation be endorsed by the Minister. To rely on PNO to apply prices that are 'commercially realistic' has insufficient regard to PNO's past pricing behaviour and its commercial incentive to maximise profit.

The NCC's preliminary assessment of competition impacts associated with changes in the status of declaration is examined in section 2.5.2 below.

2.5.2 Impact of declaration on competition in coal tenements market

Synergies presented evidence (2018a)[43] that revocation will result in a material loss of competition in the coal tenements market, as it will weaken investment incentives and lower coal resource values. This is because a future without declaration will result in a higher cost and risk profile for new and prospective coal miners in the Newcastle catchment. As the economic viability of new mines deteriorates, this will most likely reduce the incentives of miners to invest in tenement rights. We consider that this will be likely to have a material adverse impact on effective competition in the tenements market. It will also entail a transfer of resource rents from tenement sellers including the State of NSW to the shareholders of the Port of Newcastle.

The NCC reached a different view, concluding that competition in the tenements market would remain effective irrespective of the declaration. This view was based on the following reasons:

[43] See section 3.3.3 of Synergies 8 August 2018 report.

- while acknowledging that the tenements market is likely to be characterised by higher costs and risks than may be present for existing mines, the NCC considered that Service charges would be a small component of coal costs and, even absent declaration, would have a minimal impact on the profitability of coal exports;
- consistent with this view, the NCC considered that:
  - any uncertainty about Service charges is likely to be relatively small compared to other risks, including coal prices, labour costs and taxes; and
  - any advantage enjoyed by Glencore as a result of its arbitrated terms would be too small to make a material difference to the state of competition in the tenements market;
- the NCC did not receive any submissions to provide evidence of the vulnerability of small mining participants in the tenements market.

We respond to these points below.

Materiality of Service charge in tenements market

Synergies' (2018a) and (2018b) presented evidence about the importance of port charges to investment incentives in the coal tenements market.[44] The possibility of higher port charges is an important risk factor when making a decision about whether to invest in exploration or development. Coal producers will base their decisions on their assessment of many factors, including the price that they anticipate PNO will apply.

In considering the relative significance of port charges, the NCC has had regard to PNO's submission that Service charges are a small proportion of the cost of coal and has concluded that Service charge increases (to a commercially realistic level) would remain a small component of costs and would have a small impact on the profitability of exporting coal.[45]

However, in making this assessment, not only has the NCC adopted a benign view of the potential increase in Service charges absent declaration (as discussed above), the NCC does not appear to have taken into consideration that PNO's assessment of the Service charges and producer margins was **based on the costs borne by the lowest cost Hunter Valley coal producer**.[46] (PNO's assessment concluded that an average Hunter Valley coal miner bears cash costs of $43.02/t, earning a margin of $45.39/t at a coal price of $88.42/t.)

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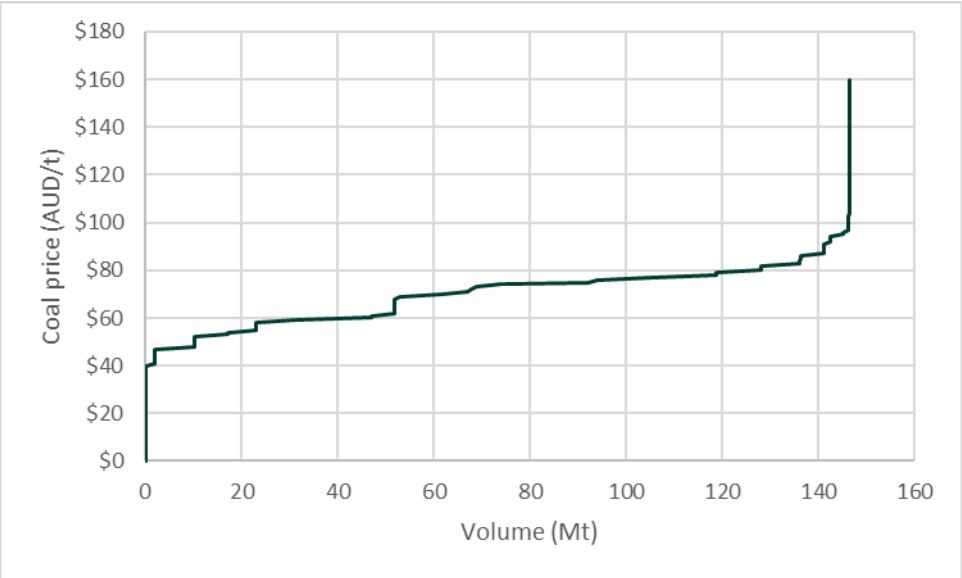
[44] Synergies (2018a), p.59, (2018b), p.16.

[45] NCC (2018), p.54.

[46] This was demonstrated in Synergies (2018a), p.59 and Synergies (2018b), p.16

It is true that for the lowest cost mines, higher port charges may not influence production decisions. For the reasons outlined above, PNO's profit maximising price is very likely to affect marginal mines – the mines in the Hunter Valley with the highest operating costs and lowest margins. In this regard, our previous analysis (re-produced in Figure 2 below) indicates that there are numerous existing mines with cash costs above AU$80/t.[47]

Figure 2 Port of Newcastle thermal coal supply curve – existing projects (2018, AU$/t)



Source: Wood Mackenzie, Synergies analysis

Moreover, for future coal mines (those that are, in effect, sub-marginal today), the impacts can be expected to be more significant. The key consideration for demand in the tenements market relates to the expected costs and margins applicable to planned and prospective mines, that are, at present, by definition, sub-marginal. Margins for new coal developments are much thinner than for operating mines, and the risk of a significant increase in Service charges is likely to be material for such projects. As we have previously explained:[48]

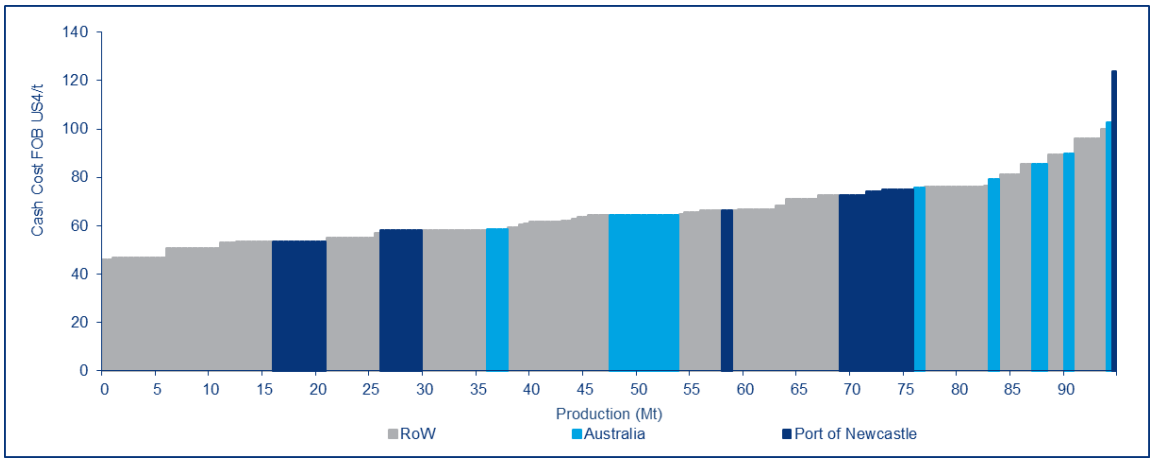
> Wood Mackenzie also maintains cost curves for known, but yet to be developed, projects. Wood Mackenzie estimates that, in 2025, the cash cost for several of these projects will range from US$70-75/t or AU$95-100/t (2018$s) as shown in Figure 19 [reproduced below at Figure 3]. Given a coal price forecast in 2025 of US$75/t

[47] Price and cash cost data from Wood Mackenzie are expressed in US$. We have converted these values to AU$ using an exchange rate of 0.74 US$/AU$, which is consistent with the exchange rate at the end of July 2018.

[48] Synergies (2018a), p.60.

(2018$s),[49] these projects would have a cash margin of less than $US5/t to contribute to the capital costs of the projects, which is less than NERA's estimate of capital costs of US$7.2/t. In this context, the perceived risk of a change in input cost of up to $2/t would appear likely to have a material impact on whether or not these projects will be considered viable.

Figure 3 Global Seaborne Energy Adjusted (6,322) New Thermal Coal Projects FOB supply curve (2018, US$/t, nominal) in 2025



Source: Wood Mackenzie

Having regard to:

- the costs and margins applicable to new mine developments; and
- the full range of Service price outcomes that can be anticipated in an unregulated environment given PNO's ability and incentive to increase prices;

the NCC's conclusion that the possible change in Service charge is too small to have a material impact on expected investment returns for new mine developments is based on irrelevant information and accordingly is not reasonable.

Synergies therefore considers that the NCC, in examining the impact of competition on the tenements market, has placed undue weight on PNO's claim that port charges will be relatively insignificant to the overall cost structure of coal exports, even in a future without declaration. Despite acknowledging PNO's clear profit maximising pricing incentives and lack of constraint in a future without declaration (but to a more limited extent than the Synergies assessment), the NCC's preliminary view that competition is unaffected by the declaration status relies too heavily on this determinative assumption.

[49] Wood Mackenzie forecast for 'FOB Newcastle @ 6,000 kcal/kg NAR, market'

Put another way, it is very unlikely that PNO will maximise profits without adversely affecting competition in the tenements market.

Significance of Service charge risk relative to other risks

The NCC has concluded that coal producers and exporters face significant uncertainty resulting from the magnitude and timing of potential future changes for a number of factors, including coal prices, labour costs and taxes. Compared to these other factors, the NCC considers that any uncertainty about Service charges is likely to be relatively small, and the reduction in uncertainty resulting from declaration of the Service is so small that it is not likely to promote a material increase in competition in the export coal market.

Synergies disagrees with the NCC's conclusions for two reasons:

- first, the NCC's view on the significance of the risk reflects its benign view of the potential price increases that may occur absent declaration (as discussed above), which we have shown is not consistent with profit maximising incentives and which is unlikely to be shared by all potential investors in the tenements market; and
- second, the NCC's view does not adequately distinguish between those risk factors that are able to be mitigated for or entail some upside potential, and those other risks which cannot be mitigated or which do not entail upside potential.

In a future without declaration, Synergies maintains that PNO's unfettered ability and clear incentive to impose significantly higher charges at any point in time will result in a material loss of competition in the coal tenements market, primarily because of investors' concerns over the prospect of higher costs, which will reduce the economic viability of new and prospective mining developments. Absent declaration, PNO's unfettered ability to price the use of the channel empowers it to appropriate much of the economic rent that would otherwise incentivise mine investment.

The issue of risk and its impact on competition in the tenements market is largely a matter of whether or not the costs imposed by that risk can be mitigated and also whether there is any upside potential to offset downside risk. Risk in a relevant economic sense is defined as an expected value i.e. the probability of an outcome multiplied by the impact if the outcome is realised and a range (the latter informing possible impact).[50]

[50] Black, J., (2010) The Role of Risk in Regulatory Processes, in Baldwin, R., M. Cave and M. Lodge, The Oxford Handbook of Regulation, Oxford University Press, p. 310: *"Risk is conventionally measured to be probability × impact (Knight 1921; Fischoff, Watson and Hope, 1984)."*

Where there are several possible outcomes, the expected value is the sum of the probabilities of each outcome multiplied by the value (positive or negative) associated with each outcome. Where the range of credible alternatives is wide, parties may place greater weight on worst case scenarios when assessing the desirability of investing in the Hunter Valley relative to alternative investment opportunities.[51]

Where risks cannot be mitigated or entail no meaningful upside potential and so reduce the expected economic viability of new mining ventures, then this will result in reduced demand for, and competition for, mining tenements. Where risks are able to be mitigated or are characterised by some offsetting upside potential, then any competition losses that arise should be less significant.

The risk of PNO increasing prices in a future without declaration is highly likely (insofar as it will occur, the size and timing of the increase is far less certain). The main problem with risk arises where there is no offsetting upside potential. In this case there is most likely to be a Service charge increase that does not entail any offsetting benefit for a user. This contrasts with other risks, such as coal price changes, where there is scope to manage that risk (e.g. through hedging arrangements) and the risk involves both upside and downside changes.

The NCC's view does not adequately distinguish between those risk factors that are able to be mitigated for or entail some upside potential, and those other risks which cannot be mitigated or which do not entail upside potential. This is consistent with evidence submitted by Yancoal to the NCC which notes that:[52]

> In respect of the report from HoustonKemp Report, Yancoal considers its reasoning and conclusions deeply flawed as:
>
> …
>
> (e) It simply ignores that volatility in coal prices, freight rates or foreign exchange rates are completely different to the uncertainty of future channel charges in terms of their impact on investment decisions, as:
>
> (i) volatility of coal prices, freight rates and foreign exchange rates are things that coal producers can predict and have the potential to mitigate (whether through hedging or fixed price contracting);

[51] This is consistent with the economic literature associated with loss aversion, see for example Kahneman and Tversky (1979), Benartzi and Thaler (1995) and Rothschild and Stiglitz (1970).

[52] Yancoal (2018), Further submission on revocation application for the Port of Newcastle Shipping Channel Service, 5 October 2018, p.6.

> (ii) coal prices, freight rates and foreign exchange rates are generally cyclical such that they will 'turn' over the life of the project if they are initially adverse;
>
> whereas the likely increases in pricing by PNO are something that (in the absence of declaration) cannot be estimated or mitigated and are highly unlikely to ever be reversed.

We note that QCA also considered such a distinction to be an important one when assessing the impact of risk associated with increased pricing uncertainty and its impact on competition in the coal tenements market. It concluded that:[53]

> To summarise, the QCA's view is that in a future without declaration, access seekers would face the risk of negotiating access in an environment where DBCT Management would have the discretion to set access terms and conditions, the risk of paying a materially higher access charge reflecting the cost of accessing WICET as well as the uncertainty as to whether and when they would obtain access to the terminal. This risk would be unmanageable and fundamental, considering the essential nature of the DBCT service for mining operations in the Goonyella system, and is over and above the normal uncertainties miners would face in conducting their operations.

We consider that, similar to DBCT, the risk of significant increases in Service charges at Port of Newcastle will be perceived by investors to be both unmanageable and fundamental, as well as being over and above the normal uncertainties that miners face in conducting their operations. As coal producers do not have access to an alternative port, apart from the option of reducing production, there is no way for them to mitigate the risk of increased port charges.

The risk is unmanageable because it cannot be mitigated and it is a one sided downside risk for users of the Service.

Impact of Service charge risk on incentive to invest in mine exploration and development

Given its view that the risk associated with increases in Service charges is insignificant (discussed above), the NCC has taken the view that declaration status will have no impact on investor incentives to invest in mine exploration and development.

However, if it is accepted that the risk associated with increases in Service charges may be significant for the reasons discussed above, then we consider that this would

[53] QCA (2018), p.71.

necessarily alter the NCC's assessment of the implications that revocation may have on incentives to invest.

The economic rent that a coal tenement buyer expects to earn from its investment is a major factor in its investment decision. Without these rents, miners cannot justify making the necessary investment to undertake mining exploration activities.

This is consistent with economic literature on exhaustible resources and expectations of future economic rents (marginal profits) in decisions by resource owners about if and when to draw out deposits. For instance, Solow notes that:[54]

> A resource deposit draws its market value, ultimately, from the prospect of extraction and sale. In the meanwhile, its owner, like the owner of every capital asset, is asking: What have you done for me lately? The only way that a resource deposit in the ground and left in the ground can produce a current return for its owner is by appreciating in value…Since resource deposits have the peculiar property that they yield no dividend so long as they stay in the ground, in equilibrium the value of a resource deposit must be growing at a rate equal to the rate of interest. Since the value of a deposit is also the present value of future sales from it, after deduction of extraction costs, resource owners must expect the net price of the ore to be increasing exponentially at a rate equal to the rate of interest. If the mining industry is competitive, net price stands for market price minus marginal extraction cost for a ton of ore. If the industry operates under constant costs, that is just market price net of unit extraction costs, or the profit margin. If the industry is more or less monopolistic, as is frequently the case in extractive industry, it is the marginal profit – marginal revenue less marginal cost – that has to be growing, and expected to grow, proportionally like the rate of interest.

To the extent that potential higher port charges add to expected marginal costs and therefore squeeze the marginal profit expectations of tenement owners (assuming all other things remain equal), this will discourage mineral extraction and delay investment decisions.

Where PNO is able to substantially increase prices, much of the impact would be reflected in a transfer of resource rents from the sellers of coal tenements and ultimately the State of NSW when it sells new coal tenements (from lower tenement values) to PNO

[54] Robert M. Solow (1974), The Economics of Resources or the Resources of Economics, published in the American Economic Review, Vol. 64, No.2 Papers and Proceedings of the Eighty-Sixth Annual Meeting of the American Economic Association, May 1974, pp.1-14. In practice, the value of tenements will also be affected by expectations of factors such as productivity enhancements enabling extraction costs to be reduced and future demand.

shareholders (as a result of higher Service charges).[55] There is also likely to be a reduction in coal exploration investment and in coal production relative to what would occur in the absence of the revocation over the longer term. Synergies (2018a) previously demonstrated that that the transfer of economic rents from coal producers to PNO would be avoided through continued declaration.[56]

Synergies presented evidence (2018a) which demonstrated that it is the smaller coal producers that typically participate in the coal tenements market. Over time the deposits which are being explored and developed have a tendency to be further away from the port (i.e. in the Gunnedah Basin), such that infrastructure costs are anticipated to become more and more important to the prospect of tenements being developed into producing mines, and hence to the valuation of those tenements.

Where economic rents in coal production are transferred to PNO in the form of higher prices, this will ultimately lead to reduced competition and consolidation in the market for coal tenements as smaller coal producers have less available financial resources to invest in coal exploration. The expectation of lower returns will lower the attractiveness of coal tenements which will ultimately lower coal resource values in the Newcastle catchment as explained above.

With respect to its assessment about the competitive impacts in the coal tenements market of increased risk from higher port charges, the NCC noted an absence of submissions from small mining participants as an indicator of there being no evidence about the vulnerability of market participants to PNO's pricing behaviour.[57]

Synergies maintains that the absence of submissions about pricing uncertainty by tenement buyers or prospective bidders is not a reasonable basis to infer evidence of a position one way or the other. Clearly existing coal producers (other than Glencore) have indicated the importance of the issue, and the fact that smaller miners typically invest in coal tenements is an established characteristic of the mining industry. Further, as we have previously submitted, such evidence may not even exist as it is unrealistic to expect that a coal tenement buyer would be willing to disclose its capacity to purchase tenements at a higher price.

Extent of Glencore advantage due to arbitration outcome

As discussed in section 2.5.1, given the existence of its arbitration outcome, Glencore will not be subject to the same risk of Service charge increases as will other coal producers

[55] See section 3.5 of this report.

[56] Synergies (2018a), p.82.

[57] NCC (2018), p.53.

over the term that the arbitrated outcome applies. The NCC's view that this benefit will be limited depends entirely on its benign view of the potential pricing outcomes that may occur absent declaration. If the full range of potential pricing outcomes is considered, it becomes apparent that Glencore's pricing advantage may indeed be significant, leading to a distinct advantage over other coal producers in coal exploration and future mine development. This comparative disadvantage for smaller companies is likely to lead to further consolidation and less rigorous competition in the coal tenements market.[58]

We note that this concern has been raised in other evidence provided to the NCC in which Yancoal, for example, considered there will be a distortion in a number of dependent markets if the declaration is revoked, as it is likely that Glencore will have the benefit of the ACCC's arbitrated terms.[59] Yancoal further argue that this effect would make coal authorities more valuable to Glencore and place Glencore in an advantageous position compared to other potential acquirers in the tenements market. Synergies agrees with this proposition as a matter of economic and commercial reality and is consistent with the likelihood of less competition in the tenements market.

Current state of competition in the tenements market

We consider that, in forming its view that competition in the tenements market will not be affected by the declaration, the NCC has had insufficient regard to the current level of competition in this market.

The NCC states that, in 2015, it considered the tenements market was and would remain effectively competitive with or without declaration of the Service. However, we note that the NCC has not undertaken any analysis on the current extent of competition in the tenements market, either in 2015 or in 2018. While the NCC has claimed that the large number of companies holding tenement licences in the Newcastle catchment supports its view that the tenements market is effectively competitive, we do not consider that this factor alone provides any robust indication on the state of competition in this market.

As we have previously submitted,[60] there are a number of factors that indicate that the tenements market is not highly competitive and which were largely not considered by the NCC. This view is supported by the NSW Government's concerns about the

[58] Synergies (2018a), p.66.

[59] Yancoal (2018), Submission on revocation application for the Port of Newcastle Shipping Channel Service, 8 August 2018, pp.15-16.

[60] Synergies (2018a), p.63-65.

effectiveness of existing competition in the coal tenements market and its announced reforms to the process for bidding for tenement rights aimed at improving competition.[61]

In this context, while we acknowledge that the declaration is unrelated to the proposed NSW Government reforms to the tenement bidding process, we remain of the view that a regulatory change that is expected to reduce expected returns from coal tenements is likely to adversely impact on competition in the tenements market by reducing the incentive for bidders to participate and vigorously compete in the tenements market.

Hold-up problem in the coal tenements market in a future without declaration

The NCC's preliminary view considered the issue of hold-up only in terms of the potential for PNO to hold up individual mining investments. On this basis, the NCC took the view that hold up could only occur where PNO is able to price discriminate between mines, and that the NCC was not satisfied that this was possible.

As we have discussed in previous submissions,[62] while the ability to price discriminate will assist in allowing a service provider such as PNO to increase prices in a targeted way in order to expropriate a user's profit margin after its investment is sunk, some level of profit expropriation is clearly possible through the application of general price increases. This is particularly the case for coal mines where, once investment in the mine is sunk, coal volumes (particularly for inframarginal producers) are relatively insensitive to changes in port charges.

Given this, we consider that the NCC has erred in only considering investment hold up to be a risk only if PNO is able to price discriminate.

Conclusions

The NCC's conclusion that the declaration status will not have any impact on competition in the coal tenements market rests largely on its presumption that, absent declaration, PNO can be relied upon to take a restrained approach in setting future price increases. This is not consistent with the behaviour that can be expected from a profit maximising monopolist in the circumstances considered here.

The very high likelihood that prices will rise in the absence of any credible constraints in turn puts new investments in future coal exploration and development in the Newcastle catchment region at considerable risk, and as a result will undermine competition in the coal tenements market.

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[61] NSW Government (2014), Strategic Statement on NSW Coal, August 2014, p.2

[62] Synergies (2018b), p.18.

3 Response to NCC assessment of criterion (d)

3.1 Summary

This section presents Synergies' response to the NCC's preliminary view on criterion (d).

The NCC is not 'positively satisfied' that a future with declaration would promote the public interest.[63] Although the NCC considers that there are some benefits and some detriments that are likely to be realised as a result of declaration, the NCC is not satisfied declaration will materially improve efficiency and welfare.[64]

Synergies disagrees with the NCC's preliminary findings and maintains its earlier position that continued declaration will promote the public interest by creating incentives for increased efficiency in supply chain infrastructure and enhancing growth in the NSW and Australian economies, thus satisfying criterion (d).[65]

This position is consistent with regulatory precedent set by the QCA in its current review of the DBCT declaration, in which the regulator considered many of the factors that the NCC also assessed, yet the QCA concluded declaration will promote the public interest:[66]

> Access as a result of declaration would create an environment for efficient investment in coal tenements markets, which would likely result in higher coal export revenues as well as would likely generate wider economic benefits to the regional and state economies, including higher coal royalties.
>
> There is no evidence to suggest that declaration will impact DBCT Management's incentives to invest in the terminal. In fact, declaration is likely to have a positive impact on the incentives to invest in DBCT as well as on the incentive to invest in the rail network and haulage facilities that service the terminal, to the extent that there is an increase in mining investment as a result of declaration.
>
> The administrative and compliance costs incurred by DBCT Management as a result of declaration are not considered excessive relative to those that may be incurred in the absence of declaration, such as to have an impact on the public interest.
>
> …

[63] NCC (2018), p.79.

[64] NCC (2018), p.78.

[65] Synergies (2018a), p.71, pp.75-82.

[66] QCA (2018), p.127.

> Having weighed all of the costs and benefits, the QCA considers that there is a net public benefit.
>
> The QCA therefore concludes that access (or increased access) to the service provided by DBCT, on reasonable terms and conditions, as a result of declaration would promote the public interest.

The QCA's analysis and findings support the evidence presented earlier by Synergies that declaration of the PNO channel Service will promote the public interest.

3.2 Background

Criterion (d) requires as set out in subsection 44CA(1) of the CCA:

> (d) that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote the public interest.

The NCC has previously identified that the central question associated with this criterion is whether the declaration is likely to generate overall gains to the community. The NCC and the Minister may have regard to a very wide range of matters when considering this criterion. The NCC has also indicated that issues of economic efficiency and competition to be important in the context of promoting the public interest.[90] We consider that the objects of Part IIIA and the broader CCA are highly relevant to the consideration of the public interest. This is discussed in section 4 of this report.

There are also mandatory public interest considerations pursuant to s 44CA(3) of the CCA, in which the NCC must consider:

- the effect that declaring the service would have on investment in:
  - infrastructure services; and
  - markets that depend on access to the service; and
- the administrative and compliance costs that would be incurred by the provider of the service if the service is declared.

As a result of the amendments to the previous criterion (f), this is now a positive test. Under the old criterion (which was a negative formulation), the NCC found that declaration would not be contrary to the public interest, thus satisfying criterion (f).[67]

Under the amended criterion, the NCC notes that it does not call into question its conclusions on criteria. It accepts those results and inquires whether, on balance,

[67] NCC (2015), p.53.

declaration of the service would promote the public interest giving consideration to likely flow-on effects that follow its conclusions as well as any other matters that are relevant to the public interest.

Synergies assessment of criterion (d) is consistent with this approach. We identified (2018a) the additional benefits associated with improved access based on reasonable terms and conditions (compared to access on PNO's imposed terms) and which have not already been identified in criterion (a). These additional benefits fell into two broad categories:

- the additional economic growth in the NSW and Australian economies associated with increased mining production (i.e. where increased investment attractiveness because of the declaration leads to deposits being proven and ultimately mined);[68]
- the avoided efficiency losses that would have otherwise materialised resulting from diminished competition in the tenements market leading to a deterioration in the value of tenements, including new tenements sold by the NSW Government, and reduced investment and investor confidence in mining development.

3.3 Synergies' previous views on criterion (d)

Synergies (2018a) presented evidence to indicate that there are strong efficiency benefits associated with maintaining the declaration. Access (or increased) access to the Service, based on reasonable terms and conditions resulting from continued declaration, relative to revocation, will ensure that disincentives to future investment in coal mining, exploration, development and production are not introduced. Disincentives will arise in a future absent declaration where tenements represent a less attractive investment as potential entrants anticipate reduced margins given the very high likelihood that Service charges will rise. Reduced competition will also result in lower tenement values reflecting a transfer of economic rent from tenement sellers to PNO shareholders. This will further distort the incentives for efficient investment in infrastructure. Continued declaration will avoid these disincentives, and not put at risk the economic gains associated with such investment.

Possible efficiency losses without competition losses

In light of the NCC's recommendation to have the declaration revoked, it is important to re-emphasise that efficiency losses can occur in markets without there being a material

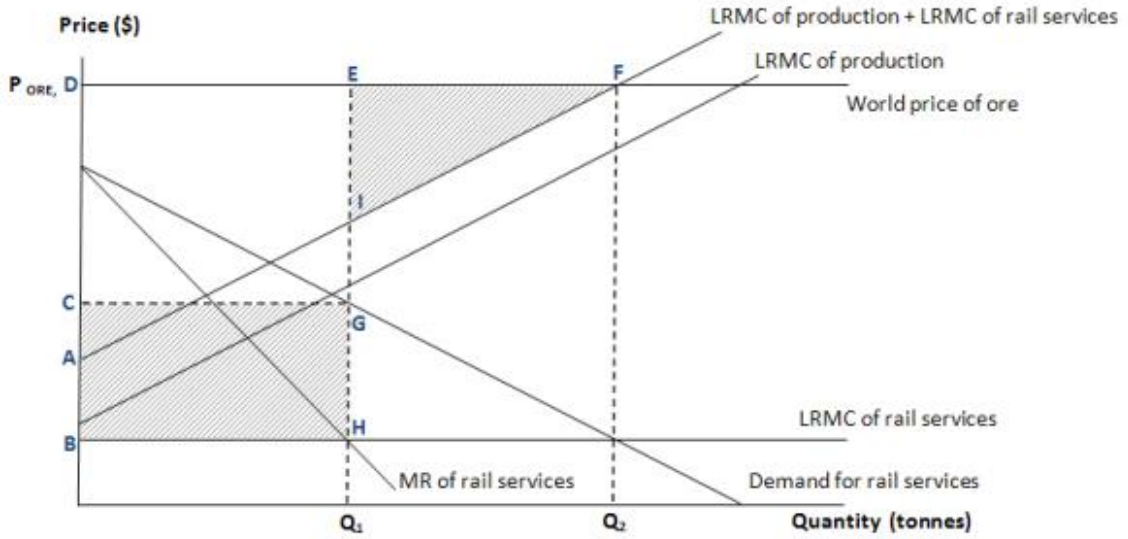
[68] Synergies (2018a), p.71.

adverse impact on competition in those markets. The NCC's preliminary view does not address this point. Our key contentions are that:

- allocative economic efficiency losses can occur in markets without there being a material adverse impact on competition in those markets. This is because allocative economic efficiency effects arise wherever the pattern and associated value of economic activity differs between a status quo factual position and a counter factual position following a policy or parameter change (in this case, where the counter factual results in materially higher Service charges where declaration is revoked).
- these effects are not necessarily dependent on there being a material reduction in workable competition in any market. For example, where coal exported from the Newcastle catchment is less competitive in relevant export markets and volumes decline, there could be an efficiency loss for coal mines where the access prices exceed the efficient costs of supply through the Port of Newcastle.

We have re-produced the following figure from our earlier report (2018a) which was based on an ACCC submission to a Productivity Commission review and demonstrates that efficiency losses can arise despite no reference to competition losses necessarily occurring.

Figure 4 Efficiency losses as a result of monopoly pricing



Source: Reproduced from Synergies 8 August 2018 report at p.73. Originally sourced from ACCC (2013), Productivity Commission Review of the National Access Regime - ACCC submission to issues paper, February 2013, p.77

In presenting this diagram, the ACCC used the example of a miner exporting its output into a global market to show that there can be efficiency losses without there being reference to a material reduction in workable competition, by, for example, noting that:[69]

> Even if the railway operator is able to expropriate some or all of the miner's rents (the area ADF) without affecting the miners' marginal costs of supply (for example, by imposing a two-part tariff for rail services), there may still be negative efficiency consequences from the expropriation of the miner's economic rents. Mining exploration is inherently risky as many prospects will be found not to be viable after substantial exploration and initial development expenditures have been incurred. The economic rents made on commercially viable mines allow miners to recover losses on prospects that prove unviable and to achieve at least a commercially acceptable risk-adjusted rate of return across their entire operations (including losses on unviable prospects). Expropriation of these economic rents may discourage investments in prospecting for, and developing, new mines—with negative implications for allocative and dynamic efficiency, productivity and export earnings, and, in turn, for community welfare.

This example shows that there is no impact on the marginal cost of supply and by implication no impact on current production and so is consistent with a view that if there is no impact on current production there is no impact on competition in the market in which that production competes. However, as explained, the extraction of rents may discourage investment and subsequently production over the longer term.

Our earlier report also considered that there would also be a significant public detriment associated with a revocation of the declaration where:

- there is no other credible constraint on PNO engaging in monopoly pricing which would mean that the application of the Part IIIIA regulatory framework is redundant;
- revocation of the declaration will cause a reduction in the value of investments made by coal producers who legitimately expected that PNO's ability to engage in monopoly pricing would be constrained; and
- it establishes a precedent for undeclared ports, across Australia, to raise prices where they perceive the threat of regulation is similarly weak.

Our 5 October 2018 report also addressed specific claims from PNO that:

[69] ACCC (2013), Productivity Commission Review of the National Access Regime – ACCC submission to issues paper, February 2013, p.77.

- declaration may have a chilling effect on investment in infrastructure services. It is true that inappropriate regulatory pricing of declared services may affect investment incentives. In this regard, we have already presented evidence there is significant channel capacity such that no significant investment in channel capacity is required over the medium term. Moreover, even if any such investment is required, based on the history of channel development (which was substantially funded by users) as well as PNO's public statements regarding future investments, those future investments will most likely be required to be funded by users. This means that:
  - there is no expectation that PNO will commit its own funds to channel development for the foreseeable future, and therefore the risk that declaration will have a chilling effect on PNO's investment in the declared service is in practice very limited;
  - however, the absence of declaration may in fact have a chilling effect on investment that other parties are willing to make, both in relation to the declared service (e.g. users may be reluctant to fund capital dredging works if they consider that PNO is likely to seek to also recover the costs of such works in Service charges) and in relation to complementary infrastructure (e.g. users may be reluctant to fund complementary infrastructure if they consider that PNO may subsequently increase Service charges to expropriate profit margins);
- declaration has created significant compliance costs. In this regard, while we acknowledge that significant costs are likely to have been incurred in the Glencore-PNO arbitration, we demonstrated that many of these costs are likely to be one-off in nature and avoided in future arbitrations if the outcomes of arbitration are publicly known.

For these reasons, Synergies considered criterion (d) to be satisfied to warrant the declaration remaining in place.

3.4 NCC's preliminary view

The NCC is not 'positively satisfied' that declaration will promote the public interest, for the reasons, we have summarised below:[70]

- effect of declaration on investment in infrastructure services

[70] NCC (2018), pp.75-79.

  - while acknowledging that declaration may limit the potential for PNO to set prices at an inefficiently high level, and give users of the port services greater opportunity to invest in other mining related infrastructure, the NCC considered this effect to be limited, and given its view on the likely magnitude of the Service charge with or without declaration, would be unlikely to impact volumes in dependent markets.

- effect of declaration on investment in dependent markets
  - given its view on the likely magnitude of the Service charge with or without declaration, the NCC considered that investment incentives in dependent markets will be similar with or without declaration.

- administrative and compliance costs of declaration
  - the NCC acknowledged that in a future with declaration, the number of future disputes is uncertain, although future disputes are likely to be relatively less complex and less costly due to matters already considered in the Glencore-PNO arbitration.

- other matters the NCC considered are identified as follows:
  - *Improved efficiency* - where the NCC is not satisfied under criterion (a) that declaration will promote a material increase in competition in any dependent market, it is similarly not satisfied that declaration will improve efficiency and welfare.
  - *Transfer of surplus* – the NCC considers declaration is likely to result in more favourable terms and conditions of access for users, which would redistribute surplus from PNO to users; however it does not consider the wealth transfer effect to be sufficient to warrant continued declaration.
  - *Economic growth* – the NCC does not consider declaration will appreciably impact economic growth. The NCC did not provide further detail.

In assessing a change from the status quo of a future with declaration to a future without declaration, the NCC considers the public detriments will be minimal, noting that:

- while acknowledging the value of investment in tenements made while the declaration was in place may drop, the NCC considers the drop to be minimal (as sophisticated investors will have anticipated the risk of the declaration of being overturned);[71]

[71] NCC (2018), p.76.

- the NCC rejected the premise that revocation will prompt other ports to raise their prices as it does not view declaration as a relevant precedent for other ports, as according to the NCC, the circumstances applicable to the provision of port services vary significantly.[72]

Our response to these issues is provided below.

3.5 Synergies' response to the NCC's preliminary view

Criterion (a) assessment and its flow on effects dominates the NCC's assessment of criterion (d)

The NCC's assessment of criterion (a), and in particular its benign view of the extent to which Service charges may rise absent the declaration and its resulting view that the declaration status will not impact incentives to invest in coal mine developments, effectively means it does not consider it likely that there will be any additional public benefits associated with new mine development under criterion (d).

It is not possible to fully test the NCC's position that declaration will not appreciably affect economic growth as this was not explained in the Statement, nor did the NCC directly respond to evidence presented in Synergies' 8 August report that demonstrated the economic benefits that will arise in the NSW and Australian economies from stimulated investment in mining developments.[73] However, we remain of the view that, to the extent that continued declaration will avoid the creation of disincentives to investment in mine development, this will lead to economic benefits to the NSW and Australian economies.

We note that the QCA similarly recognised DBCT's importance to the Queensland economy as well as the terminal's 'substantial' contribution in facilitating that state's coal exports, royalties and employment when considering the public interest impact of declaration.[74]

Further, where the NCC considers there is no material competition benefits in a future with declaration, the NCC concludes that there will be no derived efficiency gains or other public benefits either.

Notwithstanding our respective views about the competition impacts resulting from a change in declaration and the potential stimulation of mining development, we consider

[72] NCC (2018), p.79.

[73] See section 4.3 of Synergies' 8 August 2018 report.

[74] QCA (2018), pp.103-107.

that the NCC does not adequately recognise the possibility that, in a future absent declaration, there can be adverse efficiency effects without any commensurate, adverse competition effects (as we have outlined in section 3.3).

Other matters relevant to the criterion (d) assessment

Our examination of the other matters identified in the NCC's Statement indicates that there are two matters upon which the NCC and Synergies appear to agree in their respective assessments of the public benefits that will arise from a future with declaration: (1) that administrative and compliance costs of declaration are not deemed excessive; and (2) declaration is likely to result in a transfer of surplus from PNO to users and also to sellers of coal tenements, including the State of NSW (although, even here, given its benign view on the likely price increases that PNO may apply, the NCC does not regard wealth transfers as material).

However, in addition to not agreeing on the scope for efficiency gains as a result of continued declaration, Synergies and the NCC also disagree on the scale of public detriments that will arise if revocation occurs. In considering the impact of a change from the status quo where declaration currently applies, the NCC considered that the public detriment associated with revocation will be minimal. Given that the NCC has already acknowledged that, without declaration, PNO has the ability and incentive to significantly raise prices, this claim significantly understates the considerable risk for existing coal producers and potential, new investors from revocation.

Further, to conclude, as the NCC has done, that other ports are not watching the outcome of the current declaration process understates the strategic role of economic regulation, particularly in today's current climate around port pricing. Such a view understates the heightened public scrutiny that is taking place by other economic regulators (such as the ACCC and the QCA) around port pricing in Australia and the extent to which economic regulation is seen as a real constraint (or, as a result of this current declaration, a credible threat). While different ports will:

- interpret the threat of regulation differently, particularly in light of the threat of State based regulatory intervention;
- assess the value of their social license differently; and
- have differing levels of exposure to the risk of declaration under Part IIIA, with certain ports being unaffected by the NCC's decision,

removing the threat of declaration is likely to influence future pricing outcomes for at least some ports.

QCA has assessed that DBCT declaration satisfies criterion (d) based on the same legislative criteria examined by the NCC

The scope for a different regulatory opinion to apply in an assessment of the public benefits resulting from declaration is evidenced through the QCA's review of the DBCT declaration. The QCA considered the same legislative factors that were assessed by the NCC having regard to very similar circumstances. The QCA concluded the public interest is promoted through continued declaration of DBCT, thus satisfying criterion (d). A summary of the contrasting regulatory positions between the NCC and the QCA is presented in the table below.

Table 2 Criterion (d) assessment NCC vs QCA

Factor	NCC (PoN revocation)	QCA (DBCT declaration review)
That access on reasonable terms and conditions as a result of declaration would promote the public interest	Criterion (d) is not satisfied for PoN	Criterion (d) is satisfied for DBCT
The effect of declaration on investment in infrastructure services	Declaration may lessen PNO's incentive to invest due to limiting the returns which might otherwise have been accrued to PNO from such investment On the other hand, declaration may increase the incentives for other efficient investment to be made. This effect is likely to be limited in this case given the magnitude of the Service charge, with or without declaration, is unlikely to impact volumes in dependent markets	There is no evidence to suggest that declaration will impact DBCT Managements incentives to invest in DBCT. However, declaration is likely to promote investment in mining and in the rail network and haulage facilities and so is likely to have a positive impact on the incentives to invest in DBCT
The effect of declaration on investments in markets that depend on access to the service	Investment incentives in dependent markets will be similar with or without declaration of the Service Service charges or uncertainty around how they might change are not sufficient to materially impact investment decisions	Declaration is likely to promote investment in the market for coal tenements Absence of declaration would likely have an adverse impact on efficient investment in coal tenements market
Administrative and compliance costs of declaration	A relatively small number of access disputes are likely to arise or result in arbitration if declaration applies because uncertainty around the particulars of arbitrated access terms will continue to narrow as disputes are arbitrated (where determinations are published) and PNO is likely to be incentivised to have regard to these terms in future negotiations with access seekers to avoid arbitration. Where such disputes result in arbitration, they are likely to be less costly than the Glencore-PNO Arbitration	The administrative and compliance costs incurred by DBCT Management as a result of declaration are not excessive. It is also open for DBCT Management to submit a draft access undertaking to the QCA that includes measures to reduce its compliance costs
Other considerations		
Improved efficiency	The NCC is not satisfied that declaration will promote a material increase in competition in any dependent market and thus improve efficiency and welfare	Declaration would promote the public interest by increasing the incentive to invest in the market for coal tenements. It will otherwise have no adverse impacts on productive or allocative efficiency
Transfer of surplus (incl . Royalties)	Declaration is likely to result in terms and conditions of access (including price) that are more favourable to access seekers and, thus, would redistribute surplus from PNO to users	As declaration would promote a material increase in competition in the market for coal tenements, it will also promote the public interest because of

Factor	NCC (PoN revocation)	QCA (DBCT declaration review)
	of the Service. The wealth transfer effected by declaration will not be sufficient to have any material effect A transfer of surplus from entities operating under one taxation regimes to those operating under a different taxation regime (i.e. royalties) does not, of itself, promote the public interest	the wider economic benefits of promoting investment in that market, including higher coal royalties
Economic growth	The NCC does not consider that declaration will appreciably impact economic growth	If efficient investment in this market is deterred in the absence of declaration, there are not only foregone revenue opportunities, but the community also forgoes the wider economic benefits of maximising the value of the state's coal resources, including increased coal royalties, employment and associated regional development
May prompt other ports to raise their prices (i.e. precedent)	Declaration does not necessarily provide a relevant precedent for other ports	

Source: Synergies, based on the NCC's Preliminary View and the QCA's Draft Recommendation – table 15, p.108.

Once again, we consider that the key factor that has led to these different conclusions is the NCC's benign view of PNO's future pricing levels in an environment unconstrained by the declaration.

4 Objects of Part IIIA

4.1 NCC's preliminary view

The NCC has stated that it has had regard to the objects of Part IIIA when formulating its proposed recommendation to revoke the declaration at the Port of Newcastle.[75]

This is part of the NCC's mandatory consideration:[76]

> Section 44J of the Competition and Consumer Act 2010 (Cth) (the CCA) provides that the Council may recommend to the designated Minister that a declaration be revoked. The Council must have regard to the objects of Part IIIA of the CCA and cannot recommend revocation of a declaration unless it is satisfied that subsection 44F(1) or 44H(4) of the CCA would prevent the declaration of service from being considered, recommended or made (as applicable).

The object of the CCA is, in part, to enhance the welfare of Australians through the promotion of competition. Pursuant to s 44AA of the CCA, the objects of Part IIIA are to:[77]

> (a) promote the economically efficient operation of, and use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
>
> (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

This is based on the premise that competition provides an incentive for firms to improve economic efficiency.

4.2 Synergies' response

The NCC has stated that it has had regard to the objects of Part IIIA when formulating its proposed recommendation to revoke the declaration at the Port of Newcastle.[78] However, how the NCC has applied this mandatory consideration of the Part IIIA objects clause is unclear.

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77 See s 44AA of the CCA.

78 NCC (2018), p.8.

We note that the NCC considered several submissions on how the Council should approach this consideration, including from Glencore, which in part, relied upon our earlier analysis[79] which stepped through our reasoning that showed:

- revocation is inconsistent with the Objects clause (a) as it will introduce distorting price signals for investment and dampen incentives for innovation in the dependent markets and reduce competition in dependent markets; and
- revocation is also inconsistent with Objects clause (b) because it undermines the effectiveness of Part IIIA as a credible regulatory constraint.

The NCC's preliminary view does not directly address how its revocation recommendation aligns with Part IIIA objects other than noting that: (1) there is no provision in the legislation for how this should be conducted, and (2) there is no requirement for it to consider whether there has been a material change in circumstances since the Declaration was made.[80]

Without more detail, Synergies considers that the NCC has had insufficient regard to the Objects clause. Absent the declaration, the effectiveness of Part IIIA is diminished as not only does Part IIIA fail to respond to a situation where a provider of essential bottleneck infrastructure is clearly setting prices above the efficient cost of service provision in a manner that will disincentivise the efficient use of that infrastructure, but the threat of Part IIIA applying for ports generally is considerably weakened.

This also weakens the credibility of Part IIIA for all infrastructure sectors where competition is not deemed to be a sufficient constraint on monopoly behaviour and no other regulatory tool is available or adequate to address issues of access. This is particularly disappointing given the recent ACCC Glencore-PNO arbitration which, irrespective of the final pricing outcome, demonstrates that economic regulation can deliver appropriate constraints on opportunistic, unjustified price increases arising from the exercise of market power.

Acceptance that declaration acts as a credible threat on such behaviour is consistent with the QCA's draft recommendation to continue the DBCT declaration where it noted the following:[81]

[79] Synergies (2018a), pp.93-95.

[80] NCC (2018), p.8.

[81] QCA (2018), p.78.

> In contrast, when considering the future with declaration, the QCA Act's third party access regime provides a credible constraint on DBCT Management's exercise of market power and enables a balanced access negotiation framework.
>
> For instance, declaration under the QCA Act establishes a right for an access seeker, and an obligation on DBCT Management (as the access provider of the service), to negotiate an access agreement. This right extends to any access seeker. The QCA Act envisages that those negotiations will end in the successful conclusion of an access agreement, and if commercial negotiations fail, in arbitration by the QCA.
>
> …
>
> The QCA approves those standard terms, having regard to the factors listed in s. 138(2) of the QCA Act, which, among other things, seek to promote economically efficient outcomes in relation to essential infrastructure services, and protect the legitimate business interests of access provider, the interests of access seekers and access holders, and the public interest.

We therefore maintain revocation is inconsistent with the objects of Part IIIA, as demonstrated in this and earlier submissions, it will undermine efficient use of infrastructure and competition in dependent markets.

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Revocation of declaration of the shipping channel service at the Port of Newcastle

Response to NERA report

Prepared on behalf of Glencore Coal Pty Ltd

April 2019

Synergies Economic Consulting Pty Ltd
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Executive Summary

NERA Economic Consulting (NERA) prepared a brief, high level report for the National Competition Council (NCC) as part of the NCC's consideration of whether declaration of the shipping channel service provided by Port of Newcastle Operations Pty Ltd (PNO) at the Port of Newcastle (Port) would be likely to satisfy the criterion set out in section 44CA(1)(a) of the *Competition and Consumer Act 2010* (Cth) (CCA) in respect of the coal tenements market and to respond to our report dated 4 February 2019 lodged on behalf of Glencore.

On 8 April 2019, the NCC published NERA's report and invited written submissions.[1] Synergies has been instructed by Glencore to provide a report in the time available which responds to the issues raised by NERA.

The primary matter for consideration in determining whether or not there is a loss of competition in the coal tenements market in a future absent declaration is (a) whether PNO will have the incentive to impose significantly higher port charges and (b) the effect of higher port charges in the dependent market for coal tenements.

While we and NERA agree that PNO, as an infrastructure monopolist, has an incentive to maximise profits, NERA places considerable weight on an expectation that PNO will impose future price increases that do not limit coal volumes or distort investment incentives in the coal tenements market. However, we consider that a comprehensive assessment of PNO's incentives to exercise market power must consider the extent to which the profit impact of such lost coal volumes may be compensated by the profit impact of significantly higher prices for the coal volumes that can be expected to continue to be exported, particularly from existing mines. In this regard, we have demonstrated in this submission that, as an infrastructure monopolist, the potential increase in PNO's profitability from increasing prices and accepting the consequential loss in volumes far outweighs the potential increase in PNO's profitability from maintaining or increasing volumes.

Whilst PNO may have no direct incentive to damage volumes or distort investment incentives, this is to be an expected and indeed inevitable consequence of a profit maximising firm pursuing that objective in the absence of any effective pricing constraint. This reflects that the potential for future significant price increases will create an expectation of higher costs and risks for investors in future coal mines, reducing the economic viability of new and prospective mining developments in the Newcastle catchment area, particularly for smaller companies who are less diversified and have

[1] See http://ncc.gov.au/application/consideration-of-possible-recommendation-to-revoke-declaration-of-service-a/4

fewer available pathways to finance. The resulting reduction in the number of potential buyers of tenements will lessen rivalry for the acquisition of tenements, resulting in a lessening of competition in this market.

The critical issue that will affect participants in the tenements market is their perception of the risk that PNO will introduce substantially higher prices, as opposed to whether or not PNO actually intends to do so. The history of this matter, where the Tribunal has found that PNO significantly increased charges without any change in costs or any consultation with users and where such increases have been found by the ACCC to exceed its view of reasonable cost recovery, and where PNO has vigorously argued against any form of regulatory constraint on its charges, has highlighted to users the nature and extent of Port pricing risks they bear (particularly if the declaration is revoked). In this context, the mere existence of a credible scenario where such adverse pricing outcomes are possible creates significant pricing uncertainty and risk that must be borne as an additional, and unavoidable cost by participants in the coal tenements market.

At a more granular level, as explained in this response submission, Synergies:

- disagrees with NERA's view that the likely adverse effect on future coal mining investment resulting from PNO's reputation if it were to impose a significant price increase, will constrain PNO from charging substantially higher prices;
  - we consider that a proper consideration of PNO's incentives requires comparing the effect on PNO's expected profits rather than simply considering the effect on future coal volumes;
  - we demonstrate that the additional revenue from charging a substantially higher price will far outweigh the likely revenue gain from any additional new demand or increased longevity of demand that may eventuate at a much lower price, and so charging a higher price will be consistent with PNO maximising profits;
- disagrees with NERA's view that the coal tenements market is wider than the Newcastle catchment region;
  - NERA's approach in its brief, high level report is not sufficiently rigorous to fully assess this market for competition purposes and, as a consequence, NERA's conclusions on geographic scope are flawed. NERA's view does not take into account the significant regional and country differences that exist between coal tenements in the Hunter Valley and those in the various Asian Pacific countries, making them far less substitutable than NERA presupposes. We reiterate our view that the geographic boundary of the market is the Newcastle catchment region, and note that this is consistent with the

geographic boundary taken by the NCC in its Statement of Preliminary Views ('NCC's preliminary view'). Our approach is consistent with that of the Queensland Competition Authority in its review of the declaration at the Dalrymple Bay Coal Terminal (DBCT), and is also consistent with the approach taken by the Tribunal in the Fortescue matter as well as the Federal Court and High Court in relation to iron ore tenements in that matter;

- disagrees with NERA's argument that increased cost and risk of mining operations would lead to a reduction in the value of tenements but does not mean a lessening of competition;
  - we consider that the higher costs and risks would disproportionately impact smaller producers and more marginal tenements, resulting in smaller producers being less likely to acquire tenements;
  - standard auction theory shows that a reduction in the number of bidders for tenements would lead to lower acquisition prices, and a lessening of competition in the tenements market;
- disagrees with NERA's argument that PNO would be unable to set a price just below the level that would make Newcastle coal producers' operations unviable;
  - given PNO's incentives to charge a substantially higher price that is consistent with maximising profits, we consider the future threat of regulation is not a credible constraint, which the NCC already noted in its preliminary view;
  - NERA's argument that removing the existing regulation (via declaration) on the basis that regulation (via an alternative stated based regulation) would pose a credible threat and act as a constraint on PNO's market power seems circular, if not, somewhat counter-intuitive, particularly if the declaration is revoked. There is no credible basis for NERA's assertion given the absence of any action or indication of an intention to take action from the NSW Government in response to PNO's past price increases.

Contents

1 Introduction

1.1 Background and instructions

Synergies Economic Consulting (Synergies) has been assisting Glencore Coal Pty Ltd (Glencore) in its response to the National Competition Council (NCC)'s consideration of the application submitted by Port of Newcastle Operations Pty Limited (PNO) to the NCC on 2 July 2018 to have the existing declaration of the shipping channel service at the Port of Newcastle revoked.

The NCC released its Statement of Preliminary Views on 19 December 2018 which concluded that criterion (a) and (d) established in s 44CA of the *Competition and Consumer Act 2010* (Cth) (CCA) are not satisfied and therefore indicated that it proposes to recommend to the designated Minister that the declaration be revoked.[2]

Synergies' report of 4 February 2019 disagreed with the NCC's preliminary view on the basis that the NCC had not properly considered the manner in which and extent to which PNO will be incentivised to maximise profits in a future without declaration. As a consequence, we concluded that the NCC had not appropriately assessed the risk associated with the strong likelihood that substantially higher port charges will materially reduce the investment incentives for coal tenement buyers in the Newcastle catchment region and impact adversely on competition in the coal tenements market.

The NCC has since commissioned a brief, high level report by NERA to assist its consideration of whether declaration would be likely to satisfy criterion (a) in respect of the coal tenements market.

NERA provides opinion on three key aspects:

- PNO's incentives to impose significantly higher charges, with particular respect to a "coal tenements" market;
- likely consequences of PNO's market power for competition, particularly in a "coal tenements" market; and
- the reasonableness of Synergies' price analysis of February 2019 which considered the level of price increases PNO would find profitable under various levels of coal prices.

[2] NCC (2018), pp.79-80.

1.2 Report structure

The primary issue for consideration in determining whether or not there is a loss of competition in the coal tenements market in a future absent declaration is (a) whether PNO will have the incentive to impose significantly higher port charges and (b) the effect of higher port charges in the dependent market for coal tenements.

Synergies has adopted the following structure for this report:

- Section 2 – sets out our response to NERA's analysis about PNO's incentives to increase prices in which we demonstrate that NERA has not adequately considered the extent to which PNO's incentives are aimed at maximising profits, and not as they argue, to maximise coal volumes — this distinction has important implications for our respective views about the impact of port charges on resource values of coal tenements and the state of competition in the coal tenements market;
- Section 3 – presents our response to NERA's views about the effect of declaration of competition in the coal tenements market in which we first show that NERA's assessment is based on an inappropriately wide definition of the geographic scope of the coal tenements market. We then show that NERA has not had sufficient regard to the effect that higher port access charges will have on tenement values and therefore to the attractiveness of those tenements for potential purchasers; and
- Section 4 – we respond to NERA's assessment of our earlier pricing analysis in which we maintain our view that the factors identified by NERA do not provide any credible constraint on PNO's ability to adopt considerably higher prices.

2 PNOs' incentives to exercise market power

The NCC has previously established that PNO has market power in respect of coal exports through its shipping channels, which NERA assumes is correct.[3] Synergies endorses this view. We also agree, consistent with our previous reports, with NERA's view that as an infrastructure monopolist, PNO's incentive is to maximise profits.

The main point of disagreement between Synergies and NERA relates to how PNO will most effectively maximise its profits, and our points of disagreement are summarised as follows:

- we consider that PNO's profit maximising incentive will most effectively be achieved through PNO increasing its prices and accepting potential, consequential impacts of reduced volumes;
- NERA, argue, without empirical assessment, that PNO's profit maximising objective will require PNO to encourage further investment in coal mining such that it will act as a constraint on PNO imposing substantial price increases.

While PNO may have no direct incentive to undermine competition in the coal tenements market, this is an inevitable economic consequence of PNO's incentives to target profit maximisation through price increases, for the reasons discussed in Section 3.

2.1 NERA's views on PNO's incentives

NERA accepts that PNO's incentive is to maximise profits from the shipping channel service, and accepts that for a firm with market power, this is generally different to maximising the volume or quantity of shipping utilising the service.[4]

NERA also accepts that PNO is a monopolist in respect of shipping services for existing coal mines in the Newcastle catchment.[5] That means PNO is able to charge a substantially higher price from existing coal mines than those currently imposed. Indeed, as Synergies has previously argued, PNO is able to extract economic rents from existing coal mines where, once investment in the mine is sunk, coal volumes

[3] NCC (2018), para 6.26; NERA (2019), para 7.

[4] NERA (2019), para 11.

[5] NERA (2019), paras 4, 15.

(particularly for inframarginal producers) are relatively insensitive to changes in port charges.[6]

However, in assessing PNO's incentives to exercise market power (that is, to impose a substantially higher price), NERA limits its analysis to a qualitative review of the potential impact on volumes, in particular, volumes from future coal mines[7], rather than on PNO's profits. It claims that:

- in setting prices, PNO will account for the potential reductions in future coal output, including both reductions in current coal volumes as well as from potential future mines; and
- a tenement market that was not competitive would have fewer tenement transactions and so fewer mines developed, reducing coal volumes across the port.[8]

On this basis, NERA concludes that PNO has a positive incentive to encourage coal mine investment. The accepted fact that PNO increased its Port charges by up to 60% in 2015, at a time when coal prices had fallen dramatically and some coal mines were operating with negative cash margins, does not support the view that PNO's pricing decision was based on incentivising coal mine investment.[9]

2.2 Synergies' response

We agree with NERA's view that, in setting prices, PNO will take into account the potential reductions in future coal output, including both reductions in current coal volumes as well as reductions from potential future mines. However, we consider that the result of such assessment will be quite different from that suggested by NERA.

NERA relies on the Hilmer Report to argue that where the owner of an essential facility is not vertically integrated, it will usually have little incentive to deny access because maximising competition in vertically related markets maximises its own profits.[10] This,

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6 Synergies (2019), p.35.

7 NERA (2019), paras 15, 16, 40.

8 NERA (2019), para 10.

9 Glencore's 2015 application for declaration noted that the Port of Newcastle Ops published price increases and changes to the charging regime effective from 1 January 2015 resulted in an increase in prices for coal vessels of approximately 60% for Handymax, Panamax and Post Panamax vessels and 26% for Capesize vessels. As a direct result of this increase, Glencore estimated that the Port of Newcastle Op's revenue from navigation charges would increase by approximately 40%, or at least $20m per year compared to the 2012/13 Annual Report for the Port of Newcastle. See Glencore (2015), Application for a declaration recommendation in relation to the Port of Newcastle, May 2015, p.14.

10 NERA (2019), para 9.

in our view, overlooks an essential point in the context of the current debate— that PNO has no incentive to avoid distorting markets where it profits from doing so.

A comprehensive assessment of PNO's incentives to exercise market power must consider the extent to which the profit impact of such lost coal volumes may be compensated by the profit impact of higher prices for the coal volumes that can be expected to continue to be exported particularly from existing mines. In other words, it is necessary to assess whether it is in PNO's interest to charge a higher price from existing coal mines notwithstanding that this would likely deter volume, including that resulting from investment in future coal mines, compared to PNO charging a lower price that would encourage continued volumes from existing mines as well as future mine development. This is particularly important where, as accepted by the NCC, demand for the channel service is known to be relatively price inelastic.[11]

In this regard, Synergies' previous analysis has demonstrated that PNO's profits would continue to increase even in the face of increases in port charges by $12.50/t, notwithstanding that this would lead to a loss in volume, with potential volume losses increasing as coal prices decrease. We have previously assessed that, at the 5-year average coal price of AU$95/t, coal export volumes could be expected to fall to 153mtpa from the current volume of 159mtpa[12] (note, we respond to NERA's assessment of this analysis in Section 4). Wood Mackenzie's most recent forecast indicates an improved price outlook compared to 2018, with Newcastle thermal coal prices forecast to range from US$78-97/t or AU$111-139/t (2019$s) over the next ten years,[13] indicating that there may be even less impact on demand over this timeframe from a $12.50/t price increase.

A simple calculation shows that PNO could potentially earn revenue[14] of about $1,995 million per annum from increasing port charges by $12.50 per tonne (that is a port charge of $13.03 per tonne applied to a volume estimate of 153 mtpa), which dwarfs the revenue of:

- about $84 million per annum, if PNO were to charge its current price to existing coal volumes (that is, $0.53 per tonne to 159mtpa throughput realised in 2017[15]); or

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11 NCC (2018), p.25.

12 Synergies (2019), p.20.

13 Wood Mackenzie forecast for 'FOB Newcastle @ 6,000 kcal/kg NAR, market', April 2019; Synergies conversion from USD to AUD based on current exchange rate of 0.70. This compares to Wood Mackenzie's August 2018 forecast for that same coal type, which ranged from US$72-86 over a ten year timeframe.

14 Since costs of providing shipping services are largely fixed, we have focused on revenues rather than profits.

15 NCC (2018), para 6.31

- about $113 million per annum if PNO were to charge its current price to the highest total coal export volume expected by Wood Mackenzie over the current declaration period, comprising coal volumes from existing as well as future coal mines over that period (that is, $0.53 per tonne to 214 mtpa throughput[16]).

Assuming as the discount factor the WACC the ACCC determined in the arbitration determination, at current prices and maximum foreseeable volumes, PNO will need to earn revenue for an additional approximate 27 years[17] in order to match the revenue from a $12.50 per tonne price increase applied for a single year.

This simple calculation confirms that the incentives for PNO to charge a substantially higher price are strong even knowing that this is likely to result in some loss of current volumes as well as have the effect of discouraging investment in future coal mines (or demand from new coal mines) and accelerating the expected pace of decline in future coal exports. As a result, it is insufficient to simply assume, as NERA has done, that PNO's commercial incentive for coal exports at a higher volume and for a longer period will outweigh the commercial benefit that it would receive from price increases.

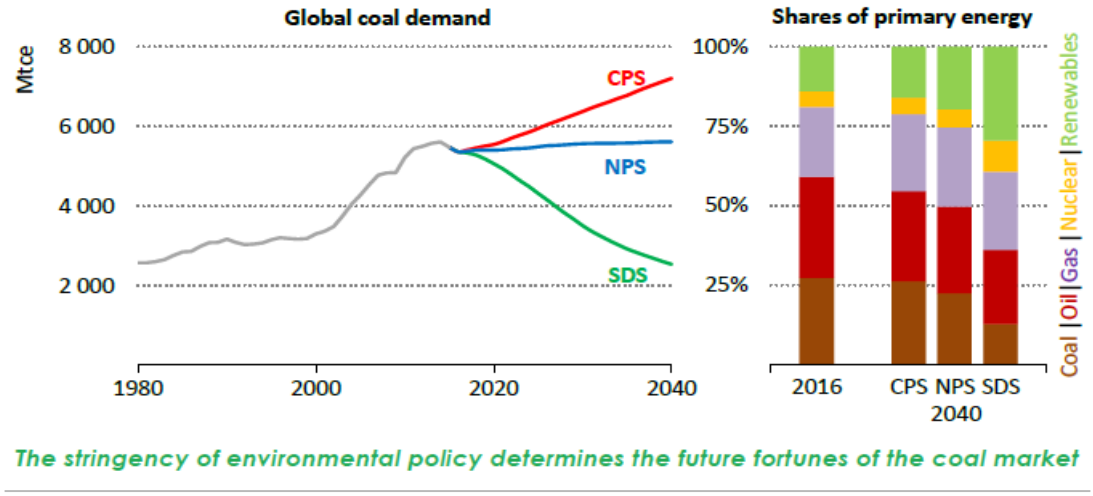
Therefore, we disagree with NERA that competition for future coal mines will effectively constrain PNO from imposing significantly higher charges. Rather, our quantitative analysis demonstrates that PNO will be strongly incentivised to charge a significantly higher price to existing coal mines and accept the consequential loss in volume.

This is particularly the case given the significant uncertainty in future demand. The International Energy Agency, for example, has forecast a range of long-term scenarios of world coal demand up to 2040. These scenarios are shown in the figure below and the projected outcomes vary widely.

[16] NCC (2018), para 6.31; Synergies (August 2018), pp. 22-23.

[17] The ACCC determined a real post-tax WACC of 3.93 per cent (ACCC, Final Determination: Statement of Reasons, Access dispute between Glencore Coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd, 18 September 2018, p. 165. Noting that at the end of the first year the revenue from increasing port charges by $12.50 per tonne would be $1,995 million compared to the maximum foreseeable revenue of $113 million at current prices, we calculated the additional years it would take for the present value of an ordinary annuity of $113 million per year to equal the difference between $1,995 million and $113 million, which produced 27.4 years.

Figure 1 Global coal demand



Note: CPS = Current Policies Scenario; NPS = New Policies Scenario; SDS = Sustainable Development Scenario.

Source: International Energy Agency (2017), World Energy Outlook 2017, p.208

Briefly, under its current policies scenario (which is based on measures already in force), global coal demand is projected to expand rapidly. Under its new policies scenario, there is a projected dampening of growth prospects over the next 25 years. Under the sustainable development scenario, goals of this scenario (which include significant reductions in air pollution) are not compatible with unabated coal use, and thus, global coal demand is expected to decline over the outlook period.[18]

The uncertainty of the future demand outlook for PNO is reflected in Wood Mackenzie's most recent forecast for Newcastle thermal coal exports,[19] which anticipates that:

- under Wood Mackenzie's base case price forecast, total exports of thermal coal from Newcastle will decline from 136.5mt in 2019 to 127.0mt in 2030;
- however under Wood Mackenzie's high scenario price forecast, total exports of thermal coal from Newcastle decline more substantially to 114.3mt by 2030 on the basis that the higher prices trigger the development of large thermal coal mines in Queensland, displacing new Hunter Valley developments.

In each case, Wood Mackenzie's total coal exports include volumes anticipated from new Hunter Valley mining developments, demonstrating that new investment remains important to the longevity of the Hunter Valley coal industry.

[18] International Energy Agency (2017), World Energy Outlook 2017, p.208.

[19] Wood Mackenzie, April 2019

Given this uncertainty, PNO may legitimately consider that its commercial interests are better promoted by earning higher profits on the existing, more certain, volumes, and foregoing future profits on the uncertain volume associated with new mine developments.

In any case, if volume impacts became significant, it would be possible for PNO to react by changing its pricing arrangements to limit the potential for a reduction in volumes. For example, it could uniformly reduce prices and/or provide long term commitments on price, if it considered that this was likely to promote throughput. Alternately, it could introduce price discrimination in order to encourage new mines, for example by entering into long term agreements with a producer in a similar manner as will occur with Glencore upon finalisation of the current arbitration, or by offering a simple rebate on shipping charges to selected coal mines based on demonstrated throughput. Notwithstanding the NCC's preliminary view that PNO is unable to price discriminate, we consider that PNO has the ability and incentive to price discriminate, and in considering such actions, is unlikely to be concerned about inducing distortions in competition amongst Hunter Valley coal producers.[20]

We note that the NCC's preliminary view that PNO is unable to price discriminate between mines, primarily reflected that PNO's customers are usually the ship owners and agents, not individual mines and that PNO will not have sufficient visibility over the source of coal loaded onto most vessels to be able to set charges so as to expropriate profits from individual mine investments.[21]

However, given PNO's strong commercial incentives to exercise market power to increase profits absent declaration, it may engage in third degree price discrimination and divide the coal market on the basis of signals that are observable and verifiable (such as the age of mine, JORC reserve of a mine[22] or location of a tenement). Although PNO may apply a uniform price to ship owners and agents, it could implement a rebate mechanism associated with the observable and verifiable signals to price discriminate

[20] Indeed, the ACCC arbitration outcome will induce a distortion amongst coal producers in the Hunter Valley if that arbitration outcome is not available to all coal producers.

[21] NCC, December 2018, para 6.117.

[22] The Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves ('the JORC Code') is a professional code of practice that sets minimum standards for Public Reporting of minerals Exploration Results, Mineral Resources and Ore Reserves. The JORC Code provides a mandatory system for the classification of minerals Exploration Results, Mineral Resources and Ore Reserves according to the levels of confidence in geological knowledge and technical and economic considerations in Public Reports. Public Reports prepared in accordance with the JORC Code are reports prepared for the purpose of informing investors or potential investors and their advisors. See http://www.jorc.org/.

between existing mines and new mines, and between tenements being developed, which may distort competition in the tenements market or even in the coal market.

3 Effect of declaration on competition in coal tenements market

NERA provides an opinion on the market definition for the tenements market and the effect that revocation of the declaration may have on competition in that market. NERA adopts a much wider market definition (being at least Australia wide and potentially as broad as the Asia Pacific) than that taken by the NCC in its preliminary view where the geographic dimension of the tenements market was limited to the Newcastle catchment area. NERA concludes that PNO does not have an interest in undermining development in new mines, but even if it did, it is not 'convinced' that there would necessarily be a material reduction in competition in the tenements market.[23]

In contrast, we consider that the maximum geographical scope of the tenements market is confined to the Newcastle catchment area, and that substantial increases in port charges will increase the cost and risk of coal production in this area resulting in a reduction in the attractiveness of future development. As we have previously highlighted, similar to investors in the residential housing market, prospective bidders for coal tenements are likely to have less interest in purchasing tenement rights when they assess that their expected returns will be materially lower in the face of rising costs which cannot be mitigated. This in turn most likely means a material loss in competition in the coal tenements markets and less efficient outcomes for existing tenement holders where coal resource values are reduced.[24]

Hence, the most significant impact of PNO's profit maximisation will fall on the tenements market, with higher costs and risks of mine development leading to a smaller pool of bidders for available tenements resulting in a material lessening of competition in this market.

3.1 Market definition

3.1.1 NERA's views

While NERA accepts that each tenement is specific to one location, it argues that the market for coal tenements is likely to encompass a geography that is wider than the Newcastle catchment, at least as wide as Australia, and potentially as broad as the Asia Pacific.[25] This is because a tenement's ultimate value is derived from its sole use as an

[23] NERA (2019), para 29.

[24] Synergies (February 2019), p.8.

[25] NERA (2019), para 24.

input into the production of supply for the coal export market. NERA further argues that because the coal export market is most likely global, it 'does not make sense' to consider the tenements market to be limited to the Newcastle catchment.[26]

3.1.2 Synergies' response

We do not agree with NERA's approach nor its conclusions on the market definition for the coal tenements market. In our view:

- NERA does not consider aspects of a market definition for tenements which is consistent with accepted competition practice;
- when assessing the geographic scope of the market, NERA only considers options available to tenement buyers, and does not adequately account for the options available to tenement sellers, who as we have previously established in earlier submissions have no option but to sell to a buyer reliant on export through the Port of Newcastle; and
- by establishing a market definition that encompasses the Asia-Pacific region, NERA's definition is not consistent with previous regulatory decisions relating to tenement markets.

We further note that NERA's views are not consistent with the NCC's Preliminary View which has taken the geographic dimension of the tenements markets to be the Newcastle catchment area.[27]

SSNIP analysis to inform market definition

NERA's approach to considering the geographic dimension of the tenements market does not appear to adopt an analytical approach that is consistent with accepted competition analysis.

In our 8 August 2018 report, we applied a purposive approach in defining the market for coal tenements connected to the Port of Newcastle, where the purpose of the market definition is to identify the area in which market power could potentially be exercised.

The most common analytical tool for assessing the scope of markets is the "hypothetical monopolist" small but significant non-transitory increase in price (SSNIP) test. This test has been commonly applied in Australia and other jurisdictions. At the heart of this test is the scope for substitution. The test starts by considering the relevant product being

[26] NERA (2019), para 24.

[27] NCC (2018), p.52, para 6.146.

provided, and assuming a hypothetical monopolist for that product or region. The question then asked is whether the hypothetical monopolist could profitably increase prices by a small but significant and non-transitory amount, assuming the terms of sale of other products are held constant. If the answer is yes, the market is no wider, but if the answer is no then other products or regions are added to the definition until a profitable price increase could occur.

NERA does not appear to perform such an analysis, but asserts that, as potential investors in tenements are not linked to a specific location (or to coal mining at all), the geographic scope of the tenements market is broad, and could be as broad as the geographic scope of the dependent market for coal exports.

NERA's view about the substitutability of coal tenements in different regions makes no allowance for the fact that other parts of the Asia Pacific region have very different characteristics to those in the Newcastle catchment. Indonesian tenements, for example, produce low energy coal in a politically unstable, developing nation. Chinese tenements also produce a significantly different coal type, with investment opportunities limited by a restricted foreign investment policy. As a result, the investors in the various different countries are expected to be markedly different, such that it is unlikely to be the case that many potential buyers of tenements in the Newcastle catchment would also seek to invest in other Asia Pacific countries. In particular, junior Australian miners/explorers may be unlikely to have the resources or mandate to participate in these other markets.

Furthermore, in our 8 August 2018 report, we conducted a detailed assessment of the geographic limitations of the coal tenements sector between different regions within Australia. We noted that even within Australia, there are significant differences between coal types and quality (i.e. thermal coal is predominately mined in NSW while coking coal is predominantly mined in Queensland), and the extent of access to, and cost of, logistics infrastructure (noting that the most substantial thermal coal deposits in Queensland are located in the Surat and Galilee basins, which have limited, if any, existing available transport infrastructure).[28] These factors will influence the extent to which buyers will see tenements in different regions as direct substitutes.

Further, putting aside the question of the extent to which tenements in different regions are substitutes from a buyer's perspective, NERA has not given any consideration to the limited options available to tenement sellers, who as we have previously established in earlier submissions have no option but to sell to a buyer reliant on export through the Port of Newcastle.

[28] Synergies (August 2018), p.44.

For all of these reasons, we consider this analysis by NERA to be inadequate and not sufficiently rigorous to fully assess this market for competition purposes. As a consequence, NERA's conclusions on geographic scope are flawed.

Our previous submissions on the geographic dimension of the tenements market presented evidence to support the view that the dependent market was confined to the Newcastle catchment level (at its broadest level), and that it is likely that it comprises smaller regional markets in the areas of the Hunter Valley/Western Basins and the Gunnedah Basin. We reached this conclusion on the basis of assessing the location of customers, sales and the geographic boundaries that limit trade.[29]

A key factor in our consideration of the geographic boundaries of this market was our application of a Hypothetical Monopsony Test – this is an application of the logic in the standard Hypothetical Monopolist Test, but assessing market power from the perspective of a monopsony. This means that seller substitution takes the place of buyer substitution in the standard Hypothetical Monopolist Test, while other buyers take the place of substitution on the supply side. In this instance, we defined the hypothetical monopsonist as a buyer of tenements who is linked to the Port of Newcastle export supply chain. Linking the hypothetical monopsonist to the Port of Newcastle supply chain is appropriate, given the purpose of the assessment is to consider the impact that declaration of the Port of Newcastle shipping channel will have on competition in dependent markets.

On the basis that sellers have no option but to sell to a buyer linked to supply through the Port of Newcastle, it follows that a monopsony buyer of tenements linked to the Port of Newcastle could profitably reduce the prices paid for those tenements, relative to the outcome of a competitive market on the buyer side.

Tribunal decision in FMG Decision

NERA's proposition that the geographic scope of the tenements market is at least as wide as Australia and potentially as broad as the Asia Pacific is also not supported by regulatory precedent.

As the Tribunal stated in its consideration of the Fortescue Metals Group (FMG) matter[30]:

> Most of the experts accept that the market for tenements is at least Pilbara-wide. Dr Fitzgerald supported a global market and pointed to the prevalence of international investors in joint venture arrangements. By the same token, many investors in

[29] Synergies (August 2018), p.40 and Synergies (October 2018), p.9.

[30] Australian Competition Tribunal (2010), Fortescue Metals Group Limited [2010] ACompT 2, 30 June 2010, p.258

> tenements only participate in Australia. Further, as Mr Houston pointed out, differences in the scale and quality of resources, and different regulatory requirements and business environments, mean that businesses most likely characterise their operations on a region-by-region basis, rather than a global basis. We believe that the market is most likely Pilbara wide, and not global for the reasons given by Mr Houston.

Our definition of the geographic market for tenements is consistent with the region by region approach adopted as the most likely geographic market by the Tribunal.

3.2 Impact on competition in the tenements market

3.2.1 NERA's views

NERA examines the effect of revocation on its defined market for coal tenements and reaches the following conclusions:

- firstly, NERA's characterisation of the current process for allocating tenement rights in NSW would seemingly imply that the scope for competition is very limited;
- nevertheless, NERA considers that PNO would not exercise market power in a way that would reduce the attractiveness of mining in the Newcastle catchment, and hence reduce competition in the tenements market;
- even if PNO was to set prices in a way that did reduce the attractiveness of future mining in the Newcastle catchment, NERA considers there would not necessarily be a material reduction in competition in the tenements market; and
- finally, NERA concludes that price reductions in the tenements market are not an indication of a lessening of competition but more a reflection of the lower value of the mining project.

3.2.2 Synergies' response

Scope for competition in the tenements market

NERA describes the allocation process for tenement rights in NSW as one that is essentially administrative in nature; such that an exploration licence is most commonly awarded administratively (except in the case of strategic releases). It also notes that trading in tenements, while possible, is rare.

This would seemingly imply that there is limited potential for competition in the coal tenements market. Synergies does not agree with this inference, based on our

understanding of the process for allocating tenement rights. There are two frameworks (1) an operational allocation framework and (2) a strategic release framework:

- under the operational allocation framework, an existing tenement holder may seek an operational allocation, however a market interest test applies. This test for valid interest applies through an expression of interest process that includes a Gazettal notice. If no market interest is identified, then an allocation may be awarded to the applicant, subject to meeting other essential requirements. Where valid market interest is identified, details of the application will be referred to the 'Advisory Body for Strategic Release' to consider the most appropriate process;[31] and
- under the strategic release framework, applicants that meet the prequalification criteria will progress into an auction and be required to submit a work program and a bid price. A reserve price, based on recovery of the state's costs in assessing and releasing the area, will be set for the auction. The reserve price will not be disclosed at this point. If the reserve price is met, the application with the highest bid will be considered for the granting of the prospecting title. If the reserve price is not met, a second auction will take place where the reserve price is disclosed to all pre-qualified bidders.[32]

As we noted in our 8 August 2018 report, while the NSW Government is yet to release new exploration permits under this process, it is anticipated that the market may evolve similarly to that in Queensland, where the Queensland Government periodically releases exploration areas for tender. A competitive process is held for the allocation of those permits, with allocations based on established criteria including the bidder's technical credibility and planned exploration program.[33] Therefore, we consider that there is considerable scope for future improved competition in the coal tenements market as a result of the NSW Government's recent reforms.

Impact of increasing port charges in tenements market

As explained in section 2, PNO will have a strong incentive to exercise market power by substantially increasing port charges even if that has the effect of discouraging investment in future coal mines (or demand from new coal mines). Indeed, as Synergies

[31] NSW Planning and Environment (2017), Guidelines for coal exploration licence applications for operational allocation purposes, November 2017, v1.1.

[32] NSW Planning and Environment (2017), Strategic Release Framework for Coal and Petroleum Exploration Fact Sheet, December 2017.

[33] See the Queensland Government's Mineral and Coal exploration guide at https://www.dnrme.qld.gov.au/__data/assets/pdf_file/0017/241190/mineral-coal-exploration-guideline.pdf

has previously demonstrated, PNO is able to extract economic rents from existing coal mines where, once investment in the mine is sunk (whether in the form of irreversible investments in coal mining facilities or take or pay commitments to infrastructure), coal volumes (particularly for inframarginal producers) are relatively insensitive to changes in port charges. As explained in our 4 February 2019 report, this effectively results in a transfer of resource rents from the sellers of coal tenements and ultimately the State of NSW when it sells new coal tenements (from lower tenement values) to PNO shareholders (as a result of higher service charges).[34]

It is relevant to understand how the expectation of a substantial increase in the PNO charge would lessen competition in the tenements market and lower the value of coal tenements, all other things remaining unchanged.

The expectation that PNO has an ability and an incentive to impose significantly higher charges would increase the expected cost and risk of operating coal mines and lower the expected returns of coal mining projects in the Newcastle catchment, all other things remaining unchanged. NERA accepts this argument as it notes that 'because the PNO charge is a cost to a coal miner, an increase in the PNO charge would lower the expected net present value of a mining project to which a tenement relates'.[35]

Lower anticipated returns will, in and of themselves, be expected to reduce the value of tenements. However, the higher expected costs and risks of operating coal mines will also be likely to reduce the number of parties willing to bid on tenements, with a particular impact on smaller companies or on companies with a lower risk appetite. An expected reduction in the number of potential buyers of tenements will lessen rivalry for the acquisition of tenements, which we consider will further lower the value of tenements.

However, NERA disagrees with this outcome, stating that 'the lower value of the tenement would reflect the lower value of the mining project, not a loss of competition in the tenement market'.[36] In support of that opinion, NERA invokes auction theory to argue that the withdrawal of relatively high cost miners would not make much difference to the selling prices. NERA states that:

> Therefore the withdrawal of the relatively high cost miners (who because of their high costs would have relatively lower valuations of the tenements) would not make much

[34] Synergies (2019), pp.32-33.

[35] NERA (2019), para 30.

[36] NERA (2019), para 30.

> difference to the selling prices, unless those withdrawing bidders happened to have among the highest valuations. This seems unlikely as presumably the bidders with the lowest valuations would drop out first.[37]

NERA's position appears to assume that the increase in costs and risks resulting from increasing port charges applies equally across all miners, and that a reduction in the anticipated returns from a mine will simply result in the highest cost miners withdrawing from the process. However, as we have previously observed,[38] uncertainty over future port charges is likely to lead to reduced investor confidence and commitment to new coal mining projects in the Newcastle catchment, meaning that some pathways to securing finance are no longer available or only available at significantly higher cost. These consequences will particularly impact smaller and more marginal coal producers, who have fewer available pathways to finance and are less well placed to withstand the consequences of a tighter investment environment.

Therefore, where there are no credible constraints on PNO's ability to increase Port prices, the resulting increased investment uncertainty is likely to have a greater cost impact on smaller miners than on larger, more diversified companies. In other words, this Port pricing risk may materially contribute to some bidders becoming relatively higher cost miners.

Nonetheless, even if the miners that are discouraged from bidding for tenements were relatively high cost miners regardless of the impact of Port pricing risk, we are able to show that the withdrawal of these bidders can still result in a lessening of competition in the tenements market.

NERA's auction theory argument assumes that the bidder values are commonly known for everyone. However, in reality, their values are their own private information. Indeed, it is a standard result in auction theory that, in private value auctions, a reduction in the number of bidders would reduce the expected sale price of the auctioned item due to a lessening of competition.

For instance, a Productivity Commission (PC) report into the role of auctions notes:

> The auction price is affected by the strength of bidding competition, which depends on the number of bidders and the profile of bidders' valuations … As the number of bidders increases, bidders generally need to bid closer to their own valuations to win an auction. Consider the situation in which a particular bidder has the highest valuation; a new competitor may have a valuation higher than those of the other

[37] NERA (2019), para 37.

[38] Synergies (August 2018), p.57.

> existing bidders. The entry of this new competitor does not affect the outcome that the highest-valuation bidder wins; however, it may increase the second highest valuation among bidders and therefore the required payment for the winner. Consequently, the price is expected to rise with an increased number of bidders.[39]

Furthermore, when entry is deterred due to an exogenous effect (where lower value bidders do not participate), the expected sale price from an auction would be lower as compared to the benchmark where all potential bidders are expected to participate. This is shown as a model in the summary box below. The effect of excluding lower value bidders from the auction is less competition, and reduced revenue to the auctioneer.

Box 1 Economic model of auction price setting

As an example, consider 4 bidders who has independently and uniformly distributed private valuations over [0,1] for the object to be sold. Consider two scenarios, in the first scenario all bidders participate in a First-Price Auction, and in the other scenario only the ones that have values greater than 0.5 will participate in the auction. The first scenario is well known and it will bring an expected revenue of 0.6 to the auctioneer (i.e. expected second-highest value, see Auction Theory book by Vijay Krishna.) In the second scenario, the expected selling price will be

$$\left(\left(\frac{1}{2}\right)^4 + 4\left(\frac{1}{2}\right)^4\right) \times 0 + 6 \times \left(\frac{1}{2}\right)^4 \times \frac{2}{3} + 6 \times \left(\frac{1}{2}\right)^4 \times \frac{3}{4} + \left(\frac{1}{2}\right)^4 \times \frac{4}{5} = \frac{93}{160} \simeq 0.581$$

(where the first term represents the case where there are 0 or 1 bidders bidding; the second, third and fourth terms represent the cases where there are 2, 3 and 4 bidders bidding respectively) which is less than 0.6. Since revenue equivalence theorem applies in this model, this would be true for all other standard auctions (where the highest bidder wins) including second-price auctions.

More generally, the following is true.

Proposition 1: Suppose there are n bidders whose private values are independently and identically distributed over [a,b]. The revenue in any standard auction is strictly higher than in a standard auction where bidders whose values are smaller than some c ϵ [a,b] cannot participate in the auction.

Source: Synergies analysis

The PC report further notes:

> Despite the exclusion of low-valuation bidders, the auction outcome may remain efficient because only high-valuation bidders have any prospect of winning. However, the revenue from auction is expected to fall with a reduced number of bidders. By containing the costs of entry and bidding, the seller can attract bidders, and thereby strengthen bidding competition and increase potential revenue.[40]

[39] Chan, C., Laplagne, P. and Appels, D. (2003). The Role of Auctions in Allocating Public Resources, Productivity Commission Staff Research Paper, Productivity Commission, pp. 18-19.

[40] Chan, C., Laplagne, P. and Appels, D. (2003), p. 40.

Therefore, NERA's argument that price reductions in the tenements market are not an indication of a lessening of competition is not sound.

NERA also argues that a competitive tenements market is one in which the tenements are allocated to the most efficient miners/explorers. NERA states that 'even if the value of tenements was reduced because of PNO's pricing, the tenements are likely to be allocated to the most efficient miners/explorers'.[41]

As we noted above, the impact of PNO's pricing risk will not present evenly for all miners, with smaller producers more likely to be adversely affected. The presence or absence of smaller coal producers is particularly significant, as it tends to be those smaller companies who carry out the more marginal coal projects which do not attract the attention of the major producers, because for example they do not provide sufficient scale for major producers to generate an acceptable return.

The importance of smaller producers and more marginal coal projects to the investment pipeline in the Newcastle catchment area is clearly evident from the list identified by PNO in its application for revocation of July 2018, of proposals to develop coal mines in the Newcastle catchment area. As we have previously shown, these development proposals are largely either from new coal producers, or in the Gunnedah Basin, which is generally accepted to be a more marginal development area given the significantly higher transport cost to port.[42] In these circumstances, a reduction in the number of bidders for a tenement, for example resulting from the exclusion of such smaller miners from the bidding process, may result in the development of some tenements simply not being progressed.

The emerging importance of junior miners is evident in the Queensland coal sector, where it is the junior miners who are promoting innovative, low cost solutions. Aurizon Network's customer base in the Central Queensland Coal Network are seeking alternative, less capital-intensive solutions, to generate additional coal production. Larger mining companies are seeking operational changes to increase capacity with minimal capital outlay, and junior miners are seeking low capital solutions to allow them to commence railing and subsequently start generating cashflow.[43]

Moreover, even if NERA's economic argument were correct, it is not a correct interpretation of the 'promote a material increase in competition' test under section 44CA(1)(a) of the CCA.

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41 NERA (2019), para 39.

42 Synergies (August 2018), p.58.

43 Aurizon Network (2018), Response to QCA UT5 Draft Decision, March 2018, p.9.

For instance, the NCC stated in its Declaration of Services guide:

> 3.30 There are a number of ways the use of market power in the provision of the service for which declaration is sought by a service provider may adversely affect competition in a dependent market. For example:
>
> - a service provider with a vertically related affiliate may engage in behaviour designed to leverage its market power into a dependent market to advantage the competitive position of its affiliate
> - where a service provider charges monopoly prices for the provision of the service, those monopoly prices may suppress demand or restrict entry or participation in a dependent market, and/or
> - explicit or implicit price collusion in a dependent market may be facilitated by the use of a service provider's market power. For example a service provider's actions may prevent new market entry that would lead to the breakdown of a collusive arrangement or understanding or a service provider's market power might be used to 'discipline' a market participant that sought to operate independently.[44]

The second dot point is directly relevant to this matter. As explained above, PNO will have a strong incentive to charge a substantially higher price in respect of shipping services for existing coal mines in the Newcastle catchment. The risk of a substantial increase in the PNO charges would discourage some miners from participating in the coal tenements market, particularly impacting on smaller miners or more marginal tenements, which would lessen competition and lower the value of coal tenements, all other things remaining unchanged.

In a future absent declaration, the resulting consequences of reduced attractiveness of investments in the coal tenement market and the consequential impact of a material lessening of competition could negatively compound an already 'grim' outlook for Newcastle thermal coal exports based on analysis from the Institute for Energy Economics and Financial Analysis. With an expectation of a long term contraction in global demand for coal and rising stranded asset risks, the Institute identifies a number of key issues facing the NSW thermal coal industry, including 'major investors and financial institutions are turning away from coal at an accelerating rate…'.[45] Any reduced incentives to invest in coal tenements in the Newcastle catchment is expected to

[44] National Competition Council. (April 2018), Declaration of Services, A guide to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth), version 6, pp. 33-34, para 3.30.

[45] Institute for Energy Economics and Financial Analysis (2018), New South Wales Thermal Coal Exports Face Permanent Decline – Grim Outlook Prompts the Need for a Planned Transition, November 2018, p.3.

seriously undermine an already challenging outlook for miners, and particularly for smaller miners, who are less able to diversify and manage their risk exposure.

4 Synergies price analysis

NERA disputes our earlier price analysis contained in our 4 February 2019 report. We presented evidence of the potential magnitude of the profit maximising price that could theoretically prevail in a future absent declaration which showed that even under a low coal price assumption, port charges could increase by around $12.50/t before profits would start to decline.[46] While we did not intend to suggest that PNO would levy charges at this price,[47] we considered it was important to base the analysis of the potential harm resulting from revocation of the declaration on a clear understanding of the range of potential pricing outcomes that reflect PNO's commercial objectives.

NERA disagrees with our methodology and argues that such a pricing strategy would not be plausible for PNO and that the profit maximising price is likely to be lower than this level. They further argue that our approach does not place any weight on the threat of regulation.

We disagree with NERA's position, for the reasons outlined below.

4.1 Profit maximising price

4.1.1 NERA's views

NERA does not agree with the methodology we had used to estimate the monopoly (without declaration) prices that PNO could potentially set.

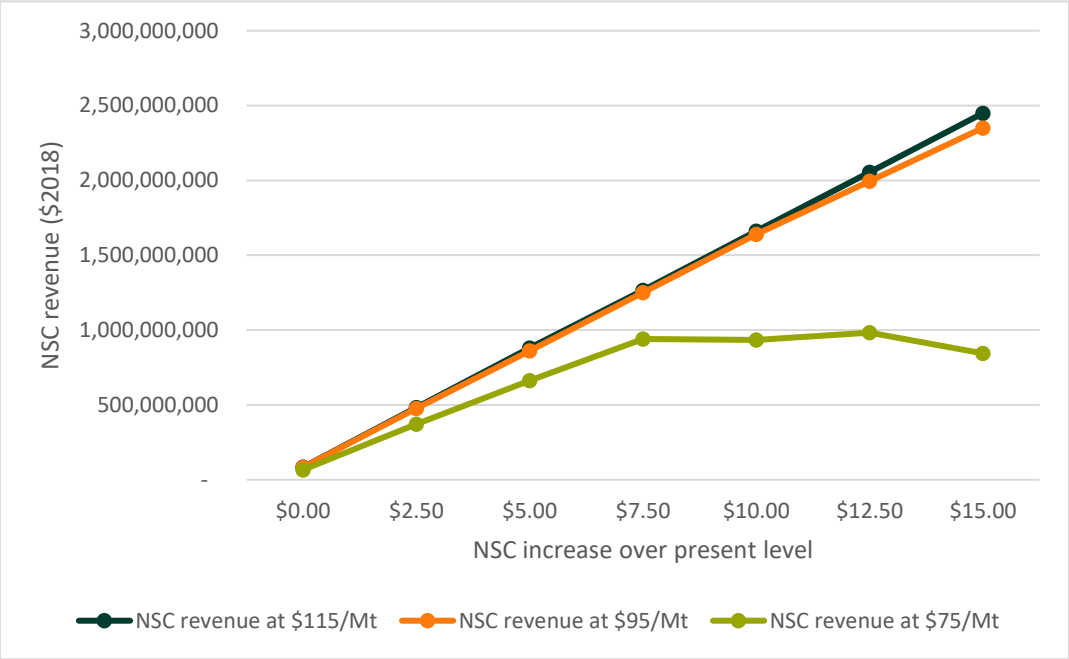
By way of summary, to obtain an estimate of the indicative magnitude of a profit maximising price, we had undertaken a high level assessment based on the Wood Mackenzie data utilised in our previous submissions. The assumed incremental increase in the Navigation Service Charge (NSC) had been added to the total cash cost for each mine as measured by Wood Mackenzie. This allowed us to ascertain the threshold coal price at which a given coal operation is expected to be priced out of the market. We then added up the total coal volume (across all producers) that is expected to be produced at that price, in order to determine the relevant quantity for the revenue calculation. The estimated revenue from the NSC is then derived as this expected quantity multiplied by the total NSC (the base NSC of $0.53 plus the modelled increase). In our view, this analysis was conservative since coal logistics relating costs (rail access, rail haulage and export coal terminal services) are typically contracted under long term take or pay terms, meaning these costs are effectively sunk, notwithstanding their inclusion in cash costs).

[46] Synergies (2019), p.20.

[47] Synergies (2019), p.20.

Figure 2 (re-produced from our 4 February 2019 report) shows that the point at which each of the identified NSC increases ranging between a $2.50/t increase up to a $15/t increase was expected to lead to an increase in revenue (which, for PNO, broadly equates to profit given an environment of mostly fixed costs), at prevailing coal prices of AU$75/t, AU$95t, and at AU$115/t. These price scenarios are conservative, compared with Wood Mackenzie's most recent forecast of the Newcastle thermal coal price which ranges from US$78-97/t or AU$111-139/t (2019$s) over the next ten years.

Figure 2 Profit maximising scenarios under various coal prices and Navigation Service Charge (NSC) increases



Source: Synergies

NERA argues that this pricing approach is not rational and is inconsistent with PNO's incentives as it would cause a reputation to develop that PNO is likely to appropriate revenues accrued by miners to recover sunk costs, which would deter future mining investments.

Instead, it argues that a profit maximising price is likely to be lower than the level indicated in our analysis. NERA indicates that a more plausible pricing strategy for PNO is to price up to the gap between the expected export coal price and the *total* costs of Newcastle coal producers, including unrecovered sunk costs.

4.1.2 Synergies' response

NERA does not quantify nor provide supporting analysis to substantiate its claim that the profit maximising point is likely to be lower than the indicative level which Synergies

had earlier presented. Further, while NERA argues that PNO would more plausibly price up to the gap between the expected export coal price and the *total* costs of Newcastle coal producers, including unrecovered sunk costs, standard economic theory does not support the view that a profit maximising infrastructure monopolist would adopt this approach. NERA's basis for this position is its view that PNO's commercial incentive for coal exports at a higher volume and for a longer period will outweigh the commercial benefit that it would receive from price increases, which we demonstrated in Section 2 is not supported by the available data.

In any case, the critical issue that will affect participants in the tenements market is their perception of the risk that PNO will introduce substantially higher prices, as opposed to whether or not PNO actually intends to do so. The history of this matter, where the Tribunal has found that PNO significantly increased charges without any change in costs or any consultation with users, and where such increases have been found by the ACCC in the recent arbitration of the access dispute between PNO and Glencore to exceed the ACCC's view of reasonable cost recovery, and has vigorously argued against any form of regulatory constraint on its charges, has highlighted to users the nature and extent of Port pricing risks they bear (particularly if the declaration is revoked). In this context, the mere existence of a credible scenario where such adverse pricing outcomes are possible creates significant pricing uncertainty and risk that must be factored into, and borne as an additional, and unavoidable cost by participants in the coal tenements market.

4.2 Constraints on PNO's pricing behaviour

4.2.1 NERA's views

NERA claims that our approach to estimating the extent to which profit maximising prices implies significant price increases are theoretically possible in a future without declaration does not place any weight on the threat of regulation.

NERA points to the Ports and Maritime Administration Regulation 2012 (NSW) as providing a "degree of transparency" (SOPV [6.4.1]) over PNO pricing. It also offers the absence of a previous price increase of this size as evidence that existing price restraints have been effective at suppressing the port's profits by a substantial amount.[48]

[48] NERA (2019), para 50.

4.2.2 Synergies' response

Contrary to this view, our previous reports have considered, at length, the factors that could potentially constrain PNO's profit maximising behaviour (see for example Synergies' 8 August 2018 report, section 2.3.4).

In that report, we specifically considered the threat of regulatory oversight. As part of the original declaration proceedings, PNO (and NSW Treasury) both submitted that the ability of PNO to increase prices is constrained by legislative price monitoring arrangements, specifically the *Ports and Maritime Administration Act 1995* (NSW), *Ports and Maritime Administration Regulations 2012* (NSW) and the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW).[49] However, both the Tribunal and the NCC have acknowledged that the existing NSW price monitoring regime provides effectively no constraint on pricing practices, and as such, the regime would be highly unlikely to meet the requirements for certification under the National Access Regime.

Therefore, to suggest, as NERA does, that the absence of significant price increases is evidence of existing restraints working, is without foundation and not supported by any of the conventional regulatory opinion. As we have identified previously, the ACCC's view is that price monitoring, in general, is not an effective constraint on monopoly power.[50]

While we do not consider that the existing price monitoring regime provides any effective constraint on PNO's exercise of market power, we agree that a credible threat of more heavy handed regulatory responses to the exercise of monopoly power can provide such a constraint. The risk of declaration under the National Access Regime has historically been one such credible constraint. However, we consider that revocation of the existing declaration will remove this threat.

We agree that the possibility of heavy handed regulation by the NSW Government provides an alternate potential regulatory constraint. However, we note that the NSW Government strongly resisted introducing more intrusive regulation prior to its port privatisation program and has not publicly responded in any way to PNO's conduct to date. Therefore, the nature of and prospect of such regulatory intervention appears highly uncertain and most likely would entail a considerable time lag resulting in economic damage in the meantime.

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[49] PNO (2015), Submission in response to Glencore's application to the National Competition Council, 18 June 2015, p.14. see also NSW Treasury (2015), Glencore's application for Declaration of Shipping Channel Services at the Port of Newcastle, June 2015, p.5

[50] Synergies (August 2018), p.30.

As we have previously stated, absent regulation, the only factor that will effectively constrain PNO's incentives to increase prices is the responsiveness of volumes; that is, price will increase towards a level at which demand is no longer inelastic such that volumes are materially affected. In this respect it is a basic economic condition that a monopolist will set prices based on the elastic part of the demand function that it faces. Although the simple monopoly textbook model may not exactly apply, the basic principle of increasing prices if demand is inelastic should not be controversial.[51]

[51] Synergies (2019), p.18.

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Synergies
ECONOMIC CONSULTING

Port of Newcastle Operations ability and incentive to exercise market power and its impact on competition in Newcastle catchment coal tenements market

Prepared on behalf of New South Wales Minerals Council

July 2020

Synergies Economic Consulting Pty Ltd
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Executive Summary

Criterion (a) focuses on whether access as a result of declaration would promote a material increase in competition in market(s) other than the market for the service. Specifically, the focus is on whether efficient entry and efficient participation by firms in a dependent market would likely be promoted in a future with declaration compared to a future without declaration.

Port of Newcastle is the only facility coal miners in the Newcastle catchment can use to export coal into relevant overseas markets, and Port of Newcastle Operations Pty Ltd (PNO) has control over that natural bottleneck facility.

As a commercial entity, PNO has an incentive to maximise profits.

PNO's conduct to seek to negotiate bilaterally with coal producers and its actions to refuse to collectively negotiate is a significant departure from the arrangements assumed by the National Competition Council (NCC) of uniform, transparent pricing in its previous assessment. PNO has signalled that the arrangements assumed by the NCC in its previous assessment are not in its best interests., and it has sent a clear signal that potential coal producers would not have transparency of terms provided by PNO to other users.

This conduct demonstrates that PNO has the ability and incentive to set access terms as per a user's circumstance, and there will be an imbalance of negotiating power between PNO and coal producers.

In the context of the coal tenements market, a decision to enter (or re-invest) involves substantial sunk investments.

In a future without declaration, PNO's ability and incentive to exercise market power would give rise to the hold-up problem. The risk of hold-up in the presence of substantial sunk investments is sufficiently material that it would likely discourage efficient firms from entering the coal tenements market.

In contrast, a future with declaration would constrain PNO's ability and incentive to exercise market power and address the hold-up risk and would likely promote efficient entry (and efficient participation) such that there would be a non-trivial, material improvement in the environment for competition in the Newcastle catchment coal tenements market.

Contents

1 Introduction

Synergies Economic Consulting (Synergies) has been engaged to assist the New South Wales Minerals Council (NSWMC) in its application for a declaration recommendation in relation to certain essential services provided at the Port of Newcastle by the Port of Newcastle Operations Pty Ltd (PNO).

The purpose of this report is to consider the implications of PNO's recent conduct to seek to negotiate bilaterally with coal producers and its actions to refuse to collectively negotiate with coal producers.

We consider this to be a significant departure from the arrangements assumed by the National Competition Council (NCC) of uniform, transparent pricing in its previous consideration of the declaration of the shipping channel service at the Port of Newcastle, particularly in relation to the assessment of the competition test under criterion (a).

The remainder of the report is structured as follows:

- Section 2 – sets out our understanding of criterion (a) assessment;
- Section 3 – sets out our analysis of PNO's ability and incentive to exercise market power, particularly having regard to PNO's revealed conduct to negotiate bilaterally with coal producers; and
- Section 4 – analyses the impact of PNO's exercise of market power on the environment for competition in the Newcastle catchment coal tenements markets.

2 Criterion (a) test

Criterion (a) focuses on the effect of declaration in dependent markets, and specifically whether the requisite access as a result of declaration would promote a material increase in competition in market(s) other than the market for the service.

The NCC describes the relevant test in the following terms:

> 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.[1]

The NCC stated in its Declaration of Services guide:

> [3.30] There are a number of ways the use of market power in the provision of the service for which declaration is sought by a service provider may adversely affect competition in a dependent market. For example:
>
> - a service provider with a vertically related affiliate may engage in behaviour designed to leverage its market power into a dependent market to advantage the competitive position of its affiliate
> - where a service provider charges monopoly prices for the provision of the service, those **monopoly prices may suppress demand or restrict entry or participation in a dependent market**, and/or
> - explicit or implicit price collusion in a dependent market may be facilitated by the use of a service provider's market power. For example a service provider's actions may prevent new market entry that would lead to the breakdown of a collusive arrangement or understanding or a service provider's market power might be used to 'discipline' a market participant that sought to operate independently.[2] **[emphasis added]**

The Queensland Competition Authority (QCA) was guided by the principles outlined by the NCC and in respect of the declaration review of the service provided by Queensland Rail considered that:

> the concept of promoting a material increase in competition involves an improvement in the opportunities and environment for competition, such that competitive

[1] NCC, Declaration of Services, A guide to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth), April 2018 edn, p. 32, para. 3.23.

[2] NCC, Declaration of Services, A guide to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth), April 2018 edn, pp. 33–34, para. 3.30.

> outcomes are materially more likely to occur in a future with declaration, compared to a future without declaration. Promoting a material increase in competition is not necessarily equivalent to promoting the greatest number of competitors in the market—strong competition may exist between a few firms. Rather, **it involves the possibility that efficient entry and efficient participation by firms would be promoted in a future with declaration, compared to a future without declaration. If efficient entry is likely to be promoted in a future with declaration (compared to a future without declaration), the QCA considers that this would indicate that access as a result of declaration would promote an increase in competition that is material**.[3] **[emphasis added]**

We have approached the assessment of criterion (a) as set out in the above passages, that is, we have focussed on whether efficient entry and efficient participation by firms would likely be promoted in a future with declaration compared to a future without declaration.

In the context of the Newcastle catchment coal tenements market, a decision to enter or develop involves substantial sunk investments. We demonstrate that in a future without declaration, PNO's ability and incentive to exercise market power would give rise to the hold-up problem. The risk of hold-up in the presence of substantial sunk investments is sufficiently material that it would likely discourage efficient firms from entering the coal tenements market as well as developing such tenements. In contrast, a future with declaration would constrain PNO's ability and incentive to exercise market power and address the hold-up risk and would likely promote efficient entry (and efficient participation) such that there would be a non-trivial, material improvement in the environment for competition in the Newcastle catchment coal tenements market.

[3] QCA, final recommendation, Part B: Queensland Rail declaration review, March 2020, p. 67.

3 PNO's ability and incentive to exercise market power

As a commercial entity, PNO has an incentive to maximise profits.

Port of Newcastle is the only facility coal miners in the Newcastle catchment can use to export coal into relevant overseas markets, and PNO has control over that natural bottleneck facility.

As such, PNO would not be constrained from exercising its market power by the availability of substitute facilities, by the countervailing power of users, or by the threat of a new facility being built. In those respects, PNO has the ability and incentive to exercise market power.

3.1 Non-vertically integrated and excess capacity

The issue is whether being a non-vertically integrated service provider with substantial surplus capacity would constrain PNO's ability and incentive to exercise market power.

As a general proposition, the presence of spare capacity does not imply that PNO will not behave in a profit-maximising manner. Put another way, a firm with market power has an incentive to maximise profits, not utilisation of capacity, even with spare capacity. The NCC considered that PNO would prefer that markets related to the Port are effectively competitive as this is likely to maximise demand (and hence profits) from providing the Service at any given prices it charges.

However, the trouble with the NCC's proposition is that at the prices PNO has been charging, there is already substantial surplus capacity at the Port (ie demand is low relative to Port's capacity). In that event, PNO would have an incentive to increase the charges to maximise its profits rather than expect demand to increase when historically demand has been low relative to capacity. PNO's conduct of increasing its charges is consistent with this incentive.

Indeed, maximising capacity utilisation will rarely be consistent with profit maximisation, especially in a situation where a uniform price is charged. To increase capacity utilisation, the service provider will have to decrease its price. However, under a uniform pricing structure, that will result in lower profit from existing users (due to the lower price with cost of providing service remaining unchanged). The service provider will weigh the expected reduction in profit from existing users against the expected gain in profit from new users that respond to the lower price, and will consider decreasing the price so long as the expected gain in profit more than offsets the expected reduction in profit. Put another way, a monopolist who commits to charging a uniform

price will always price on the elastic part of the demand curve – if it doesn't, it will not be maximising profit.[4]

A monopolist that is able to price discriminate has a strong incentive to do so to capture as much of the economic surplus as is available. Moreover, in the circumstances where a uniform price is not charged, there is greater likelihood that a monopolist will be able to increase utilisation. However, even here, the objective is not maximising capacity utilisation; rather it is maximising profit. Maximising capacity utilisation will only occur if it also allows profit maximisation.[5]

Nevertheless, the NCC's view has been that PNO would not have the ability and incentive to impose excessive charges on new users (or generally, on users who have not yet made (sunk[6]) investments). The NCC had stated that:

> Charging excessively high prices for the Service is likely to increase the incentive for some potential future miners to invest in other activities (e.g. investing in coal mining activity in other parts of Australia, or overseas) rather than coal mining in the Newcastle catchment.[7]

The argument here is that, in the presence of spare capacity, PNO is not expected to behave as a monopolist when negotiating with users who are yet to make (sunk) investment. The Productivity Commission also noted that the infrastructure service provider would have a strong incentive (through the sharing of its fixed costs) to provide access to any capacity that will be unused for the foreseeable future, provided the access price recovers the full costs of use by the third party.[8]

The QCA did not subscribe to this view in its review of the service provided by Queensland Rail which like PNO is not vertically integrated and has excess capacity on its network. The QCA stated that:

> The QCA considers that a firm with market power would only have incentives to maximise volume in a limited set of circumstances. One such circumstance could be an infrastructure provider that faces previously unanticipated competition from

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4 J. Tirole, The Theory of Industrial Organization, p. 66

5 J. Tirole, p. 136.

6 An investment is sunk when its value in alternative uses is lower than its value in the current trading relationship. The more specific the assets are to the current relationship, the more difficult it becomes for the investor to redeploy them to other uses. As a result, exit from the relationship is costly. For example, the underlying value of a coal mine, once established, resides in its potential output. In the case of PNO, the value of coal mine is locked into the Port of Newcastle, which is the only option for coal producers in Newcastle catchment to export coal.

7 NCC, Revocation of the declaration of the shipping channel service at the Port of Newcastle, Recommendation, July 2019, p. 2

8 Productivity Commission, National Access Regime, Inquiry report no. 66, October 2013, p. 10.

> another provider that has recently gained entry into the market. Given the presence of competition for demand, the incumbent provider might have an incentive to decrease its price below the profit-maximising price in order to gain sufficient revenue to cover (at least) its fixed costs. Importantly, this strategy would require some elasticity of demand for the service in order to expand output. [footnote omitted]
>
> However, this does not characterise the general situation of Queensland Rail. It is the dominant service provider in most of its markets and does not face the prospect of competition. For example, in the West Moreton and Mount Isa regions, rail is the most economical option for the haulage of bulk minerals and coal. In those markets, Queensland Rail faces a relatively inelastic demand for its service, as there is no economically viable long-term substitute for rail to transport bulk minerals and coal. Accordingly, the QCA considers that economic circumstances in these regions are more likely to support the standard profit-maximising incentive.[9]

The QCA's conclusion in respect of Queensland Rail also applies to PNO, which is the only port terminal for coal producers in the Newcastle catchment to export coal, and so PNO's conduct will be informed by the standard profit-maximising incentive.

The demand for the service provided at the Port is from users who make long term investment decision (given economic life of a coal mine is on average 30 years), so require access over a long term. Therefore, the important consideration is whether PNO would have an incentive to maintain that conduct (as assumed by the NCC) over the life of a user's investment and whether PNO could credibly commit to behaving in that manner over that investment period.

The problem is that once the investment is made (i.e. costs are sunk), the incentives of the parties change. As the provider of a service for which there is no economically viable long-term substitute, PNO would have an incentive to behave opportunistically in order to appropriate the maximum possible available rents from a coal producer, who is locked in to using the Port.

3.2 Ability and incentive to price discriminate

Arguably, PNO would behave opportunistically, only if it is able to discriminate between users. That is, when PNO is able to bilaterally negotiate with each user and is able to agree and modify (when required) access terms as per the user's circumstances.

In this respect, NCC's view has been that:

[9] QCA, March 2020, pp. 38–39.

- while PNO could enter into individual contracts for different coal miners seeking to use the Service by virtue of section 67 of the PAMA Act, it does not appear to have done so to date.
- whether PNO would seek to engage in future price discrimination between different coal miners seeking to acquire the Service is unclear.
- based on the evidence before it at this point in time, the Council is not persuaded that PNO will engage in extensive price discrimination between different coal miners seeking to acquire the Service.

This is a simplistic and superficial assessment. It fails to address the core economic incentive, which was unchallenged by the NCC, that is PNO will have an incentive to price discriminate between users (or between mines of the same user) to maximise its profits (as noted above).

The Australian Competition and Consumer Commission (ACCC) had also questioned the assertion that PNO would be unable to obtain sufficient information to price discriminate between mines, either now or in the future. ACCC's view was that in addition to overall monopoly pricing and the resulting potential reduction in volumes, PNO could further increase the prices faced by some mines to capture additional profit. In its submission to the NCC, ACCC had raised the threat of hold-up faced by users of the service and considered that:

> the threat of the continued future expropriation of profits of miners by PNO is likely to have a dampening or chilling effect on future investment in the Hunter Valley coal mines, which is in turn damaging to the conditions and environment for competition in dependent markets.[10]

We demonstrate that PNO's position as the natural monopoly provider of an essential service and its recent conduct to seek to negotiate bilaterally with individual coal producers shows that it has the ability and incentive to price discriminate.

3.2.1 The incentive to price discriminate

As argued above, a monopolist will always price on the elastic part of the demand curve – if it doesn't, it will not be maximising profit.

A monopolist that is able to price discriminate has a strong incentive to do so to capture as much of the economic surplus as is available. In the limit, a monopolist will seek to

[10] ACCC, NCC preliminary view to recommend to revoke declaration at the Port of Newcastle, 6 February 2019, p. 5.

"perfectly" price discriminate to effectively capture all of the economic surplus available to others in a supply chain.

Moreover, in the circumstances where a uniform price is not charged, there is greater likelihood that a monopolist will increase utilisation. However, even here, the objective is not maximising capacity utilisation; rather it is maximising profit. Maximising capacity utilisation will only occur if it also allows profit maximisation.

3.2.2 The ability to price discriminate

It is clear that PNO has the ability to price discriminate – this simply arises from the lack of alternatives available to Hunter Valley producers – there are simply no substitutes available to use the Port.

The NCC was not convinced that PNO will be able to separately identify different miners in order to charge different amounts to them. The NCC had noted that a key requirement in order for a firm to be able to successfully price discriminate is that it must be able to identify different customers (or customer groups) in order to set different prices for them.

Since then and in contrast to the view held by the NCC, PNO has been seeking to enter into individual contracts with coal miners seeking to use the Service. PNO has also refused to negotiate collectively with coal producers. This conduct shows that PNO has the ability to separately identify coal producers, and so would be able to set different prices for them to extract the maximum possible economic surplus when the opportunity arises. This is exactly as a profit maximising monopolist would be expected to behave where the value from investing in coal mining derived by a coal producer is specific to each user (for instance, due to coal miners not having uniform costs of production, transportation cost would vary depending on the location of their mine, and quality or grade of coal produced could vary between mines (as is the case for the Hunter Valley coal producers).

These events demonstrate that PNO's conduct and commercial incentives are not aligned with what the NCC had assumed in its previous assessment. Through its conduct PNO has demonstrated that it has the ability and incentive to negotiate individually with coal miners.

Individual contracts with coal producers will enable PNO to price discriminate between users and appropriate the maximum possible rents available from each producer which will maximise PNO's profits.

4 Impact on competition in Newcastle catchment coal tenements market

As a business, PNO has an incentive to maximise profits.

In a future without declaration, PNO will not face any effective long-term constraints on its ability and incentive to exercise market power in order to maximise profits.

Negotiating with a profit maximising monopolist that has control over a natural bottleneck facility will create risks for potential coal miners.

It is in this environment that market participants will face decisions to enter or operate in the Newcastle catchment coal tenements market in a future without declaration. In particular, a new entrant to the coal tenements market will have to incur significant sunk costs. Sunk costs include the costs of exploration and preparatory activities prior to developing a mine (e.g. feasibility studies), which are site-specific. Sunk costs also include the costs of developing the mine itself—the underlying value of the mine, once developed, resides in its potential output, and is site-specific. The presence of sunk investments gives rise to the 'hold-up problem'.

NCC's view has been that as PNO charges a uniform price to all users and is transparent about the price terms it will not be in PNO's interest to hold up coal miners. NCC's view was that opportunistic pricing by PNO in that circumstance will send a signal to potential miners in the future that PNO will take advantage of them after they make investments, and that they are at risk of not being able to recover sunk costs if they invest in coal mining activities in the Newcastle catchment. In other words, as per NCC's view, any gains made by PNO from holding up a miner will be outweighed by the loss of future profits from potential miners who would have otherwise invested in the coal tenements.

However, NCC's view assumes PNO will set uniform prices and the access terms agreed with coal producers will be transparent. On the contrary, PNO is seeking to negotiate bilaterally with coal producers which will enable it to set producer-specific charges. This conduct demonstrates that PNO has the ability and incentive to set access terms as per a user's circumstance, and there will be an imbalance of negotiating power between PNO and coal producers in the presence of sunk investments.

An imbalance in bargaining power would inhibit the ability of coal producers to effectively manage risks, in particular the risk of hold-up, which would have a significant effect on the expected profitability of entry into (and operations within) the market. The presence of such risks, and an imbalance in the ability of users to address these risks in a future without declaration, would likely deter efficient entry or efficient

investments by market participants. Put simply, PNO's conduct demonstrates that such risks cannot be avoided in a future without declaration.

In comparison, in a future with declaration, PNO's ability and incentive to exercise its market power in order to maximise profits will be constrained by the regulatory regime. A future with declaration will provide market participants the assurance that access will be provided on reasonable terms and conditions, and will mitigate the risk of hold-up for users. As such, the protections offered in a future with declaration would likely promote efficient entry (and efficient participation) such that there would be a non-trivial, material improvement in the environment for competition in the Newcastle catchment coal tenements market.

4.1 Hold-up risk

A potential coal miner seeking to make a long-term investment decision would know PNO's ability and incentive is to behave strategically over the term of its investment. Although PNO has offered a 10-year contract, it is difficult to devise a contract that enables parties to adapt to the uncertainties and at the same reduce the scope for opportunism.

Given economic life of a coal mine is on average 30 years, a coal producer would require an access contract of longer than 10 years. The longer the contract required, as in the case with long-lived sunk investments, the greater the need to allow for adaptation and adjustment in the face of changing market conditions. In particular, it is difficult to entirely eliminate the need for contract renegotiation in the context of a very long-term contract.

In this context, the 10-year contract offered by PNO gives PNO the discretion to change prices in response to changing market conditions. That discretion enjoyed by PNO shows that the coal producer not only faces a risk of expropriation during the contract term but also faces a greater risk when that contract is to be renegotiated after 10-years.

Given PNO has control over the natural bottleneck facility, it will have the superior bargaining position at the time of renegotiation, and the coal producer will be exposed to the risk of expropriation.

While PNO could choose not to exercise this bargaining power ex post, it does not seem possible for PNO to credibly commit ex ante that it will not do so at that later time. For example, by including price openers during the contract term, PNO has demonstrated that it is not able to credibly commit ex ante that a contract will never need to be renegotiated during its term. Additionally, by giving itself the discretion to change

prices, PNO has demonstrated that its incentive is to be able to expropriate investment value from the other negotiating party at that future time.

The NCC's view has been that while PNO may have the ability to price in a way that "holds up" those miners that have already sunk costs in coal exploration/mining in the Newcastle catchment, it may not have an incentive to do so due to the signal this would send to those investors that have not yet made any such investments. The NCC considered that it is important for PNO's future coal-derived profits that it develops a reputation for not holding-up its customers.

In other words, as per the NCC, a potential coal producer can be confident that PNO would not engage in "hold up" of their sunk investments, as PNO would be incentivised to avoid a 'bad behaviour' reputation.

The fundamental proposition is that as a business PNO's incentive is to maximise profits and it would engage in behaviour consistent with that incentive.

If PNO were concerned about avoiding a 'bad behaviour' reputation, ie if PNO considered that the NPV of profits over long term by maintaining status quo arrangements outweighed NPV of profits from it seeking to extract users' sunk costs, it would have continued to conduct itself in the manner assumed by the NCC. That is, PNO would have continued to seek to charge a uniform price to all coal producers and make its conduct transparent to all users.

However, PNO has moved away from that assumed conduct and has signalled that the arrangements assumed by the NCC in its previous assessment are not in its best interests.

Even if we assume PNO has an incentive to encourage entry in the tenements market, a well-functioning and effective reputation mechanism depends on sufficient and available information on PNO's performance.

PNO's preference to negotiate bilaterally with coal producers and its actions to refuse to collectively negotiate with coal producers has sent a clear signal that potential coal producers would not have transparency of terms provided by PNO to other users. Indeed, PNO has a strong incentive to keep these deals secret. In circumstances where there is limited availability of information, the threat of reputational damage would not be an effective constraint on PNO's ability and incentive to exercise market power.

Given the long term nature of coal mining investment, the problem is that events could develop over that investment period where the benefits to PNO of expropriating the value of an investment at that later time exceed the benefits of continuing to abide by the status quo arrangements. It is this risk—that significant sunk investments in coal mining

will be expropriated—that will lead to a material adverse effect on the environment for competition in the coal tenements market in a future without declaration. For example, existing customers or potential entrants into a market might either delay, or forgo, new investment that would otherwise be economically efficient.

In a future with declaration, the supporting regulatory structure would enable independent regulatory oversight in relation to material price and non-price terms. This oversight would be sufficient to constrain PNO's ability and incentive to exercise market power. The protections offered in a future with declaration would materially improve the environment for competition by encouraging efficient entry and actions (through a stable and predictable environment), which would in turn promote a material increase in the environment for competition in the coal tenements market in the Newcastle catchment.

C Documents supplied

I have been supplied with the following documents from Clifford Chance:

1. ACCC's Determination in respect of Application for authorisation (AA1000473) lodged by NSW Minerals Council (NSWMC);
2. Application to Tribunal for Review of ACCC authorisation (AA1000473) filed by the Port of Newcastle (PON);
3. PON's Statement of Facts, Issues and Contentions (SOFIC);
4. NSWMC's SOFIC;
5. ACCC's SOFIC;
6. Expert Report of Rhonda Smith; and
7. PON's Pro Forma Long Term Pricing Deed.

D Instructions

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25 June 2021

Euan Morton
Synergies Economic Consulting
Suite 518, 377 Kent Street
Sydney NSW 2000

Dear Mr Morton,

ACT 2 of 2020 – Independent Expert Report – Letter of Instructions

Introduction and background

1. We act for New South Wales Minerals Council (**NSWMC**) in the above **Proceedings**.

2. The purpose of this letter is to:

   (a) confirm your engagement to prepare an independent report answering the questions set out in this letter, which may be used in the Proceedings before the Australian Competition **Tribunal**; and

   (b) enclose documents for your review.

3. We note that in addition to the expert report, you may be required in due course to (*inter alia*):

   (a) prepare supplementary reports;

   (b) if required by the Tribunal, confer with other expert witnesses in relation to issues not agreed, with a view to reach agreement where possible and to prepare a joint report setting out the outcome of the conferral;

   (c) if required by the Tribunal, appear during the hearing of the Proceeding.

4. As you may be aware, the Proceedings were initiated by the Port of Newcastle Operations (**PNO**) challenging a **Determination** of the ACCC dated 27 August 2020 authorising NSWMC and other mining companies exporting goods, or requiring future

access, through the **Port** of Newcastle (collectively, the **Applicants**) to engage in the following conduct (**Proposed Collective Bargaining Conduct**):

(a) collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port;

(b) discuss amongst themselves matters relating to the above discussions and negotiations;

(c) enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the port and the export of minerals through the Port.

5. The Proposed Collective Bargaining Conduct is voluntary (for the Applicants and PNO), and does not include:

(a) boycott activity by the Applicants; or

(b) the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume / capacity projections for individual users.

6. Authorisation was granted for a period of 10 years.

Materials

7. Please find enclosed, for your review, the following materials:

(a) the Determination;

(b) PNO's application to the Tribunal for review filed on 17 September 2020;

(c) the Statements of Facts, Issues and Contentions (**SOFIC**) filed by the parties (PNO, NSWMC and the ACCC);

(d) the expert report of Dr Rhonda Smith prepared for the ACCC dated 22 April 2021; and

(e) PNO's Pro Forma Long-Term Pricing Deed (**Producer Deed**).

Instructions

8. You are instructed to prepare a report in response to the following questions:

(a) Please state your opinions in respect of the expert report of Dr Rhonda Smith dated 22 April 2021.

(b) Please state how PNO might be expected to act in setting prices and negotiating access, given its economic circumstances and incentives.

Assumptions

9. Please make the following assumptions in preparing your report:

(a) PNO intends to build a MDT at the Port within the short to medium future.

Practice Note

10. Enclosed with this letter is the Federal Court of Australia Expert Evidence Practice Note (GPN-EXPT) including Annexure A (Harmonised Expert Witness Code of Conduct) to that Practice Note (together, the **Expert Guidelines**). Please read the Expert Guidelines carefully and ensure that your report complies with each of its elements.

Confidentiality

11. We remind you that you must treat all material prepared by you and obtained by you in connection with your engagement as confidential and subject to legal professional privilege and litigation privilege which is not to be waived without our permission.

12. Please do not hesitate to let us know if you would like to discuss any of the above or need any further clarification.

Yours sincerely

Dave Poddar
Partner
Clifford Chance

Determination

Application for authorisation AA1000473 lodged by
NSW Minerals Council and mining companies

to collectively negotiate with Port of Newcastle Operations Pty Ltd all terms and conditions of access relating to the export of coal from the Port of Newcastle.

Authorisation number: AA1000473

Date: 27 August 2020

Commissioners: Sims
Keogh
Rickard
Court
Ridgeway

Summary

The ACCC has decided to grant authorisation to enable the NSW Minerals Council and coal producers that export coal through the Port of Newcastle (Port) to collectively negotiate with Port of Newcastle Operations Pty Ltd (PNO) in relation to the terms and conditions of access, including price, to the Port.

The ten coal producers that export coal through the Port are Glencore Coal, Yancoal Australia, Peabody Energy Australia, Bloomfield Collieries, Centennial Coal, Malabar Coal, Whitehaven Coal, Hunter Valley Energy Coal, Idemitsu Australia, and MACH Energy Australia.

The bargaining group seeks authorisation for ten years to enable them to collectively negotiate terms of access for coal vessels entering the channels and berthing at the Port. The group also seeks authorisation to jointly discuss and negotiate common industry issues, such as proposed capital expenditure at the Port and allocation of costs. The proposed collective bargaining conduct is voluntary for all parties and does not include boycott activity.

PNO has been the operator of the Port since it was privatised in 2014, and publishes a full schedule of service charges that apply to the commercial use of the Port.

In December 2019, PNO invited coal producers to commence bilateral discussions with it to secure discounted access charges under a new long term (ten year) Producer Deed, subject to annual price reviews by PNO.

During the ACCC's consultation process, PNO indicated that it does not support the proposed collective bargaining conduct, and will only continue to discuss the long term Producer Deed with coal producers individually. As such, PNO submits that the proposed collective bargaining conduct will have no effect because PNO will not participate in any collective negotiations.

The ACCC recognises that the outcome of voluntary collective bargaining arrangements is uncertain. However, the ACCC is not required to attempt to predict the likely outcome of the collective negotiations on the relevant issues. The ACCC's role is to assess whether proposed collective bargaining conduct is likely to result in public benefits if the parties engage in the conduct.

In this instance, the ACCC has assessed the likely public benefits and public detriments if the coal producers have the opportunity to collectively negotiate with PNO, including any likely public detriments resulting from a lessening of competition.

The ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in public benefits. In particular, the ACCC considers that the bargaining group will have greater input into the terms and conditions of access under the Producer Deed, and increased transparency around capital expenditure plans and cost allocation at the Port. This will provide greater certainty for the delivered price of Hunter Valley coal, more timely resolution of industry-wide issues, and facilitate more efficient investment decisions at the Port and across the Hunter Valley coal industry. The ACCC also considers these outcomes will enhance the international competitiveness of the Hunter Valley coal industry, with investment and employment benefits in Australia.

Further, collective bargaining conduct can result in more efficient contracting, which can benefit both PNO and the bargaining group. The ACCC considers the proposed collective bargaining conduct is also likely to result in public benefits from lower transaction costs.

The ACCC considers there is likely to be minimal public detriment from the proposed collective bargaining conduct because participation in the proposed collective bargaining conduct is voluntary for both coal producers and PNO, and does not include boycott activity. The ACCC considers that there is unlikely to be an impact on competition between the coal producers. Individual coal producers are still free to negotiate terms and conditions of Port access separately through bilateral discussions with PNO if they believe it is in their commercial interests to do so. In addition, the proposed collective bargaining conduct does not involve coal producers sharing individual coal projection volumes, customer pricing information or marketing strategies.

Therefore, the ACCC is satisfied that the proposed collective bargaining conduct is likely to result in a public benefit and that this public benefit would outweigh any likely detriment to the public from the proposed collective bargaining conduct.

Accordingly, the ACCC grants authorisation for ten years, until 30 September 2030.

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1. The application for authorisation

1.1. On 6 March 2020 the NSW Minerals Council lodged application for authorisation AA1000473 with the Australian Competition and Consumer Commission (the **ACCC**) on behalf of itself and certain coal producers that export coal through the Port of Newcastle (the **Applicants**). The ten applicant coal producers that export coal through the Port of Newcastle (**Port**) are:

- Glencore Coal Assets Australia Pty Limited
- Yancoal Australia Limited
- Peabody Energy Australia Pty Ltd
- Bloomfield Collieries Pty Ltd
- Centennial Coal Company Limited
- Malabar Coal Limited
- Whitehaven Coal Mining Limited
- Hunter Valley Energy Coal Pty Ltd
- Idemitsu Australia Resources Pty Ltd, and
- MACH Energy Australia Pty Ltd.

1.2. This application for authorisation (AA1000473) was made under subsection 88(1) of the Competition and Consumer Act 2010 (Cth) (**the Act**). The ACCC may grant authorisation which provides businesses with legal protection for arrangements that may otherwise risk breaching the law but are not harmful to competition and/or are likely to result in overall public benefits.

1.3. The Applicant coal producers are likely to be considered competitors for access to the Port. Accordingly, the Applicants seek authorisation to collectively negotiate and discuss the terms of access to the Port, including price, with Port of Newcastle Operations Pty Ltd (**PNO**). Specifically, the Applicants seek authorisation to:

- collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port
- discuss amongst themselves matters relating to the above discussions and negotiations, and
- enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port,

collectively, the **(Proposed Collective Bargaining Conduct)**.

1.4. The Proposed Collective Bargaining Conduct is voluntary for all parties, including PNO, and does not include boycott activity by the coal producers.

1.5. The Proposed Collective Bargaining Conduct 'does not include the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume / capacity projections for individual users.'[1]

1.6. The Applicants seek authorisation on behalf of themselves and 'future access seekers / port users' that choose to participate in the proposed collective bargaining group in the future.[2] On 15 May 2020 the Applicants clarified that the proposed collective bargaining group will primarily comprise coal mining companies. However, future participants could conceivably involve other mining company members of NSW Minerals Council. The class of persons proposed to engage in the Proposed Collective Bargaining Conduct is confined to mining companies.[3] Authorisation is sought for ten years.

1.7. The Applicants submit they are seeking authorisation to collectively negotiate with PNO following significant increases in access charges that have occurred since the Port was privatised in 2014 and given future pricing uncertainty at the Port.[4]

1.8. More specifically, the Applicants submit the need for this application for authorisation arises because PNO:

> …is an infrastructure monopoly service provider that enjoys the commercial benefits of that position in circumstances where the Port was privatised at the end of a multi user export supply chain, and in the absence of any regulatory constraints…

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1 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 6.2.

2 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 3.5.

3 NSW Minerals Council submission, 15 May 2020, paragraph 2.5.

4 NSW Mineral Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 1.23.

> …it is noted that after revocation of the declaration [at the Port of Newcastle], PNO increased its prices significantly once again and in particular, based on the inclusion of user contributions that PNO did not…expend.[5]

Interim authorisation

1.9. On 2 April 2020 the ACCC granted interim authorisation under subsection 91(2) of the Act[6] to enable the Applicants to commence collective discussions amongst themselves and negotiations with PNO in relation to the terms and conditions of access, including price, to the Port. Interim authorisation does not extend to entering into any collectively negotiated agreements.

1.10. Since then, the Applicants advise that they wrote to PNO on 29 April 2020 requesting an initial meeting with it to 'commence negotiations around pricing and access principles that may work for both PNO and the Applicants.'[7] In response, PNO wrote to NSW Minerals Council on 11 May 2020 declining the request for an initial meeting and indicating that it does not support the proposed collective bargaining arrangements.

1.11. Interim authorisation will remain in place until the date the ACCC's final determination comes into effect or until the interim authorisation is revoked.

The Applicants

1.12. The **NSW Minerals Council** is an industry association representing the NSW minerals industry. The NSW Minerals Council's members include many of the largest coal exporters from the Port. The Port is the only practical alternative to export coal to international customers from the Hunter Valley, Gunnedah Basin, Gloucester Basin, and parts of the Western Coalfields.

1.13. The NSW Minerals Council seeks authorisation on behalf of itself and ten member coal producers listed in the application that export (or intend to export) coal through the Port:[8]

- **Glencore Coal** – one of Australia's largest coal producers, operating seven mines in the Hunter Valley and one in the Western Coalfields in NSW.[9]
- **Yancoal** – is Australia's largest pure-coal producer, operating several mines in the Hunter Valley region.
- **Peabody Energy** – operates the Wambo and Wilpinjong coal mines in the Hunter Valley.
- **Bloomfield Collieries** – an Australian owned group of private companies which operates two open cut mines in the Hunter Valley.
- **Centennial Coal** – wholly owned by Banpu Pcl (a Thailand company). It operates mines in the Hunter Valley and Western coalfields near Lithgow.

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5 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 3.8.

6 See ACCC decision of 2 April 2020 available at Authorisations Public Register - NSW Minerals Council.

7 NSW Minerals Council submission, 15 May 2020, p. 6.

8 Unless otherwise stated, information about the Applicants' mining operations is sourced from NSW Minerals Council supporting submission to the application for authorisation, 6 March 2020, Schedule One.

9 Glencore's website: https://www.glencore.com.au/en/who-we-are/energy-products/Pages/coal.aspx, viewed 24 April 20020.

- **Malabar Coal** – an independent Australian-owned mining company. It expects to export coal through the Port in the future. It owns two exploration licenses in the Hunter Valley.
- **Whitehaven Coal** – operates several mines in NSW's Gunnedah Basin.
- **Hunter Valley Energy Coal** – is a wholly owned subsidiary of BHP Billiton. It operates the Mount Arthur mine, which is the largest mine in the Hunter Valley region.
- **Idemitsu Australia** – owns the Boggabri and Muswellbrook coal mines in the Hunter Valley region, and
- **MACH Energy Australia** – formed the Mount Pleasant Joint Venture with Japan Coal Development Australia Pty Ltd, and currently operates the Mount Pleasant mine in the Hunter Valley.

1.14. The ACCC understands that there are two coal producers exporting coal through the Port which are not currently Applicants, but could join the bargaining group in the future – namely, Delta Coal and New Hope Group.[10]

The target – Port of Newcastle Operations Pty Ltd

1.15. **PNO** became the operator of the Port in May 2014, following the privatisation of the Port by the NSW Government. It controls the terms and conditions of access at the Port under a long term lease arrangement from the NSW Government, as trustee for the Port of Newcastle Unit Trust ('**Port of Newcastle Ops**').

1.16. Port of Newcastle Ops is equally owned by two investors: The Infrastructure Fund and China Merchants Port Holding Company.[11] *The Infrastructure Fund's* (**TIF**) 50 per cent shareholding in the Port is held on behalf of TIF investors. According to PNO's website, TIF is an Australian infrastructure fund with a portfolio of Australian and overseas assets worth more than $2.4 billion. TIF investors include industry superannuation funds and other institutional investors.[12]

1.17. *China Merchants Port Holdings Company Limited* was listed on the Hong Kong Stock Exchange in 1992. According to PNO's website, China Merchants Port Holdings Company is China's largest port developer, investor and operator, with a comprehensive ports network portfolio spanning six continents and 18 countries and regions.[13]

1.18. PNO publishes a schedule of service charges that apply to the commercial use of the Port, in accordance with the *Ports and Maritime Administration Act 1995 (NSW*) (the **PAMA Act**) and *Ports and Maritime Administration Regulations 2012* – including, a **navigation service charge** and **wharfage charge**.[14] PNO may vary this schedule from time to time, including varying or introducing new fees, subject to it providing ten business days' notice on its website before it takes effect.[15]

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10 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 2.6.

11 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 1.18.

12 PNO's website, https://www.portofnewcastle.com.au/about-our-port/, viewed on 6 May 2020.

13 PNO's website, https://www.portofnewcastle.com.au/about-our-port/, viewed on 6 May 2020.

14 Port of Newcastle, *Schedule of Service Charges, effective 1 January 2020,* p. 1.

15 Port of Newcastle, *Schedule of Service Charges, effective 1 January 2020,* p. 2.

Navigation Service Charge means the charge levied by PNO under section 50 of the PAMA Act upon a vessel's entry to the Port of Newcastle for the general use of the Port and its infrastructure – excluding the use of a pilot, the use of land based port facilities, and the port access for cargo at the interface between the vessel and land-based facilities for the purpose of stevedoring operations. This charge is in addition to any Wharfage Charge, Site Occupation Charge and any other fee (for example, Non-Standard Vessel Charges). The charge is payable by the owner of the vessel and is calculated by reference to the gross tonnage of the vessel.[16]

Wharfage Charge means the charge levied by PNO under section 61 of the PAMA Act for the availability of a site at which stevedoring operations can be carried out. For vessels being loaded at a site, the charge is payable by the owner of the cargo (immediately prior to the cargo being loaded). This charge is calculated by reference to the quantity of cargo loaded or unloaded at the site (unless the PAMA Regulations say otherwise).[17]

1.19. From 1 January 2021, the published navigation service charge and wharfage charge for coal vessels will be increased annually by at least CPI, and may also be increased to reflect additional investment at the Port or increases in government charges or taxes.[18]

1.20. As an alternative to its published schedule of service charges, at the end of 2019 PNO invited coal producers, vessel agents, vessel operators and FOB coal consignees to enter into bilateral long term discounted pricing arrangements (or deeds). The deed offered to producers (the **Producer Deed**) includes discounted navigation service charges and wharfage prices set by PNO. It is the terms and conditions of this Producer Deed that the Applicants seek to collectively negotiate with PNO. The term offered by PNO under the Producer Deed is ten years.

1.21. Further detail about the access charges levied by PNO, its alternative long term Deed offered to coal producers, and role of PNO at the Port is provided in the Background section of this determination.

The Proposed Collective Bargaining Conduct in practice

1.22. This application for authorisation focuses heavily on proposed collective bargaining in relation to access charges that apply to coal vessels entering the channels and berthing at the Port – namely, the navigation service charge and wharfage price set by PNO.

1.23. Having said that, the Applicants advise that, for the avoidance of doubt, they seek authorisation to 'negotiate all terms of access to the Port that are practically necessary or otherwise desirable for their export task involving the use of the channel and berth facilities at the Port.'[19]

1.24. Practically, the Applicants submit that they are seeking to discuss and negotiate the terms and conditions of access under the contractual framework put forward by PNO – that is, the price of access and the 'mechanics / language of the Producer Deed.'[20] They also seek to collectively discuss and negotiate industry wide issues within the

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16 This definition is compiled from section 50 of the PAMA Act and from Port of Newcastle, *Schedule of Service Charges, effective 1 January 2020,* p. 5.

17 This definition is compiled from section 61 of the PAMA Act and from Port of Newcastle, *Schedule of Service Charges, effective 1 January 2020,* p. 6.

18 Port of Newcastle, *Schedule of Service Charges, effective 1 January 2020,* p. 5.

19 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 1.4.

20 NSW Minerals Council submission, 30 April 2020, p. 9.

Producer Deed with PNO. By way of example, the Applicants submit this could involve collective discussions and negotiations with PNO about the following issues:

- pricing mechanisms under the Producer Deed, for example the inclusion of user funded expenditure in PNO's capital base[21]
- PNO's capital expenditure forecasts at the Port and the impact on prices paid by coal producers either directly or indirectly,[22] and
- PNO' proposed annual price adjustments under the Producer Deed.[23]

The Negotiating Committee and proposed contracting process[24]

1.25. Following interim authorisation, the Applicants formed a Port of Newcastle Working Group (**the Working Group**) for the purposes of coordinating any collective discussions or negotiations. The Working Group is comprised of representatives from the Applicant mining companies and NSW Minerals Council.

1.26. Further, the Applicants advise that a Negotiating Committee will be formed from the members of the Working Group, which are yet to be selected.

1.27. Regarding the proposed collective bargaining process, the Applicants advise that the Negotiating Committee will:

(a) seek instructions from the Working Group as to the key industry concerns / issues to be collectively discussed / negotiated

(b) engage in collective discussions / negotiations in relation to such concerns / issues with PNO (to the extent that PNO is willing to participate in such discussions / negotiations with the Negotiating Committee), and

(c) report back to the Working Group in relation to outcomes achieved through such collective discussions / negotiations, and where necessary, seek instructions as to further negotiations with PNO.

1.28. It is also proposed that the Working Group will convene on an ongoing basis, as the Applicants consider necessary, in response to annual access price adjustments by PNO.

1.29. Under the Proposed Collective Bargaining Conduct each coal producer can independently determine whether to accept any negotiated terms and conditions offered by PNO following collective negotiations. Each coal producer may undertake independent negotiations with PNO at any time, should they wish to do so.[25]

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21 NSW Minerals Council submission, 30 April 2020, pp 2, 3, 7.

22 NSW Minerals Council submission, 30 April 2020, p. 7.

23 NSW Minerals Council supporting submission to the application AA1000473, 6 March 2020, paragraph 1.10.

24 Unless stated otherwise, the information under this heading was obtained from NSW Minerals Councils' submission, 15 May 2020, pp 4-6.

25 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2030, paragraph 1.33.

Who pays Port access charges?

1.30. The Applicants submit that PNO has previously disputed whether coal producers are entitled to negotiate with PNO in relation to access arrangements.[26]

1.31. PNO advises that in practice, the coal customer engages the vessel operators who are responsible for transporting the coal. In turn, vessel operators appoint vessel agents to engage with PNO on their behalf in respect of a vessel's visit to the port, including the payment of relevant port charges. PNO does not deal directly with the vessel operators, but rather 8 to 10 vessel agents. The vessel agent receives the navigation service charge invoice from PNO, together with details about the vessel's visit and gross tonnage loaded, and then pays the invoice to PNO on behalf of its principal (the vessel operator). As such, apart from a small minority of cases where the coal producer happens to be the charterer of the vessel, the Applicants' interest in the navigation service charge is limited to the effect of this charge on the price of their coal in the international market.[27]

1.32. The Applicants consider that PNO's invitation for coal producers to enter into bilateral negotiations of a long term deed indicates that PNO now recognises that 'directly or indirectly coal exporters bear the cost of the infrastructure service charges imposed by PNO irrespective of the form of contractual arrangement with the [coal] customer.'[28]

1.33. Further, in an oral submission to the ACCC, Whitehaven Coal acknowledged that it is the coal customers that pay the navigation service charge (due to coal being sold FOB), but it impacts the competitiveness of Newcastle coal in the international market. It advised that some customers have expressed interest in having the uncertainty over the level of the navigation service charge resolved to provide greater certainty over (delivered) coal prices.[29]

2. Background

The Port of Newcastle and access charges

2.1 The Port is located at the end of a multi-use coal export supply chain that involves an extensive rail network from multiple mine sites in the Hunter Valley, Gunnedah Basin, Gloucester Basin, and parts of the Western coalfield.

2.2. Excluding the coordination of supply chain logistics between the mines and landside coal loading terminals, the task of exporting coal from the Port involves vessels entering the Port, transiting the channels in the Port, tying up at the berths to load coal at the terminals and then once again transiting the channels before exiting the Port.

2.3. The Port has deep water channels, capacity to double trade volumes, available portside land, and berthside connections to an extensive rail network.[30] In 2019, there were 2 296 ship visits to the Port, with coal representing 96 per cent of the commodities exported (or 165 252 666 mass tonnes).[31] Other commodities exported

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[26] NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 1.6.

[27] Submission from PNO, 7 April 2020, paragraphs 48 – 49.

[28] NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 1.6.

[29] Record of oral submission from Whitehaven Coal, 18 March 2020.

[30] PNO's website, https://www.portofnewcastle.com.au/about-our-port/, viewed on 15 May 2020.

[31] PNO, *Port of Newcastle 2019 Trade Report,* p. 2.

at the Port include ammonia, metal concentrates, general cargo, aluminium, pitch and tar products, steel and wheat.[32]

2.4. Coal from the Port is exported to around 20 countries, primarily in Asia. Japan is the largest customer of coal from Newcastle, receiving 44 per cent of exports. China, Korea and Taiwan currently account for a further 44 per cent.[33]

2.5. At the Port, PNO works closely with the **Port Authority NSW,** a state-owned corporation with responsibility for Sydney Harbour, Port Botany, Port Kembla and the ports of Newcastle, Yamba and Eden. Among other things, PNO is responsible for channel dredging services, vessel schedules and wharf and berth services for vessels entering the Port, while Port Authority NSW provides a variety of services including, navigation (pilotage), security and operational safety at the Port. The Port Authority NSW receives a quarterly fee from PNO for those services (excluding pilotage services) which, for recent and future years, is calculated as a fixed proportion of the navigation service charge that PNO receives from its customers.[34]

Published schedule of service charges at the Port of Newcastle

2.6. As mentioned, PNO publishes a full schedule of service charges that apply to the commercial use of the Port. Where a Port user has *not* entered into a long term deed with PNO, the following 2020 access prices include:[35]

Service	Vessel (gross tonnage)	Price
Navigation service charge	*Non-coal vessels* (over 600GT)	$0.5247 per GT for the first 50,000 GT plus $1.1810 per GT thereafter. (Subject to a maximum NSC for passenger cruise ships of $55,816.82 per visit)
	Standard price for *coal vessel* (over 600GT) where bilateral long term price deed does *not* apply to the vessel.	$1.0424 per GT
Wharfage (non-containerised cargo by berth)	Dyke 1	$1.91 (per revenue tonne)
	Dyke 2	$1.02 (per revenue tonne)
	Mayfield 4, West Basin 3 and 4, Kooragang 2 and 3	$2.07 (per revenue tonne)
	East Basin 1 and 2, Dyke 4 and 5, Kooragang 4 - 10, BHP 6 and Mayfield 7	$0.0802 (per revenue tonne)

[32] PNO, *Port of Newcastle 2019 Trade Report,* p. 3.

[33] NSW Minerals Council supporting submission to the application for authorisation AA1000473, paragraph 2.3.

[34] Port Authority NSW submission, p. 2.

[35] The ACCC has only listed the navigation service change and wharfage price for the purposes of the Proposed Collective Bargaining Conduct. For the full schedule of PNO's services charges, see *Port of Newcastle Schedule of Service Charges, effective 1 January 2020, available at* https://www.portofnewcastle.com.au/wp-content/uploads/2020/03/OAR-TERMS-Schedule-of-Charges-2020-V2-13-March-2020.pdf.

2.7. Following the privatisation of the Port in 2014, PNO's published port access charges at the Port have increased significantly. Since 2014, the navigation service charge has increased 143 per cent, and there has been a 22 per cent increase in the wharfage charge.[36]

Overview of PNO's long term pro forma Deed for coal producers

2.8. As previously mentioned, PNO offered an alternative to its published schedule of access charges to coal producers in December 2019, and it is the terms and conditions of this long term Producer Deed that the Applicants seek to collectively negotiate with PNO. The Producer Deed[37] is for an initial term of ten years and sets out the following 'producer specific charges' for covered vessels transporting producers' coal at the Port:

- **navigation service charge** – currently **A$0.81** per vessel gross tonne (adjusted annually) and
- **wharfage charge** – currently **$0.08** per revenue tonne of producer coal loaded onto a covered vessel (adjusted annually).

2.9. Other features of PNO's pro forma Producer Deed include:

- Annual price adjustments (clause 7 of the Producer Deed) – at the beginning of each contract year, PNO will apply an annual price adjustment of the navigation service and wharfage charges (it will apply the higher of two formulae). It may also vary producer charges following arbitration of a pricing dispute (under the Producer Deed) or in accordance with PNO's projected 5 year capital expenditure.
- Notice of variations to proposed producer charges (clause 8 of the Producer Deed) – PNO will provide no less than 45 days written notice of variations to producer changes at the Port. Coal producers may object to a price variation by lodging a Price Variation Objection Notice within 14 days.
- Non-discriminatory pricing (clause 5 of the Producer Deed) – PNO commits to not discriminate adversely against any coal producer on price.
- Consultation in relation to efficiency improvements and capital expenditure at the Port (clause 10 of the Producer Deed) – PNO will meet coal producers with executed Producer Deeds at least twice in any contract year to consult on the following matters:
  - efficiency improvements to vessel services that PNO could make, and
  - PNO's delivery of vessel services – including capital expenditure, proposed variations to fees and charges, PNO's cost of operations, a coal producer's future needs (including the producer's forecast coal volumes to be shipped from the Port for the next six months) and any other matter agreed between a coal producer and PNO.

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[36] NSW Minerals Council's supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 1.22.

[37] PNO, *Producer pro forma long term pricing deed*, available from https://www.portofnewcastle.com.au/wp-content/uploads/2020/03/OAR-TERMS-Producer-Deed-13-March-2020_.pdf

The Hunter Valley coal chain

2.10. The Hunter Valley coal export supply chain is the largest coal export operation in the world.[38] In 2018-19, NSW exported 168 million tonnes of coal, and 161 million tonnes (or 96 per cent) was exported through the Port. The remainder was exported through Port Kembla.

2.11. The Hunter Valley coal chain is made up of coal producers (mines), rail haulage providers[39], the Australian Rail Track Corporation (**ARTC**) as the owner of the track, three coal export terminals (owned by Port Waratah Coal Services and Newcastle Coal Infrastructure Group), port managers, and the Hunter Valley Coal Chain Coordinator (**HVCCC**).

2.12. The current application does not cover coal chain logistics coordination in rail or at the coal loading terminals at the Port themselves. Such long term coordination is the subject of a separate ACCC authorisation.[40]

Recent history and developments at the Port of Newcastle

2.13. Over the last several years there have been significant regulatory issues at the Port, including: 'declaration' of the Port under Part IIIA of the Act, and the removal of that 'declaration'; an ACCC 'access determination' under Part IIIA; and a Federal Court review of the Australian Competition Tribunal's decision on the terms of access by Glencore Coal Assets Australia Pty Ltd (Glencore) to certain services at the Port. The following overview of these issues provides broader background to the Proposed Collective Bargaining Conduct:

- **2015** – Glencore seeks declaration of the shipping channel at the Port by the National Competition Council (**NCC**). The NCC does not recommend declaration of the channel services.
- **2016** – Glencore appeals the Treasurer's decision not to declare the channel services, as per the NCC's recommendation, and the Australian Competition Tribunal (**Tribunal Determination No. 1**) determines that the shipping channel at the Port of Newcastle is declared.
- **November 2016 –** Pursuant to this declaration, Glencore notifies the ACCC of an access dispute with PNO about the increase in price for coal vessels entering the Port, and requests the ACCC to arbitrate.
- **July 2018** – following amendment of the declaration criteria under Part IIIA of the Act in 2017, PNO seeks recommendation from NCC to revoke declaration of the shipping channel service at the Port.
- **September 2018** – the ACCC finalises its arbitration of the access dispute between Glencore and PNO. The **ACCC's Access Determination** concludes that PNO should charge ships entering the port to carry Glencore's coal $0.61 per gross tonne (**GT**). In this process, the ACCC had to establish the value of assets used to provide the 'declared' shipping channel service. The ACCC determined it

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38 NSW Minerals Councils' supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 2.1.

39 There are currently four rail operators providing rail haulage services to coal producers in the Hunter Valley coal chain – Pacific National, Aurizon, Genesee & Wyoming and Southern Shorthaul Railroad.

40 ACCC determination, 9 December 2009, applications for authorisation A91447-A91449, A91168-A91669 lodged by Port Waratah Coal Services, Newcastle Coal Infrastructure Group and the Newcastle Port Corporation – see Final Determination.

was appropriate to exclude previous user-funded channel dredging from the costs that PNO could recover.

PNO subsequently appealed the ACCC's Access Determination to the Australian Competition Tribunal.

- **July 2019** - NCC recommends that the declaration of the Port under Part IIIA of the Act be revoked.
- **October 2019** – the Australian Competition Tribunal issues a determination increasing access charges (from $0.61 per gross tonne) to $1.01 per gross tonne **(Tribunal Determination No. 2).** In its determination the Tribunal included previous industry-funded expenditure for channel dredging in PNO's regulated asset base. This allowed PNO to recover the user-funded amounts in its access charge.

  The Tribunal's Determination No. 2 is limited to the terms and conditions of access where Glencore owns or, either directly or by agent, charters a vessel that enters the Port and loads Glencore coal. It does not apply to:

  - the terms and conditions of access to apply in respect of vessels carrying coal that are not owned, or have not been chartered, by Glencore
  - the terms and conditions of access for vessels other than those calling at the coal terminals at the Port, and
  - any charges imposed by PNO other than the Navigation Service Charge and the Wharfage Charge.
- **September 2019** – the Treasurer confirmed that following the expiration of the 60 day period to consider the NCC's recommendation, the declaration at the Port is deemed to be revoked.
- **November 2019 –** Glencore and the ACCC applied to the Federal Court for a review of the Tribunal Determination No. 2. The parties sought review of the Tribunal's treatment of user funding at the Port. While the declaration of the Port has been revoked, the Tribunal Determination No. 2 remains in force until 2031. On 24 August 2020 the Federal Court ordered that the Tribunal Determination No. 2 be set aside and the matter be remitted back to the Tribunal for determination.[41]

New application for Part IIIA declaration lodged with National Competition Council

2.14. On 23 July 2020, the NSW Minerals Council lodged an application with the National Competition Council for declaration of certain services in relation to the Port of Newcastle.[42] The application for declaration with the National Competition Council is made under Part IIIA of the Act.

2.15. Part IIIA of the Act sets out a number of mechanisms by which access can be sought to infrastructure services, including declaration and arbitration. Where a service has been declared under Part IIIA and an access seeker and provider cannot agree on the terms and conditions of access to that service, either party may request in writing for the ACCC to arbitrate the dispute.

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41 The Federal Court ordered that the ACCC's application be dismissed on 24 August 2020.

42 The NSW Minerals Council's application for declaration under Part IIIA of the Act is available from the National Competition Council's website: http://ncc.gov.au/application/application-for-declaration-of-certain-services-in-relation-to-the-port-of.

2.16. NSW Minerals Council's application for declaration under Part IIIA defines certain services as:[43]

> The service comprises the provision of the right to access and use all the shipping channels and berthing facilities required for the export of coal from 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 (Service). The Service is currently provided by PNO.
>
> …the Service relates to all coal being exported from the Port either on a Free on Board (FOB) or Cost including Freight (CIF) basis…
>
> …The facilities used to provide the Service are the shipping channels and vessel berth areas…

2.17. The National Competition Council is currently seeking submissions on the declaration application, prior to issuing a draft recommendation.

3. Consultation

3.1. A public consultation process informs the ACCC's assessment of the likely public benefits and detriments from the Proposed Collective Bargaining Conduct.

3.2. All public submissions by the Applicants and interested parties are available on the ACCC's Authorisations Public Register for this matter.

Prior to the draft determination

3.3. The ACCC invited submissions from a range of potentially interested parties including PNO, other service providers and infrastructure owners in the Hunter Valley coal chain, and relevant government departments.[44]

3.4. The ACCC received two public submissions opposing the application for authorisation, from PNO and the Port Authority NSW, which are summarised below:

- **PNO**, the target, submits that the application is seeking to re-litigate the issues which have been the subject of continuing dispute between PNO and Glencore (see paragraph 2.13 above for relevant history).

  PNO submits that there are no public benefits likely to result from the Proposed Collective Bargaining Conduct, and authorisation is not necessary for the certainty of pricing or future investment in the Hunter Valley. PNO submits that there are clear mechanisms in the Deed to understand how pricing increases will occur over the course of the Deed. Changes will be consistent with the Competition Principles Agreement pricing principles,[45] under which PNO will need to justify those changes above the greater of 4% or CPI in that year. PNO submits that it has been open with Port users about its future plans, and PNO is under a contractual obligation to provide coal producers with a forward looking five year forecast of its projected capital expenditure, potentially impacting its Producer Specific Charges, and to discuss those changes.

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[43] NSW Minerals Council's application for declaration under Part IIIA of the Act, July 2020, pp. 7, and17.

[44] A list of the parties consulted and the public submissions received is available from the ACCC's public register www.accc.gov.au/authorisationsregister.

[45] PNO submits that the pricing Principles reflect those found in Part IIIA and the Competition Principles Agreement requirements for an access regime to be certified.

PNO submits that contractual negotiation processes between PNO and Port users are already occurring and that PNO has been open to reasonable commercial compromise.

PNO submits that the Proposed Collective Bargaining Conduct is likely to remove each Port user's unique interests, and negotiations would proceed on the basis that users all have the same interests. PNO submits that in its experience, users have a spectrum of unique and varied incentives and interests in the transaction, and for some Port users, non-price terms of the Deed are equally important to price aspects. PNO submits that the interests of smaller exporters and Port users would be marginalised.

PNO submits its concerns that the Proposed Collective Bargaining Conduct carries a risk of improper information exchange, with serious implications for competition. Further it would be extremely difficult to detect and monitor any improper information exchange through such discussions.

PNO submits that any reduction in Navigation Services Charges would result in an immaterial reduction in price in overseas export markets, and any public benefits will have no material impact on relevant domestic markets.

- **Port Authority NSW** submits that the proposed collective negotiation of the navigation service charge between the Applicants and PNO, and the potential for a reduction of those charges, may have flow on effects to the amount that PNO pays the Port Authority NSW for services provided at the Port (it receives a proportion of the navigation service charge). It submits that this has the potential to compromise the safe operation of the Port. The Port Authority NSW submits that authorisation should be limited to collective negotiation of the wharfage charge only, alternatively, it submits that that a condition to authorisation should be imposed by the ACCC to limit any change to the revenue that Port Authority NSW receives under the navigation services charge.

  Further, Port Authority NSW submits that the Proposed Collective Bargaining Conduct has the potential to result in information sharing amongst the Applicants, which could impact the domestic market for coal supply.

3.5. The ACCC received three public submissions expressing support for the application for authorisation, from Port Waratah Coal Service (**PWCS**), Yancoal, and Whitehaven Coal, which are summarised below:

- **PWCS** (a coal loading terminal operator) supports the application to allow the Applicants to collectively negotiate with PNO on all terms of access that are necessary for the exporting of coal.

  PWCS raises concerns around the current lack of transparency in recent increases of Port charges by PNO and its re-investment into the Port. Further, PWCS is concerned with PNO's proposed regulated asset base, particularly the inclusion of over $500 million for channel dredging works funded by PWCS.

  PWCS submits that the Proposed Collective Bargaining Conduct is likely to lead to public benefits including, increased investment and employment in the Hunter region, increased transparency of pricing and certainty as to longer term expenditure and investment, increased competition for supply of coal to export markets, and reduced transaction cost savings.

- **Yancoal** (a large coal producer, and Applicant) submits that bilateral negotiations have so far been difficult, and public benefits from the Proposed Collective Bargaining Conduct are likely to include, transaction cost savings for all parties, and a higher degree of certainty for PNO and the Hunter Valley coal industry as to

future increases in charges, creating a more favourable environment for future investment in both coal production and Port infrastructure.

Yancoal submits that detriments due to the Proposed Collective Bargaining Conduct will be minimal, considering that participation is voluntary for all parties, there is no collective boycott proposed, and the exchange of information between coal-producers will only relate to channel services terms, and exclude any sensitive information relating to future marketing, production plans or coal operations.

- **Whitehaven Coal** (mines operator and Applicant) submits that the uncertainty of navigation charges impacts the competitiveness of Newcastle coal in the international market, and customers require greater certainty over coal pricing.

  Whitehaven Coal submits that it is important that all coal producers face the same terms and conditions of access so that shippers don't favour one over another based on their terms of access.

3.6. The ACCC received a submission from the **Hunter Valley Coal Chain Coordinator Ltd** (**HVCCC**), which submits that generally it finds it unlikely that there would be either a benefit or detriment to HVCCC's ability to meet its objects, regardless of the outcome of this application.

Applicants' response to submissions – prior to the draft determination

3.7. In response to submissions made by interested parties, the Applicants submit that:

- they are seeking to discuss legitimate industry-wide concerns. Discussions are not limited to past user contributions or issues raised in previous litigation between Glencore and PNO, but include future user-funder expenditure at the Port
- bilateral negotiations between PNO and Port users have not succeeded
- there is no incentive for any competitively sensitive information to be shared amongst the Applicants. Information relating to terms and conditions of access to the Port, including price, is public and not volume based. Further, the Applicants have common interests for transparency and efficiency, and through collective negotiations, they seek that terms and conditions to be understood and approached in a consistent manner across the industry, and
- the condition of authorisation suggested by Port Authority NSW should not be imposed. Access seekers should be able to negotiate efficient pricing with PNO irrespective of commercial arrangements between PNO and Port Authority NSW.

After the draft determination

3.8. On 19 June 2020 the ACCC issued a draft determination proposing to grant authorisation to the Proposed Collective Bargaining Conduct for 10 years. A conference was not requested following the draft determination.

3.9. The ACCC received two public submissions in response to the draft determination – one opposing the proposed authorisation from PNO, and one supporting the proposed authorisation from PWCS. In making its assessment of the application, the ACCC has also taken into account information provided by PNO on a confidential basis.

3.10. **PNO** expressed concern about the ACCC's draft determination. In its public submission, PNO states that it relies on its two previous submissions to the ACCC. In particular, it maintains that the authorisation test is not met because:[46]

- The proposed Collective Bargaining Conduct will result in public detriments – notwithstanding that it is voluntary for all parties, collective bargaining will 'substantially alter competitive dynamics' between coal producers in the market for access to port services at the Port of Newcastle, with larger producers placing pressure on smaller producers within the bargaining group. It also increases the potential for collective activity among the bargaining group, beyond the authorised conduct.
- There is no public benefit from the proposed Collective Bargaining Conduct. In particular:
  - There is no increased certainty or efficient investment – PNO submits it has been in 'active negotiations for several months' and is 'well aware' of the parties' positions. Simply putting these positions collectively is 'unlikely to be of benefit', or reduce asymmetry of information.
  - The competitiveness of the Australian export coal industry is unlikely to be enhanced by the Proposed Collective Bargaining Conduct – PNO submits the navigation service charge (at the level already set by it, and the likely subject of collective negotiation) will not impact the competitiveness of Hunter Valley coal in the international market.
  - There are unlikely to be improved efficiencies through transaction cost savings – PNO considers that collective negotiations will make reaching any negotiated outcome with it 'significantly less likely'.

3.11. In contrast, **PWCS** expressed support for the ACCC's conclusions in the draft determination. It submits that:[47]

> Given the importance of coordination across the Hunter Valley coal chain, we believe the most efficient outcome is for an ACCC authorisation to enable the Applicants and PNO to discuss access charges, annual access price adjustments, projected capital expenditure, the cost of operations, efficiency improvements to vessel services, delivery of vessel services and the future needs or demand for vessel services.

Applicants' response to submissions – after the draft determination

3.12. In response, the Applicants maintain that collective negotiations with PNO in relation to industry wide issues will have pro-competitive outcomes. Further, the Applicants submit it is unclear what commercial interests larger producers have in dissuading smaller producers from individually negotiating terms and conditions of access with PNO should they wish to do so.[48]

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46 Port of Newcastle Operations submission, 10 July 2020, p. 2.

47 PWCS submission, 10 July 2020, p. 2.

48 Applicants' submission in response to interested parties, 18 August 2020, pp 1, 2.

4. ACCC assessment

4.1. The ACCC's assessment of the Proposed Collective Bargaining Conduct is carried out in accordance with the relevant authorisation test contained in the Act. In assessing the application for authorisation relating to the Proposed Collective Bargaining Conduct, the ACCC has had regard to the public benefit and detriment issues raised in submissions from interested parties and the Applicants, including information excluded from the public register.

4.2. The Applicants have sought authorisation for the Proposed Collective Bargaining Conduct that would or might constitute a cartel provision within the meaning of Division 1 of Part IV of the Act and may substantially lessen competition within the meaning of section 45 of the Act.[49]

4.3. Consistent with subsection 90(7) and 90(8) of the Act as they apply to this application for authorisation, the ACCC must not grant authorisation unless it is satisfied, in all the circumstances, that the conduct would result or be likely to result in a benefit to the public, and the benefit would outweigh the detriment to the public that would result or be likely to result from the conduct (**authorisation test**).

Relevant areas of competition

4.4. To assess the likely effect of the Proposed Collective Bargaining Conduct, the ACCC identifies the relevant areas of competition likely to be impacted.

4.5. The Applicants submit the main area of competition affected by the Proposed Collective Bargaining Conduct is the 'market for the provision of infrastructure access at the Port.'[50]

4.6. The Applicants consider the Proposed Collective Bargaining Conduct could also impact the following other areas of competition:[51]

- the coal export market
- the acquisition and disposal of exploration and/or mining authorities (the Tenements Market), and
- supply of specialist mining services such as geological and drilling services, and construction, operation and maintenance services.

4.7. The ACCC considers that the most relevant area of competition affected by the Proposed Collective Bargaining Conduct is competition for access to port services at the Port which are owned and operated by PNO. This includes channel shipping services and wharfage, but does not include landside coal loading infrastructure which is owned by other parties, or marine pilotage services.

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49 NSW Minerals Council submission, 15 May 2020, paragraph 2.2-2.3.

50 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 4.3.

51 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 5.6.

Future with and without the Proposed Collective Bargaining Conduct

4.8. In applying the authorisation test, the ACCC compares the likely future with the Proposed Collective Bargaining Conduct that is the subject of the authorisation to the likely future in which the Proposed Collective Bargaining Conduct does not occur.

Submissions

4.9. The Applicants submit that without the Proposed Collective Bargaining Conduct, they would not be able to 'collectively discuss with PNO industry issues relating to access to the Port and the provisions of the proposed Producer Deed that PNO has issued, particularly in relation to capital expenditure and PNO's investment in the Port.'[52]

4.10. PNO submits that in the absence of the proposed collective bargaining arrangements, and if individual Applicants elect not to enter into a long term Producer Deed with it via bilateral discussions, 'the terms and conditions of access are openly available, as are the fees and charges' in its published schedule of service charges, albeit at non-discounted rates.

4.11. The Applicants acknowledge that with the Proposed Collective Bargaining Conduct 'PNO is free to decline to collectively negotiate if it so chooses.'[53]

4.12. PNO advises that:[54]

> …it has stated explicitly to the Applicants that any authorisation will have no practical effect given that PNO will not be engaging in collective negotiations with the Applicants, but rather will continue to offer to undertake bilateral negotiations.

ACCC view

4.13. As noted above, the ACCC's role is to assess the public benefits and detriments that are likely to arise in the future with and without the Proposed Collective Bargaining Conduct. It is not the ACCC's role to attempt to predict whether the proposed conduct will be engaged in by the parties, or the outcome of collective negotiations on any specific issues.

4.14. PNO currently offers a pro forma long term deed to producers, which covers 'producer specific' access charges (defined in the Producer Deed as, the navigation service charge and wharfage charge), as well as setting out broader common terms and conditions – for example, PNO's proposed industry consultation in relation to capital expenditure at the Port, and any proposed changes to PNO's fees and charges. PNO maintains it is willing to engage in bilateral discussions with individual producers to enter into a Producer Deed.[55] The ACCC's role is to assess the public benefits and detriments that are likely to arise if negotiations with producers occurred collectively.

4.15. The ACCC considers that with the Proposed Collective Bargaining Conduct, the Applicants would seek to engage in collective negotiations with PNO, through the Negotiating Committee and the process outlined above at paragraphs 1.25 – 1.29, for the purpose of then individually entering a long term Producer Deed for access to the

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52 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 4.2.

53 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 4.2

54 Port of Newcastle Operations submission, 7 April 2020, paragraph 5.

55 Port of Newcastle Operations submission, 10 July 2020, p. 7.

Port. During these collective negotiations, the Applicants would seek to discuss issues common to the Hunter Valley coal industry, such as PNO's planned capital expenditure at the Port, as well as 'producer specific charges' under the Deed (that is, the navigation service charge and wharfage). The Applicants would then individually decide whether to enter any long term access Deed agreed upon with PNO for a period of ten years, or undertake further separate negotiations with PNO.

4.16. The ACCC considers that without the Proposed Collective Bargaining Conduct, each member of the bargaining group is likely to seek to engage in bilateral discussions with PNO about the terms and conditions of access proposed in its ten year pro forma Producer Deed. In the absence of entering into a long term Producer Deed with PNO, the vessels carrying coal for the Applicants will be subject to PNO's published access charges (referred to at paragraph 2.6 of this determination).

Public benefits

4.17. The Act does not define what constitutes a public benefit. The ACCC adopts a broad approach. This is consistent with the Australian Competition Tribunal (the **Tribunal**) which has stated that the term should be given its widest possible meaning, and includes:

> *…anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements … the achievement of the economic goals of efficiency and progress.* [56]

4.18. The Applicants submit that the Proposed Collective Bargaining Conduct will result in public benefits including the following:[57]

- efficiencies, including transaction cost savings, from collective negotiation generally, and from collective discussion of industry wide issues, such as proposed capital expenditure at the Port
- improved pricing outcomes through increased transparency on PNO's capital expenditure and cost allocation, and
- enabling coal producers to more efficiently compete to export coal from the Hunter Valley, and a material increase in competition in a number of dependent markets.

4.19. PNO submits that 'there are no discernible public benefits likely to flow from the Proposed Collective Bargaining Conduct.'[58] It believes that many of the claimed benefits already exist without the Proposed Collective Bargaining Conduct (via bilateral discussions), represent private benefits to coal producers only, or are benefits that flow offshore.

4.20. In any event, PNO submits that the Proposed Collective Bargaining Conduct 'will have no practical effect because it will not be engaging in collective negotiations with the Applicants.'[59]

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56 Queensland Co-operative Milling Association Ltd (1976) ATPR 40-012 at 17,242; cited with approval in Re 7-Eleven Stores (1994) ATPR 41-357 at 42,677.

57 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraphs 5.1 – 5.6.

58 PNO submission, 7 April 2020, paragraph 8.

59 PNO submission, 7 April 2020, paragraph 5.

4.21. The ACCC notes that upfront statements from 'targets' of proposed collective bargaining that they will not engage with a bargaining group does not mean there can be no public benefits from the proposed conduct.

4.22. A collective bargaining authorisation granted by the ACCC, when it does not include a collective boycott, does not compel the target to deal with the group. It is not uncommon in these circumstances for the target to submit that they will not engage with the group, or that they would not change their standard terms in any event. However, the ACCC's role is to assess the public benefits that are likely to result from the proposed collective bargaining conduct if it is engaged in by the parties.

4.23. In addition, the ACCC considers that public benefits result from providing the opportunity for the collective bargaining group to form and attempt to collectively bargain, even when the target advises that it will not deal with the group.

4.24. Generally, the ACCC considers that collective bargaining can result in public benefits by improving the efficiency of contracting between the 'target' and members of a collective bargaining group - for example, generating mutual benefits by reducing transaction costs or reducing information asymmetries between negotiating parties.

4.25. In assessing the current application for authorisation, the ACCC has assessed the public benefits and public detriments that are likely to arise if the Applicants have the opportunity to collectively negotiate with PNO, including any public detriments resulting from a lessening of competition.

Increased certainty and efficient investment from having greater input into the template producer Deed and reducing information asymmetry

4.26. Information asymmetry occurs when one party to a negotiation has access to relevant information that the other party does not. Where there is information asymmetry, the party lacking information may accept or contemplate different terms than it would if more information were available to it. Under these circumstances, the outcomes of the negotiation may not capture many of the available efficiencies. Information asymmetry can often be addressed by improving the transparency of market information. If collective bargaining improves the availability and use of information, it has the potential to enable more complete and efficient contracts to be negotiated that better reflect the needs of members of the bargaining group.

Submissions – prior to the draft determination

4.27. The Applicants submit that collective negotiation of common industry issues under the Deed, such as cost allocation at the Port (for example, how user funding should be treated in that framework) and increasing transparency about PNO's forecast capital expenditure relating to services at the Port would be likely to lead to 'more efficient investment and … the potential for reduced charges being imposed on the mining industry over time.'[60]

4.28. Conversely, PNO submits that the Proposed Collective Bargaining Conduct would not likely result in any discernible public benefits from increased transparency and providing greater input into the terms and conditions of Port access because this already occurs without collective bargaining. In particular, it submits that it has been open about its plans with Port users and has offered producers the opportunity to enter

[60] NSW Minerals Council supporting submission to the application for authorisation AA10000473, 6 March 2020, paragraph 5.2.

into discounted long term pricing arrangements through bilateral negotiations on its template Deed. Even if producers do not elect to enter into a long term pricing Deed, PNO publishes its Port access terms and conditions on its website.[61]

4.29. Further, PNO submits that during bilateral discussions about its template producer Deed it has been open to reasonable commercial compromise – for example, it added a new clause in its template Deed which commits PNO to not discriminate adversely against any producer on price.[62]

4.30. PNO also submits that under the current template Producer Deed, a variation to the access charges covered by the Deed can only be made by PNO once a year. It submits that:[63]

> A variation can only be made over and above the 4%/CPI increase where it is Material (as that term is defined in the Deed), which is designed to avoid trivial increases. Moreover, in the event of a Permitted Price Dispute (as that term is defined in the Deed) arising, the parties are bound to conduct mediation and, failing the resolution within 28 days, arbitration in accordance with the Australian Centre for International Commercial Arbitration (ACICA) Arbitration Rules.

4.31. In response, the Applicants submit that the Proposed Collective Bargaining Conduct could facilitate more effective resolution of industry-wide issues, as opposed to individual negotiations. In this regard, the Applicants note that ten of the largest users of the Port have not been satisfied with bilateral discussions to date and seek authorisation to negotiate industry issues from an industry-wide perspective.[64] While noting PNO's new 'non-discrimination clause' in the template Producer Deed, the Applicants consider that it provides 'minimal utility' to producers in circumstances where they have limited prospect of 'achieving a balanced and reasonable contractual set of terms with PNO' through bilateral negotiations.[65]

4.32. Further, the Applicants submit that PNO holds all of the data on past expenditures at the Port while coal producers, irrespective of their size or volume of coal exported though the Port, have little 'bargaining power or ability to question PNO in relation to capital expenditures or price increases.'[66] Individual coal producers seeking to have bilateral negotiations with PNO in relation to its long term template Deed would not have access to that data.

4.33. The Applicants note that although PNO has committed under its template Deed to provide individual Port users with a five year forecast of its projected capital expenditure, they consider this 'is simply a forecast and users have no input or ability to materially influence that forecast.'[67] For example, the Applicants note that Clause 7(c) of the annexure to the template Producer Deed states that PNO:[68]

> …may, but is not obliged to, implement any comments made by the Producer on its 5 year CAPEX forecasts or any proposed increase to the Producer Specific Charges.

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61 PNO submission, 7 April 2020, p. 3.

62 PNO submission, 7 April 2020, p. 3.

63 PNO submission, 7 April 2020, p. 3.

64 NSW Minerals Council submission, 30 April 2020, p. 4.

65 NSW Minerals Council submission, 30 April 2020, pp. 4-5.

66 NSW Minerals Council submission, 30 April 2020, pp 7-8.

67 NSW Minerals Council submission, 30 April 2020, p. 8.

68 NSW Minerals Council submission, 30 April 2020, p. 8.

4.34. Similarly, PWCS submits that increasing transparency of PNO's expenditure and cost allocation would likely lead to more efficient investment and pricing at the Port.[69]

4.35. Further, PWCS submits that the Proposed Collective Bargaining Conduct will 'assist the coal industry overcome material concerns relating to access to essential infrastructure and services at the Port, including significant increases in prices and inflexibility in commercial negotiations.'[70] For example, PWCS submits that it shares the Hunter Valley coal industry's concerns about:

> PNO's proposed regulated asset base (RAB) and, in particular, the inclusion of expenditure totalling in excess of $500 million related to dredging of the channels. Port Waratah [PWCS] funded the construction of the existing deep-water channel, swing basin, berth pockets and seawalls adjacent to the Kooragang Coal Terminal. As a result, our customers have already paid for these construction costs via historical terminal access charges.
>
> …the lack of evidence that PNO has provided to show that recent increases in port charges have been re-invested in the Port for the benefit coal export operations.[71]

4.36. Yancoal considers the Proposed Collective Bargaining Conduct is likely to improve the prospects of a beneficial negotiated outcome because bilateral discussions with PNO have been difficult – for example, individual coal producers are reluctant to reach an arrangement with PNO that might be less favourable than an outcome reached by another producer; there is an inequality of bargaining power that exists between an individual coal producer and PNO; and the proposed producer Deed relates to issues that are relevant to the Port and coal industry as a whole, such as future capital expenditure at the Port, and the impact on prices paid by coal producers.

Submissions – following the draft determination

4.37. In response to the draft determination, PNO reiterated its view that there is already sufficient transparency and producers can already have input into the terms and conditions of Port access without collective bargaining. It also maintains that its non-discriminatory pricing commitment under its long term producer Deed means collective bargaining is unnecessary. In particular, PNO submits that:[72]

> Over the past several months PNO has been actively negotiating with a number of port users including the Applicants in relation to the terms of long-term pricing arrangements subject to agreeing the terms of a Port User Pro Forma Long Term Pricing Deed and the parties' respective positions have been clearly articulated.

4.38. Further, PNO considers it unlikely that the Proposed Collective Bargaining Conduct would reduce asymmetry of information about past expenditures at the Port between the Applicants and PNO. Regarding any proposed capital investment at the Port, PNO submits that it:[73]

> …is prepared to consult in good faith with port users prior to any future development and receive their comments in relation to such investment (as reflected in Clause 7(c) of the annexure to the template Producer Deed). However, any final decision in relation to future development of the Port must, of course, remain at PNO's discretion.

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69 PWCS submission, 3 April 2020, p. 2.

70 PWCS submission, 3 April 2020, p. 1.

71 PWCS submission, 3 April 2020, p. 2.

72 Port of Newcastle Operations submission, 10 July 2020, p. 5.

73 Port of Newcastle Operations submission, 10 July 2020, p. 6.

4.39. In contrast, PWCS submits that the Proposed Collective Bargaining Conduct:[74]

> ...should enable the industry to reach a long-term commercial solution in relation to port charges. Uncertainty in relation to these charges has the potential to undermine industry confidence and threaten future long-term investment in the Hunter Valley region.

ACCC view

4.40. The ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in public benefit through addressing, in part, an asymmetry of information between each of the Applicants and PNO. In so doing, this is likely to facilitate more efficient and timely outcomes from negotiations, including the terms and conditions of the Producer Deed and ultimately, investment decisions within the Hunter Valley coal industry.

4.41. The ACCC considers that the Proposed Collective Bargaining Conduct will allow the Applicants to jointly identify, strategise and propose solutions in relation to standard contract terms under the template Producer Deed, as well as common industry issues such as forecast capital expenditure at the Port and cost allocation methodology. The ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in a public benefit where the increased input of the Applicants into the Producer Deed results in more efficient terms and conditions and more timely resolution of common industry issues, which are mutually beneficial to both the Applicants and PNO (for example, through more efficient capital expenditure at the Port). Increased certainty about terms and conditions of access at the Port is also likely to lead to more efficient investment decisions within the Hunter Valley coal industry, which is a public benefit.

Increasing competitiveness of Australian export coal industry

4.42. The Act recognises that increasing the international competitiveness of Australian industries is a public benefit.[75] In the current application for authorisation, the Applicants and some interested parties submit that the Proposed Collective Bargaining Conduct ultimately enhances the international competitiveness of Australian coal exports.

Submissions – prior to the draft determination

4.43. The Applicants submit that the Proposed Collective Bargaining Conduct is likely to result in the more efficient use of PNO's services, which in turn will allow Australian coal companies to more efficiently export coal from the Hunter Valley.[76]

4.44. In its oral submission to the ACCC, Whitehaven coal acknowledged that it is the customers that pay the navigation charge (due to coal being sold FOB), but it impacts the competitiveness of Newcastle coal in the international market. Some international customers have expressed interest in having the uncertainty over the level of the navigation service charge resolved to provide greater certainty over (delivered) coal prices.[77]

4.45. PWCS submits that access to services provided by PNO for use of the channel, a key piece of monopoly infrastructure, on reasonable terms and conditions is essential to the efficient operation of the Hunter Valley coal chain. It considers that collective

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74 PWCS submission, 10 July 2020, p. 1.

75 Section 90(9A) of the Act.

76 NSW Minerals Council supporting submission to the application AA1000473, 6 March 2020, paragraph 5.5.

77 Whitehaven Coal oral submission to the ACCC, 18 March 2020.

negotiations are likely to assist the industry in reaching long-term, sustainable and beneficial commercial outcomes.[78] In particular, assisting Australian coal producers, particularly smaller producers, to manage long term pricing certainty and investment is likely to promote competition in relation supply of Hunter Valley coal into export markets.[79]

4.46. PNO submits that the Proposed Collective Bargaining Conduct will not result in any discernible public benefits, particularly as any benefits would flow offshore given that 'coal from the Port is exported to overseas markets and it is customers in North Asia that ultimately pay the charges in question.'[80]

Submissions – following the draft determination

4.47. In response to the draft determination, PNO submits that the competitiveness of the Australian export coal industry is unlikely to be enhanced by the Proposed Collective Bargaining Conduct. In particular, it considers the navigation service charge (and any collectively negotiated discount) is unlikely to impact the overall competitiveness of Hunter Valley coal in the international market.

ACCC view

4.48. The ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in some benefits from increased pricing certainty and more timely resolution of industry-wide issues, which facilitates more efficient investment decisions for Australian coal producers, as well as increased certainty for the delivered coal price for international coal customers. Any collectively negotiated discount to the navigation service charge could provide additional benefit. Even though this would be a small proportion of the overall cost of delivered coal, small reductions in price can still make an impact at the margin. The ACCC considers these outcomes are likely to ultimately enhance the international competitiveness of the Hunter Valley coal industry, with employment and investment benefits for Australia.

Improved efficiencies through transaction cost savings

4.49. Collective bargaining enables members of a bargaining group to share some or all of the transaction costs of preparing to negotiate and negotiating, and thus can reduce the total costs borne by members of the group. Lower transaction costs can result in more efficient outcomes. This can potentially benefit both the bargaining group and the target.

4.50. The Applicants consider that generally, 'given the nature of services provided by PNO and that it is a monopoly infrastructure service provider', there are substantial efficiencies likely to result from the Proposed Collective Bargaining Conduct.[81] By offering a ten year pricing Deed to coal producers, which includes features impacting the entire Hunter Valley coal industry (such as forecast capital expenditure at the Port), a collective approach to negotiations would be more efficient than dealing with these common issues bilaterally.

4.51. The Applicants submit that the Proposed Collective Bargaining Conduct will realise transaction cost savings for both PNO and the Applicants, relative to PNO negotiating

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78 PWCS submission, 3 April 2020, p. 1.

79 PWCS submission, 3 April 2020, p. 2.

80 Port of Newcastle Operations submission, 7 April 2020, p. 1.

81 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 5.1.

individually with each member of the bargaining group.[82] The Applicants consider that over the proposed (ten year) authorisation period, these savings could be significant.

4.52. The Applicants, including Yancoal, submit that through collective negotiations, and given the significant number of coal producers impacted, it is likely that a single collective negotiation will involve materially lesser negotiation costs and resources for all parties in comparison to a series of bilateral negotiations with PNO (which to date have not yielded a satisfactory resolution to industry issues).[83]

4.53. PWCS submits that PNO's proposed access arrangements will affect the industry as a whole (for example, forecast capital expenditure at the Port) and should be dealt with at an industry level. In particular, it considers a long-term arrangement on user funded expenditure will lead to more certain pricing and efficient investment for the Hunter Valley coal industry.[84]

4.54. PWCS also considers that collective negotiations with PNO would result in transaction cost savings to all parties, who would otherwise be required to negotiate with PNO on an individual basis.[85]

4.55. PNO did not specifically comment prior to the draft determination on whether the Proposed Collective Bargaining Conduct would result in transactions cost savings.

Submissions – following the draft determination

4.56. Following the draft determination, PNO submits that even if it was prepared to engage in collective negotiations, 'transaction cost savings will not arise' given that the Proposed Collective Bargaining Conduct will make reaching any negotiated outcome significantly less likely, given the diverse interests of the collective bargaining group.[86]

ACCC view

4.57. Compared to the 'future without the conduct', where members of the bargaining group would negotiate individually with PNO the terms and conditions of the long term Producer Deed, the ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in transaction cost savings (to all parties to the collective negotiations):

- The Applicants are likely to share the costs associated with preparing for, and engaging in negotiations through identifying and discussing common contractual issues, and sharing the costs of engaging expert advice and/or administrative services.
- PNO, is likely to reduce its costs, through reducing the number and length of negotiations, legal and administrative costs, compared to engaging in individual negotiations with each Applicant – including, for example, annual transaction cost savings by conducting collective discussions with the group rather than twice yearly consultation with individual coal producers (as contemplated under the Producer Deed) to discuss PNO's capital expenditure, any proposed variation to PNO's fees and charges, and PNO's costs of operations.

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82 NSW Minerals Council supporting submission to the application for authorisation AA1000473, 6 March 2020, paragraph 5.4.

83 NSW Minerals Council submission, 30 April 2020, p. 7.

84 PWCS submission, 3 April 2020, p. 2.

85 PWCS submission, 3 April 2020, p. 2.

86 Port of Newcastle Operations submission, 10 July 2020, p. 7.

ACCC conclusion on public benefits

4.58. The ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in public benefits. In particular, the ACCC considers that the bargaining group will have greater input into the terms and conditions of access under the Producer Deed, and increased transparency around capital expenditure plans and cost allocation at the Port. This will provide greater certainty for the delivered price of Hunter Valley coal, more timely resolution of industry-wide issues, and facilitate more efficient investment decisions at the Port and across the Hunter Valley coal industry. The ACCC also considers these outcomes will also enhance the international competitiveness of the Hunter Valley coal industry, with investment and employment benefits in Australia.

4.59. The ACCC also consider the Proposed Collective Bargaining Conduct is likely to result in a public benefit in the form of transaction costs savings.

Public detriments

4.60. The Act does not define what constitutes a public detriment. The ACCC adopts a broad approach. This is consistent with the Tribunal which has defined public detriments as:

> *…any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.*[87]

4.61. The ACCC considers that public detriment may arise as a result of collective bargaining arrangements in circumstances where competition is reduced between members of the group as a result of acting collectively, the ability of businesses outside of the bargaining group to compete against the group is affected, and/or by increasing the potential for collective activity beyond the collective bargaining arrangements which are sought to be authorised.

4.62. The Applicants submit that the Proposed Collective Bargaining Conduct is likely to result in minimal, if any, public detriment, due to the following:

- The voluntary nature of the participation by the coal mining industry in the application, including the absence of any requirement on PNO to collectively negotiate.
- There is no collective boycott activity proposed.
- The Applicants are seeking to engage with PNO regarding its pricing arrangements and access terms to the Port that are already publically available, and so they submit that there is no risk of any information sharing as prohibited under the Act.

4.63. The ACCC considers the Proposed Collective Bargaining Conduct is unlikely to materially harm competition between coal producers. In particular, the proposed arrangements are voluntary, with coal producers free to enter collectively negotiated agreements with PNO or to seek to enter into bilateral discussions with PNO in relation to long term terms and conditions of access under the Producer Deed. In addition, the Proposed Collective Bargaining Conduct is limited in scope and relates to terms and conditions that are publicly available in PNO's published template Producer Deed, and authorisation is not being sought for members of the collective bargaining group to

[87] Re 7-Eleven Stores (1994) ATPR 41-357 at 42,683.

share individual coal projection volumes, customer pricing information or marketing strategies.

4.64. PNO submits that the Proposed Collective Bargaining Conduct carries a risk of improper information exchange, with serious implications for competition. The Port Authority NSW shares this concern.

4.65. Further, PNO submits its concerns that the unique interests of each coal producers in the collective bargaining group will be overshadowed by the interests of the collective group as a whole, resulting in a 'lowest common denominator position.'[88] PNO believes this will likely favour the interests of the larger coal producers.

4.66. Port Authority NSW submits that the proposed collective negotiation of the navigation service charge between the Applicants and PNO, and the potential for a reduction of those charges, may have flow on effects to the amount that PNO pays the Port Authority NSW for services provided at the Port.

4.67. These issues are discussed below.

Increased potential for collective activity beyond that authorised

4.68. Generally, the ACCC considers that information sharing in collective bargaining arrangements is of concern if it allows the parties to co-ordinate their conduct beyond that for which authorisation is granted, for example, if it facilitates collusion or provides a focal point for competitors to align their behaviours in related markets such as the downstream supply of services to consumers.

Submissions – prior to the draft determination

4.69. The Applicants submit that the exchange of information between the Applicants, and reaching an understanding only relates to the Proposed Collective Bargaining Conduct. Information will only be shared to the extent that it is reasonably necessary for, and related to, this purpose. The Proposed Collective Bargaining Conduct does not involve the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume/capacity projections for individual users. The Applicants submit that pricing at the Port has been historically based on a 'cost to use' basis (rather than individual volumes), and as such there is no reason to share production, customer information or industry data (which is already publicly available).

4.70. Further, the Applicants submit that they are generally large and sophisticated mining companies which have compliance processes in place to ensure that no information is exchanged that would be problematic under the Act.

4.71. Yancoal submits that the exchange of information between coal producers will only relate to channel services terms, and exclude any sensitive information relating to future marketing, production plans or coal operations, given the non-customer specific pricing model proposed by PNO.

4.72. PNO submits that authorisation would give the Applicants the ability to collectively discuss and negotiate the terms of access, including price to the Port for the export of coal through the Port. It would be extremely difficult to detect and monitor any improper information exchange through such discussions. Further PNO submits that, the fact that companies may be large and sophisticated does not diminish the risk of improper information exchange, with serious implications for competition.

[88] Port of Newcastle Operations submission, 7 April 2020, paragraph 25.

4.73. Following the draft determination, PNO acknowledged that any authorisation would not extend to the sharing of certain sensitive information. However, it reiterated that it would be difficult to detect and monitor any improper information exchanges between members of the bargaining group.[89]

4.74. Port Authority NSW agrees with PNO and submits that the Proposed Collective Bargaining Conduct has the potential to result in information sharing amongst the Applicants, for example sharing sensitive information on future production and export volumes, could potentially give the bargaining group insight into each other's intentions for domestic coal supply for energy generation.

ACCC view

4.75. The ACCC notes the concerns of PNO and Port Authority NSW, that there is a risk that competitively sensitive information may be shared in any collective bargaining discussions and it would be difficult to detect any improper information exchanges, which could potentially impact domestic coal supply.

4.76. The majority of Hunter Valley thermal coal is exported, with some supplied to power stations in the region for domestic energy generation. The ACCC acknowledges that all competing coal companies in the region will potentially be engaged in the Proposed Collective Bargaining Conduct, thereby increasing the risk of collusion.

4.77. However, the ACCC considers that the Proposed Collective Bargaining Conduct does not significantly increase the likelihood of collusion occurring in relation to matters for which authorisation is not being sought, or increase the likelihood of the members of the bargaining group sharing commercially sensitive information. The bulk of Hunter Valley coal is exported and the Applicants' face competition from many other producers in a global market. In any event, the Applicants have not sought authorisation to share customer information, marketing strategies or volume/capacity projections. Such conduct would not be covered under the authorisation and any such information sharing would be subject to the operation of the Act.

Potential to lose unique interests of bargaining group members

Submissions

4.78. PNO submits that in its experience, Port users have a spectrum of unique and varied incentives and interests in the transaction, and for some Port users, non-price terms of the Producer Deed are equally as important as price aspects. PNO submits that the Proposed Collective Bargaining Conduct would proceed on the basis that all members of the bargaining group have the same interest, and removes Port users' unique individual interests. Further, it considers that that the collective negotiations would favour the interests of the largest exporters in the bargaining group.

4.79. Following the draft determination, PNO maintains that:[90]

> The interests of all of the coal producer members of the NSWMC [NSW Minerals Council] are not aligned and the collective approach will not allow those differing interests to be ventilated.

4.80. PNO considers that while smaller producers 'may well be technically free' to enter into bilateral negotiations under the proposed voluntary Collective Bargaining Conduct, it

[89] Port of Newcastle Operations submission, 10 July 2020, p. 5.

[90] Port of Newcastle Operations submission, 10 July 2020, p. 4.

considers that in practical terms smaller producers 'will be placed under pressure not to break from the negotiating bloc.'[91]

4.81. In response, the Applicants submit that it is unclear what commercial reasons larger producers would have to dissuade smaller producers from individually negotiating terms and conditions of access with PNO if they so wish.[92]

4.82. The Applicants submit that they are seeking to discuss and negotiate the terms and conditions of access under the contractual framework proposed by PNO. This will include discussions related not only to price but also the mechanics of the template Producer Deed. The Applicants also submit that they have largely common interests in transparency and efficiency, and for the terms and conditions of access to be understood and approached in a consistent manner across the industry.

ACCC view

4.83. The ACCC considers there are common issues at the Port which are appropriately dealt with on an industry-wide basis. This can be facilitated by the Proposed Collective Bargaining Conduct. The ACCC also notes that PNO is offering standard terms and conditions to producers under its template Deed.

4.84. Further, the Proposed Collective Bargaining Conduct is voluntary for all coal producers, who will still be free to negotiate terms and conditions of Port access separately through bilateral discussions with PNO if they believe it is in their interests to do so, or where their individual commercial interests have not been met through collective negotiations.

4.85. The ACCC considers the 'smaller' coal producers in the Hunter Valley are willing and able to independently negotiate with PNO if they considered it in their best commercial interests to do so.

Effect of collective bargaining on Port Authority NSW's revenue

4.86. The Port Authority NSW receives a quarterly fee from PNO for certain services at the Port, which is currently calculated as a fixed proportion of the navigation service charge that PNO receives from its customers.

Submissions

4.87. Port Authority NSW submits that the collective negotiation between the Applicants and PNO around the navigation service charge, and the potential for a subsequent reduction of those charges, may have flow on effects to the amount that PNO pays Port Authority NSW. Port Authority NSW submits that this has the potential to compromise the safe operation of the Port and its ability to meet its future costs.

4.88. Port Authority NSW submits that it anticipates material investments and cost increases in its Port operations in the next few years to meet more stringent safety obligations, including new nationally-mandated accreditations, upgrades to its Vessel Traffic Information Service, and increases in personnel.

4.89. Port Authority NSW submits that any authorisation should be limited to collective negotiation of the wharfage charge only. Alternatively, that a condition of authorisation should be imposed by the ACCC to limit any change to the revenue that Port Authority NSW receives from PNO by way of the navigation service charge.

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[91] Port of Newcastle Operations submission, 10 July 2020, p. 4.

[92] Applicants' submission in response to interested parties, 18 August 2020, p. 2.

4.90. In response, the Applicants submit that commercial arrangements between Port Authority NSW and PNO are confidential, and that the fees payable between the two service providers is a matter between PNO and Port Authority NSW. The Applicants submit that they would not wish to see the safe operation of the Port compromised. However, the State of NSW by virtue of the sale proceeds of port privatisations, and the charges, taxes and royalties it collects from the mining industry, should have sufficient funds for current and future operations of Port Authority NSW.

4.91. The Applicants submit that the conditions proposed by Port Authority NSW should not be imposed by the ACCC. Access seekers should be able to negotiate efficient pricing with PNO irrespective of commercial arrangements between PNO and Port Authority NSW.

ACCC view

4.92. The ACCC considers that the contractual relationship between each individual Applicant and PNO is open to bilateral negotiation, including in relation to the discounted navigation service charge and wharfage charge offered under the Producer Deed, whether or not authorisation of the Proposed Collective Bargaining Conduct is granted by the ACCC. The Proposed Collective Bargaining Conduct will be voluntary for the Applicants and PNO, and will be a commercial decision for each party as to what terms and conditions they agree to, in considering their particular incentives and interests.

4.93. Similarly, the contractual relationship between PNO and Port Authority NSW is subject to commercial negotiation between those parties. When Port Authority NSW agreed to payments from PNO that are linked to the navigation service charge payments PNO receives, it accepted the risk that those payments may go up or down over time. The ACCC does not consider that any potential flow on impact on Port Authority NSW's revenue is a relevant consideration in its assessment of this application. Port Authority NSW's obligations to operate the Port safely, or to cover future expenditure, are its own separate responsibility and a matter for commercial negotiation between Port Authority NSW and PNO.

4.94. As a result, the ACCC considers that the condition of authorisation requested by Port Authority NSW is not necessary for the proposed authorisation to further enhance the likely public benefits, or reduce the likely public detriments.

ACCC conclusion on public detriment

4.95. The ACCC considers that the Proposed Collective Bargaining Conduct is likely to result in minimal, if any, public detriments from any reduction in competition because:

- participation in collective bargaining will be voluntary, both for the Applicants and PNO
- the Applicants have not sought authorisation for collective boycott activity
- authorisation would not extend to the sharing of sensitive information about which PNO and Port Authority NSW is concerned, for example future production or export volumes. Authorisation of collective discussions will be limited to the terms and conditions of access to the Port, including price, contained in the proposed Producer Deed, and
- the ACCC does not consider that a condition of authorisation is required to reduce the likely minimal public detriments discussed above.

Balance of public benefit and detriment

4.96. For the reasons outlined in this determination, based on all the information before it, the ACCC is satisfied that the Proposed Collective Bargaining Conduct is likely to result in a public benefit and that this public benefit would outweigh any likely detriment to the public from the Proposed Collective Bargaining Conduct.

Length of authorisation

4.97. The Act allows the ACCC to grant authorisation for a limited period of time.[93] This enables the ACCC to be in a position to be satisfied that the likely public benefits will outweigh the detriment for the period of authorisation. It also enables the ACCC to review the authorisation, and the public benefits and detriments that have resulted, after an appropriate period.

4.98. In this instance, the Applicants seek authorisation for ten years. The Applicants submit that authorisation of the Proposed Collective Bargaining Conduct for ten years would enable the industry to constructively negotiate and discuss the terms and conditions for access to the Port with PNO in a transparent and co-operative way.

4.99. As noted, the NSW Minerals Council lodged an application for declaration of certain services at the Port of Newcastle with the National Competition Council on 23 July 2020. Pursuant to any ACCC authorisation, the Applicants intend to collectively negotiate with PNO prior to and subsequent to any declaration of the Port's channel services.

4.100. Port Authority NSW submits that the ten year authorisation sought is unusually long, and impacts of the authorisation may be long lasting and difficult to predict across the full period.

4.101. The ACCC considers that an authorisation term of ten years is appropriate considering that the subject of the Proposed Collective Bargaining Conduct, being the long term Producer Deed, is proposed for ten years. This would enable the Applicants to collectively negotiate any proposed changes during the operation of the Producer Deed, for example in response to annual access price adjustments by PNO.

4.102. Further, the ACCC notes that the proposed period of authorisation would also cover a period where the Applicants envisage potentially seeking to collectively negotiate terms and conditions of access with PNO in the event that the NSW Minerals Council's application for the declaration of the Port was successful.

4.103. Therefore the ACCC grants authorisation for ten years, until 30 September 2030.

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93 Subsection 91(1) of the Act.

5. Determination

The application

5.1. On 6 March 2020 the NSW Minerals Council lodged application AA1000473 with the ACCC on behalf of itself, certain coal producers that export coal through the Port of Newcastle (the **Port**), and mining companies requiring future access through the Port of Newcastle[94] (the **Applicants**), seeking authorisation under subsection 88(1) of the Act.

5.2. The ten Applicant coal producers are:

- Glencore Coal Assets Australia Pty Limited
- Yancoal Australia Limited
- Peabody Energy Australia Pty Ltd
- Bloomfield Collieries Pty Ltd
- Centennial Coal Company Limited
- Malabar Coal Limited
- Whitehaven Coal Mining Limited
- Hunter Valley Energy Coal Pty Ltd
- Idemitsu Australia Resources Pty Ltd, and
- MACH Energy Australia Pty Ltd.

5.3. The Applicants seek authorisation to:

- collectively discuss and negotiate the terms and conditions of access, including price to the Port for the export of coal (and any other minerals) through the Port
- discuss amongst themselves matters relating to the above discussion and negotiations, and
- enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port (the **Proposed Collective Bargaining Conduct**).

The authorisation test

5.4. Under subsections 90(7) and 90(8) of the Act as they apply to this application for authorisation, the ACCC must not grant authorisation unless it is satisfied in all the circumstances that the Proposed Collective Bargaining Conduct would result or is likely to result in a benefit to the public, and the benefit would outweigh the detriment to the public that would result or be likely to result from the conduct.

5.5. For the reasons outlined in this determination, the ACCC is satisfied, in all the circumstances, that the Proposed Collective Bargaining Conduct would be likely to result in a benefit to the public and the benefit to the public would outweigh the detriment to the public that would result or be likely to result from the Proposed Collective Bargaining Conduct, including any lessening of competition.

[94] Section 88(2)

5.6. Accordingly, the ACCC has decided to grant authorisation as described below.

Conduct authorised

5.7. The ACCC grants authorisation A1000473 to enable the Applicants to collectively negotiate with Port of Newcastle Operations Pty Ltd in relation to the terms and conditions of access, including price, to the Port as described in paragraph 5.3 above and defined as the Proposed Collective Bargaining Conduct.

5.8. The Proposed Collective Bargaining Conduct may involve a cartel provision within the meaning of Division 1 of Part IV of the Act or may have the purpose or effect of substantially lessening competition within the meaning of section 45 of the Act.

5.9. The ACCC has decided to grant authorisation AA1000473 for ten years, until 30 September 2030.

Conduct not authorised

5.10. The authorisation does not extend to permit the Applicants to engage in any collective boycott activity, and does not involve the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume/capacity projections for individual users.

Interim authorisation

5.11. On 2 April 2020 the ACCC granted interim authorisation under subsection 91(2) of the Act[95] to enable the Applicants to commence collective discussions amongst themselves and negotiations with PNO in relation to the terms and conditions of access, including price, to the Port. Interim authorisation does not extend to entering into any collectively negotiated agreements.

5.12. Interim authorisation will remain in place until the date the ACCC's final determination comes into effect or until the interim authorisation is revoked.

Date authorisation comes into effect

5.13. This determination is made on 27 August 2020. If no application for review of the determination is made to the Australian Competition Tribunal it will come into force on 18 September 2020.

[95] See ACCC interim authorisation decision of 2 April 2020 available at Authorisations Public Register - NSW Minerals Council.

NOTICE OF LODGMENT

AUSTRALIAN COMPETITION TRIBUNAL

This document was lodged electronically in the AUSTRALIAN COMPETITION TRIBUNAL and has been accepted for lodgment pursuant to the Practice Direction dated 3 April 2019. Filing details follow and important additional information about these are set out below.

Lodgment and Details

Document Lodged:	Form I – Application to Tribunal for Review
File Number:	ACT 2 of 2020
File Title:	Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020
Registry:	VICTORIA – AUSTRALIAN COMPETITION TRIBUNAL

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REGISTRAR

Dated: 17/09/2020 5:52 PM

Important information

This Notice has been inserted as the first page of the document which has been accepted for electronic filing. It is now taken to be part of that document for the purposes of the proceeding in the Tribunal and contains important information for all parties to that proceeding. It must be included in the document served on each of those parties.

Public Version

FORM I

(subregulation 20(1))

APPLICATION TO TRIBUNAL FOR REVIEW

*Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council (**NSWMC**) on behalf of itself, certain coal producers that export coal through the Port of Newcastle (**Port**), and mining companies requiring future access through the Port (together, the **Applicants**), and the determination made by the ACCC on 27 August 2020*

1. Port of Newcastle Operations Pty Limited ACN 165 332 990 (**PNO**) hereby applies to the Australian Competition Tribunal (**Tribunal**) pursuant to section 101 of the *Competition and Consumer Act 2010* (Cth) (**CCA**) for review of the determination of the Australian Competition and Consumer Commission (**ACCC**) dated the 27th day of August 2020 (Commission file no. AA1000473) (**Determination**).

2. (a) PNO was not the applicant for the authorisation to which the Determination relates.

   (b) PNO's interest in the Determination is as follows:

      (i) PNO is the target of the conduct the subject of the Determination (**Proposed Collective Bargaining Conduct**). The Proposed Collective Bargaining Conduct relates to the terms and conditions of access to the Port provided by PNO, including price for the export of coal and any other minerals through the Port;

      (ii) as the Port operator authorised to fix and levy charges under the *Ports and Maritime Administration Act 1995* (NSW), PNO is directly affected by the Proposed Collective Bargaining Conduct authorised by the Determination; and

      (iii) PNO has actively participated throughout the consultation conducted by the ACCC since 6 March 2020, including by providing three written submissions dated 18 March 2020, 7 April 2020 and 10 July 2020.

3. PNO is dissatisfied with the Determination in the following respects:

   (a) The Proposed Collective Bargaining Conduct should not be authorised when it would not be likely to result in any tangible or significant public benefit at all, including because:

      (i) the price terms and conditions of Port access are insignificant to the competitiveness of coal exported from the Hunter Valley;

      (ii) the Proposed Collective Bargaining Conduct would not increase certainty for any price terms and conditions of Port access **[CONFIDENTIAL TO PNO]** [redacted];

      (iii) it has not been identified, nor established, how there would be any meaningful reduction in transaction costs relative to bilateral negotiations between PNO and coal producers; and/or

      (iv) it has not been identified, nor established, how the Proposed Collective Bargaining Conduct would facilitate more efficient terms and conditions of Port access in agreements between PNO and coal producers.

   (b) The Proposed Collective Bargaining Conduct should not be authorised when any benefits in which it might result would be of a private, not public, nature.

(c) Further or alternatively, the Proposed Collective Bargaining Conduct should not be authorised when it would not be likely to result in any tangible or significant public benefit in circumstances where it involves cartel conduct that:

(i) is presumptively harmful to competition;

(ii) could facilitate the exchange of competitively sensitive information between coal producers that otherwise would not occur; and/or

(iii) could adversely affect competition and/or efficient investment in a range of markets in which coal producers participate in the Hunter Valley coal supply chain, including rivalry between coal handling terminals in which some but not all coal producers have an ownership interest.

(d) Further, the Proposed Collective Bargaining Conduct would be likely to result in significant public detriment by inhibiting efficiency enhancing competition between coal producers with respect to acquiring access services from PNO, including because:

(i) it would have the practical effect of replacing efficiency enhancing bilateral negotiations between PNO and individual coal producers with collective negotiation; and/or

(ii) the terms and conditions of Port access negotiated between PNO and coal producers would be reduced to a lowest common denominator when that might not be an efficiency maximising outcome.

(e) The Proposed Collective Bargaining Conduct should not be authorised as a matter of discretion in the following circumstances:

(i) it involves cartel conduct that is presumptively harmful to competition and that should not be authorised without it being likely to result in substantial net public benefit;

(ii) any net benefit that it would be likely to result (which is denied) would be of a private nature; and

(iii) any net public benefit that it would be likely to result (which is denied) would be insignificant.

(f) The Determination fails properly to take into account, in accordance with s 90(6A) of the CCA, all of the submissions and information that the ACCC received from PNO in circumstances where the ACCC could not be satisfied that the Proposed Collective Bargaining Conduct would be likely to result in a public benefit that would outweigh any likely detriment to the public if this material had been properly taken into account.

(i) For example, the Determination makes only cursory reference to critical information that PNO provided to the ACCC on a confidential basis, and failed properly to take this information into account (Determination, 3.9).

(g) The following findings made by the ACCC in the Determination were not supported by the information and submissions before the ACCC, and further or alternatively are not supported in all the relevant circumstances:

(i) the ACCC's conclusion regarding the likely future without the Proposed Collective Bargaining Conduct, and in particular, that in the absence of entering into a long term deed with PNO, vessels carrying coal for the Applicants will be subject to PNO's published access charges (Determination, 4.16);

(ii) that the Proposed Collective Bargaining Conduct is likely to result in public benefit through addressing, in part, an asymmetry of information between each of the Applicants and PNO (Determination, 4.40-4.41);

(iii) that the Proposed Collective Bargaining Conduct is likely to result in some benefits from increased pricing certainty and more timely resolution of industry-wide issues, which facilitates more efficient investment decisions for Australian coal producers, as well as increased certainty for the delivered coal price for international coal customers (Determination, 4.48);

(iv) that the Proposed Collective Bargaining Conduct is likely to result in transaction cost savings to all parties to the collective negotiations (Determination, 4.57);

(v) that the Proposed Collective Bargaining Conduct does not significantly increase the likelihood of collusion occurring in relation to matters for which authorisation is not being sought, or increase the likelihood of the members of the bargaining group sharing commercially sensitive information (Determination, 4.77); and

(vi) that the Proposed Collective Bargaining Conduct would not proceed on the basis that all members of the bargaining group have the same interest and remove Port users' unique individual interests, such that the Proposed Collective Bargaining Conduct is likely to result in minimal public detriment (Determination, 4.83-4.85).

4. The determination that PNO is seeking from the Tribunal is as follows:

(a) that the Determination be set aside;

(b) that the interim authorisation determination of the ACCC dated the 2nd day of April 2020 be set aside and the interim authorisation be revoked; and

(c) that application for authorisation AA1000473 be dismissed.

5. Particulars of the facts and contentions upon which PNO intends to rely in support of the application for review, and a statement of the issues as PNO sees them, are attached.

6. PNO's address for service for the purpose of regulation 21 of the *Competition and Consumer Regulations 2010* is:

Port of Newcastle Operations Pty Limited
c/o Bruce Lloyd
Clayton Utz
blloyd@claytonutz.com
DX 370
Level 15
1 Bligh Street
Sydney NSW 2000

7. Documents may be served on PNO at blloyd@claytonutz.com.

Dated this 17th day of September 2020.

Signed on behalf of the applicant

……

Bruce Llewelyn Lloyd
Partner, Clayton Utz
Solicitor for the Applicant

ATTACHMENT - BACKGROUND, FACTS, CONTENTIONS AND ISSUES FOR THE TRIBUNAL TO CONSIDER

1. The Applicant

Port of Newcastle Operations Pty Limited (**PNO**) operates the Port of Newcastle (**Port**) under a 98-year sublease which commenced on 30 May 2014. Prior to 30 May 2014, the Port was owned by the State of New South Wales.

The Port is the largest port on the East Coast of Australia, and the world's largest coal export port. The Port services the Hunter Valley coal fields. More than 90% of the Port's revenue is derived from coal export operations.

The NSW Government retains regulatory oversight of the Port as well as responsibility for a range of maritime safety and security functions, including emergency response, the Harbour Master, Port Safety Operating Licence and pilotage functions.

As the operator of the Port, and under the terms of its lease, PNO has the power and authority to exercise the statutory powers conferred under Part 5 of the *Ports and Maritime Administration Act 1995* (NSW) (**PAMA Act**). These include the power to fix and levy certain port charges in respect of the use of the Port.

Under Part 5 of the PAMA Act, six types of port charges can be fixed and levied by "relevant port authorities". Two are relevant for the purposes of the Application:

(a) the navigation service charge, which is payable in respect of general use by a vessel of the Port and its infrastructure (**NSC**); and

(b) the wharfage charge, which is payable in respect of the availability of a site at which stevedoring operations may be carried out (**Wharfage Charge**).

Other charges provided for by Part 5 include pilotage charges, port cargo access charges, site occupation charges, berthing charges, and port infrastructure charges.

In Part 5 of the PAMA Act, "relevant port authority" is defined to mean the port operator or the appropriate public agency for the port, the Minister, the Port Corporation or the pilotage service provider as the case may be for each type of port charge. The effect of this definition is that:

(a) PNO has power to fix and collect navigation service charges, wharfage charges or site occupation charges without Ministerial approval;

(b) PNO also has power, concurrently with the Minister, to fix and collect port infrastructure charges, although Ministerial approval is required under the lease; and

(c) pilotage charges, port cargo access charges and berthing charges are fixed and charged to users of the Port, but are not fixed or collected by PNO.

2. Application for authorisation

8. PNO was the target of the application for authorisation (non-merger) dated 6 March 2020 pursuant to section 88(1) of the *Competition and Consumer Act 2010* (Cth) (**CCA**) made by the New South Wales Minerals Council (**NSWMC**) to the Australian Competition and Consumer Commission (**ACCC**) on behalf of itself and the following coal producers that export coal through the Port:

(a) Glencore Coal Assets Australia Pty Limited;

(b) Yancoal Australia Limited;

(c) Peabody Energy Australia Pty Limited;

(d) Bloomfield Collieries Pty Limited;

(e) Centennial Coal Company Limited;

(f) Malabar Coal Limited;

(g) Whitehaven Coal Mining Limited;

(h) Hunter Valley Energy Coal Pty Limited;

(i) Idemitsu Australia Resources Pty Limited; and

(j) MACH Energy Australia Pty Limited,

(together, the **Applicants**).

9. PNO actively participated in the ACCC's public consultation in respect of the Application. It provided three written submissions in the periods both before and after the ACCC's interim authorisation and draft determination: on 18 March 2020, 7 April 2020 and 10 July 2020.

3. Proposed Collective Bargaining Conduct

10. The Applicants sought authorisation to collectively negotiate and discuss the terms of access to the Port, including price, with PNO. Specifically, the Applicants sought authorisation to:

(a) collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port;

(b) discuss amongst themselves matters relating to the above discussions and negotiations; and

(c) enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port,

(the **Proposed Collective Bargaining Conduct**).

11. The Applicants sought authorisation on behalf of themselves and "future access seekers / port users" that choose to participate in the proposed collective bargaining group in the future. On 15 May 2020, the Applicants clarified that the proposed collective bargaining group will primarily comprise coal mining companies. However, future participants could conceivably involve other mining company members of NSWMC.

12. The Applicants submit they are seeking authorisation to collectively negotiate with PNO primarily because of increases in access charges that have occurred since the Port was privatised in 2014 and asserted pricing "uncertainty" at the Port.

13. On 2 April 2020, the ACCC granted interim authorisation under s 91(2) of the CCA to enable the Applicants to commence collective discussions amongst themselves and negotiations with PNO in relation to the terms and conditions of access, including price, to the Port.

14. On 27 August 2020, the ACCC issued its Determination in respect of the application for authorisation. The Determination granted authorisation for the Applicants to engage in the Proposed Collective Bargaining Conduct in relation to the terms and conditions of access, including price, to the Port. The ACCC granted authorisation for a period of ten years, until 30 September 2030.

15. The Determination did not extend to permit the Applicants to engage in any collective boycott activity, and does not involve the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume/capacity projections for individual users.

4. Impact of the Determination on PNO

16. PNO is the target of the Proposed Collective Bargaining Conduct.[1] The Applicants include coal producers that export coal through the Port and access certain services at the Port. As the Port operator authorised to fix and levy the terms and conditions of access (including prices) at the Port, the Proposed Collective Bargaining Conduct directly affects the business and commercial affairs of PNO.

17. The class of persons to whom the Determination applies is broadly defined as "mining companies".[2] The Determination could therefore apply to future participants in addition to the Applicants listed in the Determination.

18. The Proposed Collective Bargaining Conduct the subject of the Determination is broad and imprecise. It authorises discussions and negotiations among the Applicants, and between the Applicants collectively and PNO, as to the "terms and conditions of access" to the Port and "the export of minerals through the Port". The Determination does not appropriately identify with precision the detriment and benefits by reference to the conduct owing to the breadth of the proposed conduct.

19. PNO is concerned about the competitive harm and public detriments that the Proposed Collective Bargaining Conduct as authorised by the ACCC will have on competitive dynamics in the market for access to port services at the Port.

20. Participation in the Proposed Collective Bargaining Conduct is voluntary, both for the Applicants and PNO. The Determination states that, because participation in the Proposed Collective Bargaining Conduct is voluntary, it is likely to result in "minimal, if any, public detriment".[3] However, the fact that participation is voluntary does not mean that public detriments will not arise. PNO submits that the Proposed Collective Bargaining Conduct has the potential to detrimentally and substantially alter competitive dynamics in the market for access to port services at the Port. This concern arises in particular from the pressure that will be placed on smaller producers to remain within the negotiating bloc in practice.

21. PNO has a sufficient interest in the Determination to bring this Application.

5. Key contentions

22. PNO contends that the Proposed Collective Bargaining Conduct should not be authorised, principally because:

    (a) the Tribunal cannot be satisfied that this conduct would be likely to result in any tangible or significant benefit to the public at all;

    (b) the conduct involves cartel conduct, which is presumptively harmful to competition, and could facilitate information exchange between coal producers that could adversely affect competition and/or efficient investment in a range of markets in which coal producers participate in the Hunter Valley coal supply chain; and

    (c) the conduct involves significant public detriment because it would inhibit efficiency enhancing competition between coal producers with respect to acquiring access services from PNO.

[1] Determination, [1.15].

[2] Determination, [1.6].

[3] Determination, [4.62].

5.1 No tangible or significant public benefits

23. PNO contends that the Proposed Collective Bargaining Conduct would not be likely to result in any tangible or significant public benefits at all, let alone any of the public benefits set out in the Determination.

Competitiveness of the Australian export coal industry unlikely to be enhanced

24. Contrary to the ACCC's finding in the Determination that the Proposed Collective Bargaining Conduct would be likely to enhance the international competitiveness of the Hunter Valley coal industry (Determination, [4.48]), this is not so. Further, even if the conduct were likely to result in "*some benefits which facilitates more efficient investment decisions for Australian coal producers, as well as increased certainty for the delivered coal price for international coal customers*"[4] (which is denied), this still would not significantly improve the competitiveness of Australian export coal.

25. *First*, as was found by the National Competition Council (**NCC**) in its *'Revocation of the declaration of the shipping channel service at the Port of Newcastle'*, dated 22 July 2019, coal from the Hunter Valley is predominantly exported, with Glencore estimating in 2015 that 70% of exports go to Japan, Korea and Taiwan, with a further 20% exported to China. What this means is that the coal producers participate in a competitive global coal market and compete against coal produced and sold through other ports in Australia and overseas.

26. *Secondly*, as was also found by the NCC, *"it is also highly unlikely that changes in the price of the Service within the range considered in paragraph 7.160 above* [i.e. $0.41 per GT to $1.36 per GT] *in any given period are likely to alter export prices for coal*". That is, if PNO's port usage charges are within this range, they are unlikely to have any impact on export prices charged by coal producers. That is a relevant range of charges for the purposes of the present application.

27. The relevant Port charges the subject of the Proposed Collective Bargaining Conduct constitute a very small percentage of the total cost of coal. Thus, there is no basis for concluding that any impact that collective bargaining may have on Port charges, or the certainty of those charges, would be likely to result in any materially improved competitiveness for coal producers in coal export markets. Even if those charges were to change significantly, they would remain a very small proportion of the price of coal.

No increased certainty and efficient investment is likely to arise from the Proposed Collective Bargaining Conduct

28. Contrary to the ACCC's finding that the Proposed Collective Bargaining Conduct would increase pricing certainty and facilitate more efficient investment decisions for coal producers (Determination, [4.48]), PNO contends that collective bargaining would not have this effect.

29. *First*, the Proposed Collective Bargaining Conduct would not materially increase pricing certainty on Port usage charges, because **[CONFIDENTIAL TO PNO]** [redacted]. In particular:

(a) Section 67 of the *Ports and Maritime Administration Act 1995* (NSW) (**PAMA Act**) allows the port operator to enter into agreements with any person liable to pay charges under the PAMA Act. The persons liable to pay the NSC under section 50 of the PAMA Act are vessel owners.

(b) **[CONFIDENTIAL TO PNO]** [redacted]

[4] Determination, [4.48].

[redacted]

(c) **[CONFIDENTIAL TO PNO]** [redacted]

(d) **[CONFIDENTIAL TO PNO]** [redacted]

(e) **[CONFIDENTIAL TO PNO]** [redacted]

(f) **[CONFIDENTIAL TO PNO]** [redacted]

30. To the extent that collective bargaining may result in a long term agreement concerning other Port usage charges, it is difficult to see how any additional certainty in this regard could be material, in circumstances where the already set NSC constitutes the bulk of these charges, and these charges are insignificant to the export coal price in any event.

31. What this also demonstrates is that ACCC failed to properly take into account certain confidential information that PNO provided during the authorisation process. In particular:

    (a) The ACCC states in the Determination that "[i]*n the absence of entering into a long term Producer Deed with* PNO*, the vessels carrying coal for the Applicants will be subject to PNO's published access charges*" (Determination, [4.16]).

    (b) However, this is factually incorrect and inconsistent with the confidential information set out above that PNO provided to the ACCC.

    (c) Further, this confidential information is given scant treatment in the Determination beyond a passing reference to "*information provided by PNO on a confidential basis*".[6]

32. Had the ACCC properly taken into account this information, it could not have misunderstood the counterfactual in the way that it did.

33. *Secondly*, PNO has been actively negotiating with a number of Port users, including the Applicants, in relation to the terms of long-term pricing arrangements subject to agreeing the terms of a Port User Pro Forma Long Term Pricing Deed (**Deed**) and the parties' respective positions have been clearly articulated. It is difficult to see how simply putting these positions collectively will achieve any 'increased certainty and efficient investment'.

34. PNO has already offered Port users discounted long-term pricing arrangements, subject to agreeing the terms of the Deed. That is, in the absence of any authorisation, PNO has already voluntarily opted-into contractual regulation of its prices under the Deed it has offerred. The relevant provisions of the Deed state that the charge can only be varied under the Deed where the increased charge is consistent with pricing principles drawn from the Competition Principles

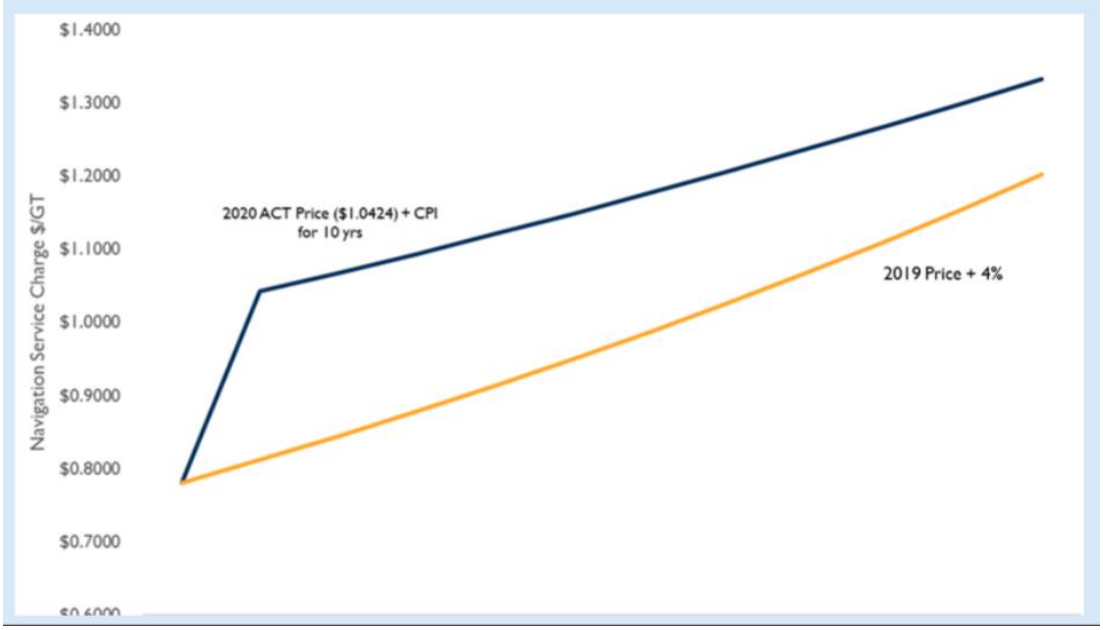
[5] **[CONFIDENTIAL TO PNO]** [redacted]

[6] Determination, [3.9].

Agreement. The current offers have been published transparently on the PNO website, and offer long-term certainty if Port users wish to take up the voluntary offer.

35. Even if the Port users do not wish to enter into the Deed, PNO has publicly committed to ensuring transparent and open access to the land side and port side services and facilities provided by it at the Port, through its open access arrangements for users published on its website. The terms and conditions of access are openly available, as are the fees and charges, as set out in PNO's Schedule of Service Charges, which will apply to a vessel's visit to the Port.

36. The graph below shows the per gross tonne charges from 2019 to 2030 and is indicative only of the forward 10 year price variance between the standard coal vessel pricing and the bilateral price Deed coal vessel pricing (assuming CPI is 2.37-2.50%).



37. PNO is bound by the Deed not to discriminate adversely against any producer/vessel operator on the NSC.

38. The ACCC concluded that the Proposed Collective Bargaining Conduct will promote "[i]ncreased certainty about terms and conditions of access at the Port" which is "likely to lead to more efficient investment decisions within the Hunter Valley coal industry, which is a public benefit".[7] Contrary to the ACCC's conclusions that authorisation will promote increased pricing certainty, as explained above PNO has already provided producers with clear mechanisms to understand how pricing increases will occur over the course of the term, and has applied a contractual form of the Competition Principles Agreement pricing principles, under which PNO will have to justify if it wishes to increase these charges above the greater of 4% or CPI, in any year of the term. PNO is also contractually bound to provide Producers with a forward looking forecast of its proposed capital expenditure. These provisions provide very significant transparency and accountability benefits to producers - and without the need for authorisation.

39. *Thirdly*, the Determination also states that the Proposed Collective Bargaining Conduct is likely to result in public benefit through addressing, in part, an asymmetry of information between each of the Applicants and PNO.[8] However, it is not clear how such a purported reduction in asymmetry of information would arise. For example, the Applicants submit that PNO holds all of the data on past expenditures at the Port, and that individual coal producers seeking to have bilateral negotiations with PNO in relation to its long term template Deed would not have access to that

[7] Determination, [4.41]; see also [4.48], [4.58].

[8] Determination, [4.24].

data.[9] Even on the assumption that this assertion is correct, which it is not, the Determination does not articulate how the Proposed Collective Bargaining Conduct would reduce this asymmetry of information.

40. *Fourthly*, in any event, coal producers face much greater uncertainty from other sources, principally in relation to fluctuations in the price of coal, than they do in relation to the future cost of services at the Port. In that context, it is difficult to see how any additional certainty concerning Port usage charges could make any material difference.

No proof of any meaningful reduction in transaction costs

41. The ACCC finds in the Determination that compared to the 'future without the conduct', where members of the bargaining group would negotiate individually with PNO, the Proposed Collective Bargaining Conduct is likely to result in transaction cost savings (to all the parties to the collective negotiations).[10]

42. However, the Applicants have not identified, let alone established, how there would be any meaningful reduction in transaction costs relative to bilateral negotiations between PNO and coal producers.

43. PNO contends that such transaction cost savings are highly unlikely to materialise. From a practical perspective, any authorisation will have no practical effect given that PNO will not be engaging in collective negotiations with the Applicants, but rather will continue to offer to undertake bilateral negotiations.[11]

44. Further, even on the assumption that PNO were prepared to engage in collective negotiations, PNO contends that any transaction cost savings will not arise given that collective negotiations will make reaching any negotiated outcome significantly less likely. Even if a reasonable compromise could be reached which satisfied the interests of PNO, smaller exporters and other port users, it is extremely unlikely that this compromise would proceed because negotiation would proceed on the basis of the bloc's single, collective interest. Notwithstanding that participation in the collective negotiation is voluntary, PNO expects that large exporters would use their dominant position to hold out reaching any compromise until their interests were met. This is inherently contrary to the structure of negotiation that is desirable for infrastructure services and is likely to increase costs for both PNO and the Applicants, rather than result in transaction cost savings.

No proof of how it would facilitate more efficient terms and conditions

45. The ACCC finds in the Determination that compared with the 'future without the conduct', the Proposed Collective Bargaining Conduct is likely to result in a public benefit in the nature of more efficient terms and conditions, and more timely resolution of common industry issues (Determination, [4.41]).

46. However, it has not been identified, let alone established, how the Proposed Collective Bargaining Conduct would facilitate more efficient terms and conditions of Port access in agreements between PNO and coal producers, or more timely resolution of common industry issues.

Any benefits resulting from the conduct would be 'private' benefits

47. In circumstances where the Proposed Collective Bargaining Conduct would not be likely to result in any meaningful improvement in the competitiveness of Australia export coal, it has not been established that any of the benefits put forward by the Applicants, or found by the ACCC, are "public", in contrast to "private", benefits.

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[9] Determination, [4.32].

[10] Determination, [4.24].

[11] Determination, [4.13]-[4.16].

5.2 Proposed Collective Bargaining Conduct will result in public detriments and competitive harm

48. PNO contends that the Proposed Collective Bargaining Conduct is likely to result in public detriments, as set out below.

The proposed conduct is cartel conduct that is presumptively harmful

49. The Applicant coal producers are competitors in a number of markets, including in acquiring of services from PNO. The Proposed Collective Bargaining Conduct would involve cartel conduct, because it would moderate their rivalry by allowing them to collectively discuss and agree on the terms and conditions of access, including price, they might negotiate with PNO.

50. Cartel conduct is presumptively harmful to competition. This is why the CCA prohibits cartel conduct absolutely without resort to any form of competition test such as a purpose or effect of substantially lessening competition. Further, the mere fact that all competing coal companies will potentially be engaged in the Proposed Collective Bargaining Conduct, which will provide them with occasion to regularly meet and discuss the flow of coal through the Port, itself increases the risk of collusion in markets in which they compete.

51. Accordingly, the Proposed Collective Bargaining Conduct should not be authorised unless it would be likely to result in some substantial public benefit that would provide satisfaction that this presumptive harm to competition is outweighed.

The conduct could lead to the sharing of certain sensitive information and it increases the potential for collective activity beyond the authorised conduct

52. PNO contends that the Proposed Collective Bargaining Conduct would be likely to facilitate exchange of competitively sensitive information between coal producers, and collective activity beyond the collective bargaining arrangements.

53. This proposition is supported by the Determination itself, which states that *"… public detriment may arise as a result of collective bargaining arrangements in circumstances where competition is reduced between members of the group as a result of acting collectively … and/or by increasing the potential for collective activity beyond the collective bargaining arrangements which are sought to be authorised"* (emphasis added).[12]

54. In particular:

(a) The coal producers would be likely to share a range of information with each other for the purposes of the Proposed Collective Bargaining Conduct that otherwise would not be shared. The sharing of this information could affect their incentives or decision-making in relation to other markets in which they participate in the Hunter Valley coal supply chain.

(b) Further, although the Applicants did not seek authorisation (and are not authorised under the Determination) to share customer information, marketing strategies or volume/capacity projections, and such conduct would not be covered under the authorisation, they have formed a Port of Newcastle Working Group comprising representatives from the Applicant mining companies and the NSWMC, and which will convene on an "*ongoing basis*".[13] The opportunity to meet in this forum creates a significant risk of a sharing of a range of information.

(c) The fact that it would be extremely difficult to detect and monitor any improper information exchange through the Working Group discussions also increases the level of risk that this might occur.

[12] Determination, [4.61].

[13] Determination, [1.28].

55. These concerns were shared by the Port Authority of New South Wales in its submission to the ACCC dated 16 April 2020:

> *the Applicants are not only coal exporters, but also suppliers to domestic industries such as electricity generation assets. Sharing of competitively sensitive information about future production and export volumes may, for example, give the group insight into each other's intentions for domestic coal supply.*

The conduct could adversely competition in related markets in the coal supply chain

56. The Proposed Collective Bargaining Conduct, along with the opportunity for exchange of competitively sensitive information that it creates, could adversely affect competition and/or efficient investment in a range of markets in which coal producers participate in the Hunter Valley coal supply chain.

57. For example, some but not all coal producers have an ownership interest in one or other of the coal handing terminals at the Port. All coal producers need to acquire services from those coal handling terminals in order to export their coal. What that means is that there is rivalry between coal producers in acquiring services from the coal handling terminals. However, it is rational to expect that information would be exchanged during the course of the Proposed Collective Bargaining Conduct that may be relevant to decisions that individual coal producers make in relation to coal handling services. If so, the exchange of such information that otherwise would not be exchanged could moderate competition that otherwise would exist in relation to acquiring those services.

The fact that participation in collective bargaining will be voluntary, both for the Applicants and PNO does not mean that public detriments will not arise

58. PNO contends that the Proposed Collective Bargaining Conduct has the potential to detrimentally and substantially alter competitive dynamics in the market for access to port services at the Port.

59. As a practical matter, the Proposed Collective Bargaining Conduct is likely to result in the coal producers attempting to negotiate as a bloc with PNO, and preclude smaller producers in particular from engaging in separate negotiations. The fact that the collective bargaining would be voluntary, and that smaller producers may well be technically free to negotiate through bilateral discussions with PNO, does not gainsay that this would be the practical effect.

60. **[CONFIDENTIAL TO PNO]** [redacted]

61. There are a number of ways in which this consequence, namely that individual coal producers no longer engage in bilateral negotiations with PNO, could be detrimentral to efficiency enhancing competition between coal producers in acquiring services from PNO. For example:

(a) Coal producers have a spectrum of unique and varied incentives and interests, and for some of them, the non-price terms are as important as price terms. It well be that one particular coal producer would be prepared to be more flexible on Port charges (because it exports its coal FOB in contrast to CIF), in exchange for non-price terms that could make the passage of its coal through the port more efficient. Such efficiency enhancing outcomes, which result from bilateral negotiations, would be precluded.

(b) In practical terms, smaller producers will be placed under pressure not to break from the negotiating bloc, and are likely to find it difficult to conduct such bilateral discussions with PNO in these circumstances. This will mean that discrete issues, unique to individual Applicants and PNO, will be unable to be appropriately dealt with on a commercial, bilateral basis. The effect of the Proposed Collective Bargaining

Conduct is that the interests of smaller producers and other port users will be marginalised.

(c) Large producers are likely to use their dominant position to hold out reaching any compromise until their interests are met. Even if a reasonable compromise could be reached which satisfied the interests of PNO, smaller producers and other port users, it is extremely unlikely that this compromise would proceed because negotiation would proceed on the basis of the bloc's single, collective interest (which would inevitably favour the interests of the largest exporters).

(d) What the Proposed Collective Bargaining Conduct would do is reduce the access terms and conditions negotiated between PNO and coal producers to the lowest common denominator (or even worse, the requirements of the large producers), when this might not be the efficiency maximising outcome. It is more likely that efficiency maximising outcomes would be reached if coal producers, in a practical sense, continued to have bilateral negotiations with PNO.

5.3 The "Need" for authorisation is not substantiated

62. The ACCC notes in the Determination that the Applicants submit the need for authorisation arises because PNO:[14]

> *…is an infrastructure monopoly service provider that enjoys the commercial benefits of that position in circumstances where the Port was privatised at the end of a multi user export supply chain, and in the absence of any regulatory constraints…it is noted that after revocation of the declaration [at the Port of Newcastle], PNO increased its prices significantly once again and in particular, based on the inclusion of user contributions that PNO did not…expend.*

63. The increases to Port charges levied by PNO since the privatisation of the Port need to be considered in the context of the significant under-recovery by the State in the period prior to privatisation - exceeding $8 billion since 1990 alone. As the Tribunal has already accepted:[15]

> *In the period after the 1990 restructure until 2014, NSC at Newcastle were largely unchanged with charges in 2014 only 7 percent higher than in 1990 in nominal terms. In the same period, the CPI rose by over 80 percent, so prices fell substantially in real terms …*
>
> *…*
>
> *Prices remained unchanged from 1990 until 1996. In June 1996 the Premier announced a 10 percent reduction over two years commencing 1 July 1996. This was to assist trade and improve competitiveness to support the coal industry and employment in the Hunter. There was no commercial or financial basis for this reduction.*
>
> *After that date, charges remained essentially unchanged until 2012 when a series of small CPI-type annual increases of 3 percent to 4 percent were applied.*
>
> *…*
>
> *We conclude that prior to a price restructure in 1990, Port charges were little more than a tax on different commodities with no attempt to reflect the costs of the services provided and that financial accounts were non-commercial and asset values understated or simply not recorded.*

[14] Determination, [1.8].

[15] *Application by Port of Newcastle Operations Pty Ltd* [2019] ACompT 1 at [332]; see also at [333]-[334], [365].

64. PNO implemented a pricing review which took effect on 1 January 2015 - the first in 20 years - which took into account for the first time an assessment of the cost of service. At that time, the previous two tiered NSC construct was removed and replaced with a flat rate / gross tonnes (**GT**) for coal vessels, and the maximum NSC for large coal vessels was removed. The 2015 increase to $0.69 per GT was still well below the actual cost of service.

		Pre price increase 2014	Post price increase 2015
NSC First 50,000	Per GT	$0.4292	$0.6900
NSC Above 50,000	Per GT	$0.9656	$0.6900
Max NSC Charge	Cap	$45,633.68	None

65. Further, while the 2015 increase has been cited as a 40 – 60% increase based on a whole of vessel calculation,[16] the NSC (much less the portion of increase) per GT represents a small fraction of the delivered price per tonne of coal, which fluctuates on the world market for delivered coal in the range $70 to $150 per tonne over the past 2 years (and on the world market can vary on a daily basis in the ordinary course by more than the amount of the NSC).

66. The service at the Port for which the NSC is payable was previously declared and subject to the regulatory constraints under Part IIIA until September 2019. At that time, the National Competition Council (**NCC**) recommended that the declaration be revoked at that time on the basis that the declaration criteria were no longer fulfilled, the objectives of Part IIIA were no longer relevant to the declared service, the Treasurer acceded in that recommendation, and declaration was revoked.

67. The Applicants' assertion of an "absence of any regulatory constraints" on PNO is incorrect. PNO's statutory power to levy certain fees and charges under the PAMA Act is not "unconstrained":

(a) PNO can only fix NSC in accordance with its operating licence;

(b) Part 6 of the PAMA Act contains a price monitoring mechanism for charges levied under the PAMA Act - including those levied by PNO. For example, PNO is required to give notice of any proposed changes to Port charges to the responsible Minister and on PNO's website;

(c) PNO is also required to provide an annual report to the responsible Minister on its charges, and is subject to directions from the Minister to produce specified information in respect of PNO's charges;[17] and

(d) the threat of declaration is a constant regulatory backdrop which constrains PNO.

68. The NSW Government would therefore be likely to intervene if PNO imposed excessive price increases or other access limitations that had the potential to have a material adverse impact on competition in the dependent markets, or otherwise harm the public interest.

69. The Determination makes no reference or acknowledgement of the effect of these regulatory constraints on PNO.

6. Issues for Tribunal to consider

70. PNO contends that the key issues for the Tribunal to consider are as follows:

[16] See NSWMC application at [1.21].

[17] PAMA Act ss 80-82.

(a) Whether the Proposed Collective Bargaining Conduct would be likely to result in any tangible public benefits at all?

(b) If so, whether or not those benefits are “public” in contrast to “private” benefits?

(c) Whether the Proposed Collective Bargaining Conduct would be likely to result in detriment to the public?

(d) If so, whether any public benefits of the Proposed Collective Bargaining Conduct outweigh the public detriments?

(e) Whether, in any event, authorisation should be granted as a matter of discretion?

71. PNO contends that the Tribunal should answer "no" to issues (a), (b), (d) and (e), and “yes” to issue (c), in summary because:

(a) The Proposed Collective Bargaining Conduct involves cartel conduct, so it should not be authorised unless there is substantial net public benefit, because cartel conduct is presumptive harmful to competition.

(b) However, there are no discernible public benefits arising from the Proposed Collective Bargaining Conduct:

(i) no increased certainty and efficient investment is likely to arise from the Proposed Collective Bargaining Conduct. PNO has been undertaking active negotiations over several months and is well aware of the parties' positions. Simply putting these positions collectively is unlikely to be of benefit. It is difficult to see how the Proposed Collective Bargaining Conduct will reduce asymmetry of information issues;

(ii) the competitiveness of the Australian export coal industry is unlikely to be enhanced by the Proposed Collective Bargaining Conduct. The NSC (at the level already set by PNO and likely to be the subject of negotiation by the Proposed Collective Bargaining Conduct) will not impact on the competitiveness of Hunter Valley coal in the international market; and

(iii) there are unlikely to be improved efficiencies through transaction cost savings. Amongst other things, collective negotiations will make reaching any negotiated outcome with PNO significantly less likely.

(c) Further, the Proposed Collective Bargaining Conduct is likely to result in significant public detriments and competitive harm:

(i) the fact that participation in collective bargaining will be voluntary, both for the Applicants and PNO, does not mean that public detriments will not arise. The Proposed Collective Bargaining Conduct has the potential to detrimentally and substantially alter competitive dynamics in the market for access to port services at the Port. This concern arises from the pressure that will be placed on smaller producers to remain within the negotiating bloc in practice. The Proposed Collective Bargaining Conduct may well make it less likely for agreement to be reached; and

(ii) although authorisation would not extend to the sharing of certain sensitive information, it increases the potential for sharing of competitively sensitive information – which itself could adversely affect other markets in the Hunter Valley coal supply chain in which the coal producers participate – and for collective activity beyond the authorised conduct. It will be extremely difficult to detect and monitor any improper information exchange through the Working Group discussions.

(d) In any event, the Tribunal should exercise its discretion not to grant authorisation, because any benefits that may result would be too insubstantial, and PNO is subject to ongoing NSW Government oversight.

72. If the Tribunal sets aside the Determination, and dismisses the application for authorisation, the interim authorisation granted by the ACCC also should be revoked.

NOTICE OF LODGMENT

AUSTRALIAN COMPETITION TRIBUNAL

This document was lodged electronically in the AUSTRALIAN COMPETITION TRIBUNAL and has been accepted for lodgment pursuant to the Practice Direction dated 3 April 2019. Filing details follow and important additional information about these are set out below.

Lodgment and Details

Document Lodged:	Statement of Facts, Issues and Contentions
File Number:	ACT 2 of 2020
File Title:	Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020
Registry:	VICTORIA – AUSTRALIAN COMPETITION TRIBUNAL

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REGISTRAR

Dated: 14/12/2020 6:51 PM

Important information

This Notice has been inserted as the first page of the document which has been accepted for electronic filing. It is now taken to be part of that document for the purposes of the proceeding in the Tribunal and contains important information for all parties to that proceeding. It must be included in the document served on each of those parties.

Public Version

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No: ACT 2 of 2020

Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council and mining companies to collectively negotiate with Port of Newcastle Operations Pty Ltd all terms and conditions of access relating to the export of coal from the Port of Newcastle.

PORT OF NEWCASTLE OPERATIONS PTY LTD (ACN 165 332 990)

Applicant

APPLICANT'S STATEMENT OF FACTS, ISSUES AND CONTENTIONS

A. FACTS

A1. The applicant

1. The applicant, Port of Newcastle Operations Pty Ltd (**PNO**) operates the Port of Newcastle (**Port**) under a 98-year sublease which commenced on 30 May 2014.

2. PNO was not the applicant for authorisation.

3. PNO is the target of the conduct the subject of the Determination. (The conduct which was the subject of the Determination is identified below at paragraph 18 and is defined in this document as the Conduct.)

4. The Port is the largest port on the East Coast of Australia. It services the Hunter Valley coal fields and is the world's largest coal export port. More than 70% of the Port's revenue is derived from coal export operations.

5. Not all functions at the Port are performed by PNO. In particular:

   (a) the NSW Government retains regulatory oversight of the Port and has responsibility for a range of maritime safety and security functions at the Port, including emergency response, the Harbour Master, as holder of the Port Safety Operating Licence, and pilotage functions;

   (b) the Minister has power under Part 5 of the *Ports and Maritime Administration Act 1995* (NSW) (the **PAMA Act**) to fix and levy port cargo access charges and berthing charges at the Port; and

   (c) the pilotage services operator has power under Part 5 of the PAMA Act to fix and levy pilotage charges.

6. The functions for which PNO is responsible, as Port operator under the PAMA Act and under the terms of the sublease, include the fixing and collection of port charges, and the making of directions for the purpose of maintaining or improving safety and security at the Port.

7. In particular, Part 5 of the PAMA Act permits PNO to fix and levy three types of port charges without approval from the relevant Minister:

   (a) the navigation service charge, which is payable in respect of general use by a vessel of the Port and its infrastructure (**navigation service charge**) (the navigation service charge is described in more detail below at paragraphs 30 to 36);

   (b) the wharfage charge, which is payable in respect of the availability of a site at which stevedoring operations may be carried out (**wharfage charge**), and is paid by the owner of the cargo at the time it is loaded or unloaded; and

   (c) site occupation charges, which are payable by occupiers of land-side facilities such as stevedoring at terminals.

8. Part 5 of the PAMA Act permits PNO, concurrently with the Minister, to fix and collect port infrastructure charges from port users, subject to obtaining Ministerial approval pursuant to the sublease.

9. The Conduct relates to the terms and conditions of access to the Port provided by PNO. PNO is directly affected by the Conduct.

10. As the target of the Conduct, and a party directly affected by the Conduct, PNO has a sufficient interest in the Determination, within the meaning of s 101(1AA) of the *Competition and Consumer Act 2010* (**CCA**).

A2. The Application for authorisation

11. This proceeding concerns the application for authorisation lodged on 6 March 2020 by the NSW Minerals Council on behalf of itself and certain coal producers who export coal through the Port of Newcastle (the **Port**) (the **authorisation applicants**), seeking authorisation under subsection 88(1) of the CCA.

12. The following coal producers were the persons on whose behalf the NSW Minerals Council sought authorisation:

    (a) Glencore Coal Assets Australia Pty Ltd;

    (b) Yancoal Australia Ltd;

    (c) Peabody Energy Australia Pty Ltd;

    (d) Bloomfield Collieries Pty Ltd;

    (e) Centennial Coal Company Ltd;

    (f) Malabar Coal Ltd;

    (g) Whitehaven Coal Mining Ltd;

    (h) Hunter Valley Energy Coal Pty Ltd;

    (i) Idemitsu Australia Resources Pty Ltd; and

    (j) MACH Energy Australia Pty Ltd.

13. On 15 May 2020, the NSW Minerals Council clarified that future participants in the proposed conduct could include other mining companies, such that the class of persons to whom the authorisation application relates is mining companies including the persons identified at paragraph 12 above.

14. Following receipt of the application for authorisation, the ACCC conducted a consultation process.

15. On 2 April 2020, the ACCC granted interim authorisation under subsection 91(2). The ACCC said this was done to enable the authorisation applicants to commence collective discussions amongst themselves and negotiations with PNO in relation to the terms and conditions of access, including price, to the Port. Interim authorisation did not extend to entering into any collectively negotiated agreements. The interim authorisation remained in place until the date of the ACCC's final determination.

16. PNO participated in the ACCC's consultation process, including by providing three written submissions (dated 18 March 2020, 7 April 2020 and 10 July 2020).

A3. The ACCC's determination

17. On 27 August 2020, the ACCC issued its final determination in respect of the application.

18. The conduct which the ACCC authorised the applicants to engage in is set out in paragraph 5.5 of the ACCC's determination as follows:

    (a) collectively discuss and negotiate the terms and conditions of access, including price to the Port for the export of coal (and any other minerals) through the Port;

    (b) discuss amongst themselves matters relating to the above discussion and negotiations; and

(c) enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port,

(together, the **Conduct**).

19. Participation by the applicants in the Conduct is voluntary.

20. The authorisation does not authorise the applicants to:

(a) engage in any collective boycott activity; or

(b) share competitively sensitive information that relates to customers, marketing strategies, or volume or capacity projections of individual applicants.

21. The ACCC granted authorisation for the Conduct for a period of ten years, until 30 September 2030.

A4. Global coal market in which Hunter Valley coal producers participate

22. Coal producers operating in the Hunter Valley produce thermal coal.

23. Coal producers operating in the Hunter Valley export most of the thermal coal they produce to customers overseas.

Particulars

(a) As at September 2020, approximately 75-80% of Australia's thermal coal output was exported;

(b) Coal from the Hunter Valley is exported to around 20 countries, primarily in Asia. Approximately 165 million tonnes of coal was exported through the Port in 2019; and

(c) In 2015 and in 2018-19, approximately 88% of coal exports from the Hunter Valley was supplied to customers in Japan, China, Korea and Taiwan.

24. By reason of paragraphs 22 and 23 above, coal producers operating in the Hunter Valley participate in a global market for the supply of thermal coal.

25. Participants in the global market for the supply of thermal coal include coal producers in other parts of Australia, and coal producers overseas.

Particulars

(a) China is by far the largest global consumer of thermal coal, accounting for nearly half of annual global consumption, and driving most of the growth in production in recent decades. Thermal coal exports to China have increased rapidly over the past decade, from less than 2 per cent of Australian thermal coal exports in 2008, to around one-quarter as at 2019. Sustained economic growth over recent decades in India and other Asian economies has also contributed to increased global thermal coal consumption;

(b) The two largest exporters of thermal coal are Australia and Indonesia;

(c) In Australia, the Hunter Valley region in New South Wales and the Bowen-Surat region in central and south-west Queensland are the major coal mining regions of Australia;

(d) The authorisation applicants include the largest coal producers operating in Australia; and

(e) For example, Glencore, the largest coal producer in Australia, has 17 mining operations across New South Wales and Queensland. For the year ended 31 December 2019, Glencore reported revenues from its Australian operations in thermal coal production of approximately US$6 billion, and adjusted earnings before interest, taxes, depreciation and amortisation from its Australian operations in thermal coal production of approximately US$2.3 billion.

26. The global thermal coal market is highly competitive. Hunter Valley coal producers are constrained by global thermal coal prices.

A5. Global thermal coal prices

27. During past five years, global thermal coal prices typically have ranged between approximately US$49 per metric tonne (**MT**) and US$119 per MT, and are currently around US$76 per MT.

28. Global coal prices (which also include prices for coal from Newcastle which is a benchmark price on world coal markets) are unpredictable and fluctuate on a daily basis and routinely by more than 1%.

A6. PNO's charges for navigation services at the Port

29. By contrast to the fluctuations in global coal prices, PNO's charges for navigation services at the Port are not unpredictable, and do not fluctuate regularly.

30. Pursuant to a 50 of the *PAMA Act,* PNO charges a navigation service charge for all vessels (including coal vessel) which enter the Port.

31. This charge is imposed on vessel owners or charterers (**vessel operators**) of vessels which enter the Port.

32. Each time a vessel enters the Port, the vessel operator enters into a contract by conduct with PNO for use of the shipping channels containing PNO's published standard terms and conditions including the applicable navigation service charge. This contract is a single visit contract that covers the duration of the vessel's visit to the Port.

33. On a day-to-day basis, PNO does not deal directly with vessel operators, but rather deals with agents, known as ships' agents, that act on behalf of vessel operators. Before vessels enter the Port, the relevant ships' agent submits details pertaining to the visit to the Port. After vessels leave the Port, PNO issues invoices to the ships' agents, on behalf of vessel operators, for the payment of charges at the Port payable by those vessel operators. Those ships' agents pay the invoiced charges on behalf of the vessel operators.

34. The navigation service charge payable by vessel operators of coal vessels is fixed and payable according to the gross tonnage of a vessel that enters the Port and uses the channels, referred to as "Vessel Gross Tonnage" (**GT**). GT refers to the capacity of the vessel using the channel, rather than the volume of coal or other cargo which might be loaded onto the vessel during its visit at the port.

35. Since 16 December 2019, PNO has published on its website standard terms governing use of the channels by vessel operators.

36. The navigation service charge under PNO's current published schedule of Port Charges is $1.04 per GT.

37. In recent years, ten different ships' agents have represented the vessel operators of all the coal vessels that have used the Port.

38. [**Confidential to PNO**]

39. [**Confidential to PNO**]

    (a) [**Confidential to PNO**]

    (b) [**Confidential to PNO**]

    (c) [**Confidential to PNO**]

40. [**Confidential to PNO**]

41. By reason of paragraphs 27 to 40 above:

    (a) the charge levied by PNO on coal vessels for navigation services at the Port is unlikely to exceed 1% of the global thermal coal price per MT; and

    (b) any reduction in the charge levied by PNO on coal vessels navigation services at the Port that may be negotiated by coal producers would be unlikely to exceed 0.2% of the global thermal coal price per MT.

A7. Bilateral negotiations between PNO and individual coal producers

42. In or around December 2019, PNO started negotiating with a number of Port users on a bilateral basis, including the applicants, in relation to long-term pricing arrangements according to the terms of a Port User Pro Forma Long Term Pricing Deed (**Long Term Pricing Deed**) published on PNO's website.

Particulars

(a) The Long Term Pricing Deed has an initial term of 10 years - the same period as the ACCC's authorisation determination. The initial term can be extended by agreement, with renewal discussions to commence not later than three years prior to expiry of the initial term.

(b) Pricing arrangements for the navigation service charge under the Long Term Pricing Deed start at substantially similar levels to the Port's standard 2019 Schedule of Port Charges, at $0.81/GT.

(c) Entry into the Long Term Pricing Deed by Port users is voluntary. For parties who do not wish to enter into the Port User Pro Forma Long Term Pricing Deed, PNO has publicly committed to ensuring transparent and open access to the land side and port side services and facilities provided by it at the Port, through its open access arrangements for users published on its website.

43. [**Confidential to PNO**]

(a) [**Confidential to PNO**]

(b) [**Confidential to PNO**]

(c) [**Confidential to PNO**]

44. The current draft of the Port User Pro Forma Long Term Pricing Deed provides that:

(a) access charges can only be increased where the increase is consistent with pricing principles under Part IIIA of the CCA;

(b) the navigation service charge will remain fixed for the whole 10 year term of the Long Term Pricing Deed except for annual escalation of the greater of 4% or CPI, and PNO may increase the navigation service charge once a year, but only if it can be justified under the Part IIIA pricing principles;

(c) the producer / vessel agent may dispute a proposed price increase if it considers that the proposed increase is not in accordance with the variation provisions. The Long Term Pricing Deed sets out a dispute resolution process and principles for the arbitrator to apply which are drawn from Part IIIA of the CCA;

(d) PNO must provide coal producers with forward looking forecasts of any proposed capital expenditure; and

(e) PNO cannot discriminate adversely between any coal producer or vessel operator in relation to the navigation service charge.

45. Bilateral negotiations between PNO and individual coal producers in relation to long-term access terms promote efficient outcomes, including because:

(a) coal producers in the Hunter Valley have a spectrum of unique and varied incentives and interests that are more easily accommodated in bilateral negotiations;

(b) for some coal producers, non-price terms are as important as price terms, and their preferences in this regard are more easily accommodated in bilateral negotiations;

(c) some coal producers may be more flexible on price terms in exchange for better non-price terms that could make passage of its coal through the Port more efficient;

(d) bilateral negotiations ensure that the interests of smaller coal producers are not marginalised by larger coal producers; and

(e) bilateral negotiations ensure that long-term access terms are not reduced to a lowest common denominator amongst all coal producers.

46. By contrast, collective negotiation by coal producers with PNO would not promote efficient outcomes compared with bilateral negotiations between PNO and individual coal producers.

47. Bilateral negotiations between PNO and individual coal producers do not reduce information asymmetry compared with collective negotiation by coal producers.

48. Bilateral negotiations between PNO and individual coal producers do not involve higher transaction costs compared with collective negotiation by coal producers.

49. [**Confidential to PNO**]

(a) [**Confidential to PNO**]

(b) [**Confidential to PNO**]

50. To date, notwithstanding the negotiations between PNO and individual coal producers in relation to the Long Term Pricing Deeds, no individual coal producers have entered Long Term Pricing Deeds with PNO.

51. PNO remains ready and willing to negotiate and enter Long Term Pricing Deeds with individual coal producers, but does not intend to participate in collective negotiations with coal producers.

A8. Risks associated with collective negotiation by coal producers

52. Notwithstanding that the authorisation does not authorise the sharing of commercially sensitive information, the Conduct is likely to facilitate increased risk of collusion and anti-competitive information sharing, because it will encourage, if not require, competing coal producers to meet with each other regularly, and to share information about the markets in which they compete that otherwise would not be shared.

B. ISSUES

B1. Issues for determination by the Tribunal

53. The present proceeding is a re-hearing of the ACCC's decision to grant authorisation pursuant to s 90(7) of the CCA: s 101(2).

54. By virtue of the operation of s 90(8)(a), s 90(7)(a) does not apply.

55. Accordingly, the ultimate issue for determination by the Tribunal in this proceeding is whether, pursuant to s 90(7)(b), the Tribunal is satisfied in all the circumstances:

    (a) the conduct would result, or be likely to result, in a benefit to the public; and

    (b) the benefit would outweigh the detriment to the public that would result, or be likely to result, from the conduct.

56. In deciding this ultimate issue, the following issues arise for determination:

    (a) whether the conduct would be likely to result in any benefit to the public?

(b) if so, whether the conduct would be likely to result in any detriment to the public?

(c) if so, whether the public benefits outweigh the public detriments?

57. Finally, in the event the Tribunal is satisfied the public benefits outweigh the public detriments, the Tribunal must decide whether authorisation should be granted as a matter of discretion.

C. CONTENTIONS

C1. No public benefits are likely

58. The Conduct is not likely to result in any significant public benefit because:

(a) it has not been identified or established that the Conduct would facilitate more certain or efficient terms and conditions of Port access in agreements between PNO and ship agents, particularly given [**Confidential to PNO**];

(b) it has not been identified or established that the Conduct would facilitate more certain or efficient terms and conditions of Port access in agreements between PNO and coal producers;

(c) it has not been identified or established that the Conduct would result in any meaningful reduction in transaction costs relative to bilateral negotiations between PNO and coal producers;

(d) it has not been identified or established that any improvement in the terms and conditions of Port access, or the transaction costs in negotiating such terms and conditions, constitutes a public benefit, rather than a private benefit to coal producers.

59. Further, contrary to the ACCC's finding in its determination (at [4.48]), the Conduct is unlikely to enhance the competitiveness of coal exported from the Hunter Valley given:

(a) coal producers in the Hunter Valley sell coal in a global, competitive market for thermal coal;

(b) the charge levied by PNO on coal vessels for navigation services represents a very small proportion of the global thermal coal price per MT;

(c) without the Conduct, coal producers have certainty about the Port's charges for navigation services;

(d) coal producers face much greater uncertainty from other sources, including, principally, fluctuations in the price of coal.

60. The Conduct is not likely to result in any significant public benefit given it involves cartel conduct that:

(a) is presumptively harmful to competition;

(b) could facilitate the exchange of commercially sensitive information between coal producers that otherwise would not occur; and

(c) could adversely affect competition and/or efficient investment in a range of markets in which coal producers participate in the Hunter Valley.

C2. Significant public detriments are likely

61. The Conduct would be likely to result in significant public detriment by inhibiting competition between coal producers in the acquisition of services from PNO in the following circumstances:

(a) the Conduct would be likely to have the effect of discouraging individual coal producers from pursuing bilateral negotiations, and consequently it is less likely that individual producers will be able to negotiate terms and conditions tailored to their own individual needs; and

(b) collective negotiations, to the extent they occur, will be less likely to be tailored to the needs of individual producers, and will more likely reflect the needs of the larger producers.

62. The Conduct may result in the consequences identified above in paragraph 60(b) and 60(c), each of which would represent a public detriment.

C3. Discretionary considerations favour not making the determination

63. Even if the Tribunal is satisfied that the Conduct would be likely to result in a benefit to the public which outweighed any detriment to the public, the Tribunal

should still, as a matter of discretion, decline to authorise the Conduct given the following circumstances:

(a) the Conduct involves cartel conduct which is presumptively harmful, and therefore should be not be authorised unless it is likely to result in a substantial net public benefit;

(b) any benefit that would be likely to result in the present case (which is denied) would be of a private nature; and

(c) any net benefit that would be likely to result in the present case (which is denied) would not be substantial.

C4. Relief sought by PNO

64. PNO seeks the determination set out in its application, namely:

(a) the ACCC's determination be set aside;

(b) that the interim authorisation determination of the ACCC dated 2 April 2020 be set aside and the interim authorisation be revoked; and

(c) the application for authorisation AA1000473 be dismissed.

Dated: 14 December 2020

Cameron Moore SC

Declan Roche

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NOTICE OF LODGMENT

AUSTRALIAN COMPETITION TRIBUNAL

This document was lodged electronically in the AUSTRALIAN COMPETITION TRIBUNAL and has been accepted for lodgment pursuant to the Practice Direction dated 3 April 2019. Filing details follow and important additional information about these are set out below.

Lodgment and Details

Document Lodged:	Statement of Facts, Issues and Contentions
File Number:	ACT 2 of 2020
File Title:	Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020
Registry:	VICTORIA – AUSTRALIAN COMPETITION TRIBUNAL

REGISTRAR

Dated: 28/01/2021 1:19 PM

Important information

This Notice has been inserted as the first page of the document which has been accepted for electronic filing. It is now taken to be part of that document for the purposes of the proceeding in the Tribunal and contains important information for all parties to that proceeding. It must be included in the document served on each of those parties.

Re Application for Authorisation AA1000473 lodged by New South Wales Minerals Council and mining companies to collectively negotiate with Port of Newcastle Operations Pty Ltd all terms and conditions of access relating to the export of coal from the Port of Newcastle.

PORT OF NEWCASTLE OPERATIONS PTY LTD (ACN 165 332 990)

Applicant

NEW SOUTH WALES MINERALS COUNCIL'S STATEMENT OF FACTS, ISSUES AND CONTENTIONS

A. INTRODUCTION

1. New South Wales Minerals Council (**NSWMC**) and certain coal producer members[1] (the **Authorisation Applicants**) are seeking to negotiate collectively with Port of Newcastle Operations Pty Limited (**PNO**) the terms and conditions of access to the channels and berthing facilities at the Port of Newcastle (**Port**), which access is necessary for the export of coal from the Hunter Valley in New South Wales. In that regard, the Authorisation Applicants are seeking to achieve a long-term commercial solution so as to provide certainty for long term investment in the Hunter Valley region.

2. The need for collective negotiations with PNO arises in the following circumstances. The Port is a natural "bottleneck" facility at the end of a multi-user coal export supply chain. The Authorisation Applicants are seeking to negotiate matters that apply across the Hunter Valley coal industry. PNO enjoys the commercial negotiating position of being a monopoly service provider. Since 2014, when PNO was granted a long-term lease by the State of New South Wales, PNO has repeatedly increased the Port access charges with no change in the nature or quality of the service.

3. Highlighting the need and importance of the Authorisation Application is the absence of any regulatory constraint or other mechanism to constrain PNO's unfettered monopoly power over Port access. By comparison, the Australian Rail Track Corporation (**ARTC**) provided an access undertaking to the Australian Competition and Consumer Commission (**ACCC**) in relation to ARTC's monopoly rail infrastructure network used for the export of coal in the Hunter Valley. This network takes coal from coal mines to the industry loading terminals at the Port. In the absence of specific processes such as those applicable to the ARTC, the authorisation process under the *Competition and Consumer Act 2010* (Cth) (**CCA**) enables the Authorisation Applicants to seek to collectively bargain with PNO on behalf of its members in compliance with Australian competition laws.

[1] These coal producer members are: Yancoal Australia Limited; Peabody Energy Australia Pty Ltd; Bloomfield Collieries Pty Ltd; Centennial Coal Company Limited; Malabar Coal Limited; Whitehaven Coal Mining Limited; Idemitsu Australia Resources Pty Ltd; MACH Energy Australia Pty Ltd and Glencore Coal Assets Australia Pty Limited. Note: Hunter Valley Energy Coal Pty Ltd is no longer seeking to collectively negotiate with PNO.

4. Access terms and conditions to the Port are significant and important issues for the Hunter Valley coal industry. It is critically important to the Authorisation Applicants to ensure that infrastructure costs imposed by PNO on Port users (through Port access charges) are fair, reasonable and efficient and the terms and conditions of access give the industry certainty in relation to future investment. This is particularly so given:

    a. The significant price increases imposed by PNO following revocation of declaration of the Port, which have occurred without any right of recourse. In the absence of regulatory constraints or other mechanisms to constrain PNO's unfettered monopoly power over Port access, there is a legitimate concern that PNO will impose further price increases, which have significant ramifications for the Hunter Valley coal industry.

    b. The critical importance to NSWMC in ensuring that access charges imposed by PNO do not contribute to individual mines in the Hunter Valley becoming uneconomic, as global coal customers turn to alternatives of overall less costly coal. Noting the constant trade challenges faced by the industry, a recent significant example being the trade issues with China affecting coal exports, Hunter Valley producers must seek to be competitive in the global market, including by finding new markets as alternatives to exports to China.

    c. PNO is seeking to develop a large container terminal at the Port and the industry is concerned that the costs of that terminal development may be imposed on the coal industry (through Port access charges).These concerns are acute because PNO has publicly stated that coal industry operations in the Hunter Valley have a 15-year timeframe.[2] In this context, PNO has a commercial incentive to extract from coal industry participants as much as it can over that period, including to facilitate the development of the new container terminal operations. Importantly, the access terms that PNO currently imposes (and that the Authorisation Applicants are seeking to negotiate), expressly remove any ability for coal exporters to discuss or negotiate user funded expenditure and do not provide any real ability to negotiate future capital expenditure at the Port by PNO. The Authorisation Application provides the opportunity for the industry to seek a solution to issues including long term pricing and access terms at the Port, and in particular, creating certainty as to user funded expenditures and for investment in the future by both PNO and the mining industry. These are perfectly reasonable industry issues requiring long term certainty given the billions invested by the industry in the Hunter Valley coal export chain, including in the coal export terminals operated by Port Waratah Coal Services Limited (**PWCS**)[3] and Newcastle Coal Infrastructure Group (**NCIG**).[4]

    d. In 2020, NSWMC lodged a declaration application under Part IIIA of the CCA for access to the channel with the National Competition Council (**NCC**). That application is currently being considered by the Federal Treasurer. NSWMC lodged that application in response to the deemed revocation of the declared

[2] NSWMC submission to National Competition Council, 25 November 2020, page 2. See: https://ncc.gov.au/images/uploads/NSWMC.pdf
[3] https://www.pwcs.com.au/
[4] https://www.ncig.com.au/

service at the Port in 2019 when the Treasurer did not make a decision within the statutory timeframe. Given the relevant provisions of Part IIIA, the coal industry was not able to appeal the deemed revocation (appeal rights do not extend to third parties on a revocation). PNO's claims that the coal industry is satisfied with its access arrangements at the Port are not correct. Rather than seeking to have litigation or declaration applications, NSWMC's collective bargaining application to the ACCC was a genuine attempt by the industry to seek a constructive solution. NSWMC's Part IIIA application only arose because after the ACCC granted interim authorisation, PNO refused to even meet with the industry to seek to discuss access terms, something the coal industry has not experienced with any other service provider.

5. In this context, the Authorisation Applicants seek to collectively bargain with PNO, as the monopoly infrastructure provider, on access to the Port to ensure that Hunter Valley coal exports remain commercially viable and globally competitive now and into the future. This has both direct and indirect impacts on employment and investment in the Hunter Valley.

6. The Authorisation Applicants' key contentions are that the authorisation should be allowed, because:

   (a) the Tribunal can be satisfied that the Authorisation Conduct will be likely to result in significant public benefits;

   (b) the Tribunal can be satisfied that there will be no significant (if any) public detriments likely to result from the Authorisation Conduct;

   (c) there are no discretionary reasons for refusing the authorisation.

A1. Background

7. On 6 March 2020, NSWMC lodged application for authorisation AA1000473 (**Application**) with the ACCC on behalf of itself and certain member coal producers that export coal through the Port.

8. The Application sought authorisation to collectively discuss and negotiate (on a voluntary basis) the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port; to discuss amongst themselves matters relating to the above discussions and negotiations; and to enter into and give effect to contracts, arrangements, or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port (the **Authorisation Conduct**).

9. On 2 April 2020, the ACCC granted interim authorisation under s 91(2) of the CCA to enable the Authorisation Applicants to commence collective discussions among themselves and negotiations with PNO in relation to the terms and conditions of access, including price, to the Port. The interim authorisation did not extend to entering into any collectively negotiated agreements.

10. Since that time, NSWMC has participated in the ACCC's consultation process. This has included lodging submissions with the ACCC dated 30 April 2020, 15 May 2020 and 17 August 2020.

11. On 27 August 2020, the ACCC authorised the Conduct in **Determination** AA1000473. The ACCC noted that the conduct may involve a cartel provision. The ACCC granted authorisation for ten years, until 30 September 2030. The ACCC did not authorise any collective boycott activity and did not authorise the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume/capacity projections for individual Port users.

12. The ACCC determined that the Authorisation Conduct is likely to result in public benefits. In particular, by providing the Authorisation Applicants with greater input into the terms and conditions of access and increased transparency around capital expenditure plans and cost allocation at the Port.

13. The ACCC considered that the conduct would provide greater certainty for the price of coal, more timely resolution of industry-wide issues and facilitate more efficient investment decisions at the Port and across the Hunter Valley coal industry. The ACCC also considered that these outcomes would enhance the international competitiveness of the Hunter Valley coal industry, including by more efficient contracting and associated public benefits from lower transaction costs.

14. The ACCC considered there were likely to be minimal public detriments. In particular, the ACCC determined that there was unlikely to be any negative impact on competition among coal producers because they were free to negotiate terms and conditions of Port access through bilateral discussions with PNO. The ACCC acknowledged that the Authorisation Conduct does not involve coal producers sharing individual coal projection volumes, customer pricing information or marketing strategies.

15. On 17 September 2020, PNO lodged its application for review of the ACCC's Determination with the Tribunal under s 101 of the CCA.

A2. Jurisdiction of the Tribunal

16. The Tribunal's review of the ACCC's Determination is a hearing *de novo* pursuant to s 101(2) of the CCA.

17. As a re-hearing, the Tribunal must assess the Application on its merits and by reference to the information and evidence given to the ACCC and any further material that the parties put before the Tribunal.

18. The role of the Tribunal in conducting the review is not confined by the issues raised by the parties to the review and the Tribunal must determine itself whether the statutory test for authorisation is satisfied.

19. The ACCC's Determination may provide the Tribunal with a reference point for determining which matters are truly in dispute: *Application by Flexigroup Limited (No 2)* [2020] ACompT 2 at [136].

A3. The Test for Authorisation

20. The statutory precondition for authorisation is stated in ss 90(7) and (8) of the CCA. As the Authorisation Applicants seek authorisation in respect of the possible application of the cartel conduct prohibitions, the relevant statutory precondition is s 90(7)(b) of the CCA.

21. The Tribunal must be satisfied that the conduct would result, or be likely to result, in a benefit to the public and the benefit would outweigh the detriment to the public that would result, or be likely to result, from the conduct.

22. The CCA does not define what constitutes a public benefit. The ACCC takes a broad view as to what constitutes a public benefit. In the ACCC's Authorisation Guidelines, a benefit to the public includes:

> …anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress. Plainly the assessment of efficiency and progress must be from the perspective of society as a whole: the best use of society's resources. We bear in mind that (in the language of economics today) efficiency is a concept that is usually taken to encompass "progress"; and that commonly efficiency is said to encompass allocative efficiency, production efficiency and dynamic efficiency.

23. Similarly, a detriment to the public includes "any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency".

24. In *Medicines Australia*, the Tribunal stated:

> Although ''detriment'' covers a wider field than anti-competitive effects in many cases the important detriments will have that character. The relevant detriment will flow from the anti-competitive effect of the conduct to which authorisation is sought. This does not exclude consideration of other detriments which may be incidental to and therefore detract from a claimed public benefit. To that extent such detriment will be relevant in weighing the public benefit".[5]

25. The statutory test requires the Tribunal on review, to compare the future with the conduct and without the conduct.

26. Satisfaction of the statutory conditions does not oblige the Tribunal to grant authorisation. Nevertheless, if the Tribunal on review were to be satisfied that the conduct is likely to result in a net public benefit, ordinarily authorisation would be granted.

[5] *Re Medicines Australia Inc* [2007] ACompT 4.

B. FACTS

B1. The Hunter Valley coal industry

27. The Hunter Valley coal industry and associated supply chain are the largest coal export operations in the world. The Hunter Valley/Newcastle coalfields produce approximately 170 million tonnes of saleable coal per year.

28. The Hunter Valley coal supply chain is made up of coal producers (or mines) who export their coal, above rail haulage and below rail (track) providers, three coal export terminals operated by PWCS and NCIG, port managers and the Hunter Valley Coal Chain Coordinator.

29. There are more than 30 coal mines in the Hunter Valley operated by 11 coal producers as well as other coal projects. Coal is transported by rail haulage providers from the mines to the three terminals at the Port, and is then loaded onto vessels at one of the loading terminals.

30. The Hunter Valley coal industry and its associated supply chain is responsible for around 90% of New South Wales's coal production and around 40% of Australia's total black coal production.

31. The Hunter Valley coal industry presently faces volatile market conditions. For example, some 70 ships carrying Australian coal have been unable to unload in China since October 2020. Coal exports to China from Newcastle have ceased and data reflects that export levels of thermal and metallurgical coal to China were down 83% and 85% respectively between November 2019 and November 2020.

32. There are, therefore, significant cost pressures on the Hunter Valley coal industry, as coal customers turn to alternatives and Hunter Valley producers compete in finding new markets as alternatives to exports to China (coal from Australia competes with coal from other countries such as Indonesia, Russia and the United States of America). It is therefore important that infrastructure charges whether for rail (in respect of the ARTC) or at the Port are fair, reasonable and efficient in order to facilitate the competitiveness of Australia's coal exports.[6]

B2. The Port

33. The Port is the largest coal exporting port in the world. Coal is the primary commodity exported through the Port.[7] The Port is the only means of exporting coal from the Hunter Valley. For that reason, the shipping channels are a natural "bottleneck" monopoly.

34. The task of exporting coal from the Port involves vessels entering the Port, transiting the channels in the Port, tying up at the berths to load coal at the coal terminals and then once again transiting the channels before exiting the Port for delivery of the coal at its

[6] Hao Tan, Elizabeth Thurbon, John Matthews and Sung-Young Kim "Opinion: Forget about the trade spat – coal is passe in much of China, and that's a bigger problem for Australia" UNSW Sydney Newsroom (20 January 2021), citing Australian Bureau of Statistics data.
[7] Other commodities also pass through the Port including machinery, project cargo and vehicles, pitch and tar products, steel and grains.

ultimate destination. The destination of the coal is another port or ports located in the country where the coal exporters' customer is located.

B3. New South Wales Mineral Council

35. NSWMC is the leading mining industry association in New South Wales. Many of NSWMC's members are exporters of coal (and other commodities) from the Hunter Valley region through the Port. The Port is located at the end of a multi-user export supply chain that involves an extensive rail network from multiple mine sites that culminate at coal loading terminals located at the Port.

B4. Port of Newcastle Operations Pty Ltd

36. PNO is jointly owned by The Infrastructure Fund (**TIF**, a wholesale investment fund under the trusteeship of Gardior Pty Ltd) and China Merchants Group.

37. The Infrastructure Fund is an Australian infrastructure fund with a portfolio of Australian and overseas assets worth more than $2.4 billion. TIF's portfolio is managed by Macquarie Infrastructure and Real Assets.

38. China Merchants Port Holdings Company is part of the China Merchants Group, and is a global port developer, investor and operator, with a ports network portfolio spanning across 18 countries and regions. China Merchants Group is headquartered in Hong Kong with business sectors which extend beyond infrastructure to property development and financial investment. In 2018, China Merchants Group had total assets in the value of 8 trillion RMB, with 649 billion RMB in revenue (approximately AUD$130 billion). Currently, China Merchants Group operates 53 ports in 20 countries and districts, and in 2017, its container throughput exceeded over 100 million TEU[8] for the first time. It is understood that China Merchants Group would technically be considered to be a Chinese State-Owned Enterprise.

39. PNO has operated the Port since May 2014, under a 98-year lease from the State of New South Wales. Prior to this, the Port was operated by the State of New South Wales.

40. Under the terms of its long-term lease, PNO has a licence to operate shipping channels at the Port and, as noted above, it has unfettered monopoly power over Port access.

B5. Privatisation of the Port and Port charges

41. Until 2014 the Port Authority of NSW, a government owned corporation of the State of New South Wales, was responsible for the overall development and operation of the Port. As the port operator from May 2014 onwards, PNO has controlled the terms and conditions of access to the Port. PNO has and may exercise the statutory powers conferred under Part 5 of the *Ports and Maritime Administration Act 1995* (NSW) (**PAMA**) and the *Ports and Maritime Administration Regulations 2012* (NSW).

42. On each occasion a vessel enters the shipping channels, it incurs liability to pay usage charges for the use of the Port at rates determined by PNO, which has the express entitlement under the lease of the Port from the State of NSW, to exclude access to the channels if the shipping charges are not paid.

[8] Twenty-foot equivalent units, a measure of container size.

43. PNO publishes a schedule of service charges that apply to the commercial use of the Port, in accordance with the PAMA including, a Navigation Service Charge (**NSC**) and a Wharfage Charge (**WC**). PNO may vary this schedule from time to time, including varying or introducing new fees without consultation or negotiation.

44. Shortly after assuming its role as port operator, PNO substantially increased Port access prices (including, in relation to port access charges, by between 40% and 60% for some vessel types) and re-valued the Port assets from $1.75 billion to $2.4 billion. Subsequently, PNO has continued to substantially increase Port access prices. By way of example, the price increase for the NSC between 2019 and 2020 was 33.5%.

45. These price increases were not associated with any increase in productivity, efficiency or service provided by PNO, and nor were they imposed for the purpose of funding any further investment in the services provided at the Port.

46. PNO's significant price increases and the consequent uncertainty for coal producers provide critical context for the Authorisation Application. As noted by the Tribunal:

> …the understandable commercial incentive to maximise its profitability, and its revenue, may be served in different ways at different times, depending upon the strength of the coal export market. The fact remains (as noted above) that coal miners supplying coal into that market from mines in the Hunter Valley have no real practical alternative to using the Service, and in more profitable times (accepting what has been said about the present state of that industry) be vulnerable to charging changes imposed by PNO for access to the Service to absorb to a significant degree the profitability of exporting coal produced from the Hunter Valley.[9]

B6. The Producer Deed

47. As an alternative to its published schedule of service charges, at the end of 2019 PNO invited coal producers, vessel agents, vessel operators and Free on Board coal consignees to enter into bilateral long-term discounted pricing arrangements (or deeds). The deed offered to producers (**Deed**) includes NSC and WC prices at a “discount” to PNO’s published charges. It is the terms and conditions of the Deed (and any other access arrangements) that the Authorisation Applicants seek to collectively negotiate with PNO. The term offered by PNO under the Deed is ten years.

48. Importantly, the pricing mechanism set out under the Deed does not provide Port users with any pricing certainty. The Deed provides PNO with a number of "re-openers" and mechanisms by which it can adjust the price for use of the Port based on factors including capital expenditure that is solely within the discretion of PNO.

B7. No price regulation

49. In some cases of bottleneck infrastructure, there is a certified access regime or other effective regulatory framework to 'manage' the prices set by the monopoly owner or operator for use of the infrastructure. There is no such regime in place in relation to the Port. Given that it is no longer declared under Part IIIA of the CCA, there is no constraint on PNO's pricing that arises from ACCC oversight.

[9] *Application by Glencore Coal Pty Ltd* [2016] ACompT 6, [166].

50. While the prices levied by PNO are subject to price reporting to the relevant Minister of the State of New South Wales under Part 6 of the PAMA, and the Minister may refer the pricing for investigation to the New South Wales Independent Pricing and Regulatory Tribunal, it is not a certified or effective access regime.

51. PNO has in the past claimed that there are some existing constraints on PNO in relation to its pricing structures (e.g. the price reporting mechanism under the PAMA). However, the fact is that at present, there are no direct regulatory constraints on its pricing structures.

52. The Authorisation Applicants understand that the New South Wales Government has no present intention to put in place any form of regulatory oversight for access charges at the Port. This creates considerable uncertainty for the Hunter Valley coal industry, particularly in the present commercial environment (as noted above).

53. The Authorisation Conduct provides the opportunity for the Authorisation Applications to seek a solution, creating certainty for the benefit of the Hunter Valley mining industry as a whole.

54. While there is no certainty that there will be an industry agreement with PNO as to access issues at the Port as a result of the Authorisation Conduct, for the reasons outlined below, it would provide the conditions to allow the mining companies to have such discussions that would facilitate fair, reasonable and efficient access arrangements. In turn, this would provide certainty for long term investment in the region.

B8. PNO's negotiations with coal producers

55. PNO declined collective negotiations with the Authorisation Applicants on 11 May 2020 and has continued to decline any engagement in this process.

C. ISSUES

56. The issues for the Tribunal are (as correctly stated by PNO):

    (a) whether the Authorised Conduct would result, or be likely to result, in any benefit to the public;

    (b) whether the Authorised Conduct would result, or be likely to result, in any public detriment; and

    (c) whether, as a matter of discretion, the Authorised Conduct should not be authorised.

D. CONTENTIONS

D1. The Authorisation Conduct sought

57. The Authorisation Applicants seek authorisation under the CCA to:

    (a) collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port;

    (b) discuss amongst themselves matters relating to the above discussion and negotiations; and

    (c) enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port.

58. The Authorisation Conduct does not involve any collective boycott activity.

59. Participation in the Authorisation Conduct will be voluntary. The Application seeks to allow each applicant to independently determine for themselves whether to accept the terms and conditions offered by PNO following collective negotiations. Each applicant is also able to freely undertake independent negotiations with PNO at any time they wish to do so.

60. Authorisation is sought for a period of 10 years. This reflects the prospective term of an access agreement which PNO has proposed in the Deed. It also allows for renegotiation of prices associated with review events that PNO is seeking under its proposed Deed.

61. PNO will not be required to negotiate collectively with the Authorisation Applicants – authorisation merely provides the opportunity to do so.

62. The class of parties able to collectively negotiate under the proposed authorisation is not closed. Pursuant to s 88(1) of the CCA, the authorisation is sought on terms that would allow other access seekers / Port users to have the benefit of the authorisation if it chooses to participate in the collective negotiation.

63. The Authorisation Conduct will not operate to permit any collusion or information sharing between the Authorisation Applicants. It will not allow them to agree prices or other terms and conditions in respect of the coal production services which they offer in competition with one another.

D2. Relevant market/s

64. The primary market affected by the Authorisation Conduct is the market for the access to PNO's Port services. In respect of this market, PNO has a complete monopoly. PNO has the unfettered ability to raise access charges.

65. In its Application for Review and Statement of Facts, Issues and Contentions, PNO focuses on the global thermal coal market. In this context, PNO argues that any reduction in port charges that may result from a collective bargaining process will be negligible (less than 0.2% of the global thermal coal price per metric tonne) and would

not be likely to result in any materially improved competitiveness for coal producers in coal export markets.[10]

66. PNO's focus on the global thermal coal overlooks the market for access to PNO's Port service and other up-stream markets (as explained below).[11]

D3. Authorisation will provide significant public benefits

D3.1 Improving efficiency with collective negotiations

67. The Authorisation Applicants contend that the Authorisation Conduct would likely result in more efficient terms of access and resolution of associated industry issues. This was the view formed by the ACCC, following submissions from interested parties.

68. PNO has proposed a Deed for access to the Port for a period of 10 years that includes issues that affect all users of the Port (e.g. capital expenditure at the Port). The Authorisation Applicants submit that an industry response, and one facilitated by the Authorisation Applicants, is the most efficient course.

69. Contrary to PNO's contention,[12] unilateral negotiations between PNO and Port users would not likely provide an efficient means of resolving industry-wide issues.

70. The current commercial realty is that the Authorisation Applicants, being nine of the largest coal exporters of the Port, have not been able to agree with PNO in relation to the Deed. They seek to settle industry-wide issues from an industry perspective. In that respect, bilateral negotiations with PNO have not succeeded and collective bargaining by the industry is needed to achieve the economic goals of "efficiency and progress".[13]

71. It is not economically efficient for PNO to charge Port users for the cost of assets already funded by users. It also has a material impact on the related markets (as noted below) and the commercial ability / incentive for industry participants to invest in the mining industry in the Hunter Valley.

72. Because PNO analyses the test for authorisation exclusively through the lens of the global thermal coal market and concludes that collective negotiations will not result in any meaningful improvement in competitiveness in that market, PNO asserts that any benefits obtained as the result of collective negotiations will only be 'private' benefits, rather than 'public' benefits for the purposes of the statutory test. This assertion does not bear scrutiny when consideration is given to the nature of the industry-wide issues (including Port access and long-term infrastructure investment) sought to be negotiated by users of the Port with PNO.

73. The Authorisation Conduct will facilitate an industry discussion on industry issues relevant to the Port, including as to capital expenditure relating to services to be provided by the Port for the mining industry, and as to how user funding should be treated within that framework. As a matter of efficiency, the resolution of these issues (through the Deed) should apply across the industry. This would benefit all PNO's users in creating certainty for investment and long-term pricing.

[10] Application for Review at [27].
[11] See [4.4] to [4.7] of the ACCC's Determination.
[12] At [33]-[35].
[13] ACCC Authorisation Guidelines at [8.1].

74. This contention is supported by others in the industry. Yancoal and Port Waratah Coal Services in submissions to the ACCC highlighted that bilateral negotiations with PNO have been difficult, due to the inequality of bargaining power between an individual coal producer and PNO. Coal producers are dependent on PNO's services but PNO is not dependent on any user, particularly where PNO has statutory rights to increase prices at its discretion.

75. Contrary to PNO's assertions, it is evident from the Yancoal submission that the issues relating to PNO's regulated asset base is one which concerns the whole industry, and which warrants collective discussion as to how it is contemplated to be factored into the pricing mechanisms of the template producer Deed.

76. Collective negotiations will likely improve efficient outcomes for the whole Hunter Valley coal industry, as the terms and conditions of access to the Port relate to issues such as future capital expenditure at the Port, and the impact on prices paid by coal producers whether directly or indirectly.

77. The resolution of such industry issues in an efficient manner will likely deliver significant public benefits. It would create long term certainty for both coal producers and PNO, creating a far more favourable environment for future investment in coal production and Port infrastructure. In turn, this would generate significant public benefits in Australia of improved commercial outcomes, including the maintenance of strong exports, employment, coal royalties for the State of New South Wales and economic growth.

78. The Authorisation Applicants contend that the encouragement of long-term investment solutions underpinned by certainty about access terms at the Ports is crucial to securing a future for efficient coal exports in the Hunter Valley region.

79. Without the Authorisation Conduct, it is far less likely that PNO will agree to make any concessions in relation to the industry wide issues covered by its proposed Deed, including the basis on which costs will be allocated by PNO.

80. The proposed Deed reflects PNO’s monopoly position. For example, the proposed Deed offered to coal producers:

    (a) protects PNO from changes in tax and other laws by enabling it to pass on any adverse effects of those changes to users who have no alternative to the Port for the export of coal;

    (b) allows PNO to increase charges to maintain the rate of return for its shareholders;

    (c) prevents scrutiny of PNO's future investments in the Port which may have the effect of preventing Port users from being able to access data and assess whether such investments and expenditures by PNO are justified and efficient (and even related to coal export).[14]

81. In the absence of collective bargaining, and in light of the heavily skewed terms and conditions offered by PNO in the Deed, it is unlikely that there will be an efficient

[14] Item 7 of the annexure to the Deed.

resolution of these industry-wide issues with a significant detrimental effect on individual investment decisions on the coal production side.

82. Further, increased transparency in respect of these industry-wide issues, such as expenditure and costs allocation at the Port, has the potential to lead to more efficient outcomes for the mining industry.

83. As the monopoly infrastructure services provider, PNO holds all of the data on expenditures and costs at the Port. Coal producers, irrespective of their size or volumes of coal exported through the Port, have little bargaining power or ability to question PNO in relation to capital expenditures or costs.

84. This is particularly the case because of the lack of regulatory oversight. The imbalance in bargaining power and information would persist in the absence of the Authorisation Conduct. The Authorisation Applicants do not have any meaningful ability to reasonably negotiate with PNO on an individual basis in this regard.

85. A non-discrimination term as proposed by PNO under the template Deed[15] will likely be of no real utility or protection to users where no user, large or small, has any real visibility of the contractual set of terms other users have agreed with PNO.

86. PNO has asserted that it has committed to providing to users a forward looking five year forecast of its projected capital expenditure that may impact access prices. However, Port users have no input or ability to materially influence that forecast. Clause 7(c) of the Annexure to the template producer Deed expressly provides that "for the avoidance of doubt, PNO may, but is not obliged to, implement any comments made by the Producer on its 5 Year CAPEX Forecasts or any proposed increase to the Producer Specific Charges".

87. The industry is particularly concerned about this issue given the lack of evidence that recent increases in Port charges have been re-invested in the Port for the benefit of coal export operations.[16] The Authorisation Conduct would allow applicants to discuss the CAPEX forecasts provided by PNO which would likely improve information asymmetry and associated inequality in bargaining power, so as to facilitate a more efficient solution.

88. PNO's contentions that individual negotiations will bring to bear equally if not more effective resolution of industry issues, does not withstand scrutiny.

89. The reality that has transpired is that the Authorisation Applicants (9 of the largest coal producers of the Port) have not agreed with PNO's negotiating stance and have sought to negotiate industry issues collectively from an industry perspective. To this extent, individual, bilateral negotiations between PNO and users of the Port have not succeeded and collective bargaining is needed to resolve the industry issues in order to achieve the economic goals of "efficiency and progress".

90. Given this, the Authorisation Applicants are seeking the opportunity to be able to discuss and collectively engage with PNO in relation to the contractual framework proposed

[15] Item 5 of the Annexure to the Deed.
[16] As noted in the PWCS Submission to ACCC dated 3 April 2020, at page 2.

under the template Deed, in circumstances where users clearly have a common and legitimate interest in seeking to understand and negotiate the mechanics and language of the proposed terms and conditions of access in a streamlined, cost effective, reasonable and efficient manner.

91. The absence of the Authorisation Conduct, would likely result in users having to accept the contractual terms proposed by PNO on a less efficient basis. To this end, PNO has the ability to exert greater, individual commercial pressure on users to accept its terms. It is likely that coal producers, particularly smaller miners with more limited resources, will likely cede to such commercial pressure.

92. Finally, the template Deed purports to provide an avenue for dispute resolution where a "Permitted Price Dispute" arises between PNO and the Port user. However, private resolution cannot be likened to the regulatory oversight nor does it provide a meaningful avenue for dispute resolution by an access seeker.

93. In addition, the template Deed provides that "no appeal may be made to the Court on a question of law arising out of an award of the arbitrator appointed under this Dispute Resolution Process", and that the "particulars of the Dispute, any negotiation, mediation or arbitration and any terms of resolution including any Award must be kept strictly confidential by PON and the Producer".[17]

94. In these circumstances, authorisation of the proposed conduct is necessary to allow the Authorisation Applicants to seek to negotiate more efficient positions as to pricing and accountability with PNO which the Authorisation Applicants believe would improve pricing outcomes and create an improved environment for investment in the Hunter Valley.

95. The process of collective bargaining will likely assist in seeking to address the clear inequality in bargaining power in this respect.

96. In summary, the Applicants submit that in the absence of the Authorisation Conduct, the reality that would likely transpire is that PNO would be able to impose significantly less efficient terms and conditions to maximise its commercial interests as the monopoly infrastructure service provider, to the detriment of competition, exports, State royalties, employment, investment in the Hunter Valley region and growth of the Australian economy (as explained further below).

D3.2 Enhancing investment and promoting competition in relevant markets

97. The Authorisation Conduct will provide efficient terms and conditions of access by all Port users and increased certainty in investment that would facilitate increased usage of PNO's services on a more efficient basis. It is the efficiencies derived from the requested authorisation that are likely to be most important in dealing with PNO as a monopoly provider of services at the Port, as they will foster the ability of the mining companies to export coal more efficiently (and thereby compete with each other more effectively).

[17] Cl 5.3, Schedule 3 of the Deed.

98. In particular, the requested authorisation would promote a material increase in competition in a number of dependent markets, including the following:

(a) the coal export market - mining export infrastructure occupies a strategic position in the mineral export industry, and provides services required to compete in the dependent seaborne coal and other mineral markets. Considering the current economic climate and experience of Australian coal producers, even incremental cost increases at the margin may have the degree of impact to drive coal producers to exit the market, which would inevitably have repercussions for the related markets that support the coal export market. The requested authorisation would provide coal producers with the opportunity to negotiate such cost increases with PNO in a more effective and meaningful way, thereby driving competition in this market;

(b) the markets for the acquisition and disposal of exploration and / or mining authorities (the **Tenements Market**). With authorisation, owners of tenements will have increased incentives and confidence to invest in the exploration of their tenement(s), either for the purpose of developing the tenement itself or obtaining more information about the tenement to improve its prospective value. Sellers will enjoy greater competition amongst buyers when selling their tenements, thereby driving up price and activity in the Tenements Market. The New South Wales Government (as the originating seller of tenements) will benefit from increased competition in the bidding for licences, underpinned by pricing certainty in relation to Port access prices;

(c) the markets for services such as geological and drilling services, construction, operation and maintenance (the **Specialist Services Market**). If competition is materially increased in the Tenements Market, this will likely have a positive flow-on effect to the Specialist Services Market, as there will be increased demand for the specialist services which would be involved in developing mining tenements.

D3.3 Transaction cost savings

99. The Authorised Conduct would lead to transaction cost savings for both PNO and also the mining industry. It would focus the negotiations on key industry issues that would otherwise be inefficient for all involved if PNO sought to negotiate mining company by mining company – for example, PNO's proposed capital investment program that would affect the coal industry as a whole. Over the proposed 10 year period these efficiencies would likely be substantial.

D4. Authorisation has no significant (if any) public detriments

100. In the absence of authorisation, the Authorisation Applicants would not be able to collectively discuss with PNO industry issues relating to access to the Port and the provisions of the proposed Deed that PNO has issued, particularly in relation to capital expenditure and PNO's investment in the Port. On the other hand, recognising that PNO is free to decline to collectively negotiate if it so chooses, the Authorisation Conduct would not result, or be likely to result, in any significant (if any) public detriments.

D4.1 The Authorisation does not permit collective boycott

101. PNO has already publicly indicated that it wishes to deal with its users rather than have ongoing litigation as to the pricing at the Port. However, it is up to PNO if it wishes to engage in the proposed collective negotiations. There is no suggestion of any collective

boycott being sought by the Authorisation Applicants (which would not be feasible in any event given the monopoly position of PNO). Accordingly, there would be no likely public detriment arising from the application in this regard.

D4.2 There is no meaningful risk of impermissible information sharing

102. PNO's contention that authorisation will facilitate collusion and anti-competitive information sharing between coal producers is not supported by any evidence, and runs contrary to the established history of collective bargaining by industry associated members.

103. The exchange of information between the Authorisation Applicants and the reaching of any understanding only relates to the Authorisation Conduct. Information will only be shared to the extent that it is reasonably necessary for this purpose.

104. The Authorisation Conduct does not involve the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume / capacity projections for individual users. This is because, consistent with the ACCC Determination, access pricing is not on a user basis and as such there is no reason to share production or customer information or industry data (which is already publicly available).

105. The Authorisation Conduct is not novel. By way of example only, the ACCC granted coal producers authorisation to negotiate access to the Dudgeon Point Project Management Terminal proposed for Dudgeon Point, to collectively bargain on the terms and conditions, including price.

106. Finally, the companies seeking to negotiate with PNO are sophisticated mining companies which have compliance processes in place to ensure that no information is exchanged that would be problematic under the CCA. The risk of impermissible information sharing is limited and there is no evidence that this is likely to occur.

D4.3 No discrimination against smaller producers

107. PNO asserts that collective negotiations are likely to result in the coal producers attempting to negotiate as a bloc with PNO and use their dominant position to preclude smaller producers from engaging in separate negotiations.[18] The point is without substance.

108. The Authorisation Applicants are seeking to discuss and negotiate the terms and conditions of access under the contractual framework proposed by PNO. The Authorisation Applicants and others in the industry have common interests in transparency and efficiency in this respect, and in the spirit of 'non-discrimination' as suggested by PNO, so that the terms and conditions of access are understood and approached in a consistent manner across the industry.

[18] At [44] and [59].

D5. Discretion

109. Given the Authorisation Conduct would likely result in significant public benefits and no significant (if any) public detriments, the conduct should be authorised – and there is no discretionary reason to the contrary.

110. PNO's assertion that authorisation is unnecessary in circumstances where PNO is "voluntarily opting into contractual regulation of its prices", is illusory and not sustainable. Equally, PNO's proposition ignores the public benefits outlined above, relating to transaction cost savings and the ability for the Applicants to discuss issues which apply to the whole industry (in relation to which PNO and users of the Port, have inherently diverging interests).

111. Finally, as a matter of discretion, as the ACCC correctly noted, PNO's assertion that if authorisation is granted it does not intend to participate in collective negotiations with coal producers does not negative the case for authorisation.

112. The Tribunal's role is to assess the public benefits and detriments that are likely to arise in the future with and without the Authorised Conduct. It is not the Tribunal's role to attempt to predict whether the proposed conduct will be engaged in by the parties, or the outcome of collective negotiations on any specific issues.

D6. The ACCC's Determination is supported by the evidence and submissions

113. Each of the findings made by the ACCC were the subject of evidence and submissions before the ACCC by NSWMC, PNO and other interested parties.

D7. Redaction of material by PNO

114. NSWMC notes that PNO in its application has redacted certain provisions on the grounds of claimed confidentiality. These claims prevent NSWMC from responding to those allegations at this time. PNO made similar claims of confidentiality before the ACCC, which were put to NSWMC on a limited basis, and the ACCC otherwise appears to have rejected those arguments.

E. Relief sought by the Authorisation Applicants

115. NSWMC seeks the following relief:

    (a) PNO's application for review of the ACCC's Determination be dismissed;

    (b) Authorisation Application AA1000473 be allowed;

    (c) Indemnity costs.

116. NSWMC notes that costs orders before the Tribunal are discretionary. However, PNO has made this application to the Tribunal in circumstances where the authorisation was necessary in order for NSWMC to be able to seek to collectively bargain with PNO (in a manner compliant with the CCA), where the Determination did not require PNO to negotiate, where the Determination did not allow the coal exporters to engage in any activity to force PNO to negotiate, and where PNO has declined to negotiate with NSWMC.

117. In circumstances where it is not seriously in dispute that the coal industry faces significant cost pressures (including due to trade issues with China), and where it is clearly in the hands of PNO whether collective bargaining negotiations occur, this application creates unnecessary costs and is not a good use of taxpayer resources, Tribunal resources, nor time. NSWMC as an industry association seeks an indemnity costs order because while it was necessary for NSWMC to seek the authorisation from the ACCC, there is no utility in this Tribunal application.

Nicholas De Young QC

Daniel Tynan

Clifford Chance

28 January 2021

NOTICE OF LODGMENT

AUSTRALIAN COMPETITION TRIBUNAL

This document was lodged electronically in the AUSTRALIAN COMPETITION TRIBUNAL and has been accepted for lodgment pursuant to the Practice Direction dated 3 April 2019. Filing details follow and important additional information about these are set out below.

Lodgment and Details

Document Lodged:	Statement of Facts, Issues and Contentions
File Number:	ACT 2 of 2020
File Title:	Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020
Registry:	VICTORIA – AUSTRALIAN COMPETITION TRIBUNAL

REGISTRAR

Dated: 8/02/2021 4:24 PM

Important information

This Notice has been inserted as the first page of the document which has been accepted for electronic filing. It is now taken to be part of that document for the purposes of the proceeding in the Tribunal and contains important information for all parties to that proceeding. It must be included in the document served on each of those parties.

COMMONWEALTH OF AUSTRALIA

***Competition and Consumer Act 2010* (Cth)**

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No: ACT 2 of 2020

Re: Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020

Applicant: Port of Newcastle Operations Pty Limited [ACN 165 332 990]

THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION'S STATEMENT OF FACTS, ISSUES AND CONTENTIONS

A. OVERVIEW OF THE PROCEEDING

1. This proceeding is an application for review, under s 101 of the *Competition and Consumer Act 2010* (Cth) (**CCA**), of a determination by the Australian Competition and Consumer Commission (**ACCC**) under s 88(1) of the CCA, to authorise the NSW Minerals Council (**NSWMC**) and other mining companies exporting goods through the Port of Newcastle (**Port**), to negotiate collectively with Port of Newcastle Operations Pty Limited (**PNO**) in relation to the terms and conditions of access, including price, to the Port for a period of ten years ending 30 September 2030.

2. There are three parties to the proceeding.

3. The NSWMC applied to the ACCC for authorisation on behalf of itself and ten coal producers that export coal through the Port (all collectively defined as the **Authorisation Applicants**).[1]

4. PNO is the current applicant for review. It is the target of the proposed collective bargaining conduct for which authorisation was sought, and it participated in the ACCC's public consultation in respect of the Authorisation Applicants' application to the ACCC. PNO is described further below.

5. The ACCC is responsible for the enforcement of the CCA. Under s 88 of the CCA, it has the power to determine whether to grant an authorisation to a person to engage in conduct that would or might contravene a provision of Part IV of the CCA. Once a person applies to

[1] The ten coal producers are: Glencore Coal Assets Australia Pty Limited, Yancoal Australia Limited, Peabody Energy Australia Pty Ltd, Bloomfield Collieries Pty Ltd, Centennial Coal Company Limited, Malabar Coal Limited, Whitehaven Coal Mining Limited, Hunter Valley Energy Coal Pty Ltd, Idemitsu Australia Resources Pty Ltd, and MACH Energy Australia Pty Ltd.

the Tribunal for review of the ACCC's determination, for the purposes of the review, the Tribunal may perform all the functions and exercise all the powers of the ACCC. In a Tribunal review, the ACCC is not a party or protagonist in the proceeding. Its role is to assist the Tribunal in an impartial manner, regardless of any conclusions it may have drawn from its earlier analysis in the matter.[2] Its role in this review is to assist the Tribunal to reach, in the public interest, the correct or preferable decision.

B. THE CONDUCT SOUGHT TO BE AUTHORISED

6. The Authorisation Applicants sought authorisation from the ACCC, on 6 March 2020, to:

   6.1. collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port;

   6.2. discuss amongst themselves matters relating to the above discussions and negotiations; and

   6.3. enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port (collectively, the **Proposed Collective Bargaining Conduct)**.[3]

7. The Authorisation Applicants sought authorisation on the basis that the Proposed Collective Bargaining Conduct may:

   7.1. involve a cartel provision within the meaning of Division 1 of Part IV of the CCA; and

   7.2. substantially lessen competition within the meaning of s 45 of the CCA.

8. The Proposed Collective Bargaining Conduct:

   8.1. is voluntary for all parties, including PNO;[4]

   8.2. does **not** include collective boycott activity;[5] and

   8.3. does **not** include the Authorisation Applicants sharing competitively sensitive information that relates to customers, marketing strategies, or volume / capacity projections for individual users.[6]

9. The Authorisation Applicants sought authorisation to negotiate "all terms of access to the Port that are practically necessary or otherwise desirable for their export task involving the use of the channel and berth facilities at the Port"[7] and "under the contractual framework

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2 Application by Flexigroup Limited [2020] ACompT 1 at [20]

3 NSW Minerals Council (**NSWMC**) application for authorisation AA1000473, 6 March 2020, paragraph 3.1.

4 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 3.4.

5 NSWMC application for authorisation AA1000473, 6 March 2020, paragraphs 3.2.

6 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 6.2.

7 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 1.4.

put forward by PNO".[8] The focus of the application was access charges that apply to coal vessels entering the channels and berthing at the Port – namely, the **Navigation Service Charge** and **Wharfage Charge** set by PNO. The Authorisation Applicants also sought to collectively discuss and negotiate other common industry issues within the Producer Deed (as defined in paragraph 42 below) with PNO, including:

9.1. pricing mechanisms under the Producer Deed, e.g., the inclusion of user-funded expenditure in PNO's capital base;[9]

9.2. PNO's capital expenditure forecasts at the Port and the impact on prices paid by coal producers, either directly or indirectly;[10]

9.3. PNO's proposed annual price adjustments under the Producer Deed;[11] and

9.4. the nature of the expenditure that PNO states it intends to make in developing a new container terminal at the Port, and the associated basis of how costs and charges are proposed to be allocated among Port users.[12]

10. The Authorisation Applicants sought authorisation on behalf of themselves and "future access seekers / Port users" that choose to participate in the proposed collective bargaining group in the future.[13] The Authorisation Applicants advised the ACCC that the proposed collective bargaining group will primarily comprise coal mining companies, but it could conceivably include other mining company members of the NSWMC. The class of persons proposed to engage in the Proposed Collective Bargaining Conduct is confined to mining companies.[14]

11. Under the Proposed Collective Bargaining Conduct, each coal producer can independently determine whether to accept any negotiated terms and conditions offered by PNO following collective negotiations. Each coal producer may undertake independent negotiations with PNO at any time, should they wish to do so.[15]

12. The Authorisation Applicants requested authorisation for ten years.[16]

C. THE ACCC DETERMINATION

C.1 Interim Authorisation

13. On 2 April 2020 the ACCC granted interim authorisation under s 91(2) of the CCA to enable the Authorisation Applicants to commence collective discussions amongst themselves and

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8 NSWMC submission, 30 April 2020, p. 9.

9 NSWMC submission to the ACCC, 30 April 2020, pp 2, 3, 7.

10 NSWMC submission to the ACCC, 30 April 2020, p. 7.

11 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 1.10.

12 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 1.12.

13 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 3.5.

14 NSWMC submission, 15 May 2020, paragraph 2.5.

15 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 1.33.

16 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 3.9.

negotiations with PNO in relation to the terms and conditions of access, including price, to the Port. This did not extend to entering into any collectively negotiated agreements.

14. The Authorisation Applicants advised the ACCC that they wrote to PNO to request an initial meeting to commence negotiations.[17] PNO declined to meet.

15. On 2 April 2020, the ACCC granted interim authorisation until the date on which the ACCC's final determination comes into effect or until the interim authorisation is revoked.

C.2 The ACCC Determination

16. On 27 August 2020, the ACCC issued a final determination in respect of the Proposed Collective Bargaining Conduct until 30 September 2030 (the **ACCC Determination**).

17. The ACCC Determination authorised the Authorisation Applicants and other mining companies requiring access through the Port to:

    17.1. collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port;

    17.2. discuss amongst themselves matters relating to the above discussions and negotiations; and

    17.3. enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port.[18]

18. It did **not** authorise:

    18.1. the Authorisation Applicants or other mining companies requiring access through the Port to engage in any collective boycott activity; or

    18.2. the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume/capacity projections for individual users.[19]

19. Due to PNO's application to the Tribunal, the ACCC Determination did not come into effect. As a consequence, the interim authorisation remains in place.

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17 NSWMC submission, 15 May 2020, paragraph 2.16.

18 See ACCC Determination, paragraphs 1.3 – 1.6, 5.1 – 5.3, 5.7.

19 See ACCC Determination, paragraphs 1.4 – 1.5, 4.95, 5.10.

D. INDUSTRY BACKGROUND

D.1 The Port

20. The Port is the largest bulk shipping port on Australia's east coast, and Australia's largest terminal for coal exports.[20] Newcastle Harbour includes 20 operational berths, 11 of which are allocated to handling a range of cargoes and nine of which are dedicated to the handling of coal.[21] PNO has the ability to more than double current shipping movements using the existing deep water shipping channel and 200 hectares of vacant Port land.[22] The total land holdings of the Port are 792 hectares.[23]

21. In 2019, there were 2,296 ship visits to the Port.[24] Coal represents 96 per cent (165.25 million mass tonnes) of the all commodities exported from the Port.[25] Other commodities exported via the Port include ammonia, metal concentrates, general cargo, aluminium, pitch and tar products, steel and wheat.[26]

22. A commercial vessel must obtain a right to access and use the shipping channels (including berths next to 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.

23. Access is provided on an open access basis. To obtain access rights to the Port Channel and berthing services and facilities, a vessel operator must submit a Vessel Berthing Application to PNO and the Port Authority of NSW.[27] In its Vessel Standard Terms and Conditions, PNO undertakes to grant the vessel access to the Port Channel, allocate the vessel a berth in the Port and grant the vessel access to and use of facilities and services.[28]

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20 Transport NSW website: https://www.transport.nsw.gov.au/data-and-research/freight-data/port-of-newcastle, viewed on 10.12.20.

21 Port Authority of NSW website, https://www.portauthoritynsw.com.au/newcastle-harbour/port-services-facilities/, viewed on 10.12.20.

22 PNO, *The Port of Newcastle – Economic Impact Report 2016-17,* p. 2 and 3: https://www.portofnewcastle.com.au/wp-content/uploads/2019/09/ECO-011-Port-of-Newcastle_Economic-Impact-Report_V4-_-SK_v6.pdf, viewed on 28.01.21.

23 NSWMC application for authorisation AAA1000473, 6 March 2020, paragraph 1.14.

24 PNO, *Port of Newcastle 2019 Trade Report,* p. 2: https://www.portofnewcastle.com.au/wp-content/uploads/2020/05/Port-of-Newcastle-Annual-Trade-Report-2019.pdf, viewed on 3.02.21.

25 PNO, *Port of Newcastle 2019 Trade Report,* p. 2: https://www.portofnewcastle.com.au/wp-content/uploads/2020/05/Port-of-Newcastle-Annual-Trade-Report-2019.pdf, viewed on 3.02.21.

26 PNO, *Port of Newcastle 2019 Trade Report,* p. 3: https://www.portofnewcastle.com.au/wp-content/uploads/2020/05/Port-of-Newcastle-Annual-Trade-Report-2019.pdf, viewed on 3.02.21.

27 PNO website: https://www.portofnewcastle.com.au/what-we-do/port-open-access-arrangements/vesselopenaccess/, viewed on 10.12.20.

28 PNO, *Vessel Standard Terms and Conditions, Version 1,* paragraph 8.1*:* https://www.portofnewcastle.com.au/wp-content/uploads/2019/12/Vessel-Standard-Terms-and-Conditions.pdf, viewed on 14.12.20.

D. 2 PNO

24. PNO became Port operator in May 2014, following privatisation by the NSW Government. It controls the terms and conditions of access at the Port under a 98 year lease arrangement from the NSW Government, as trustee for the Port of Newcastle Unit Trust.

25. As the operator of the Port, and under the terms of its lease, PNO can exercise the powers conferred under Part 5 of the *Ports and Maritime Administration Act 1995* (NSW) (**PAMA Act**). Six types[29] of port charges can be fixed and levied, including most relevantly:[30]

    25.1. the Navigation Service Charge (see paragraph 37 below), which is payable in respect of general use by a vessel of the Port and its infrastructure; and

    25.2. the Wharfage Charge (see paragraph 38 below), which is payable in respect of the availability of a site at which stevedoring operations may be carried out.

26. In accordance with Part 5 of the PAMA Act:[31]

    26.1. PNO has the power to fix and collect the Navigation Service Charge, Wharfage Charges or site occupation charges without Ministerial approval;

    26.2. PNO has the power, concurrently with the Minister, to fix and collect port infrastructure charges, although Ministerial approval is required under the lease; and

    26.3. PNO does not fix or collect pilotage charges, port cargo access charges and berthing charges to port users.

27. PNO is currently responsible for a number of functions at the Port, including management of port land, wharf and berth services, maintenance of port assets, vessel scheduling and finance.[32]

D.3 The Port and the Hunter Valley coal export supply chain

28. The Port is a critical part of the coal export supply chain that involves an extensive rail network from multiple mine sites in the Hunter Valley, Gunnedah Basin, Gloucester Basin, and parts of the Western coalfield.[33]

29. There are more than 35 active coal mines operated by 11 coal producers that export through Newcastle, as well as other coal projects in various stages of exploration and development.[34]

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29 Other charges provided for by Part 5 include pilotage charges, port cargo access charges, site occupation charges, berthing charges, and port infrastructure charges.

30 PNO application for review by the Tribunal, 17 September 2020, p. 4.

31 PNO application for review by the Tribunal, 17 September 2020, p. 4.

32 PNO website: https://www.portofnewcastle.com.au/about-our-port/, viewed on 10.12.20.

33 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 2.1.

34 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 2.5.

30. Exporting coal from the Port, excluding the coordination of supply chain logistics between the mines and landside coal loading terminals,[35] involves bulk carrier vessels entering the Port, transiting the channels in the Port, tying up at terminal berths, being loaded with coal via ship loading systems from stockpiles, and then once again transiting the channels before exiting the Port.

31. Coal from the Port is exported to around 20 countries, primarily in Asia. Japan is the largest customer of coal from Newcastle, receiving 44 per cent of exports. China, Korea and Taiwan currently account for a further 44 per cent.[36] In 2018-19, 161 million tonnes (96 per cent of NSW coal) was exported through the Port with the remainder exported through Port Kembla.[37]

32. The Hunter Valley coal export supply chain is the largest coal export operation in the world. This chain is made up of coal producers (mines), rail haulage providers,[38] the Australian Rail Track Corporation (**ARTC**) as the owner of the track, three coal export terminals (owned by Port Waratah Coal Services and Newcastle Coal Infrastructure Group), port managers, and the Hunter Valley Coal Chain Coordinator (**HVCCC**).

33. There are three coal terminals at Newcastle Port,[39] which receive coal from the mines, stockpile it and load it onto vessels for export. The Newcastle Coal Infrastructure Group (NCIG)[40] owned terminal is located on Kooragang Island at the Port, and Port Waratah Coal Services (PWCS)[41] owns the Carrington Coal Terminal,[42] and PWCS Kooragang Island Coal Terminal.[43]

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35 The Proposed Collective Bargaining Conduct does not relate to coal chain logistics coordination in rail or at the coal loading terminals at the Port themselves.

36 NSWMC e application for authorisation AA1000473, 6 March 2020, paragraph 2.3.

37 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 2.1.

38 There are currently four rail operators providing rail haulage services to coal producers in the Hunter Valley coal chain – Pacific National, Aurizon, Genesee & Wyoming and Southern Shorthaul Railroad.

39 Owned by Newcastle Coal Infrastructure Group (NCIG) and Port Waratah Coal Services (PWCS).

40 NCIG is located on Kooragang Island and is the newest of the three terminals, beginning operations in 2010. NCIG has a total handling capacity of 66 million tonnes per annum. NCIG shareholders are: BHP, Yancoal, Whitehaven Coal, Peabody, and Centennial Coal. NCIG website: https://www.ncig.com.au/business/shareholders, viewed on 10.12.20.

41 PWCS is an unlisted public company. Its shareholders comprise a mixture of Hunter Valley coal producers and Japanese coal customers: PWCS website: https://www.pwcs.com.au/who-we-are/about-us/, viewed on 14.12.20.

42 PWCS began operating what is now Carrington Coal Terminal in 1976. It has a total handling capacity of 25 million tonnes per annum.

43 Kooragang Island began operating in 1984 and has expanded to reach a total handling capacity of 120 million tonnes per annum.

D.4 Investment in expanding the Port

34. PNO has stated in its schedule of service charges (effective from 1 January 2020) that, from 1 January 2021, the published Navigation Service Charge and Wharfage Charge for coal vessels may be increased to reflect additional investment at the Port.[44]

35. In August 2018, PNO announced its intention to develop a container terminal at the Port.[45]

D.5 Current access charges and contracting at the Port

36. PNO controls the terms and conditions of access at the Port. It publishes a schedule of service charges that apply to the commercial use of the Port, in accordance with the PAMA Act and *Ports and Maritime Administration Regulations 2012* – including, a **Navigation Service Charge** and **Wharfage Charge**.[46] PNO may vary this schedule from time to time, including varying or introducing new fees, subject to it providing ten business days' notice on its website before it takes effect.[47]

37. **Navigation Service Charge** means the charge levied by PNO under s 50 of the PAMA Act upon a vessel's entry to the Port of Newcastle for the general use of the Port and its infrastructure – excluding the use of a pilot, the use of land based port facilities, and the port access for cargo at the interface between the vessel and land-based facilities for the purpose of stevedoring operations. This charge is paid in addition to any Wharfage Charge, Site Occupation Charge and any other fee (for example, Non-Standard Vessel Charges). The charge is payable by the owner of the vessel and is calculated by reference to the gross tonnage of the vessel.[48]

38. **Wharfage Charge** means the charge levied by PNO under s 61 of the PAMA Act for the availability of a site at which stevedoring operations can be carried out. For vessels being loaded at a site, the charge is payable by the owner of the cargo (immediately prior to the cargo being loaded). This charge is calculated by reference to the quantity of cargo loaded or unloaded at the site (unless the PAMA Regulations say otherwise).[49]

39. As an alternative to its published schedule of service charges, at the end of 2019 PNO invited coal producers, vessel agents, vessel operators and FOB coal consignees to enter into bilateral long term pro forma pricing arrangements (or deeds).

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44 PNO, Schedule of Service Charges, Version: 13 March 2020, p. 6.

45 PNO, New CEO commits Port of Newcastle to developing world-class container terminal, 1 August 2018. Relatedly, the ACCC also notes that judgment in proceeding NSD 2289 of 2018 is currently reserved by Her Honour Justice Jagot. The ACCC considers that judgment in that proceeding is unlikely to substantially affect any of the matters for consideration by the Tribunal in this proceeding.

46 PNO, Schedule of Service Charges, Version: 13 March 2020, p. 2.

47 PNO, Schedule of Service Charges, Version: 13 March 2020, p. 3.

48 This definition is compiled from s 50 of the PAMA Act and from Port of Newcastle, *Schedule of Service Charges, version 13 March 2020,* p. 6.

49 This definition is compiled from s 50 of the PAMA Act and from Port of Newcastle, *Schedule of Service Charges, version 13 March 2020,* p. 7.

40. The Producer Pro Forma Long Term Pricing Deed (the **Producer Deed**)[50] is for an initial term of ten years and sets out the following 'producer specific charges' for covered vessels transporting producers' coal at the Port:

    40.1. **Navigation Service Charge** – currently **A$0.81** per vessel gross tonne (adjusted annually); and

    40.2. **Wharfage Charge –** currently **$0.08** per revenue tonne of producer coal loaded onto a covered vessel (adjusted annually).

41. Under the current Producer Deed, a variation to the charges covered by the Producer Deed can be made once a year, up to the greater of 4 per cent or CPI (which over the twelve months to the September 2020 quarter rose 0.7 per cent)[51] in any year of the term. A variation can only be made over and above the 4 per cent or CPI increase where it is 'Material' (as that term is defined in the Template Producer Deed) and meets certain pricing principles.[52]

42. Other features of PNO's Producer Deed include:

    42.1. Annual price adjustments (clause 7 of the Producer Deed) – at the **beginning** of each contract year, PNO will apply an annual price adjustment of the navigation service and wharfage charges (see paragraph 41 above). It may also vary producer charges following arbitration of a pricing dispute (under the Producer Deed) or in accordance with PNO's projected five year capital expenditure.

    42.2. Notice of variations to proposed producer charges (clause 8 of the Producer Deed) – PNO will provide no less than 45 days' written notice of variations to producer changes at the Port. Coal producers may object to a price variation by lodging a Price Variation Objection Notice within 14 days. This triggers a dispute resolution process that ultimately leads to arbitration if unresolved by negotiation and mediation.

    42.3. Non-discriminatory pricing (clause 5 of the Producer Deed) – PNO commits to not discriminate adversely against any coal producer on price.

    42.4. Consultation in relation to efficiency improvements and capital expenditure at the Port (clause 10 of the Producer Deed) – PNO will meet coal producers with executed Producer Deeds at least twice in any contract year to consult on the following matters:

        42.4.1. efficiency improvements to vessel services that PNO could make, and

        42.4.2. PNO's delivery of vessel services – including capital expenditure, proposed variations to fees and charges, PNO's cost of operations, a coal producer's

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50 See Producer Deed: https://www.portofnewcastle.com.au/wp-content/uploads/2020/03/OAR-TERMS-Producer-Deed-13-March-2020_.pdf.

51 Australian Bureau of Statistics, *Consumer Price Index Australia,* see: *https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release,* viewed on 07.12.20.

52 PNO submission, 7 April 2020, paragraphs 13, 40.

future needs (including the producer's forecast coal volumes to be shipped from the Port for the next six months) and any other matter agreed between a coal producer and PNO.

43. The Producer Deed and the Vessel Agent Pro Forma Long Term Pricing Deed (**Vessel Agent Deed**)[53] contain very similar clauses, and both offer a ten year discounted Navigation Service Charge of $0.81 per vessel gross tonne. However, the Producer Deed covers the Navigation Service charge and the Wharfage Charge (defined by PNO as 'Producer Specific Charges' under the Producer Deed), while the Vessel Agent Deed only covers the Navigation Service Charge. Both the Producer Deed and the Vessel Agent Deed contain a non-discriminatory pricing commitment from PNO.[54]

44. Practically, it is the terms and conditions of the Producer Deed that the Authorisation Applicants seek to collectively negotiate with PNO.

D.6 Coal producers' economic interest in Port access charges

45. The Authorisation Applicants advised the ACCC that PNO has previously disputed whether coal producers are entitled to negotiate with it in relation to Port service charges due to the nature of contractual arrangements between coal producers and overseas coal customers.[55] Under these contractual arrangements, coal customers typically pay the navigation service charge, as follows:

    45.1. Coal customers typically engage (charter) a vessel operator to transport their coal from the Port.[56]

    45.2. Vessel operators typically appoint vessel agents to deal with PNO on their behalf in respect of a vessel's visit to the Port, including the payment of applicable port charges. PNO generally does not deal directly with the vessel operators.[57]

    45.3. The vessel agent receives the navigation service charge invoice from PNO, together with details about the vessel's visit and gross tonnage loaded, and then pays the invoice to PNO on behalf of its principal (the vessel operator).[58]

46. The coal producer may also be the charterer of the vessel.[59]

47. Regardless of the nature of these contractual arrangements, Hunter Valley coal producers have an economic interest in the Port service charges. Such charges are part of the total delivered cost of Hunter Valley coal to international destinations. As Hunter Valley coal producers sell coal in competition with producers in other locations, an increase in Port service charges makes Hunter Valley coal more expensive relative to alternatives available

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53 See Vessel Agent Deed: https://www.portofnewcastle.com.au/wp-content/uploads/2020/03/OAR-TERMS-Vessel-Agent-Deed-13-March-2020_.pdf.

54 Clause 5 of the Producer Deed and Vessel Agent Deed.

55 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 1.6.

56 PNO submission, 7 April 2020, paragraphs 48 – 49.

57 PNO submission, 7 April 2020, paragraphs 48 – 49.

58 PNO submission, 7 April 2020, paragraphs 48 – 49.

59 PNO submission, 7 April 2020, paragraphs 48 – 49.

to international buyers. If Hunter Valley coal producers do not reduce their prices in response to an increase in Port service charges, they risk selling less coal. If Hunter Valley coal producers reduce their prices to offset (either partially or fully) an increase in Port service charges, they will make lower profits on the coal they sell. Either way, Hunter Valley coal producers have an economic interest in the Port service charges.

48. PNO's conduct in offering to engage in bilateral negotiations with coal producers in relation to Producer Specific Charges and other terms within the Producer Deed appears to acknowledge those producers' economic interest in the Port service charges.

E. ISSUES AND ACCC CONTENTIONS

49. The ACCC considers the following issues are central to the Tribunal's assessment:

    49.1. **Issue 1:** how does the Tribunal properly exercise its functions in this review?

    49.2. **Issue 2**: in assessing public benefits and detriments, what is the relevant market(s) in which to assess the competitive effects of the Proposed Collective Bargaining Conduct?

    49.3. **Issue 3*:*** what are the likely public benefits of the Proposed Collective Bargaining Conduct?

    49.4. **Issue 4:** what are the likely public detriments of the Proposed Collective Bargaining Conduct?

    49.5. **Issue 5:** how should the benefits and detriments be balanced? Is the net public benefit test in s 90(7)(b) met by the Proposed Collective Bargaining Conduct?

    49.6. **Issue 6:** if the test is met, how should the Tribunal exercise its discretion? Should the conduct be authorised? Should any conditions be imposed?

    49.7. **Issue 7:** if authorisation is granted, what is the appropriate period of authorisation?

50. The resolution of these seven issues will ultimately determine whether the Tribunal should affirm, set aside, or vary the ACCC Determination.[60] The ACCC understands that Issues 1 and 7 are not in dispute before the Tribunal.

51. In addition, the following significant issues of principle arise from the SOFICs filed by PNO and the NSWMC:

    51.1. What is the significance, if any, of PNO's statement of intention not to participate in collective negotiations with coal producers?[61]

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60 Section 102(1) of the CCA.

61 PNO SOFIC, 14 December 2020, paragraph 51. See PNO application for review by the Tribunal, 17 September 2020, paragraph 43.

51.2. Are improvements in the terms and conditions of Port access, or the reduction of transaction costs in negotiating such terms and conditions, a private benefit or a public benefit?[62]

51.3. As the Proposed Collective Bargaining Conduct involves cartel conduct, which is said by PNO to be presumptively harmful, should the Tribunal decline to exercise its discretion to authorise the Proposed Collective Bargaining Conduct unless it is likely to result in a substantial net public benefit?[63]

52. The ACCC considers that PNO's contentions in relation to the first and third of these issues (as outlined in paragraphs 51.1 and 51.3 respectively) are incorrect. The ACCC also considers that it would be open to the Tribunal to reject PNO's contention in relation to the second issue (as outlined at paragraph 51.2 above). These issues are addressed in more detail below. Subject to inquiries and directions from the Tribunal as to how it would be best assisted by the ACCC, and in light of the SOFICs filed by PNO and NSWMC, the ACCC anticipates its primary focus to be on these three issues.

Issue 1: The Tribunal's function

53. The ACCC does not understand there to be any dispute between the parties to this review as to the Tribunal's function. The relevant principles are as follows.

54. Section 101(2) provides that this review by the Tribunal under s 101(1) is a re-hearing of the matter. The Tribunal must undertake a complete rehearing of the application for authorisation based on the material before it.[64] It is not the Tribunal's role merely to resolve issues in dispute between the parties.[65] The Tribunal must engage in a re-hearing in the fullest sense and reach its own conclusions on the material before it,[66] rather than examining factual or other conclusions reached by the ACCC. The Tribunal's review is not a review of whether what the ACCC had determined was right or wrong on the material before it.[67] It is the ACCC Determination, not the published reasons, which is the subject of review before the Tribunal.[68]

55. In performing this re-hearing function, the Tribunal must apply s 90(7) of the CCA. Section 90(7)(b) provides that authorisation must not be granted unless the Tribunal is satisfied in all the circumstances that:

    (i) the conduct would result, or be likely to result, in a benefit to the public; and

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62 PNO SOFIC, 14 December 2020, paragraph 58(d).

63 PNO SOFIC, 14 December 2020, paragraph 63(a).

64 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,524 [135], [138]; *Application by Flexigroup Limited (No 2)* [2020] ACompT 2 at [135].

65 *Re 7-Eleven Stores Pty Ltd* [1998] ATPR ¶41-666 at 41,453.

66 CCA s 101(2); *Re Media Council of Australia (No 2)* (1987) 88 FLR 1; *Re 7-Eleven Stores Pty Ltd* (1994) ATPR ¶41-357 at 42,654; *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,524 [138].

67 *Re Herald & Weekly Times Ltd* (1978) 17 ALR 281 at 295-296; *Application by Flexigroup Limited (No 2)* [2020] ACompT 2 at [135].

68 *Re Applications by Australasian Performing Right Association Ltd* [1999] ACompT 3 at [27].

(ii) the benefit would outweigh the detriment to the public that would result, or be likely to result, from the conduct.

56. In applying the statutory test for authorisation, the Tribunal compares the likely future with the conduct for which authorisation is sought, with the likely future without such conduct.[69] This is not the same as comparing a future in which the proposed conduct is authorised against a future in which it is not authorised.[70]

57. The Tribunal is to identify the benefits and detriments, or the *likely* benefits and detriments, of the proposed conduct on the basis of the materials before it in this matter, and determine whether the test in s 90(7)(b) is met.

58. The power to grant authorisation is discretionary.[71] In exercising that discretion, the Tribunal may have regard to considerations relevant to the objectives of the CCA.[72] Proper identification of likely benefits and detriments is also important as it may influence the Tribunal's consideration of its discretion and the content of any conditions it may wish to consider appropriate to specify.

Issue two: Relevant market

59. A market is an area or space of close competition between firms or the field of rivalry between them.[73] Markets are defined to focus analysis by situating conduct in an area of competitive activity by reference to the four dimensions of product, geography, functional level and time.[74]

60. Neither PNO nor the NSWMC has expressly called into question the ACCC's description of the area of competition most relevant to the application for authorisation, although it may be that PNO intended to do so by referring in its SOFIC to a global market for the supply of thermal coal.[75]

61. In the ACCC Determination, the ACCC stated that the most relevant area of competition affected by the Proposed Collective Bargaining Conduct is competition for access to port services at the Port which are owned and operated by PNO. The ACCC said this includes

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69 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,520 [117]; *Re 7-Eleven Stores Pty Ltd* [1998] ATPR ¶41-666 at 41-453; *Application by Flexigroup Limited (No 2)* [2020] ACompT 2 at [137].

70 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,521 [120]-[121].

71 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,517 [106]; *Application by Flexigroup Limited (No 2)* [2020] ACompT 2 at [138]

72 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,522 [126].

73 *Re Queensland Co-operative Milling Association Ltd* (1976) 8 ALR 481 at 513, referred to with approval in *Boral Besser Masonry Ltd v Australian Competition & Consumer Commission* (2002) 215 CLR 374 at [133] (Gleeson CJ and Callinan J), [248] (McHugh J); *Flight Centre* at [66] (Kiefel and Gageler JJ).

74 *Australian Competition and Consumer Commission v Liquorland (Australia) Pty Ltd* [2006] FCA 826; (2006) ATPR 42-123 at 45,243, [429] (Allsop J, as his Honour then was); *Queensland Wire Industries Pty Ltd v The Broken Hill Pty Co Ltd* (1989) 167 CLR 177 at 187 (Mason CJ and Wilson J); *Australian Competition and Consumer Commission v P.T. Garuda Indonesia Ltd* (2016) 224 FCR 42 190 at [110] (Dowsett and Edelman JJ).

75 PNO SOFIC, 14 December 2020, paragraphs 22 – 26.

channel shipping services and wharfage, but does not include landside coal loading infrastructure, which is owned by other parties, or marine pilotage services.[76]

62. The ACCC's view remains that this is the most relevant area of competition.

63. The product dimension of this market includes the following services:

    63.1. the use of (dredged and marked) shipping channels to enter and exit the Port;

    63.2. vessel scheduling; and

    63.3. wharf and berth services, PNO allocating a berth to a vessel and access to and use of the various associated facilities and services.

64. PNO is the sole supplier of these services.

65. The ACCC considers it is open for the Tribunal to conclude, and it appears to not be in dispute, that this market does **not** include:

    65.1. the delivery of coal at the coal loading terminals at the Port from mines;

    65.2. the stockpiling of coal at the coal loading terminals; and

    65.3. the loading of coal onto vessels, or marine pilotage services,

66. These services are not demand-side or supply-side substitutes for the port services listed above. Nor do they form part of the same functional market as the port services.

67. It is also open for the Tribunal to conclude, and it appears not to be in dispute, that the geographic scope of this market is limited to the Port, given its proximity to the relevant coalfields and coal producers' reliance on rail transportation of coal from mine to port. The next nearest port with coal loading facilities is Port Kembla. It is uneconomic to transport coal from the Hunter Valley region to Port Kembla because of the significant additional distance combined with restrictions on coal trains passing through the Sydney metropolitan rail network.

68. The ACCC previously concluded that the following areas of competition are, to a lesser extent, also affected by the Proposed Collective Bargaining Conduct:

    68.1. the acquisition and disposal of exploration and/or mining authorities in the Hunter Valley region (the Tenements Market); and

    68.2. the supply of specialist mining services such as geological and drilling services, and construction, operation and maintenance services in NSW.

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[76] ACCC Determination, paragraph 4.7.

69. It is open for the Tribunal to accept the conclusions at 68.1 and 68.2, and it appears that these conclusions are not in dispute.

Issues 3, 4 and 5: Public benefits and detriments

Applicable principles

70. In assessing the application for authorisation, the Tribunal applies the net public benefit test under s 90(7)(b). The Tribunal will consider the likely public benefits and detriments flowing from the conduct for which authorisation is sought.

71. The CCA does not define "public benefit". The Tribunal has previously described it as "anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements … the achievement of the economic goals of efficiency and progress".[77] For a benefit (or detriment) to be considered it needs to be sufficiently capable of exposition (rather than ephemeral or illusory).[78] Such benefits need not be quantifiable in monetary terms.

72. Similarly, the CCA does not define "public detriment". The Tribunal has previously described public detriments as "any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency".[79]

73. The term "public" refers to the Australian public.[80] Identification of benefits or detriments to the public as benefits or detriments to the community generally does not mean that private benefits or detriments are irrelevant. The Tribunal has recognised that "encouragement or enabling of an individual to pursue legitimate ends or to attain legitimate rewards may well be beneficial to the community generally."[81] Further, even if savings are not passed on to end consumers in the form of lower prices, it remains open for the Tribunal to consider them to be public benefits,[82] and such an approach is available to the Tribunal in this review.

74. For a benefit or detriment to be taken into account, the Tribunal must be satisfied that the benefit or detriment is "likely" in the sense that there is a real chance, and not a mere possibility, of it eventuating. A speculative or a theoretical possibility will not suffice.[83]

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77 *Re Queensland Co-operative Milling Association Ltd* (1976) 8 ALR 481 at 508; cited with approval in *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677.

78 *Qantas Airways Ltd* [2005] ACompT 9 at [156]

79 *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

80 *Re Howard Smith Industries Pty Ltd* (1977) 28 FLR 385.

81 See *In the Matter of the Application by Rural Traders Co-operative (W.A.) Ltd., Elder Smith Goldsbrough Mort Ltd., Wolf Boetcher and Ors., Farmers' Union of W.A. (Inc.) and Western Livestock Ltd* (1979) ATPR 40-110.

82 ACCC Guidelines for Authorisation of Conduct (non-merger), 5 March 2019, p. 48, at [8.8]: https://www.accc.gov.au/publications/guidelines-for-authorisation-of-conduct-non-merger

83 *Qantas Airways Ltd* [2004] ACompT 9 at [156], quoted in *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,518 [109].

Issue 3: Public benefits

Likely public benefit 1: Transaction cost savings[84]

75. Each party to a negotiation and subsequent contract will incur transaction costs. Collective bargaining enables members of a bargaining group to share some or all of the transaction costs of preparing to negotiate and to avoid unnecessary duplication of costs to renegotiate, monitor and enforce the agreement. There are likely also to be cost savings for the target in undertaking a single negotiation over terms and conditions compared to a series of bilateral negotiations.

76. Transaction cost savings represent a (productive) efficiency improvement and are a public benefit in and of themselves. They can also facilitate allocative and dynamic efficiency improvements that result in further public benefits (also discussed below). For example, cost savings for a company may flow through to its shareholders or to its capacity to employ more people. For that reason, it is not correct to characterise such benefits as merely private benefits.[85]

77. , The ACCC considers that it is open for the Tribunal to conclude that:

    77.1. The Authorisation Applicants are likely to share the costs associated with preparing for and engaging in negotiations with PNO, including through identifying and discussing common contractual issues and sharing the costs of engaging expert advice and/or administrative services.

    77.2. PNO is likely to face lower upfront costs in negotiating with the collective group of producers compared to engaging in a series of individual negotiations with each producer. These cost savings result from reducing the number and length of negotiations, and include lower legal, research, technical advisory and administrative costs.

    77.3. PNO is likely to face lower ongoing negotiating costs because it has committed to twice yearly consultation with individual producers to discuss PNO's capital expenditure, any proposed variation to its fees and charges and PNO's costs of operations.

Likely public benefit 2: More efficient investment as a result of coal producers having greater and more informed input into the Producer Deed and reduced information asymmetry[86]

78. Information asymmetry occurs when one party to a negotiation has access to relevant information that the other party lacks, including price and quality of the good or service. The party lacking information is not fully informed; is unable to make rational decisions on price, quantity and quality, and may accept less efficient terms than it would if more information

84 See also NSWMC SOFIC, 28 January 2021, paragraph 99.

85 PNO SOFIC, 14 December 2020, paragraph 58(d).

86 See also NSWMC SOFIC, 28 January 2021, paragraphs 67 - 96.

were available to it. In these circumstances, the outcomes of negotiation may not capture many of the available efficiencies.

79. Collective bargaining can enable members of the bargaining group to become more informed and engaged in negotiations, improving their ability to convince the target of the merits of their position and hence have greater input into contracts. This can lead to terms of supply that are more comprehensive and that better reflect the circumstances of the group and the target business, resulting in more efficient outcomes.

80. Transaction cost savings (as described above) can result in more (allocative or dynamic) efficient outcomes because parties are willing to invest more in preparation for and participation in negotiations if the cost of doing so is lower.

81. The ACCC considers that it is open for the Tribunal to conclude that:

    81.1. Collective bargaining with PNO provides the Authorisation Applicants with confidence to accept an outcome that has been negotiated jointly. Individual Authorisation Applicants are likely to be reluctant to negotiate bilaterally with PNO over the terms of the Producer Deed due to a concern that other producers may obtain better terms and conditions than them. PNO's non-discriminatory pricing commitment is insufficient to address this concern because PNO can still discriminate between producers on other terms and conditions.

    81.2. Individual coal producers have less incentive to expend resources developing and proposing alternatives to terms and conditions in PNO's Producer Deed because the costs of doing so are likely to outweigh any expected savings. Further, the additional costs for PNO in having different contract terms with various producers are likely to exceed any benefits to it such that it acts as a disincentive for it to negotiate different terms and conditions with individual producers.

    81.3. Collective bargaining can make it viable for the Authorisation Applicants to invest jointly in developing and proposing alternative terms and conditions; including hiring expert advice or advocates.

    81.4. Collective bargaining can make it viable for the coal producers to identify changes to standard terms and conditions set out in the Producer Deed that benefit both themselves and PNO, or are at least neutral for PNO.

    81.5. Where coal producers have more efficient terms and conditions, they will make more efficient investment decisions in the exploration for and production of coal in the Hunter Valley.

    81.6. PNO has a full understanding of its reasonably expected costs in providing the relevant services over a ten-year period, whereas individual producers have less incentive than they would if acting collectively to expend resources (including hiring expert advisers) to try to develop a reasonable understanding to better inform bilateral negotiations.

    81.7. The Authorisation Applicants negotiating collectively, are likely to have greater and more informed input into the terms and conditions of the Producer Deed, resulting in

more efficient terms and conditions. There are also likely to be terms and conditions of the Producer Deed that could be changed to the mutual benefit of PNO and the Authorisation applicants (or at least that are neutral to PNO) but that PNO would not consider changing as part of a bilateral negotiation with one producer because it would be unsure if all producers would agree to the change and the cost of negotiating that separately with each producer would be prohibitively high.

Likely public benefit 3: Increased competitiveness of Hunter Valley export coal industry[87]

82. The CCA recognises that increasing the international competitiveness of Australian industries is a public benefit.

83. There has been ongoing price uncertainty for navigation service charges at the Port of Newcastle for several years, with a wide range of outcomes proposed by PNO or determined in regulatory processes (summarised in **Annexure A** hereto).

84. Certain international customers have expressed a desire to have ongoing uncertainty over the level of the navigation service charge at the Port of Newcastle resolved in order to provide greater certainty over the delivered price of coal.[88]

85. The Authorisation Applicants contend that the pricing mechanism set out under the Producer Deed does not provide them with pricing certainty. The Deed provides PNO with mechanisms by which it may adjust the price for use of the Port based on factors that are not detailed and based on capital expenditure that is solely within the determination of PNO. The Authorisation Applicants also consider that the Producer Deed provides very unclear mechanisms for users to ascertain the data needed to understand such changes or to dispute those charges. The Authorisation Applicants have sought to discuss those provisions as an industry, being the most efficient manner to discuss these concepts.[89]

86. The ACCC considers that it is open for the Tribunal to conclude that:

    86.1. While coal customers, through contracts with vessel owners or agents, typically pay the navigation service charge, those charges also contribute to the total delivered cost of Hunter Valley coal. As such, coal producers' revenues and profits will be affected by changes in the level of this charge, because they will either reduce the volume of coal they supply or need to reduce their prices to keep the delivered price of their coal competitive with alternative suppliers.

    86.2. Any potential reduction in the navigation service charge would likely be a small proportion of the total delivered price of Hunter Valley coal. However, competition generally occurs at the margins. Accordingly, even a small reduction in the total delivered price can result in Hunter Valley coal producers being more competitive in international markets.

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87 See also NSWMC SOFIC, 28 January 2021, paragraph 98(a).

88 Whitehaven Coal submissions to the ACCC, 18 March 2020.

89 NSWMC application for authorisation AA1000473, 6 March 2020, paragraph 2.25.

86.3. There are a number of issues (in addition to the level of navigation service charges) that are more efficiently dealt with between PNO and all producers, rather than in a series of bilateral negotiations. Examples include: the extent and timing of any expansions of capacity at the Port, and the impacts (potentially including increased costs) of any new Port development on existing users, such as a new container terminal.

86.4. Resolving these issues through collective negotiation rather than a series of bilateral negotiations, where the same issues must be dealt with repeatedly, is likely to result in a more timely resolution, thereby providing savings for all parties involved, including PNO.

86.5. Collective bargaining can result in greater price certainty and more timely resolution of these other issues that fall within PNO's responsibilities because any outcomes will be agreeable to all parties. This could facilitate more efficient investment decisions for Hunter Valley coal producers and increase their international competitiveness.

87. [redacted]

88. [redacted]

88.1.1. [redacted]

88.1.2. [redacted]

88.1.3. [redacted]

89. [redacted]

PNO's refusal to negotiate

90 PNO SOFIC, 14 December 2020, paragraph 58(a).

90. PNO contends that any authorisation will have no practical effect given that PNO would not engage in collective negotiations with the Authorisation Applicants, but rather will offer to undertake bilateral negotiations.[91]

91. PNO's contention is not relevant to the statutory test that the Tribunal must apply.

    91.1. In applying the statutory test for authorisation, the Tribunal compares the likely future with the conduct for which authorisation is sought, with the likely future without such conduct.[92] In this case, the conduct is the Proposed Collective Bargaining Conduct, as defined in the Authorisation Application.[93]

    91.2. Comparing the likely future with and without the Proposed Collective Bargaining Conduct is not the same as comparing a future in which the Proposed Collective Bargaining Conduct is authorised against a future in which it is not authorised.[94] The statutory test does not ask the Tribunal to determine whether the Proposed Collective Bargaining Conduct, if authorised, would occur in the future.

92. Further, PNO's contention disregards the dynamic nature of markets and the duties of directors to assess, from time to time, the facts relevant to any decision, and to act in the best interests of the company, at the time a decision arises, in light of those available facts.[95]

Issue 4: Public detriments

Potential Public Detriment 1: Potential for Reduction in competition between Hunter Valley coal producers.

93. Information sharing in collective bargaining arrangements may be of concern if it increases the potential for the parties to co-ordinate their conduct beyond that for which authorisation is granted, for example, if it facilitates collusion or aligned behaviours in related markets such as the downstream supply of products or services to consumers.

94. Public detriment may result from collective bargaining arrangements if competition is reduced between members of the group as a result of acting collectively, or where the ability of businesses outside of the bargaining group to compete against the group is affected.

95. The ACCC notes that:

    95.1. There is currently limited competition between the Authorisation Applicants in acquiring services from PNO given the nature of the pro-forma Producer Deed offered to them by PNO, and given the small incentives for Authorisation Applicants to engage in bilateral negotiations with PNO.

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91 PNO submission to the ACCC, 7 April 2020, paragraph 5(c).

92 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,520 [117]; *Re 7-Eleven Stores Pty Ltd* [1998] ATPR ¶41-666 at 41-453.

93 NSW Minerals Council application for authorisation AA1000473, 6 March 2020, paragraph 3.1.

94 *Application by Medicines Australia Inc* [2007] ATPR ¶42-164 at 47,521 [120]-[121].

95 *Corporations Act 2001 (Cth)* s 181.

95.2. The proposed arrangements are voluntary, with coal producers free to enter collectively negotiated agreements with PNO or to seek to enter into bilateral discussions with PNO in relation to terms and conditions of long term access under the Producer Deed.

95.3. The authorisation extends to any mining companies that seek to access or use the Port and that choose to participate in the proposed collective bargaining group in the future. Future access seekers are not therefore excluded.

95.4. Approximately 90 per cent of Hunter Valley coal is exported, with the remainder sold domestically. Considering the substantial competition faced by the Authorisation Applicants from many other coal producers globally, there is very little, if any, scope for the Authorisation Applicants to influence world coal pricing.

95.5. The Proposed Collective Bargaining Conduct does not extend to collective negotiations or information sharing relating to the domestic supply of Hunter Valley coal.

96. The ACCC considers it is open for the Tribunal to conclude that:

96.1. The Proposed Collective Bargaining Conduct is unlikely to materially harm competition between coal producers in any relevant market, please see discussion on relevant markets at paragraphs 59 – 69 above.

96.2. Due to the confined purposes of the limited sharing of commercially sensitive material, the Proposed Collective Bargaining Conduct does not significantly increase the likelihood of collusion occurring in relation to matters for which authorisation is not being sought, or increase the likelihood of the members of the bargaining group sharing commercially sensitive information regarding downstream markets.

Potential Public Detriment 2: Potential to lose unique interests of bargaining group members

97. PNO contends that pursuant to the Proposed Collective Bargaining Conduct individual producers will not be able to negotiate terms and conditions tailored to their own individual needs, and collective negotiations, to the extent they occur, will more likely reflect the needs of the larger producers.[96]

98. The NSWMC contends that the Authorisation Applicants have largely common interests in transparency and efficiency, and for the terms and conditions of access to be understood and approached in a consistent manner across the industry.[97]

99. The Proposed Collective Bargaining Conduct is voluntary. Coal producers will be free to negotiate terms and conditions of Port access separately if they believe it is in their interests to do so or if their individual interests have not been met fully through collective negotiations. This includes ‘smaller’ coal producers in the Hunter Valley.

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96 PNO SOFIC, 14 December 2020, paragraph 61.

97 NSWMC SOFIC, 28 January 2021, paragraphs 107 - 108.

Issue 5: Balance of public benefit and public detriment

100. The Tribunal should weigh the likely public benefits and public detriments and determine whether the net public benefit test is satisfied in respect of the Proposed Collective Bargaining Conduct.[98]

101. The ACCC considers it is open for the Tribunal to conclude that the Proposed Collective Bargaining Conduct would be likely, in all the circumstances, to result in a benefit to the public, and the benefit to the public would outweigh the detriment to the public resulting from the Proposed Collective Bargaining Conduct such that the test in s 90(7)(b) is met.

102. In particular, it is open for the Tribunal to conclude that:

    102.1. Public benefits are likely from the Proposed Collective Bargaining Conduct, such as: greater and more informed input into the terms and conditions of access under the Producer Deed, and increased transparency around capital expenditure plans and cost allocation at the Port. Further, public benefits are likely to include greater certainty for the delivered price of Hunter Valley coal, more timely resolution of common industry issues, and facilitating more efficient investment decisions at the Port and across the Hunter Valley coal industry.

    102.2. The Proposed Collective Bargaining Conduct will likely enhance the international competitiveness of the Hunter Valley coal industry, with investment and employment benefits in Australia, and result in transaction costs savings for the collective bargaining participants.

    102.3. Any public detriments from the Proposed Collective Bargaining Conduct are likely to be limited due to the voluntary nature of participation in the Proposed Collective Bargaining Conduct (so that producers are free to choose not to participate if they believe their interests would not be adequately represented or advanced by the collective bargaining group and negotiate individual deeds with PNO), and the exclusion of any collective boycott activity or the sharing of sensitive information outside of the terms and conditions of the PNO Producer Deed.

Issue 6: The Tribunal's discretion

103. PNO contends that even if the authorisation test is met, the Tribunal should exercise its discretion and not authorise the Proposed Collective Bargaining Conduct because:[99]

    103.1. it involves cartel conduct which is presumptively harmful, and therefore should not be authorised unless it is likely to result in a substantial net public benefit;

    103.2. any benefit would be of a private nature; and

    103.3. any net benefit that would likely result from the Proposed Collective Bargaining Conduct would not be substantial.

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98 See paragraph 55 above.

99 PNO SOFIC, 14 December 2020, paragraph 63.

104. At a general level, the ACCC considers that it is open to the Tribunal to be satisfied that the authorisation test in s 90(7)(b) is met such that it could exercise its discretion and authorise the Proposed Collective Bargaining Conduct in this review. But more specifically, the ACCC disputes each of the contentions made by PNO listed at paragraph 103 above.

Does the proposed collective bargaining involve presumptively harmful cartel conduct?

105. PNO contends that the Proposed Collective Bargaining Conduct involves cartel conduct that is presumptively harmful to competition so as to require a showing of substantial net public benefits in order to obtain authorisation.

106. The ACCC rejects the contention that there is a requirement to show a substantial net public benefit in order to obtain authorisation.

107. The ACCC considers that, while cartel conduct is presumptively harmful, such conduct can be authorised under the CCA precisely because that conduct can be shown to be of net benefit to the public. To this end, s 90(7)(b) of CCA requires the ACCC, and the Tribunal in this review, to be satisfied in all the circumstances that the public benefit outweighs the public detriment likely to result from the proposed conduct. It is appropriate, and directed by the statute, that the Tribunal consider the specific circumstances in each case to assess the public benefit and detriment *likely to result from* the proposed conduct. That requirement does not incorporate any presumption of detriment nor transform the statutory test to require a "substantial" net public benefit as a threshold to be met before cartel conduct can be authorised. The statutory test applies in an orthodox way, consistent with the statutory language.

108. The ACCC considers that it is open for the Tribunal to conclude that, while the Proposed Collective Bargaining Conduct involves cartel conduct, such conduct involves a very low likelihood of detriment and/or detriment that is unlikely to be significant in light of the scope of the Proposed Collective Bargaining Conduct and the considerations expressed at paragraph 95 above, such that the authorisation test is met and the Tribunal may in the circumstances exercise its discretion to authorise the Proposed Collective Bargaining Conduct.

Private benefits

109. This SOFIC has addressed this issue above: see at paragraph 73.

Substantiality of the net public benefit

110. PNO appears to contend that any net public benefit would not be substantial and therefore the Tribunal should not exercise its discretion and deny authorisation (paragraph 103). This SOFIC has addressed this issue above: see from paragraph 105-108.

Issue 7: Length of authorisation

111. Section 91(1) provides that an authorisation may be expressed to be in force for a specified period.

112. The Authorisation Applicants sought and the ACCC granted authorisation for ten years. PNO and other interested parties did not raise any concerns with the time period sought.

113. Neither PNO nor the NSWMC has taken any issue with the period of authorisation sought. The Tribunal could properly form the view that an authorisation term of ten years is appropriate. In particular, the Producer Deed is proposed for ten years[100] and this period would enable the Authorisation Applicants to collectively negotiate any proposed changes during its operation.

Ruth C A Higgins SC

Christopher Tran

Counsel for the ACCC

[100] See Producer Deed: https://www.portofnewcastle.com.au/wp-content/uploads/2020/03/OAR-TERMS-Producer-Deed-13-March-2020_.pdf.

Annexure A

Summary of recent regulatory and court decisions which have impacted PNO's access charges and pricing methodology

Over the last several years there have been significant, and ongoing regulatory issues at the Port:

2015 – Glencore sought declaration of the shipping channel at the Port by the National Competition Council (NCC). The NCC didn't recommend declaration of the channel services.

2016 – On appeal by Glencore, the Tribunal determines that the shipping channel at the Port of Newcastle is declared (Tribunal Determination No. 1).

November 2016 – Glencore notifies the ACCC of an access dispute with PNO about the increase in price for coal vessels entering the Port, and requests the ACCC to arbitrate.

July 2018 – following amendment of the declaration criteria under Part IIIA of the CCA in 2017, PNO seeks recommendation from NCC to revoke declaration of the shipping channel service at the Port.

September 2018 – the ACCC's Access Determination concludes that PNO should charge ships entering the port to carry Glencore's coal $0.61 per gross tonne (GT). In this process, the ACCC had to establish the value of assets used to provide the 'declared' shipping channel service. The ACCC determined it was appropriate to exclude previous user-funded channel dredging from the costs that PNO could recover.

PNO subsequently appealed the ACCC's Access Determination to the Tribunal.

July 2019 - NCC recommends that the declaration of the Port under Part IIIA of the CCA be revoked.

September 2019 – the Treasurer confirmed that following the expiration of the 60 day period to consider the NCC's recommendation, the declaration at the Port is deemed to be revoked.

October 2019 – the Tribunal issues a determination increasing access charges (from $0.61 per gross tonne) to $1.01 per gross tonne (Tribunal Determination No. 2). In its determination the Tribunal included previous industry-funded expenditure for channel dredging in PNO's regulated asset base. This allowed PNO to recover the user-funded amounts in its access charge.

The Tribunal's Determination No. 2 is limited to the terms and conditions of access where Glencore owns or, either directly or by agent, charters a vessel that enters the Port and loads Glencore coal. It did not apply to:

- the terms and conditions of access to apply in respect of vessels carrying coal that are not owned, or have not been chartered, by Glencore
- the terms and conditions of access for vessels other than those calling at the coal terminals at the Port, and

- any charges imposed by PNO other than the Navigation Service Charge and the Wharfage Charge.

November 2019 – Glencore and the ACCC applied to the Federal Court for a review of the Tribunal Determination No. 2. The parties sought review of the Tribunal's treatment of user funding at the Port. While the declaration of the Port has been revoked, the Tribunal Determination No. 2 remains in force until 2031. On 24 August 2020 the Federal Court ordered that the Tribunal Determination No. 2 be set aside and the matter be remitted back to the Tribunal for determination.

July 2020 – the NSWMC lodged an application with the NCC for declaration of certain 'services' in relation to the Port of Newcastle. 'Services' are defined under the application for declaration as:

> the provision of the right to access and use all the shipping channels and berthing facilities required for the export of coal from 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 (Service). The Service is currently provided by PNO.
>
> the Service relates to all coal being exported from the Port either on a Free on Board (FOB) or Cost including Freight (CIF) basis…
>
> …The facilities used to provide the Service are the shipping channels and vessel berth areas…

October 2020 – NCC releases draft recommendation not to declare the Service at the Port.

18 December 2020 – NCC sent its final recommendation in respect of the NSWMC's application for the declaration of certain services at the Port to the Treasurer. The Treasurer has 60 days after receipt of the NCC's recommendation to publish his decision and reasons.

NOTICE OF LODGMENT

AUSTRALIAN COMPETITION TRIBUNAL

This document was lodged electronically in the AUSTRALIAN COMPETITION TRIBUNAL and has been accepted for lodgment pursuant to the Practice Direction dated 3 April 2019. Filing details follow and important additional information about these are set out below.

Lodgment and Details

Document Lodged:	Expert Report
File Number:	ACT 2 of 2020
File Title:	Re Application for authorisation AA1000473 lodged by New South Wales Minerals Council on behalf of itself, certain coal producers that export coal through the Port of Newcastle, and mining companies requiring future access through the Port, and the determination made by the ACCC on 27 August 2020
Registry:	VICTORIA – AUSTRALIAN COMPETITION TRIBUNAL

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Dated: 22/04/2021 2:54 PM

Important information

This Notice has been inserted as the first page of the document which has been accepted for electronic filing. It is now taken to be part of that document for the purposes of the proceeding in the Tribunal and contains important information for all parties to that proceeding. It must be included in the document served on each of those parties.

Report of Dr Rhonda Smith

Prepared for the Australian Competition and Consumer Commission in ACT 2 of 2020 – Application by Port of Newcastle Operations Pty Limited

Authorisation for Collective Bargaining: NSW Minerals Council & 10 Coal Producers

1. I am a Senior Lecturer in the Economics Department and a Senior Fellow in the Law School at the University of Melbourne. My Curriculum Vitae is provided at Attachment 1.

2. I have been asked to prepare an independent expert report providing an opinion in answer to a number of questions (see Attachment 2). In answering these questions, I have made a number of assumptions of fact. Most of these are set out below. However, some further assumptions made in answering specific questions are explicitly stated elsewhere in the report.

3. A list of the materials supplied to me for the purpose of preparing my report is provided at Attachment 3 to this Report in accordance with the expert witness practice note. Any other materials are identified in footnotes.

4. I acknowledge that my opinions are based wholly or substantially on my specialised knowledge arising from my training, study or experience. I acknowledge that I have read the Federal Court's Expert Evidence Practice Note and the Harmonised Expert Witness Code of Conduct and agree to be bound by them. I have made all the inquiries which I believe are desirable and no matters of significance which I regard as relevant have, to my knowledge, been withheld.

Assumptions of Fact

5. At the end of 2019 Port of Newcastle Operations Pty Ltd (PNO) invited coal producers, vessel agents, vessel operators and FOB coal consignees to enter into bilateral long term discounted pricing arrangements (or deeds). The deed offered to producers (the Producer Deed) includes discounted navigation service charges and wharfage prices set by PNO. It is the terms and conditions of this Producer Deed that the Applicants seek to collectively negotiate with PNO.[1]

[1] ACCC Final Determination, paragraph 1.20.

6. The NSW Minerals Council sought authorisation on behalf of itself and ten coal producers located in the Hunter Valley region of NSW to:

   i. collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port;

   ii. discuss amongst themselves matters relating to (i) above; and

   iii. enter into and give effect to contracts, arrangements or understandings with PNO containing common terms which relate to access to the Port and the export of minerals through the Port.

   (collectively, the Proposed Collective Bargaining Conduct).[2]

   Authorisation was sought for a period of ten years.

7. The Proposed Collective Bargaining Conduct is voluntary for all parties, including the operator of the Port of Newcastle, and does not include boycott activity by the coal producers.[3] Each coal producer can (a) independently determine whether to accept any negotiated terms and conditions offered by PNO following collective negotiations, and (b) each coal producer may undertake independent negotiations with PNO at any time.[4]

8. The Proposed Collective Bargaining Conduct 'does not include the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume/ capacity projections for individual users.'[5]

[2] ACCC, Final Determination, paragraph 1.3

[3] ACCC, Final Determination, paragraph 1.4

[4] ACCC, Final Determination, paragraph 1.29

[5] ACCC, Final Determination, paragraph 1.5

9. PNO operates the Port of Newcastle after acquiring a long term lease from the NSW government in 2014.[6] This lease obliges PNO to make certain payments to the NSW Ports Authority.[7]

10. I assume that coal produced by the coal producers in the Hunter Valley region is mostly exported and coal producers compete with numerous suppliers in other countries and that the producers are price takers on the international market for thermal coal.[8] I assume also that the outlook for thermal coal is uncertain and not favourable due to concerns about climate change.

The factual and counterfactual

11. In order to respond to the questions below, it is necessary to compare the future where coal producers have the ability to negotiate collectively (the factual) with the future where negotiations between the coal producers and PNO are only able to be undertaken on a bilateral basis. In each case it is assumed that the outlook for coal exports is uncertain in light of concerns about climate change.

12. PNO states that it will not engage in collective negotiations with the coal producers. In so doing it implies that there are no benefits (public or private) that will flow from the ability of the coal producers to collectively negotiate. On this view, the factual and the counterfactual will both relate to a future where negotiation is bilateral rather than collective.

13. Such a refusal could be regarded as an exercise of market power. In my opinion, PNO possesses substantial market power in relation to the supply of port services to port users. Given this, it is able to refuse to collectively negotiate with the coal producers. If PNO were subject to competition, it would not be profit maximising to refuse to

[6] ACCC, Final Determination, paragraph 1.15

[7] ACCC, Final Determination, paragraph 2.5

[8] ACCC, Final Determination, paragraph 4.77.

negotiate because it would likely result in a loss of business. The refusal has implications for the competitiveness of coal exports from the Hunter Valley region either because any price increases that would be avoided/reduced through collective bargaining will be passed through directly reducing competitiveness; or they will be absorbed by the coal producers thus reducing profitability and reducing willingness to invest and this may indirectly reduce competitiveness on international markets.

14. Even if PNO refuses to engage in collective negotiations, the ability of the coal producers to engage in the conduct that would be required for collective negotiation will better equip each producer to engage in bilateral negotiations.

15. I assume that 'the ACCC is not required to attempt to predict the likely outcome of the collective negotiations on the relevant issues. The ACCC's role is to assess whether proposed collective bargaining conduct is likely to result in public benefits if the parties engage in the conduct.'[9]

16. Nevertheless, in my opinion, it is quite probable that PNO will change its stance at least within the 10 year period for which authorisation is sought:

    i. While the coal producers are dependent on access to the port in order to export their coal, I assume that PNO derives a very high percentage of its revenue from servicing these exporters and, as noted above, I assume that the future outlook for thermal coal exports is very uncertain and not favourable and that coal producers in the Hunter Valley region are price takers on the international market for thermal coal. A reduction in coal exports reduces the extent to which port infrastructure is used and, if supply of infrastructure services is subject to economies of scale (as would be expected where there are high fixed costs), this will reduce efficiency and profits.

[9] ACCC, Final Determination, p.2

ii. Given this, it is reasonable to expect that the coal producers and PNO will have a mutual interest in ensuring that there are no unnecessary impediments or disincentives for the export of coal through the Port of Newcastle. This, in turn, suggests that this may cause PNO to reconsider its stance in relation to collective negotiation.

iii. Other possible developments at the Port may require the agreement of the coal producers and PNO may decide that it is more effective and less costly to negotiate collectively.

Question 1

Which market(s) are relevant to a consideration of the authorisation application?

17. Market definition is the first step when undertaking a competition analysis. Consequently, it begins from the product/s and the location/s that give rise to the competition concern. In relation to an application for authorisation, it enables the assessment of public benefit/s and detriment/s.

18. The NSW Minerals Council and ten coal producers in the Hunter Valley region of NSW sought 'authorisation for ten years to enable them to collectively negotiate terms of access for coal vessels entering the channels and berthing at the Port. The group also sought authorisation to jointly discuss and negotiate common industry issues, such as proposed capital expenditure at the Port and allocation of costs.'[10]

19. This suggests that it is the market in which these port services are supplied that will need to be defined. The product at issue is access to and provision of port services in relation to the export of (mainly) thermal coal. These services are supplied at the Port of Newcastle by the port operator. For the purpose of defining the market in which these services are supplied, it is helpful to assess demand- and supply-side

[10] ACCC, Final Determination, paragraph1.3, 1.23-1.24.

responses to a small but significant non-transitory increase in the price of the services (SSNIP) by a hypothetical monopolist port operator.

20. These port services are an input into the export of coal produced in the Hunter Valley region (as well as some other minerals[11]). In my opinion, the coal producers could not substitute some other service for this service in response to a SSNIP. On the supply side, similarly, substitutability is not possible. Thus, given the lack of responsiveness to the SSNIP, in my opinion there is a relevant market for the supply of port services which enables ships to enter the port in order to be loaded with coal (or possibly other minerals).

21. This conclusion is supported by the lack of response in terms of the quantity of coal exported through the Port of Newcastle to price increases which have been applied since 2014, when the port was privatised, and which are far in excess of a SSNIP.[12] In other words, there was a very strong incentive to use alternative export facilities but no response to it.

22. By a similar process of reasoning, in my opinion, the geographic dimension of the market is the Port of Newcastle where the service is supplied. Coal (and other minerals) are bulky and the cost of transport to the port is relatively high. I assume that the Port of Newcastle is the nearest suitable port through which Hunter Valley coal producers can export their coal.[13] This suggests that if the coal producers were to seek to export through an alternative port, the additional cost of transport would outweigh the typical 5% SSNIP applied when defining markets. Consequently, it would not be rational to substitute one port for another.

23. In addition, I assume that the coal producers have access to and use an established logistics system to move coal from the mine to the port. I assume that this would not

[11] ACCC, Final Determination, paragraph 1.3

[12] Affidavit of Simon Byrnes, Graph, p.5 and paragraph 17

[13] ACCC, Final Determination, paragraph 1.12.

be available to serve an alternative port and would not be constructed in response to a 5% SSNIP in the cost of port services.

24. Consequently, the geographic dimension of the market for access to port services for exporting coal from the Hunter Valley region is, in my opinion, limited to the Port of Newcastle.

25. To summarise, given the above, in my opinion there is a relevant market for access to or supply of port services in the Port of Newcastle for the export of coal. These services are supplied by PNO and are acquired by coal producers located in the Hunter Valley region and by vessel owners, or vessel agents on their behalf, who transport the coal.

Other relevant markets

26. However, there are other markets which may be affected by the conduct for which authorisation is sought. I assume that most of the coal produced in the Hunter Valley region is thermal coal and that this is used mainly for electricity generation.[14] I assume that metallurgical coal is used in steel-making.[15] I assume that metallurgical coal is not a close substitute for thermal coal. This is because they are not close functional substitutes – they are used in different ways.[16] In addition, I assume that the metallurgical coal is a higher quality coal as it has higher energy content and lower moisture. Given this, I assume that it will be at least 5% more expensive on average than the thermal coal. This means that coal users would be unlikely to respond to a SSNIP by substituting metallurgical coal for thermal coal. Similarly, I would not expect that there would be much, if any, supply-side substitution in response to a SSNIP of 5%. This suggests that there is a market the product dimension of which is the supply and acquisition of thermal coal.

[14] Byrnes Affidavit, paragraph 12 (a); 14.

[15] Byrnes Affidavit, paragraph 12 (b)

[16] Byrnes Affidavit, paragraph 13.

27. The geographic dimension of this market, while including Australia, is primarily international. I assume that Australian thermal coal is sold to countries such as Japan, China, South Korea, and Taiwan.[17] However, in response to a SSNIP in relation to Australian thermal coal, including that from the Hunter Valley region, importing countries could turn to suppliers in other countries such as the United States, Indonesia, Russia, and South Africa which also produce and export thermal coal.[18]

28. In addition to negotiating access to the Port of Newcastle for ships exporting coal (and other minerals), authorisation was sought for collective negotiation of 'common industry issues, such as proposed capital expenditure at the Port and allocation of costs.'[19] Some of these issues may be regarded as being relevant to separate markets from that in which access is supplied, but, at least in terms of infrastructure investment, this will contribute to the supply of port services. If so, by the same reasoning, the market will be confined to these services as supplied at the Port of Newcastle.

[17] ACCC, Final Determination, paragraph 2.4.

[18] Thermal Coal Exporters – see The International Energy Agency, Coal Information Overview. Available at: https://www.iea.org/reports/coal-information-overview.

[19] ACCC, Final Determination, p.2.

Question 2

What economic principles, if any, are relevant in identifying public benefits? When is a benefit "private" rather than "public", and when is a benefit both private and public?

Public benefits – what makes something a public benefit?

29. Business conduct gives rise to a private benefit if it increases the profit of the business either directly or indirectly. A business that engages in conduct, such as improving the attractiveness of its products and charging higher prices for them, or by lowering its costs, will be able to compete more effectively in a market and thereby increase its profits and so obtain a private benefit. However, a business may also obtain a private benefit by exercising market power or by engaging in anti-competitive conduct that increases its market power, thereby enabling it to raise prices, and/or to reduce product quality and/or to adversely reduce other terms of trade and/or to focus less on innovation and investment.

30. Consumers obtain a private benefit from engaging in transactions in a market. A measure of the value that a consumer expects to obtain is the consumer's willingness to pay.[20] The actual benefit obtained from engaging with the market is the difference between the willingness to pay and the market price (the consumer surplus). [21]

31. Conduct that creates private benefit in some circumstances also creates public benefit. This will occur when the conduct has the effect of increasing economic welfare. It will do so if the relevant conduct directly or indirectly has the effect of

[20] This is determined by the factors that determine demand. These include the availability and price of substitutes, preferences/taste, and income.

[21] Dennis Carlton & Jeffrey Perloff, Modern Industrial Organization, Global Edition, 2015 p.94; Jeffrey Church & Roger Ware, Modern Industrial Organization: A Strategic Approach, 2000, p.25. Church & Ware is available at https://edisciplinas.usp.br/pluginfile.php/1663633/mod_resource/content/1/ChurchWare.pdf

increasing the amount of output produced with given resources, and/or when it increases the quality of that production and better satisfies consumer preferences. Conduct that is efficiency-enhancing increases economic welfare and so results in both a private and a public benefit.

32. The conduct of a firm or a group of firms may not increase economic welfare per se, but may increase social welfare. This would include conduct to achieve a particular public policy objective, such as ensuring public health and safety; and conduct aimed at improving environmental outcomes, even though they may impose additional adjustment costs on the supplier. Such conduct can be expected to confer a public benefit but, depending on the circumstances, it may not confer a private benefit, as for example when it is in response to a regulatory requirement and where the conduct would not occur otherwise.

Economic Welfare Standards

33. Economic welfare can be measured in various ways and this may influence whether or not the effect of particular conduct will be considered to give rise to a public benefit. The most commonly considered standards in relation to competition law are the consumer welfare standard and the total welfare standard.[22] The latter is measured as the aggregate of consumer surplus and producer surplus.[23] Producer surplus is the difference between the marginal cost of production (the firm's minimum willingness to supply), and the market price. The difference between the two standards may be reduced to the extent that the consumer welfare standard also takes account of resource saving; while the total welfare standard may be modified in relation to the weight given to a claimed public benefit where that benefit is confined to a narrow group.

[22] For a discussion of these, see OECD, The Role of Efficiency Claims in Antitrust Proceedings, Best Practice Roundtables, 2012, pp. 26-28. Available at: http://www.oecd.org/daf/competition/EfficiencyClaims2012.pdf

[23] Dennis Carlton & Jeffrey Perloff, Modern Industrial Organization, Global Edition, 2015 p.110. Church & Ware, supra Note 21, pp 26-27.

34. In the past, the Tribunal has applied a modified total welfare standard: see Qantas Airways Limited [2004] ACompT 9 at paragraph 185 and Application by Tabcorp Holdings Limited [2017] ACompT 1 at paragraph 62.

Efficiency

35. In economics, efficiency is a measure of how well a market or the firms within it are performing. There are various different aspects to efficiency. Production efficiency and allocative efficiency are static measures of efficiency as distinct from dynamic efficiency.

36. Production efficiency (also referred to as technical efficiency) occurs when a firm produces a given output at the lowest cost per unit produced given the technology employed. In circumstances where production is subject to economies of scale, efficiency gains are available as output increases until the economies of scale are fully exploited. More output is obtained using less resources per unit and, other things remaining constant, this increases economic welfare and would therefore represent both a private benefit (increased profit) and a public benefit (society's limited resources are being better used).

37. A related concept is x-inefficiency which measures cost incurred by a firm in excess of that which would be incurred in a competitive market. An example would be the 'gold plating' of the CEO's office suite or executives taking time off to play golf for leisure during business hours. Here a cost is incurred which could not be incurred in a competitive market where the flow through of the associated cost would raise the firm's price relative to its rivals and cause it to lose sales. The cost differential reflects the firm's ability to ignore, at least to some degree, market pressures, that is, it possesses market power. While there is a private benefit from such conduct, there is no public benefit. Rather, this inefficiency is a public detriment (see Question 5).

38. Allocative efficiency refers to how well resources are allocated between productive activities, in order to best satisfy consumer preferences, given the cost of the resources used in production. Firms will be allocatively efficient when those consumers who are willing to pay a price at least equal to the marginal cost of producing the product obtain supply. Increases in allocative efficiency are a public benefit.

39. A profit maximising firm that possesses substantial market power will not be allocatively efficient (unless the firm is able to perfectly price discriminate). This is because the firm restricts output in order to raise the price above the competitive level. As a consequence, some consumers who previously obtained supply because they valued the product at least equal to the competitive price, will now face a price that exceeds the benefit that they expect to obtain by purchasing the product (willingness to pay). As a consequence, they will turn to other less preferred products. To satisfy the increased demand for these products additional resources will be required. This reallocation of resources is inefficient (measured as the dead weight loss) and reduces economic welfare. The conduct confers a private benefit but not a public benefit.

40. Dynamic efficiency is an assessment of how quickly and completely firms adjust to change, whether on the demand side, such as a change in consumer preferences, or on the supply side, such as the adoption of new technology. This increases economic welfare and represents a public, as well as a private, benefit because it means that the market is better satisfying consumer wants and/or is doing so at a lower cost (using less resources).

41. Dynamic efficiency is closely related to R&D and innovation and economic growth. The effect of technical innovation may be to lower the long run average cost of production, although additional costs associated with this may be incurred in the short run. Increased dynamic efficiency may also result from the introduction of better work practices and systems. New and better products have the effect of

increasing demand which increases consumer surplus, other things remaining constant, and so increases welfare.

42. Conduct that increases efficiency is welfare-enhancing. It will usually confer a private benefit on the firm/s engaged in the conduct and it will be a public benefit.

Market failure

43. Market failure occurs when prices fail to reflect the true economic cost of production – these are understated or overstated depending on the nature of the market failure. It may also occur because the willingness to pay of consumers does not accurately reflect the value of the product for the consumer.

44. There are many sources of market failure. On the supply side they include market power (this may be structural, as in the case of natural monopoly, or strategic as the result of a firm's conduct); information deficiencies, including asymmetry of information (such as access to finance in imperfectly competitive capital markets for new entrants); free riding; externalities; and public goods.

45. On the demand side, market failure may be the result of information asymmetry. This occurs where consumers are not fully informed concerning the qualities of the relevant product or the terms and conditions on which they are supplied. Behavioural economics studies also show that consumers may fail to use, or use fully, the information available to them, again causing a market failure.[24]

46. The consequence of market failure is that supply and/or demand may be excessive or deficient relative to what it would otherwise have been. Market failure means that the market is not operating efficiently and economic welfare is reduced. Where

[24] For example, see Lucia A. Reisch & Min Zhou, Behavioural economics, consumer behaviour and consumer policy: state of the art, published online by Cambridge University Press: 06 October 2017. Available at: https://www.cambridge.org/core/journals/behavioural-public-policy/article/abs/behavioural-economics-consumer-behaviour-and-consumer-policy-state-of-the-art/2141A51B066F5031F4E97006A1DC2BE4

market failure occurs, the party or parties adversely affected by the failure have an incentive to find ways of addressing the market failure – they obtain a private benefit from doing so. However, the increased efficiency that results from addressing the market failure is also a public benefit.

47. It should also be noted that conduct by firms to address a market failure, such as the imposition of vertical restraints, may increase efficiency, which is both a private and a public benefit. However, the vertical restraint may reduce competition (for example, by entering into an exclusive supply contract for a scarce but essential input thus at least raising rivals' costs and possibly foreclosing them) which, although it may be a private benefit, will not be a public benefit. The impact on welfare will depend on the size of the public benefit from addressing the market failure relative to the adverse effect on competition of the vertical restraint.

Question 3

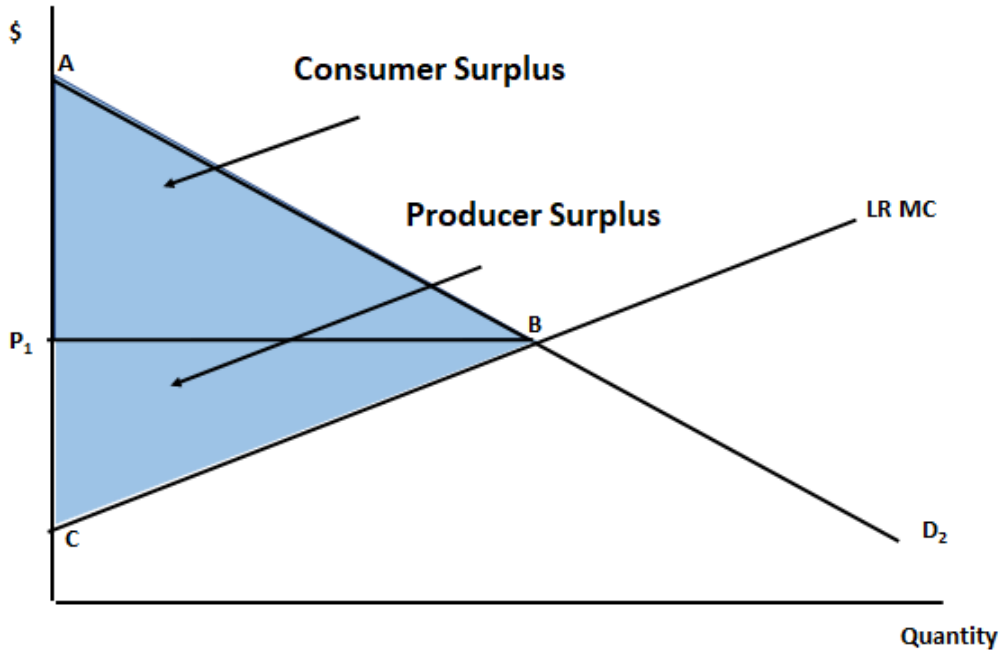
What economic principles apply in relation to collective bargaining conduct? Applying those principles, what are the public benefits and public detriments, if any, that would result or be likely to result from collective bargaining conduct?

48. Collective bargaining involves two or more competitors agreeing to collectively negotiate terms and conditions (which can include price) with a supplier or a customer (the target or counterparty).[25]

49. While bargaining is common in business dealings, collective bargaining theory has mainly been developed in relation to labour markets. One area in which concepts concerning collective bargaining have been developed independent of labour markets is in relation to the negotiation of royalties or licences for intellectual property, particularly copyright.

[25] See Stephen P. King, Collective Bargaining in Business: Economic and Legal Implications" [2013] UNSW Law Journal, 36(1).at 107, quoting ACCC. Available at: http://www.austlii.edu.au/au/journals/UNSWLJ/2013/5.html

50. In simple terms, bargaining occurs when both parties expect to gain from trade, otherwise the approach would be a take-it-or-leave-it offer by one of the parties. Buyers will be unwilling to enter into a bargain where the price (or terms of trade) exceed their maximum willingness to pay which reflects the value placed on the product by the buyer. Likewise, a supplier will not be willing to sell at a price that is less than its marginal cost of supply. The former is the upper bound for negotiation, while the latter is the lower bound, and agreement may be reached between these.



51. Negotiation is directed to the share of the surplus that each party obtains by entering into transactions in a market. That share will depend on such factors as:
    i. the alternatives each party has if the negotiations are unsuccessful;
    ii. the relevant information available to each party, that is, whether there are information deficiencies/asymmetries;
    iii. the relative urgency for each party to conclude a deal.

52. In general terms, the benefits of collective negotiation include addressing:

    i. imbalance in bargaining power between the parties;
    ii. asymmetry of information concerning supply costs;
    iii. any lack of bargaining skill/experience of individual parties.

53. The benefit that those negotiating collectively expect to obtain depends on the particular circumstances in which the bargaining occurs. However, they are likely to include:
    i. improvements in the quality of the contractual outcome – eg more appropriate risk allocation;
    ii. reduced costs associated with negotiations.

54. These outcomes are clearly beneficial to the group bargaining jointly, and possibly to the counterparty. As such, they are private benefits. However, if collective negotiation increases efficiency and hence saves resources this will be a public benefit. This may occur if:
    i. a reduction in market power causes a decrease in the dead weight loss;
    ii. transaction costs associated with negotiations are reduced;
    iii. informational deficiencies are addressed which enable better decision-making by the group.

Market power and reduced dead weight loss

55. Collective negotiation may reduce an imbalance in bargaining power that results when one party possesses substantial market power, perhaps because they control an essential input into supply by the other party. If this simply causes a redistribution of the gains from trade between the buyers and the seller this would not be regarded as a public benefit under the total welfare standard, although it would be regarded as a public benefit under the consumer welfare standard.

56. However, redressing the imbalance of bargaining power that results from one party possessing market power will also result in a reduction in the dead weight loss unless the party possessing substantial market power is able to perfectly price discriminate.[26] As the dead weight loss measures the misallocation of resources associated with market power, in my opinion, this increase in efficiency would represent a public benefit under either the consumer welfare standard or the total welfare standard. The size of the public benefit will depend on the size of the dead weight loss and the extent to which it is reduced.

Transaction costs

57. Transaction costs are defined as 'those costs of writing and enforcing contracts that arise in a world of uncertainty with asymmetric information where parties may have conflicting incentives.'[27] As the name implies, they are costs that arise when making a sale that are additional to the cost of production. They include the cost of monitoring, controlling, and managing transactions, including providing a mechanism for settling disputes.

58. Collective negotiation may reduce transaction costs. Carlton notes that '[n]egotiations involving one-on-one bargaining …are often protracted despite their high transactions costs and therefore raise the issue whether the contracts reached are efficient.'[28] Negotiations not only use the time of (generally senior) company employees and take them away from the business, they may also involve the cost of external advisors. So numerous and protracted negotiations, as well as negotiations that fail to reach a satisfactory outcome, are costly for the parties. Thus, the transaction cost of reaching an agreement will depend on many factors including

[26] If this were the case each buyer would be charged its willingness to pay and there would be no dead weight loss.

[27] D.W. Carlton, Transaction costs and competition policy, International Journal of Industrial Organization, volume 73, 2020, p.2. https://doi.org/10.1016/j.ijindorg.2019

[28] Ibid.

available information, the complexity of the terms, as well as the ability to monitor the terms of any agreement.

59. Each party involved in negotiations incurs transaction costs. For members of the group engaged in collective bargaining, it means that those costs can be pooled and shared. However, if collective negotiation results in fewer and/or shorter negotiations compared to bilateral negotiations, transaction costs will be reduced for the counterparty as well. There are economies of scale in collectively negotiating for all parties. This is a private benefit, but as it saves resources, it is also a public benefit.

Other benefits

60. If collective bargaining results in a more efficient contract,[29] this may mean that there is greater certainty/less risk in decision-making in the future. This in turn may allow more and/or more efficient investment. Clearly, there would be a private benefit for those investing, but there is also a public benefit to the extent that there is increased efficiency. Collective negotiation may be important in providing an incentive for investment and hence results in a public benefit, especially where the investment involves a significant sunk cost.

61. Nevertheless, to negotiate collectively, members of the group will need to agree their joint position which will also result in a cost, and that cost is likely to be greater the more heterogeneous the group membership is, and the more their interests diverge. This is a private cost, but because it uses additional resources to determine the public benefit resulting from collective negotiation, it is the net increase in efficiency which is relevant.

Risk of collusion

[29] From an economic perspective, an efficient contract is one that allocates risk to the party best able to bear it. It also refers to a contract that is more likely to achieve its objectives.

62. The process of joint negotiation increases the risk of coordinated conduct by the parties in relation to other aspects of their businesses. RBB Economics, in a paper commissioned by the UK Office of Fair Trading, for example, noted that 'the buying group could just be a façade to hide explicit collusion in the downstream market. For example, the European Commission came to this view in relation to the Spanish Tobacco cartel, where purchasing quotas were, in effect, market share targets in the downstream market'.[30]

63. Thus, collective negotiation may have anti-competitive effects (which reduce efficiency and are detriments to the public). The co-operation required for collective bargaining may dull the incentive to compete, that is, it provides an incentive for collusion. Collective bargaining may also provide or increase the ability to collude more broadly, that is, beyond the areas covered by collective negotiation. This is because collective bargaining involves interactions between competitors which enables the transfer of information between them.

64. The risk of collusion increases the greater the range of issues covered by collective negotiation and the more information that needs to be exchanged between the businesses in order to arrive at a common position in order to collectively bargain, especially where this information includes future prices and fees, and costs. Other factors that affect this risk include:
    i. the greater the proportion of market participants that are party to the collective negotiation;
    ii. any disincentives to act collusively.

    The former makes collusion more likely, while the latter makes it less likely.

65. Disincentives to engage in broader collusive activity include:
    i. loss of commercial advantage from revealing private information;

[30] OFT, The competitive effects of buyer groups, Economic Discussion Paper January 2007, paragraph 1.45. https://www.rbbecon.com/downloads/2012/12/oft863.pdf

ii. the competitiveness of downstream markets.

66. If collective negotiation results in collusion, this will be a private benefit to those colluding. However, collusion reduces efficiency and so is a public detriment.

Other detriments

67. Depending on the market structure, a possible harm from collective negotiation is that the group will succeed in achieving a more favourable outcome at the expense of those competitors who are not part of the group. Whether this is likely depends on whether the more favourable terms secured by the group are confined to the group or whether they benefit the industry as a whole, whether the more favourable terms are transparent enough to be recognised by non-participants in the group, and whether the group negotiating collectively is 'open' or 'closed'. If the group is 'open' it would be expected that if it was able to secure better terms, others would opt into the group. I assume that in relation to the present application, the group is 'open'.

68. Another potential detriment is raised by RBB in its OFT report:
'Sometimes it is argued that increased bargaining strength means that suppliers earn less than before and so are less likely to make investments. However, in general, buyers would be expected to realise this. If the investment by the supplier were important, a buying group would limit its ex post bargaining power (e.g. through writing an ex ante contract). Put differently, buyers may gain from lowering their share of the bargaining pie, if, as a result, the size of the bargaining pie is much larger.'[31]

69. In summary, unequal bargaining power results in not merely a transfer of surplus between parties, but inefficiency, represented by the dead weight loss. Collective bargaining helps to redress that issue. It also results in reduced transaction costs for all parties relative to bilateral negotiation. It may result in more appropriate

[31] OFT, The competitive effects of buyer groups, Economic Discussion Paper January 2007, paragraph 3.37. Available at: https://www.rbbecon.com/downloads/2012/12/oft863.pdf

contractual outcomes, including better risk allocation. To the extent that collective bargaining increases efficiency, it is a public benefit. However, there is a risk that collective bargaining may impact outside of the permitted areas and if that reduces efficiency, this will result in a public detriment.

Question 4

Applying the principles discussed in Questions 2 and 3, what are the public benefits, if any, that would result or be likely to result from the Proposed Collective Bargaining Conduct, and what is their magnitude?

Transaction cost savings

70. In applying for authorisation for collective bargaining the coal producers claimed that the ability to collectively bargain with PNO would result in transaction cost savings. In granting the authorisation, the ACCC accepted that collective negotiation would result in a public benefit. In my opinion, for the reasons provided above, I agree that collective negotiation between the coal producers and PNO would increase efficiency by reducing transaction costs and consequently would be a public benefit.

71. I have been asked to express an opinion as to the extent of this public benefit. This will depend on a number of factors. The first is that there are matters that need to be negotiated. Second is the time typically spent in bilateral negotiations to reach agreement compared to the time taken when there is collective negotiation. Third, it will depend on the number of coal producers that engage in collective negotiation given the voluntary nature of the authorised conduct. Fourth, it depends on whether negotiations are 'one off' or occur on an ongoing basis, the latter potentially resulting in greater savings.

72. [redacted]

[redacted]

73. [redacted]

74. The Affidavit of Mr Byrnes of 15 March 2021 indicates that there has been a significant amount of bilateral negotiation in relation to the Producer Deed with offers and responses between the parties over a period of time. I interpret this material to indicate that PNO has been responsive to the requirements of the coal producers. Irrespective of this, it does suggest that not insignificant time and resources have been spent by numerous parties in these negotiations.

75. In my opinion, this supports a conclusion that the savings in transaction costs associated with collective negotiation will be more than trivial, although I am unable to be more precise than that.

More efficient contractual outcomes

76. In my opinion, PNO possesses substantial market power in relation to the provision of port services at the Port of Newcastle. This results from the reliance of the coal producers on export markets for the sale of their product, the transport and logistical costs of exporting through a port other than the Port of Newcastle (see Question 1), and the barriers to entry facing a potential entrant planning to supply port services.

77. Savings in transaction costs is not the only benefit that may result from collective negotiation. In circumstances where bargaining power is very unequal, as in the case

of a monopoly supplier for example, it is unlikely that the contractual outcome from bilateral negotiations will be efficient:

'Bargaining power will affect the efficiency of contracting. In general, if one party to a negotiation has most of the bargaining power, in the sense that most of the surplus from any negotiation is seized by that party, then this will reduce the incentive for the other party to the negotiation to make mutually beneficial but non-contractible investments.'[32]

78. The ability of the coal producers to collectively negotiate with PNO will help to address the imbalance of bargaining power, which should increase the efficiency of the bargaining process in that it should produce better outcomes relative to those where the bargaining power is bilateral and less equal. This increased efficiency is both a private and a public benefit.

79. Better, more efficient contractual outcomes will also be achieved the better-informed parties are when negotiating:

'Contracting will often involve information asymmetries and limitations on the verifiability of information. Buyers and sellers will have private information that affects the efficient contract, but the incentives for each party to truthfully disclose that information will often be limited.' [33]

80. Collective bargaining may allow the group to coordinate information collection, monitor that collection, aggregate and interpret the information. This may mean that the information provided as part of the negotiation is better and more complete than would be available in bilateral negotiations. Again, this would be both a private and a public benefit. A more complete contract based on better quality information provides a better basis for decision-making by both parties – for example it is likely

[32] Stephen King, supra note 25, p.11.

[33] Dennis Carlton, supra note 27, p.4

to result in more efficient investment decisions by all parties to the negotiation. Even in circumstances where future negotiations remain bilateral, if the coal producers are better informed because they can exchange information then this is likely to result in improved contractual outcomes.

81. The coal producers in their application for authorisation claimed the outcome of the collective negotiations would be greater certainty relative to bilateral negotiation leading to more investment which will benefit the region – for example, by creating or maintaining employment opportunities. In my opinion, if that occurs there would be a private benefit from any such investment, but a public benefit from the employment effects. This may be particularly important to the extent that the future for coal exports is uncertain due to climate change.

82. I assume that coal producers in the Hunter Valley region are price takers on the world market (see paragraph 10 above). This suggests that they would need to absorb all or part of any increase in the cost of port services. This in turn would mean that there are less funds available for investment in the business. Reduced profitability reduces the incentive to invest. Although this is a private cost, ensuring that prices are kept at competitive levels would encourage investment, other things being constant, which would have advantageous effects for the Hunter Valley economy, a public benefit.

83. However, while this should be regarded as a public benefit, the extent of the public benefit depends on whether the issues that could be collectively negotiated impinge on investment decisions and the extent of future investment with or without collective negotiation.

84. Better contractual outcomes would not only benefit the coal producers, they also provide a better basis for investment decisions by PNO, for example in relation to channel widening/dredging or future port development. To the extent that investment in improved port services enables easier access for ships and quicker

loading, this has implications for exporting, which would be regarded as a public benefit.

85. In my opinion, collective negotiation provides a positive incentive for investment as well as greater ability to invest. Again, I am unable to be precise about the magnitude of the public benefit that is likely to result from the ability of coal producers in the Hunter Valley region to collectively negotiate relative to the situation where negotiation is on a bilateral basis. However, in my opinion, the significance of the public benefit is likely to be greater given the uncertain future demand for coal.

86. To summarise, in my opinion, there are public benefits that would result from the ability of the coal producers to engage in collective bargaining. In my opinion, as circumstances change, PNO acting in its own interests may change its stance in relation to collective bargaining. However, even if collective bargaining does not occur because PNO refuses to participate in it, the ability of the coal producers to discuss issues and exchange information as they would do if they were collectively bargaining is likely to mean that they are better informed when bargaining bilaterally which of itself may enable a more efficient outcome in terms of the time taken to negotiate (reduced transaction costs) and the quality of the contractual outcome.

Question 5

PNO contends that the Proposed Collective Bargaining Conduct is a form of cartel conduct that is presumptively harmful (and therefore requires a substantial net public benefit before it is authorised). What is the likely harm from the Proposed Collective Bargaining Conduct?

87. A cartel is typically thought of as an agreement between parties who compete in the supply of a particular product. The cartel members may agree to fix prices, limit output, or allocate tenders. PNO asserts that collective negotiation/bargaining by the coal producers in the Hunter Valley region is a form of cartel.

88. I assume that the coal producers in the Hunter Valley region are likely to be considered competitors in relation to access to the Port of Newcastle.[34] They are seeking to collectively negotiate with PNO on issues including:
    i. pricing mechanisms under the Producer Deed, for example the inclusion of user funded expenditure in PNO's capital base;
    ii. PNO's capital expenditure forecasts at the Port and the impact on prices paid by coal producers either directly or indirectly; and
    iii. PNO's proposed annual price adjustments under the Producer Deed. [35]

89. Cartel conduct is prohibited by the Competition and Consumer Act – it is deemed to be anti-competitive. However, if it results in a net public benefit, that is, if the public detriments from collective negotiation are less than the public benefits to which it gives rise, the conduct may be authorised. If the consequent detriment is large, then it will only be offset by a large public benefit; conversely, if the detriment is small, for there to be a net public benefit, the public benefit would not need to be large.

90. PNO claims that the public detriment that will result from collective negotiation is 'the potential for collective activity among the bargaining group, beyond the authorised conduct, that is, that there is a risk of improper information exchange, with serious implications for competition.'[36] It claims that it would be difficult to detect and monitor any improper information exchanges between members of the bargaining group.[37]

91. Although this may occur, there are several factors that, in my opinion, indicate that the risk is small. One reason for this is that collective bargaining is permitted over a relatively narrow area. The ACCC's Final Determination states that the conduct that is authorised is relatively confined and does not involve the coal producers sharing

[34] ACCC Final Determination, paragraph 1.3

[35] ACCC, Final Determination, paragraph 1.24

[36] ACCC Final Determination, paragraphs 3.4

[37] ACCC, Final Authorisation, paragraphs 4.72

individual coal projection volumes, customer pricing information or marketing strategies.[38] PNO accepted this.[39] Coordination outside of that permitted by the authorisation would be illegal.

92. Co-operation when collectively negotiating may provide businesses with the opportunity to limit competition in relation to the sale of coal, to tacitly collude. I assume that this would take the form of asking higher coal prices. However, not only are the Hunter Valley region coal producers competing for sales with other Australian coal mining companies, they are competing with other coal producers around the world for sales. In other words, as assumed previously, producers in the Hunter Valley region are price takers on the world market. [40] Given this, an attempt to raise prices would be likely to be unprofitable and hence unsustainable.

93. Further, the coal producers are likely to have limited ability to raise their prices in future given the increasingly unfavourable conditions they are likely to face as the use of coal internationally is reduced in response to concerns about climate change. Rather, they are likely to have to compete even more vigorously to secure available sales.

94. I assume that some coal produced in the Hunter Valley region is sold domestically, that is, within the region. I assume it is unlikely that local coal users would source coal from outside of the region in response to an increase in the price of locally supplied coal. Even here, the worsening outlook for coal exports is likely to provide an incentive for each producer to compete vigorously for local sales, exploiting whatever private commercial advantage they may have.

[38] ACCC, Final Determination, paragraphs 4.77

[39] ACCC, Final Determination, paragraph 4.73.

[40] See paragraph 10 of this report.

95. In my opinion, these factors suggest that the risk of collusive activity outside of collectively negotiating in relation to port services is not likely or is not likely to be significant.

96. PNO has claimed also that collective negotiation may disadvantage smaller mining companies and/or companies with different interests from those engaged in collective negotiation.[41] It claimed that collective bargaining will 'substantially alter competitive dynamics' between coal producers in the market for access to port services at the Port of Newcastle, with larger producers placing pressure on smaller producers within the bargaining group. [42] However, collective bargaining is voluntary and these companies would only be expected to engage in it if it is in their interests to do so. Consequently, any detriment is likely to be small.

97. Port Authority of NSW submits that the proposed collective negotiation of the navigation service charge between the coal produces and PNO has the potential for a reduction in those charges, which may have flow on effects to the amount that PNO pays the Port Authority of NSW for services provided at the Port.[43] It claims that 'this has the potential to compromise the safe operation of the Port and its ability to meet its future costs.'[44] This is a fee for service paid by PNO which reflects a requirement under the contract entered into when the port was privatised in 2014. In my opinion, while the effect of any agreement between the Port Authority of NSW and PNO is likely to be a factor in negotiations between PNO and the coal producers, the extent to which the cost of any agreement between PNO and the Port Authority of NSW is passed through to producers is a cost the producers might seek to negotiate and it is a cost that PNO might be prepared to negotiate.

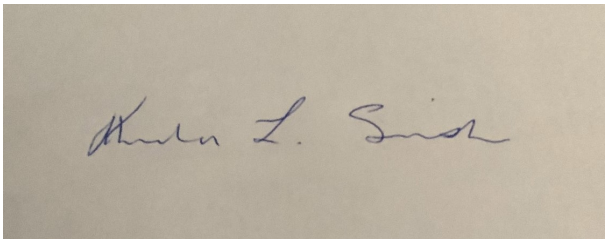
[41] ACCC Final Determination, paragraphs 4.78 – 4.80

[42] Port of Newcastle submission, 7 April 2020, paragraph 21.

[43] Submission of Port Authority of New South Wales to the ACCC, 25 February, 2021, Section 4. See also ACCC, Final Determination, paragraph 3.4.

[44] ACCC, Final Determination, paragraph 4.87

98. In summary, in my opinion there is little, if any, public detriment likely to result from collective negotiation of the matters referred to in paragraph 88 above compared to the outcome from bilateral negotiations.



22 April 2021

Attachment 1

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October 2020

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Education

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MA, Economics, University of Melbourne, 1969

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Academic Positions

Senior Fellow, Law, University of Melbourne 2016 –

Senior Lecturer, Economics Department, University of Melbourne, 1981 –

Lecturer, Economics Department, University of Southampton, 1970 – 1972

Senior Tutor, Economics Department, University of Melbourne, 1968 – 1969

Tutor, Economics Department, University of Melbourne, 1967

Visiting lecturer, Law, Australian National University, periodic

Rhonda Smith is a Senior Lecturer in the Economics Department at the University of Melbourne (fractional 0.5) and a Senior Fellow in the Law School (0.3) at the University of Melbourne. She teaches undergraduate and postgraduate courses including Economics of the Law and Foundations: Competition Law & Economics, and Unilateral Conduct (the last two are subjects in the Global Competition Law Masters); she has provided guest lectures in the Law Masers Consumer Law subject and to the Intellectual Property subject. In previous years she has also taught Economics for Public Policy, a Masters level subject.

From November 1995 to November 1998 Dr Smith was a Commissioner with the Australian Competition and Consumer Commission (ACCC). She was appointed an Associate Commissioner of the ACCC in June 1999 but resigned from the ACCC in December 1999 to return to academia.

During 2000 Dr Smith resumed consulting, mainly in relation to competition matters, both to regulatory bodies and to major businesses. She has appeared as an expert witness in a number of major competition law cases.

She has provided technical assistance on behalf of the Asian Development Bank in Papua New Guinea and in the Cook Islands.

She was appointed as the International Telecommunications Arbitrator for PNG in October 2009 to 2014.

She was a member of the Federal Government's Copyright Law Reform Committee from 1995 to 1998. In April 2001 she was appointed a member of the Copyright Tribunal and this appointment remains current.

She was a member of the Advisory Board of the Intellectual Property Research Institute of Australia (IPRIA) and a research fellow with IPRIA.

She was a lay member of the High Court of New Zealand and a member of the Commonwealth Government's Commonwealth Consumer Affairs Advisory Committee. She was also a member of the Advisory Board of the Centre for Regulation and Market Analysis at UniSA.

Dr Smith is an associate editor of the Competition and Consumer Law Journal.

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Attachment 2

Our ref. 20206679

16 April 2021

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Confidential - Subject to legal professional privilege

Dear Dr Smith

Independent Expert Report – ACT 2 of 2020 – Letter of Instructions

1. We confirm your engagement in the above proceedings, which concern an application to the Australian Competition Tribunal (Tribunal) for review of the ACCC's determination to authorise collective bargaining conduct in relation to the terms of access to the Port of Newcastle (Port), to prepare an independent report identifying the economic principles which, in your opinion, will be relevant for the Tribunal to consider in this review.

2. The ACCC's determination dated 27 August 2020 authorised the NSW Mineral Council and other mining companies exporting goods, or requiring future access, through the Port (collectively, the Applicants) to engage in the following conduct, which is described in this letter as the **Proposed Collective Bargaining Conduct**:

   a. collectively discuss and negotiate the terms and conditions of access, including price, to the Port for the export of coal (and any other minerals) through the Port

   b. discuss amongst themselves matters relating to the above discussions and negotiations and

   c. enter into and give effect to contracts, arrangements or understandings with PNO [Port of Newcastle Operations Pty Ltd] containing common terms which relate to access to the Port and the export of minerals through the Port.

3. The Proposed Collective Bargaining Conduct is voluntary (for the Applicants and PNO), and does not include:

   a. boycott activity by the Applicants or

   b. the sharing of competitively sensitive information that relates to customers, marketing strategies, or volume / capacity projections for individual users.

4. Authorisation was granted for a period of 10 years.

5. The application before the Tribunal, brought by PNO, challenges the ACCC's determination.

Materials

6. You have been provided with:

   a. the ACCC's determination dated 27 August 2020

   b. all the material filed by the ACCC with the Tribunal, which comprises the material relied on by the ACCC in its decision-making process, including the application for authorisation lodged on 6 March 2020

   c. PNO's application to the Tribunal for review filed on 17 September 2020

   d. the Statements of Facts, Issues and Contentions filed by the parties, including the ACCC and

   e. the written submission made by the Port Authority of NSW.

7. We may provide you with additional material in the course of your engagement.

Instructions

8. You are instructed to prepare a report in response to the following questions below. In the first instance, we ask that you prepare the report in draft for the ACCC to consider from the perspective of how it can best assist the Tribunal in its decision making process.

1. Which market(s) are relevant to a consideration of the authorisation application?
2. What economic principles, if any, are relevant in identifying public benefits? When is a benefit "private" rather than "public", and when is a benefit both private and public?
3. What economic principles apply in relation to collective bargaining conduct? Applying those principles, what are the public benefits and public detriments, if any, that would result or be likely to result from collective bargaining conduct?
4. Applying the principles discussed in Questions 2 and 3, what are the public benefits, if any, that would result or be likely to result from the Proposed Collective Bargaining Conduct, and what is their magnitude?
5. PNO contends that the Proposed Collective Bargaining Conduct is a form of cartel conduct that is presumptively harmful (and therefore requires a substantial net public benefit before it is authorised). What is the likely harm from the Proposed Collective Bargaining Conduct?

Assumptions for report

9. Please make the following assumptions in preparing your report:

1. Assume that coal produced by coal producers in the Hunter Valley region is mostly exported

2. Assume that coal producers in the Hunter Valley region compete with numerous suppliers in other countries
3. Assume that coal producers in the Hunter Valley region are price takers in an international market for thermal coal
4. Assume that in the context of community debate as to the future of coal mining, the outlook for Australian coal exports is uncertain
5. Assume that PNO derives a very high percentage of its revenue from servicing coal producers in the Hunter Valley region in their coal exports
6. Assume that the Port of Newcastle is the nearest suitable port through which coal producers in the Hunter Valley region can export their coal
7. Assume that coal producers in the Hunter Valley region have access to and use an established logistics system to move coal from their mines to the Port of Newcastle
8. Assume that such a logistics system would not be available to serve an alternative port and would not be developed by coal producers in the Hunter Valley region in response to a 5% SSNIP in the cost of port services
9. Assume that most of the coal produced in the Hunter Valley region is thermal coal and that this is used mainly for electricity generation
10. Assume that metallurgical coal is used in steel-making
11. Assume that metallurgical coal is not a close substitute for thermal coal
12. Assume that Australian thermal coal is sold to countries such as Japan, China, South Korea and Taiwan
13. [**CONFIDENTIAL**] [redacted]
14. Assume that the vessel agents pay the navigation charges when a ship comes into the Port of Newcastle, but that the coal producers pay the wharfage fee
15. Assume that some coal produced in the Hunter Valley region is sold domestically, that is, within the region
16. Assume it is unlikely that local coal users would source coal from outside of the region in response to a small but significant non-transitory increase in the price of locally supplied coal

Practice Note

10. Please read the Expert Evidence Practice Note GPN EXPT of the Federal Court of Australia, a copy of which is **attached** to this letter.

11. Once we have had an opportunity to consider your draft report, we will arrange a conference with you.

12. Please do not hesitate to contact us if you have any queries.

Yours sincerely

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FEDERAL COURT OF AUSTRALIA

EXPERT EVIDENCE PRACTICE NOTE (GPN-EXPT)

General Practice Note

1. INTRODUCTION

1.1 This practice note, including the *Harmonised Expert Witness Code of Conduct* ("**Code**") (see **Annexure A**) and the *Concurrent Expert Evidence Guidelines* ("**Concurrent Evidence Guidelines**") (see **Annexure B**), applies to any proceeding involving the use of expert evidence and must be read together with:

(a) the Central Practice Note (CPN-1), which sets out the fundamental principles concerning the National Court Framework ("**NCF**") of the Federal Court and key principles of case management procedure;

(b) the Federal Court of Australia Act 1976 (Cth) ("**Federal Court Act**");

(c) the *Evidence Act 1995* (Cth) ("**Evidence Act**"), including Part 3.3 of the Evidence Act;

(d) Part 23 of the *Federal Court Rules 2011* (Cth) ("**Federal Court Rules**"); and

(e) where applicable, the Survey Evidence Practice Note (GPN-SURV).

1.2 This practice note takes effect from the date it is issued and, to the extent practicable, applies to proceedings whether filed before, or after, the date of issuing.

2. APPROACH TO EXPERT EVIDENCE

2.1 An expert witness may be retained to give opinion evidence in the proceeding, or, in certain circumstances, to express an opinion that may be relied upon in alternative dispute resolution procedures such as mediation or a conference of experts. In some circumstances an expert may be appointed as an independent adviser to the Court.

2.2 The purpose of the use of expert evidence in proceedings, often in relation to complex subject matter, is for the Court to receive the benefit of the objective and impartial assessment of an issue from a witness with specialised knowledge (based on training, study or experience - see generally s 79 of the Evidence Act).

2.3 However, the use or admissibility of expert evidence remains subject to the overriding requirements that:

(a) to be admissible in a proceeding, any such evidence must be relevant (s 56 of the Evidence Act); and

(b) even if relevant, any such evidence, may be refused to be admitted by the Court if its probative value is outweighed by other considerations such as the evidence

being unfairly prejudicial, misleading or will result in an undue waste of time (s 135 of the Evidence Act).

2.4 An expert witness' opinion evidence may have little or no value unless the assumptions adopted by the expert (ie. the facts or grounds relied upon) and his or her reasoning are expressly stated in any written report or oral evidence given.

2.5 The Court will ensure that, in the interests of justice, parties are given a reasonable opportunity to adduce and test relevant expert opinion evidence. However, the Court expects parties and any legal representatives acting on their behalf, when dealing with expert witnesses and expert evidence, to at all times comply with their duties associated with the overarching purpose in the Federal Court Act (see ss 37M and 37N).

3. INTERACTION WITH EXPERT WITNESSES

3.1 Parties and their legal representatives should never view an expert witness retained (or partly retained) by them as that party's advocate or "hired gun". Equally, they should never attempt to pressure or influence an expert into conforming his or her views with the party's interests.

3.2 A party or legal representative should be cautious not to have inappropriate communications when retaining or instructing an independent expert, or assisting an independent expert in the preparation of his or her evidence. However, it is important to note that there is no principle of law or practice and there is nothing in this practice note that obliges a party to embark on the costly task of engaging a "consulting expert" in order to avoid "contamination" of the expert who will give evidence. Indeed the Court would generally discourage such costly duplication.

3.3 Any witness retained by a party for the purpose of preparing a report or giving evidence in a proceeding as to an opinion held by the witness that is wholly or substantially based in the specialised knowledge of the witness[1] should, at the earliest opportunity, be provided with:

(a) a copy of this practice note, including the Code (see Annexure A); and

(b) all relevant information (whether helpful or harmful to that party's case) so as to enable the expert to prepare a report of a truly independent nature.

3.4 Any questions or assumptions provided to an expert should be provided in an unbiased manner and in such a way that the expert is not confined to addressing selective, irrelevant or immaterial issues.

[1] Such a witness includes a "Court expert" as defined in r 23.01 of the Federal Court Rules. For the definition of "expert", "expert evidence" and "expert report" see the Dictionary, in Schedule 1 of the Federal Court Rules.

4. ROLE AND DUTIES OF THE EXPERT WITNESS

4.1 The role of the expert witness is to provide relevant and impartial evidence in his or her area of expertise. An expert should never mislead the Court or become an advocate for the cause of the party that has retained the expert.

4.2 It should be emphasised that there is nothing inherently wrong with experts disagreeing or failing to reach the same conclusion. The Court will, with the assistance of the evidence of the experts, reach its own conclusion.

4.3 However, experts should willingly be prepared to change their opinion or make concessions when it is necessary or appropriate to do so, even if doing so would be contrary to any previously held or expressed view of that expert.

Harmonised Expert Witness Code of Conduct

4.4 Every expert witness giving evidence in this Court must read the *Harmonised Expert Witness Code of Conduct* (attached in Annexure A) and agree to be bound by it.

4.5 The Code is not intended to address all aspects of an expert witness' duties, but is intended to facilitate the admission of opinion evidence, and to assist experts to understand in general terms what the Court expects of them. Additionally, it is expected that compliance with the Code will assist individual expert witnesses to avoid criticism (rightly or wrongly) that they lack objectivity or are partisan.

5. CONTENTS OF AN EXPERT'S REPORT AND RELATED MATERIAL

5.1 The contents of an expert's report must conform with the requirements set out in the Code (including clauses 3 to 5 of the Code).

5.2 In addition, the contents of such a report must also comply with r 23.13 of the Federal Court Rules. Given that the requirements of that rule significantly overlap with the requirements in the Code, an expert, unless otherwise directed by the Court, will be taken to have complied with the requirements of r 23.13 if that expert has complied with the requirements in the Code and has complied with the additional following requirements. The expert shall:

(a) acknowledge in the report that:

(i) the expert has read and complied with this practice note and agrees to be bound by it; and

(ii) the expert's opinions are based wholly or substantially on specialised knowledge arising from the expert's training, study or experience;

(b) identify in the report the questions that the expert was asked to address;

(c) sign the report and attach or exhibit to it copies of:

(i) documents that record any instructions given to the expert; and

(ii) documents and other materials that the expert has been instructed to consider.

5.3 Where an expert's report refers to photographs, plans, calculations, analyses, measurements, survey reports or other extrinsic matter, these must be provided to the other parties at the same time as the expert's report.

6. CASE MANAGEMENT CONSIDERATIONS

6.1 Parties intending to rely on expert evidence at trial are expected to consider between them and inform the Court at the earliest opportunity of their views on the following:

(a) whether a party should adduce evidence from more than one expert in any single discipline;

(b) whether a common expert is appropriate for all or any part of the evidence;

(c) the nature and extent of expert reports, including any in reply;

(d) the identity of each expert witness that a party intends to call, their area(s) of expertise and availability during the proposed hearing;

(e) the issues that it is proposed each expert will address;

(f) the arrangements for a conference of experts to prepare a joint-report (see Part 7 of this practice note);

(g) whether the evidence is to be given concurrently and, if so, how (see Part 8 of this practice note); and

(h) whether any of the evidence in chief can be given orally.

6.2 It will often be desirable, before any expert is retained, for the parties to attempt to agree on the question or questions proposed to be the subject of expert evidence as well as the relevant facts and assumptions. The Court may make orders to that effect where it considers it appropriate to do so.

7. CONFERENCE OF EXPERTS AND JOINT-REPORT

7.1 Parties, their legal representatives and experts should be familiar with aspects of the Code relating to conferences of experts and joint-reports (see clauses 6 and 7 of the Code attached in Annexure A).

7.2 In order to facilitate the proper understanding of issues arising in expert evidence and to manage expert evidence in accordance with the overarching purpose, the Court may require experts who are to give evidence or who have produced reports to meet for the purpose of identifying and addressing the issues not agreed between them with a view to reaching agreement where this is possible ("**conference of experts**"). In an appropriate case, the Court may appoint a registrar of the Court or some other suitably qualified person ("**Conference Facilitator**") to act as a facilitator at the conference of experts.

7.3 It is expected that where expert evidence may be relied on in any proceeding, at the earliest opportunity, parties will discuss and then inform the Court whether a conference of experts and/or a joint-report by the experts may be desirable to assist with or simplify the giving of expert evidence in the proceeding. The parties should discuss the necessary arrangements for any conference and/or joint-report. The arrangements discussed between the parties should address:

(a) who should prepare any joint-report;

(b) whether a list of issues is needed to assist the experts in the conference and, if so, whether the Court, the parties o r the experts should assist in preparing such a list;

(c) **t**he agenda for the conference of experts; and

(d) arrangements for the provision, to the parties and the Court, of any joint-report or any other report as to the outcomes of the conference ("**conference report**").

Conference of Experts

7.4 The purpose of the conference of experts is for the experts to have a comprehensive discussion of issues relating to their field of expertise, with a view to identifying matters and issues in a proceeding about which the experts agree, partly agree or disagree and why. For this reason the conference is attended only by the experts and any Conference Facilitator. Unless the Court orders otherwise, the parties' lawyers will not attend the conference but will be provided with a copy of any conference report.

7.5 The Court may order that a conference of experts occur in a variety of circumstances, depending on the views of the judge and the parties and the needs of the case, including:

(a) while a case is in mediation. When this occurs the Court may also order that the outcome of the conference or any document disclosing or summarising the experts' opinions be confidential to the parties while the mediation is occurring;

(b) before the experts have reached a final opinion on a relevant question or the facts involved in a case. When this occurs the Court may order that the parties exchange draft expert reports and that a conference report be prepared for the use of the experts in finalising their reports;

(c) after the experts' reports have been provided to the Court but before the hearing of the experts' evidence. When this occurs the Court may also order that a conference report be prepared (jointly or otherwise) to ensure the efficient hearing of the experts' evidence.

7.6 Subject to any other order or direction of the Court, the parties and their lawyers must not involve themselves in the conference of experts process. In particular, they must not seek to encourage an expert not to agree with another expert or otherwise seek to influence the outcome of the conference of experts. The experts should raise any queries they may have in relation to the process with the Conference Facilitator (if one has been appointed) or in

accordance with a protocol agreed between the lawyers prior to the conference of experts taking place (if no Conference Facilitator has been appointed).

7.7 Any list of issues prepared for the consideration of the experts as part of the conference of experts process should be prepared using non-tendentious language.

7.8 The timing and location of the conference of experts will be decided by the judge or a registrar who will take into account the location and availability of the experts and the Court's case management timetable. The conference may take place at the Court and will usually be conducted in-person. However, if not considered a hindrance to the process, the conference may also be conducted with the assistance of visual or audio technology (such as via the internet, video link and/or by telephone).

7.9 Experts should prepare for a conference of experts by ensuring that they are familiar with all of the material upon which they base their opinions. Where expert reports in draft or final form have been exchanged prior to the conference, experts should attend the conference familiar with the reports of the other experts. Prior to the conference, experts should also consider where they believe the differences of opinion lie between them and what processes and discussions may assist to identify and refine those areas of difference.

Joint-report

7.10 At the conclusion of the conference of experts, unless the Court considers it unnecessary to do so, it is expected that the experts will have narrowed the issues in respect of which they agree, partly agree or disagree in a joint-report. The joint-report should be clear, plain and concise and should summarise the views of the experts on the identified issues, including a succinct explanation for any differences of opinion, and otherwise be structured in the manner requested by the judge or registrar.

7.11 In some cases (and most particularly in some native title cases), depending on the nature, volume and complexity of the expert evidence a judge may direct a registrar to draft part, or all, of a conference report. If so, the registrar will usually provide the draft conference report to the relevant experts and seek their confirmation that the conference report accurately reflects the opinions of the experts expressed at the conference. Once that confirmation has been received the registrar will finalise the conference report and provide it to the intended recipient(s).

8. CONCURRENT EXPERT EVIDENCE

8.1 The Court may determine that it is appropriate, depending on the nature of the expert evidence and the proceeding generally, for experts to give some or all of their evidence concurrently at the final (or other) hearing.

8.2 Parties should familiarise themselves with the *Concurrent Expert Evidence Guidelines* (attached in Annexure B). The Concurrent Evidence Guidelines are not intended to be exhaustive but indicate the circumstances when the Court might consider it appropriate for

concurrent expert evidence to take place, outline how that process may be undertaken, and assist experts to understand in general terms what the Court expects of them.

8.3 If an order is made for concurrent expert evidence to be given at a hearing, any expert to give such evidence should be provided with the Concurrent Evidence Guidelines well in advance of the hearing and should be familiar with those guidelines before giving evidence.

9. FURTHER PRACTICE INFORMATION AND RESOURCES

9.1 Further information regarding Expert Evidence and Expert Witnesses is available on the Court's website.

9.2 Further information to assist litigants, including a range of helpful guides, is also available on the Court's website. This information may be particularly helpful for litigants who are representing themselves.

J L B ALLSOP
Chief Justice
25 October 2016

Annexure A

HARMONISED EXPERT WITNESS CODE OF CONDUCT[2]

APPLICATION OF CODE

1. This Code of Conduct applies to any expert witness engaged or appointed:

   (a) to provide an expert's report for use as evidence in proceedings or proposed proceedings; or

   (b) to give opinion evidence in proceedings or proposed proceedings.

GENERAL DUTIES TO THE COURT

2. An expert witness is not an advocate for a party and has a paramount duty, overriding any duty to the party to the proceedings or other person retaining the expert witness, to assist the Court impartially on matters relevant to the area of expertise of the witness.

CONTENT OF REPORT

3. Every report prepared by an expert witness for use in Court shall clearly state the opinion or opinions of the expert and shall state, specify or provide:

   (a) the name and address of the expert;

   (b) an acknowledgment that the expert has read this code and agrees to be bound by it;

   (c) the qualifications of the expert to prepare the report;

   (d) the assumptions and material facts on which each opinion expressed in the report is based [a letter of instructions may be annexed];

   (e) the reasons for and any literature or other materials utilised in support of such opinion;

   (f) (if applicable) that a particular question, issue or matter falls outside the expert's field of expertise;

   (g) any examinations, tests or other investigations on which the expert has relied, identifying the person who carried them out and that person's qualifications;

   (h) the extent to which any opinion which the expert has expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;

   (i) a declaration that the expert has made all the inquiries which the expert believes are desirable and appropriate (save for any matters identified explicitly in the report), and that no matters of significance which the expert regards as relevant have, to the

[2] Approved by the Council of Chief Justices' Rules Harmonisation Committee

knowledge of the expert, been withheld from the Court;

(j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;

(k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and

(l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

SUPPLEMENTARY REPORT FOLLOWING CHANGE OF OPINION

4. Where an expert witness has provided to a party (or that party's legal representative) a report for use in Court, and the expert thereafter changes his or her opinion on a material matter, the expert shall forthwith provide to the party (or that party's legal representative) a supplementary report which shall state, specify or provide the information referred to in paragraphs (a), (d), (e), (g), (h), (i), (j), (k) and (l) of clause 3 of this code and, if applicable, paragraph (f) of that clause.

5. In any subsequent report (whether prepared in accordance with clause 4 or not) the expert may refer to material contained in the earlier report without repeating it.

DUTY TO COMPLY WITH THE COURT'S DIRECTIONS

6. If directed to do so by the Court, an expert witness shall:

(a) confer with any other expert witness;

(b) provide the Court with a joint-report specifying (as the case requires) matters agreed and matters not agreed and the reasons for the experts not agreeing; and

(c) abide in a timely way by any direction of the Court.

CONFERENCE OF EXPERTS

7. Each expert witness shall:

(a) exercise his or her independent judgment in relation to every conference in which the expert participates pursuant to a direction of the Court and in relation to each report thereafter provided, and shall not act on any instruction or request to withhold or avoid agreement; and

(b) endeavour to reach agreement with the other expert witness (or witnesses) on any issue in dispute between them, or failing agreement, endeavour to identify and clarify the basis of disagreement on the issues which are in dispute.

ANNEXURE B

CONCURRENT EXPERT EVIDENCE GUIDELINES

APPLICATION OF THE COURT'S GUIDELINES

1. The Court's Concurrent Expert Evidence Guidelines ("**Concurrent Evidence Guidelines**") are intended to inform parties, practitioners and experts of the Court's general approach to concurrent expert evidence, the circumstances in which the Court might consider expert witnesses giving evidence concurrently and, if so, the procedures by which their evidence may be taken.

OBJECTIVES OF CONCURRENT EXPERT EVIDENCE TECHNIQUE

2. The use of concurrent evidence for the giving of expert evidence at hearings as a case management technique[3] will be utilised by the Court in appropriate circumstances (see r 23.15 of the *Federal Court Rules 2011* (Cth)). Not all cases will suit the process. For instance, in some patent cases, where the entire case revolves around conflicts within fields of expertise, concurrent evidence may not assist a judge. However, patent cases should not be excluded from concurrent expert evidence processes.

3. In many cases the use of concurrent expert evidence is a technique that can reduce the partisan or confrontational nature of conventional hearing processes and minimises the risk that experts become "opposing experts" rather than independent experts assisting the Court. It can elicit more precise and accurate expert evidence with greater input and assistance from the experts themselves.

4. When properly and flexibly applied, with efficiency and discipline during the hearing process, the technique may also allow the experts to more effectively focus on the critical points of disagreement between them, identify or resolve those issues more quickly, and narrow the issues in dispute. This can also allow for the key evidence to be given at the same time (rather than being spread across many days of hearing); permit the judge to assess an expert more readily, whilst allowing each party a genuine opportunity to put and test expert evidence. This can reduce the chance of the experts, lawyers and the judge misunderstanding the opinions being expressed by the experts.

5. It is essential that such a process has the full cooperation and support of all of the individuals involved, including the experts and counsel involved in the questioning process. Without that cooperation and support the process may fail in its objectives and even hinder the case management process.

[3] Also known as the "hot tub" or as "expert panels".

CASE MANAGEMENT

6. Parties should expect that, the Court will give careful consideration to whether concurrent evidence is appropriate in circumstances where there is more than one expert witness having the same expertise who is to give evidence on the same or related topics. Whether experts should give evidence concurrently is a matter for the Court, and will depend on the circumstances of each individual case, including the character of the proceeding, the nature of the expert evidence, and the views of the parties.

7. Although this consideration may take place at any time, including the commencement of the hearing, if not raised earlier, parties should raise the issue of concurrent evidence at the first appropriate case management hearing, and no later than any pre-trial case management hearing, so that orders can be made in advance, if necessary. To that end, prior to the hearing at which expert evidence may be given concurrently, parties and their lawyers should confer and give general consideration as to:

   (a) the agenda;

   (b) the order and manner in which questions will be asked; and

   (c) whether cross-examination will take place within the context of the concurrent evidence or after its conclusion.

8. At the same time, and before any hearing date is fixed, the identity of all experts proposed to be called and their areas of expertise is to be notified to the Court by all parties.

9. The lack of any concurrent evidence orders does not mean that the Court will not consider using concurrent evidence without prior notice to the parties, if appropriate.

CONFERENCE OF EXPERTS & JOINT-REPORT OR LIST OF ISSUES

10. The process of giving concurrent evidence at hearings may be assisted by the preparation of a joint-report or list of issues prepared as part of a conference of experts.

11. Parties should expect that, where concurrent evidence is appropriate, the Court may make orders requiring a conference of experts to take place or for documents such as a joint-report to be prepared to facilitate the concurrent expert evidence process at a hearing (see Part 7 of the Expert Evidence Practice Note).

PROCEDURE AT HEARING

12. Concurrent expert evidence may be taken at any convenient time during the hearing, although it will often occur at the conclusion of both parties' lay evidence.

13. At the hearing itself, the way in which concurrent expert evidence is taken must be applied flexibly and having regard to the characteristics of the case and the nature of the evidence to be given.

14. Without intending to be prescriptive of the procedure, parties should expect that, when evidence is given by experts in concurrent session:

(a) the judge will explain to the experts the procedure that will be followed and that the nature of the process may be different to their previous experiences of giving expert evidence;

(b) the experts will be grouped and called to give evidence together in their respective fields of expertise;

(c) the experts will take the oath or affirmation together, as appropriate;

(d) the experts will sit together with convenient access to their materials for their ease of reference, either in the witness box or in some other location in the courtroom, including (if necessary) at the bar table;

(e) each expert may be given the opportunity to provide a summary overview of their current opinions and explain what they consider to be the principal issues of disagreement between the experts, as they see them, in their own words;

(f) the judge will guide the process by which evidence is given, including, where appropriate:

(i) using any joint-report or list of issues as a guide for all the experts to be asked questions by the judge and counsel, about each issue on an issue-by-issue basis;

(ii) ensuring that each expert is given an adequate opportunity to deal with each issue and the exposition given by other experts including, where considered appropriate, each expert asking questions of other experts or supplementing the evidence given by other experts;

(iii) inviting legal representatives to identify the topics upon which they will cross-examine;

(iv) ensuring that legal representatives have an adequate opportunity to ask all experts questions about each issue. Legal representatives may also seek responses or contributions from one or more experts in response to the evidence given by a different expert; and

(v) allowing the experts an opportunity to summarise their views at the end of the process where opinions may have been changed or clarifications are needed.

15. The fact that the experts may have been provided with a list of issues for consideration does not confine the scope of any cross-examination of any expert. The process of cross-examination remains subject to the overall control of the judge.

16. The concurrent session should allow for a sensible and orderly series of exchanges between expert and expert, and between expert and lawyer. Where appropriate, the judge may allow for more traditional cross-examination to be pursued by a legal representative on a particular issue exclusively with one expert. Where that occurs, other experts may be asked to comment on the evidence given.

17. Where any issue involves only one expert, the party wishing to ask questions about that issue should let the judge know in advance so that consideration can be given to whether

arrangements should be made for that issue to be dealt with after the completion of the concurrent session. Otherwise, as far as practicable, questions (including in the form of cross-examination) will usually be dealt with in the concurrent session.

18. Throughout the concurrent evidence process the judge will ensure that the process is fair and effective (for the parties and the experts), balanced (including not permitting one expert to overwhelm or overshadow any other expert), and does not become a protracted or inefficient process.

Attachment 3

Documents and other materials briefed to Dr Smith

Document Title	Date	Confidential
ACCC Determination		
ACCC Determination of Application for authorisation AA1000473 lodged by NSW Minerals Council and mining companies	27 August 2020	No
Submissions to the ACCC		
NSW Minerals Council Application for Authorisation and submission (including Confidential Annexure 5)	5 March 2020	Part Confidential
Port Waratah Coal Services (**PWCS**) submission on Interim authorisation application	18 March 2020	No
Yancoal Australia Ltd submission on Interim authorisation application	18 March 2020	No
Port of Newcastle Operations Pty Ltd (**PNO**) submission on Interim authorisation application	18 March 2020	Part Confidential
Whitehaven Coal Record of oral submission on Interim authorisation application	18 March 2020	No
NSW Minerals Council response to PNO submission on Interim authorisation application	25 March 2020	No
Hunter Valley Coal Chain Coordinator submission on authorisation application	3 April 2020	No
PWCS submission on authorisation application	3 April 2020	No
Yancoal Australia Ltd submission on authorisation application	3 April 2020	No
PNO submission on authorisation application	7 April 2020	No
Port Authority of NSW submission on authorisation application	16 April 2020	No
NSW Minerals Council response to interested parties submissions on authorisation application	30 April 2020	No
NSW Minerals Council response to ACCC request for information	15 May 2020	No
PWCS submission on draft authorisation determination	10 July 2020	No
PNO submission on draft authorisation determination	10 July 2020	Part Confidential
NSW Minerals Council response to PNO submission on draft authorisation determination	17 August 2020 (received 18 August 2020)	Part Confidential
Documents before the Tribunal		
Application by PNO (confidential version)	17 September 2020	Part Confidential
Tribunal Directions	25 November 2020	No

Tribunal Memorandum	30 November 2020	No
PNO's SOFIC (confidential version)	14 December 2020	Part confidential
NSWMC's SOFIC	28 January 2021	No
ACCC's SOFIC (confidential version)	8 February 2021	Part confidential
ACCC's Issues List	8 February 2021	No
Port Authority of NSW Submission	25 February 2021	No
Port Services Agreement – Confidential Attachment 1 to Port Authority of NSW Submission	17 December 2013	Yes
Harbour Management System Access Agreement – Confidential Attachment 2 to Port Authority of NSW Submission	17 December 2013	Yes
Tribunal Directions	9 March 2021	No
Affidavit of Simon Byrnes (confidential version)	15 March 2021	Yes
Affidavit of Bruce Lloyd	15 March 2021	No
Affidavit of Gabriella Sainsbury (confidential version)	15 March 2021	Yes
Tribunal Directions	12 April 2021	No
Other Documents		
Producer Pro Forma Long Term Pricing Deed	Undated	No
Vessel Agent Pro Forma Long Term Pricing Deed	Undated	No
Qantas Airways Limited [2004] ACompT 9	16 May 2005	No
Application by Tabcorp Holdings Limited [2017] ACompT 1	22 June 2017	No
ACCC Table of Producer-specific fees and charges	24 March 2021	No
ACCC Revised Table of Producer-specific fees and charges	1 April 2021	No

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[ ] 2020

PRODUCER PRO FORMA LONG TERM PRICING DEED

This document is not binding on PON or the relevant Producer unless and until PON and the Producer have each agreed, executed and delivered the final form of the deed

[Name]
[Address]
Email:[ ]

Long term pricing arrangements: NSC and Wharfage

This document (executed as a deed) sets out the following long term charges agreed between PON and [Producer name] which will apply during the Initial Term with respect to Producer Coal loaded onto Covered Vessels:

- navigation service charge to be imposed by PON under Division 2 of Part 5 of the PAMA Act; and
- wharfage charge to be imposed by PON under Division 5 of Part 5 of the PAMA Act.

The agreed special pricing arrangements are set out in more detail in the **Annexure** to this deed. This deed constitutes an agreement under s 67 of the PAMA Act.

For the avoidance of any doubt, nothing in this deed renders [Producer name] liable to pay any PAMA Act charges to PON where [Producer name] is not the party liable to pay that charge under the PAMA Act.

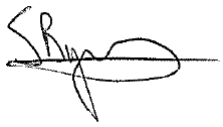
Please confirm [Producer name] agreement to these special arrangements by executing and returning to me a copy of this deed.

Following our receipt of your executed version of this deed, PON will implement those arrangements effective from the Commencement Date as set out in the Annexure.

This deed does not apply with respect to nor affect any provision of the terms and conditions of the supply of services at the Port, whether with respect to Covered Vessels, Producer Coal or otherwise other than the navigation service charge and wharfage charge applicable to Producer Coal in accordance with its terms.

Yours sincerely

Simon Byrnes
Chief Commercial Officer



Executed as a deed

Signed, sealed and delivered for and on behalf of **Port of Newcastle Operations Pty Limited (ACN 165 332 990) as trustee for the Port of Newcastle Unit Trust ABN (97 539 122 070)** by its attorneys under a power of attorney dated 11 February 2015 in the presence of:

Signature of witness	Signature of attorney who declares that the attorney has not received any notice of the revocation of the power of attorney
Full name of witness	Full name of attorney
Signature of witness	Signature of attorney who declares that the attorney has not received any notice of the revocation of the power of attorney
Full name of witness	Full name of attorney

Executed by [insert name and ABN of Producer entity] in accordance with section 127 of the Corporations Act 2001 (Cth):

Signature of director	Signature of company secretary/director
Full name of director	Full name of company secretary/director

Annexure

Item	Matter	Provision
1.	**Parties**	Port of Newcastle Operations Pty Limited (ACN 165 332 990) as trustee for the Port of Newcastle Unit Trust (ABN 97 539 122 070) trading as Port of Newcastle (**PON**). The entity named in Paragraph 1 of Schedule 1 (**Producer**).
2.	**Initial Term**	The Producer Specific Charges will commence on the Commencement Date and continue for 10 years (unless terminated earlier under Item 13) (**Initial Term**).
3.	**Extension of Initial Term**	Not later than 36 months prior to the expiry of the Initial Term, PON or the Producer may issue written notice to the other requesting that the parties enter into discussions with respect to agreeing any special pricing arrangements to apply following the expiry of the Initial Term (**Extension Notice**). Following the issue of an Extension Notice, PON and the Producer will promptly commence discussions regarding any special pricing arrangements to apply following the expiry of the Initial Term and will continue such discussions in good faith for a period of up to 6 months (or such other period as the parties agree in writing).
4.	**Producer Specific Charges**	Schedule 2 sets out the Producer Specific Charges agreed by PON and the Producer to apply during the Initial Term in respect of: (a) the Navigation Service Charge for Covered Vessels; and (b) the Wharfage Charge in respect of Producer Coal loaded onto a Covered Vessel. For the avoidance of doubt, the Producer Specific Charges: (c) are in addition to any other fees or charges payable to PON in respect of a Covered Vessel's visit to the Port pursuant PON's published standard terms and conditions and fees and charges for Port services; and (d) apply in substitution (only) for the Navigation Service Charge and the Wharfage Charge which would otherwise be payable in respect of the Covered Vessel and Producer Coal loaded onto the Covered Vessel under PON's published standard fees and charges for Port services.
5.	**Non-discriminatory pricing**	PON represents that: (a) the terms of Item 4 and Item 7 do not adversely discriminate against the Producer by comparison with Producer Specific Charges applicable to like circumstances to other Producers who have entered into materially similar deeds including as to the period of the Initial Term; (b) PON will not: (i) enter into bilateral arrangements with any other coal producer concerning Producer Specific Charges to apply over the Initial Term, or

Item	Matter	Provision
		(ii) give effect to any variations made to such charges under Item 7, which are materially dissimilar to the relevant provisions of, or different to any such variations under, this deed.
6.	**Provision of vessel and cargo information to PON**	The Producer must promptly provide to PON such information as PON may reasonably require from time to time to verify that a vessel is a Covered Vessel for the purposes of receiving the benefit of Producer Specific Charges. Without limitation, the Producer must ensure that the following information is provided to PON for each Covered Vessel within the timeframes specified below: (a) at least 14 days prior to the Covered Vessel entering the Port Channel, the vessel and cargo details prescribed by PON that are provided to the relevant coal terminal as part of the nomination process; and (b) at least 24 hours before the Covered Vessel enters the Port Channel, the following information: (i) the name of the Covered Vessel; (ii) the Covered Vessel's International Maritime Organization (IMO) Number; (iii) name and contact details of the Covered Vessel's agent; (iv) proposed berth; (v) coal destination port and country; (vi) contracted tonnes to be loaded; (vii) the mine(s) the coal has been mined from and the owner of each identified mine; (viii) the name and contact details of the Covered Vessel owner; and (ix) the operator of the Covered Vessel (if different from Covered Vessel's owner); and (c) within 24 hours of the Covered Vessel's departure from the Port Channel: (i) the Vessel Manifest; (ii) Draft Survey Report; (iii) Mates Receipt; and (iv) vessel demurrage hours and costs incurred by vessel charterer (in $US) and the nominated cause of the demurrage. If the Vessel Owner fails to provide such information to PON within the time periods specified above, PON may, if it is not

Item	Matter	Provision
		reasonably satisfied that the vessel is a Covered Vessel, decline to apply the Producer Specific Charges to that vessel and PON's published standard charges will apply to that vessel and such amount is a debt due and payable by the Vessel Owner in accordance with PON's published standard terms and conditions for vessels using the Port.
7.	**Variations to Producer Specific Charges**	The Producer Specific Charges will not be varied by PON during the Initial Term, except for the following variations which will occur at the beginning of each Contract Year (other than the beginning of the first Contract Year) (each an **Adjustment Date**): (a) **Annual Adjustment** Each Producer Specific Charge will be adjusted to the amount which is the greater of **Amount A** and **Amount B,** where: $$\text{Amount A} = C_1 + (C_1 \text{ x } 4\%)$$ $$\text{Amount B} = \left\{C_1 \text{ x } \frac{\text{Current CPI}}{\text{Previous CPI}}\right\}$$ Where: C_1 is the amount of the relevant Producer Specific Charge (excluding GST) immediately before the Adjustment Date **CPI** means the consumer price index number published by the Australian Statistician for Australia-All Groups **Current CPI** means the CPI for the quarter ending 30 September in the calendar year immediately preceding the Adjustment Date (**Current Contract Year**) **Previous CPI** means the CPI for the quarter ending 30 September in the calendar year immediately before the Current Contract Year (b) **Other variations** PON may increase the Producer Specific Charges in addition to the basis set out in Item 7(a) where each of the following requirements is met: (i) where any such increase is Material; and (ii) the increased Producer Specific Charges are consistent with the Pricing Principles. (c) **Capex transparency** (i) Without affecting PON's rights under paragraph 7(b), in order to provide the Producer with visibility of and the opportunity to comment on any prospective increases in the Producer Specific Charges on account of capital expenditure proposed to be incurred by PON, not later than 31

Item	Matter	Provision
		March 2020 PON will prepare and provide to the Producer a forward looking 5 year forecast (covering the period 1 January 2020 to 31 December 2024) of its projected capital expenditure that may impact the Producer Specific Charges and meet with the Producer to discuss those forecasts and any potential associated variations to the Producer Specific Charges. PON will update this 5 Year CAPEX Forecast annually on a rolling 5 year basis by no later than 31 March each following Contract Year and will meet with the Producer to discuss each such updated 5 Year CAPEX Forecast. For the avoidance of doubt, PON may, but is not obliged to, implement any comments made by the Producer on its 5 Year CAPEX Forecasts or any proposed increase to the Producer Specific Charges. (ii) The operation of Item 8 and Item 9 of this Deed with respect to resolving a Dispute following a Price Variation Objection Notice concerning a Notified Price Change are unaffected by the terms of, and any communications which may occur between the parties pursuant to, this Item 7(c).
8.	**Notice of proposed variations to Producer Specific Charges**	PON must provide the Producer with written notice of any proposed variations to the Producer Specific Charges pursuant to Item 7 not later than 45 days before the proposed date for commencement of the proposed variation (**Notified Price Change**). If a Notified Price Change includes any proposed variations to the Producer Specific Charges on account of PON applying paragraph (b) of Item 7, PON will issue with the Notified Price Change a copy of a report prepared by an independent appropriately qualified professional which sets out the opinion of that person, and the material facts (including all relevant cost, capital expenditure and revenue data) on which that opinion was based, as to whether those proposed variations to the Producer Specific Charges meet the requirements of Item 7 and are consistent with the Pricing Principles. If the Producer objects to any Notified Price Change, the Producer must issue a price objection notice to PON within 14 days of receipt of the Notified Price Change (**Price Variation Objection Notice**) in which event Item 9 will apply to resolve the Dispute. All variations the subject of a Notified Price Change will take effect on and from the date notified by PON (provided that the parties will retrospectively make such adjustments as may be necessary to take account of the resolution of any dispute notified by the Producer in any Price Variation Objection Notice).
9.	**Disputes in regard to Price Variation Objection Notice and other Disputes**	Where PON receives a Price Variation Objection Notice in accordance with Item 8, the Dispute is to be resolved pursuant to the Dispute Resolution Process. The Dispute Resolution Process will also apply in respect of all other Disputes.

Item	Matter	Provision
10.	**Consultation in relation to efficiency improvements and other matters**	PON and the Producer will meet at least twice in each Contract Year (or at such other frequency as PON and the Producer may agree from time to time) to consult on the following matters: (a) measures that can be introduced to improve the efficiency of delivery of any Vessel Services to Covered Vessels; (b) PON's delivery of Vessel Services, including (as they relate to the delivery of the Vessel Services): (i) PON's capital expenditure; (ii) any proposed variation to PON's fees and charges; (iii) PON's costs of operations; (iv) the Producer's future needs, including the Producer's estimates of Producer Coal to be shipped from the Port in the next 6 month period; (v) the application of these special pricing arrangements; and (vi) any other matters agreed between PON and the Producer (each acting reasonably); and (c) respective market insights of the parties, including volume forecasts and shipment destinations.
11.	**GST**	Unless expressly stated otherwise, all amounts specified in this deed are exclusive of GST and any GST payable must be paid in accordance with PON's standard terms. Words and expressions used in this Item 11 which have a defined meaning in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**) have the same meaning in this Item as in the GST Act.
12.	**Assignment**	Neither party may assign or novate its rights and obligations under this deed to any person without the prior written consent of the other party in its absolute discretion.
13.	**Termination**	**Termination by PON** If the Producer is in default of this deed and the default is not remedied within a period of 21 days from the date PON provides notice of the breach to the Producer, PON may terminate this deed by written notice to the Producer. For the avoidance of any doubt, PON acknowledges and agrees that the Producer is not liable to PON for any failure by the relevant Vessel Owner of a Covered Vessel to pay the Navigation Service Charge component of the Producer Specific Charges to PON in respect of the Covered Vessel or for any other liability of the Vessel Owner to PON (except where the Producer is the Vessel Owner for the Covered Vessel), provided always that PON will not be required to continue to afford that Vessel Owner the benefit of the Producer Specific Charges in respect of Covered Vessels if the Vessel Owner fails to pay an amount to PON as and when due and the default is not remedied within a period of 14 days of PON issuing the Vessel Owner with notice of the default. **Termination by the Producer**

Item	Matter	Provision
		If PON is in default of this deed and the default is not remedied within a period of 21 days from the date the Producer provides notice of the breach to PON, the Producer may terminate this deed by written notice to PON.
14.	**Trustee limitations**	PON is the trustee for the Port of Newcastle Unit Trust (in this Item 14, the **Trustee**) and is a party to this deed only in its capacity as trustee for the Port of Newcastle Unit Trust (in this Item 14, the **Trust**). (a) A Liability arising under this deed is limited to and can be enforced against the Trustee only to the extent to which it can be satisfied out of the property of the Trust out of which the Trustee is actually indemnified for the Liability. (b) No person will be entitled to: (i) Claim from or commence proceedings against the Trustee in respect of any Liability under this deed in any capacity other than as trustee for the Trust; (ii) seek the appointment of a receiver, receiver and manager, liquidator, an administrator or any similar office-holder to any property of the Trustee, or prove in any liquidation, administration or arrangement of or affecting the Trustee, except in relation to the property of the Trust; or (iii) enforce or seek to enforce any judgment in respect of a Liability under this deed against the Trustee in any capacity other than as trustee of the Trust. (c) The limitations of Liability and restrictions in this Item 14 will not apply in respect of any obligation or Liability of the Trustee to the extent that it is not satisfied because under the agreement governing the Trust or by operation of law there is a reduction in the extent of the indemnification of the Trustee out of the assets of the Trust as a result of fraud, negligence or breach of trust of the Trustee or the Trustee waiving or agreeing to amend the rights of indemnification it would otherwise have out of the assets of the Trust. (d) The limitation of liability in this Item 14 applies despite any other provision of this deed. (e) In this Item 14: (i) **Claim** includes a claim, cause of action, notice, demand, action, proceeding, litigation, investigation, judgement, damage, loss, cost, expense or liability however arising, whether present, unascertained, immediate, future or contingent, whether based in contract, tort (including negligence), statute or otherwise and whether involving a third party or a party to this deed; and

Item	Matter	Provision
		(ii) **Liability** includes all liabilities, losses, damages, costs, charges and expenses however arising, whether present, unascertained, immediate, future or contingent, whether based in contract, tort (including negligence), statute or otherwise including where arising under any Claim.
15.	**Variation**	This deed may only be varied by a document signed by or on behalf of PON and the Producer.
16.	**Confidentiality**	(a) (**Confidentiality**) The existence of and the terms of this deed, and any information disclosed to a party pursuant to this deed, is confidential (**Confidential Information**). (b) (**Keep confidential**) Subject to Item 16(c), each party must keep the Confidential Information confidential and not themselves nor through their servants, agents or employees directly or indirectly disclose Confidential Information to another person. (c) (**Exceptions**) A party may disclose Confidential Information: (i) to a professional adviser, financial adviser, banker, financier or auditor if that other person is obliged to keep the information confidential; (ii) to comply with any applicable law, or any requirement of any regulatory body (including any relevant stock exchange); (iii) to any of its employees on a confidential basis to whom it is necessary to disclose the information; (iv) to obtain the consent of any third party to any term of, or to any act pursuant to, this deed; (v) to enforce its rights or to defend any claim or action under this deed; (vi) to a related body corporate on a confidential basis; or (vii) if the information has come into the public domain through no fault of that party.
17.	**Definitions**	In this deed, defined terms have the meaning given in this Annexure and Schedule 4.

Schedule 1 - Reference Schedule

Paragraph	Reference	Details
1.	**Producer**	[insert name and ABN of Producer entity]
2.	**Commencement Date**	1 January 2020.

Schedule 2 - Producer Specific Charges

1. ***Navigation Service Charge***

   $0.8121 (exclusive of GST) per vessel gross tonne from the Commencement Date calculated by reference to the gross tonnage of the relevant Covered Vessel, adjusted over the Initial Term pursuant to Item 7 of this deed.

2. ***Wharfage Charge***

   $0.0802 (exclusive of GST) from the Commencement Date per Revenue Tonne of Producer Coal loaded onto the relevant Covered Vessel, adjusted over the Initial Term pursuant to Item 7 of this deed.

Illustrative example

By way of illustration with respect to the Navigation Service Charge and the Wharfage Charge only, and without limiting Item 7 of this deed, an example of the adjusted Navigation Service Charge (exclusive of GST) and adjusted Wharfage Charge each Contract Year during the Initial Term applying the Annual Adjustment under Item 7 if the increase in CPI for the relevant Contract Year is less than 4%, assuming no other adjustments apply under Item 7:

Scenario	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
CPI increase	**2.37%**	**2.37%**	**2.37%**	**2.37%**	**2.37%**	**2.39%**	**2.50%**	**2.50%**	**2.50%**	**2.50%**
NSC + 4% (A$)	0.8121	0.8446	0.8784	0.9135	0.9501	0.9881	1.0276	1.0687	1.1115	1.1559
Wharfage + 4% (A$)	0.0802	0.0834	0.0867	0.0902	0.0938	0.0976	0.1015	0.1056	0.1098	0.1142

Schedule 3 - Dispute Resolution Process

This Dispute Resolution Process forms part of and binds the parties to the Contract.

1. **Objective**

1.1 PON and the Producer are committed to the fair and final resolution of commercial disputes proactively and constructively without unnecessary delay or expense and, where possible, informally and quickly in a cost effective manner.

2. **Raising a Dispute**

2.1 Where:

(a) the Producer wishes to raise a Dispute with PON; or

(b) PON wishes to raise a Dispute with the Producer,

that party must do so within 21 days after the circumstance giving rise to that Dispute by providing a Dispute Notice to the other party for the purpose of endeavouring to resolve the Dispute.

2.2 The Dispute Notice must be in writing and include details of:

(a) the nature of the Dispute;

(b) the outcome sought by the party in relation to the Dispute; and

(c) the action on the part of the other party which the party believes will resolve the Dispute.

2.3 The parties agree and the Producer accepts that no Dispute may be raised by the Producer that is an Excluded Dispute.

3. **Resolving the Dispute**

3.1 Within 7 days of a party providing the other party with a Dispute Notice, senior representatives of each party must meet and undertake genuine and good faith negotiations with a view to resolving the Dispute expeditiously by joint discussion.

3.2 If the Dispute is not resolved in accordance with clause 3.1 within 14 days of a party providing the Dispute Notice to the other, then the Dispute shall be mediated in accordance with the ACICA Mediation Rules. The mediation shall take place in Sydney, Australia and be administered by ACICA.

3.3 If the Dispute has not been settled pursuant to the ACICA Mediation Rules within 28 days of a party providing the Dispute Notice to the other or within such other period as the parties may agree in writing, the Dispute shall be resolved by arbitration in accordance with the ACICA Arbitration Rules, and:

(a) the seat of arbitration shall be Sydney, Australia;

(b) the language of the arbitration shall be English;

(c) the number of arbitrators shall be one;

(d) the parties designate the laws applicable in the State of New South Wales as applicable to the substance of the Dispute.

4. **Matters to be taken into account in Permitted Price Disputes**

4.1 To the extent the Dispute to be resolved is a Permitted Price Dispute:

(a) a mediator in conducting a mediation must take into account; and

(b) an arbitrator in making any award must apply,

the Pricing Principles set out in clause 4.2.

Pricing Principles

4.2 The matters that must be taken into account by a mediator and applied by the arbitrator in resolving a Permitted Price Dispute are:

(a) the provisions in Item 7 of this deed (but only in relation to whether the requirements of Item 7(a) or 7(b)(i) are met (not in relation to the requirement in Item 7(b)(ii) that any proposed increase in Producer Specific Charges is consistent with the Pricing Principles, which will be measured solely by reference to the remaining principles below);

(b) PON's legitimate business interests and investment in the port or port facilities, including a reasonable opportunity to recover over the Leasehold Period the efficient cost of the service provided at the Port of Newcastle, which recovery shall include:

(i) the value of its Initial Capital Base and any updates thereof, including efficient additional capital investments;

(ii) a reasonable rate of return, commensurate with the commercial risks involved, on the value of all assets comprising its Initial Capital Base and any updates thereof, including efficient additional capital investments; and

(iii) the return over the Leasehold Period of the total value of the assets comprising its Initial Capital Base and any updates thereof, including efficient additional capital investments;

(c) the revenue expected to be derived from all users of the service;

(d) the costs to PON of providing the service (including the costs of any necessary modification to, or extension of, a port facility) but not costs associated with losses arising from increased competition in upstream or downstream markets;

(e) the economic value to PON of any additional investment that the Producer (or any other user of the service) or PON has agreed to undertake;

(f) the interests of all persons holding contracts for use of any relevant port facility or otherwise having rights to use the service;

(g) firm and binding contractual obligations of PON or other persons (or both) already using any relevant port facility;

(h) the operational and technical requirements necessary for the safe and reliable provision of the service;

(i) the economically efficient operation of any relevant port facility;

(j) the benefit to the public from having competitive markets;

(k) that prices should allow multi-part pricing and price discrimination when it aids efficiency;

(l) that prices should not allow a vertically integrated service provider to set terms and conditions that would discriminate in favour of either its upstream or downstream operations, except to the extent that the cost of providing services to others would be higher; and

(m) that prices should provide incentives to reduce costs or otherwise improve productivity.

5. **General**

5.1 The terms of this Dispute Resolution Process govern the resolution of all Disputes to the exclusion of other forms of dispute resolution unless agreed to by the parties. Neither the Producer, PON, nor any person acting on their behalf, may commence any court proceedings in relation to a Dispute, except where:

(a) an Insolvency Event affects, or is reasonably likely to affect imminently, either PON or the Producer, and the other party reasonably considers it necessary to commence court proceedings in relation to a Dispute to preserve its position with respect to creditors of the other party;

(b) PON or the Producer is seeking to enforce unpaid debts;

(c) PON or the Producer is seeking urgent interlocutory relief; or

(d) the relevant Dispute relates to a material failure by PON or the Producer to comply with this Dispute Resolution Process.

5.2 The parties agree that no appeal may be made to the Court on a question of law arising out of an award of the arbitrator appointed under this Dispute Resolution Process.

5.3 The particulars of the Dispute, any negotiation, mediation or arbitration and any terms of resolution including any Award must be kept strictly confidential by PON and the Producer.

6. **DEFINITIONS**

In this Dispute Resolution Process, capitalised terms have the meaning given in Schedule 4 of this deed and the following meanings will apply (unless the context otherwise indicates):

ACICA means the Australian Centre for International Commercial Arbitration.

Corporations Act means the *Corporations Act 2001* (Cth).

Dispute Notice means a notice given by a party of a Dispute under clause 2.1 in a form which complies with clause 2.2.

Excluded Dispute means a Dispute relating to:

(a) the amount of the Navigation Service Charge for Covered Vessels, where the amount of the Navigation Service Charge per gross tonne for Covered Vessels does not exceed $0.8121 (exclusive of GST) per vessel gross

tonne in 2020, and each subsequent Annual Adjustment in the amount of the Navigation Service Charge for Covered Vessels from 1 January 2020; and

(b) the amount of the Wharfage Charge in respect of Producer Coal loaded onto Covered Vessels, where the amount of that Wharfage Charge does not exceed $0.0802 (exclusive of GST) per revenue tonne in 2020, and each subsequent Annual Adjustment in the amount of that Wharfage Charge for Producer Coal loaded onto Covered Vessels.

Initial Capital Base means the value established by reference to the depreciated optimised replacement cost as at 31 December 2014 of the assets used in the provision of all of the services at the Port of Newcastle and, unless otherwise agreed by PON, without deduction for user contributions.

Insolvency Event means, in respect of a person:

(a) the person states that it is unable to pays its debts or becomes insolvent within the meaning of section 95A of the Corporations Act or insolvent under administration within the meaning of section 9 of the Corporations Act, or circumstances exist such that the court must presume insolvency under section 459C of the Corporations Act (regardless of whether or not an application has been made as referred to in that section);

(b) an application being made to a court for an order to appoint, or a step is taken to appoint, a controller, administrator, receiver, provisional liquidator, trustee for creditors in bankruptcy or analogous person to the person or any of the person's property or such an appointment being made;

(c) the person suspends payment of its debts or enters, or takes any step towards entering, a compromise or arrangement with, or assignment for the benefit of, any of its members or creditors;

(d) any event under any law which is analogous to, or which has a substantially similar effect to, any of the events referred to in paragraphs (a) to (c),

unless this takes place as part of a solvent reconstruction, amalgamation, merger or consolidation.

Leasehold Period means the term of the Port Lease which expires on 30 May 2112, at which time the land and improvements to the land on which the Port is situate will revert to the lessor for nil consideration.

Permitted Price Dispute means a Dispute which is not an Excluded Dispute and relates to:

(a) the amount of the Navigation Service Charge for Covered Vessels; and

(b) the amount of the Wharfage Charge in respect of Producer Coal loaded onto Covered Vessels .

Port Lease means the 98-year leasehold interest dated 30 May 2014 granted by Port of Newcastle Lessor Pty Limited to Port of Newcastle Investments (Property) Pty Limited in the land on which the Port is situate.

Schedule 4 Defined Terms

Annual Adjustment	each annual price adjustment of the Producer Specific Charges provided for in paragraph (a) of Item 7.
Commencement Date	the date specified in Paragraph 2 of Schedule 1.
Contract Year	each year in the Initial Term comprising 1 January to 31 December
Covered Vessel	a vessel that is loaded with and carries out of the Port: (a) Producer Coal and no other coal; or (b) Producer Coal and other coal in respect of which PON has agreed that the Navigation Service Charge and Wharfage Charge are the same for that other coal as the Producer Specific Charges, and no other coal.
Dispute	means any dispute, controversy or claim arising out of, relating to or in connection with this deed, including any question regarding its existence, validity or termination.
Dispute Resolution Process	the dispute resolution process set out in Schedule 3.
Initial Term	has the meaning given in Item 2.
Material	means an increase in the Producer Specific Charges of more than 5%.
Navigation Service Charge	a navigation service charge imposed by PON for standard vessel movements under Division 2 of Part 5 of the PAMA Act.
PAMA Act	*Ports and Maritime Administration Act 1995* (NSW).
Parties	the parties named in Item 1.
Port	the Port of Newcastle.
Pricing Principles	the principles set out in clause 4.2 of Schedule 3
Producer Coal	any coal to be loaded at the Port which has been mined from a Producer Mine.

Producer Mine	the following operating coal mines owned and operated by the Producer as at the Commencement Date: [insert mine details] and any further mines owned and operated by the Producer that become operational after the Commencement Date (as may be approved by PON from time to time acting reasonably in writing for the purposes of this definition).
Producer Specific Charges	the charges set out in Schedule 2, as varied pursuant to Item 7.
Revenue Tonne	a mass of 1,000 kilograms or a volume of 1 cubic metre or 1 kilolitre, whichever gives the largest number of units of quantity cargo.
Vessel Owner	an owner of the vessel concerned within the meaning of sections 48(1) to (5) of the PAMA Act.
Vessel Services	the provision of the right to access and use the shipping channels (including berths next to the wharves as part of the channels) at the Port, by virtue of which vessels may enter the Port precinct and load and unload coal at the relevant terminals located within the Port precinct and then depart the Port precinct.
Wharfage Charge	a wharfage charge imposed by PON for standard wharfage access under Division 5 of Part 5 of the PAMA Act.

FEDERAL COURT OF AUSTRALIA

EXPERT EVIDENCE PRACTICE NOTE (GPN-EXPT)

General Practice Note

1. INTRODUCTION

1.1 This practice note, including the *Harmonised Expert Witness Code of Conduct* ("**Code**") (see **Annexure A**) and the *Concurrent Expert Evidence Guidelines* ("**Concurrent Evidence Guidelines**") (see **Annexure B**), applies to any proceeding involving the use of expert evidence and must be read together with:

(a) the Central Practice Note (CPN-1), which sets out the fundamental principles concerning the National Court Framework ("**NCF**") of the Federal Court and key principles of case management procedure;

(b) the Federal Court of Australia Act 1976 (Cth) ("**Federal Court Act**");

(c) the *Evidence Act 1995* (Cth) ("**Evidence Act**"), including Part 3.3 of the Evidence Act;

(d) Part 23 of the *Federal Court Rules 2011* (Cth) ("**Federal Court Rules**"); and

(e) where applicable, the Survey Evidence Practice Note (GPN-SURV).

1.2 This practice note takes effect from the date it is issued and, to the extent practicable, applies to proceedings whether filed before, or after, the date of issuing.

2. APPROACH TO EXPERT EVIDENCE

2.1 An expert witness may be retained to give opinion evidence in the proceeding, or, in certain circumstances, to express an opinion that may be relied upon in alternative dispute resolution procedures such as mediation or a conference of experts. In some circumstances an expert may be appointed as an independent adviser to the Court.

2.2 The purpose of the use of expert evidence in proceedings, often in relation to complex subject matter, is for the Court to receive the benefit of the objective and impartial assessment of an issue from a witness with specialised knowledge (based on training, study or experience - see generally s 79 of the Evidence Act).

2.3 However, the use or admissibility of expert evidence remains subject to the overriding requirements that:

(a) to be admissible in a proceeding, any such evidence must be relevant (s 56 of the Evidence Act); and

(b) even if relevant, any such evidence, may be refused to be admitted by the Court if its probative value is outweighed by other considerations such as the evidence

being unfairly prejudicial, misleading or will result in an undue waste of time (s 135 of the Evidence Act).

2.4 An expert witness' opinion evidence may have little or no value unless the assumptions adopted by the expert (ie. the facts or grounds relied upon) and his or her reasoning are expressly stated in any written report or oral evidence given.

2.5 The Court will ensure that, in the interests of justice, parties are given a reasonable opportunity to adduce and test relevant expert opinion evidence. However, the Court expects parties and any legal representatives acting on their behalf, when dealing with expert witnesses and expert evidence, to at all times comply with their duties associated with the overarching purpose in the Federal Court Act (see ss 37M and 37N).

3. INTERACTION WITH EXPERT WITNESSES

3.1 Parties and their legal representatives should never view an expert witness retained (or partly retained) by them as that party's advocate or "hired gun". Equally, they should never attempt to pressure or influence an expert into conforming his or her views with the party's interests.

3.2 A party or legal representative should be cautious not to have inappropriate communications when retaining or instructing an independent expert, or assisting an independent expert in the preparation of his or her evidence. However, it is important to note that there is no principle of law or practice and there is nothing in this practice note that obliges a party to embark on the costly task of engaging a "consulting expert" in order to avoid "contamination" of the expert who will give evidence. Indeed the Court would generally discourage such costly duplication.

3.3 Any witness retained by a party for the purpose of preparing a report or giving evidence in a proceeding as to an opinion held by the witness that is wholly or substantially based in the specialised knowledge of the witness[1] should, at the earliest opportunity, be provided with:

(a) a copy of this practice note, including the Code (see Annexure A); and

(b) all relevant information (whether helpful or harmful to that party's case) so as to enable the expert to prepare a report of a truly independent nature.

3.4 Any questions or assumptions provided to an expert should be provided in an unbiased manner and in such a way that the expert is not confined to addressing selective, irrelevant or immaterial issues.

[1] Such a witness includes a "Court expert" as defined in r 23.01 of the Federal Court Rules. For the definition of "expert", "expert evidence" and "expert report" see the Dictionary, in Schedule 1 of the Federal Court Rules.

4. ROLE AND DUTIES OF THE EXPERT WITNESS

4.1 The role of the expert witness is to provide relevant and impartial evidence in his or her area of expertise. An expert should never mislead the Court or become an advocate for the cause of the party that has retained the expert.

4.2 It should be emphasised that there is nothing inherently wrong with experts disagreeing or failing to reach the same conclusion. The Court will, with the assistance of the evidence of the experts, reach its own conclusion.

4.3 However, experts should willingly be prepared to change their opinion or make concessions when it is necessary or appropriate to do so, even if doing so would be contrary to any previously held or expressed view of that expert.

Harmonised Expert Witness Code of Conduct

4.4 Every expert witness giving evidence in this Court must read the *Harmonised Expert Witness Code of Conduct* (attached in Annexure A) and agree to be bound by it.

4.5 The Code is not intended to address all aspects of an expert witness' duties, but is intended to facilitate the admission of opinion evidence, and to assist experts to understand in general terms what the Court expects of them. Additionally, it is expected that compliance with the Code will assist individual expert witnesses to avoid criticism (rightly or wrongly) that they lack objectivity or are partisan.

5. CONTENTS OF AN EXPERT'S REPORT AND RELATED MATERIAL

5.1 The contents of an expert's report must conform with the requirements set out in the Code (including clauses 3 to 5 of the Code).

5.2 In addition, the contents of such a report must also comply with r 23.13 of the Federal Court Rules. Given that the requirements of that rule significantly overlap with the requirements in the Code, an expert, unless otherwise directed by the Court, will be taken to have complied with the requirements of r 23.13 if that expert has complied with the requirements in the Code and has complied with the additional following requirements. The expert shall:

(a) acknowledge in the report that:

(i) the expert has read and complied with this practice note and agrees to be bound by it; and

(ii) the expert's opinions are based wholly or substantially on specialised knowledge arising from the expert's training, study or experience;

(b) identify in the report the questions that the expert was asked to address;

(c) sign the report and attach or exhibit to it copies of:

(i) documents that record any instructions given to the expert; and

(ii) documents and other materials that the expert has been instructed to consider.

5.3 Where an expert's report refers to photographs, plans, calculations, analyses, measurements, survey reports or other extrinsic matter, these must be provided to the other parties at the same time as the expert's report.

6. CASE MANAGEMENT CONSIDERATIONS

6.1 Parties intending to rely on expert evidence at trial are expected to consider between them and inform the Court at the earliest opportunity of their views on the following:

(a) whether a party should adduce evidence from more than one expert in any single discipline;

(b) whether a common expert is appropriate for all or any part of the evidence;

(c) the nature and extent of expert reports, including any in reply;

(d) the identity of each expert witness that a party intends to call, their area(s) of expertise and availability during the proposed hearing;

(e) the issues that it is proposed each expert will address;

(f) the arrangements for a conference of experts to prepare a joint-report (see Part 7 of this practice note);

(g) whether the evidence is to be given concurrently and, if so, how (see Part 8 of this practice note); and

(h) whether any of the evidence in chief can be given orally.

6.2 It will often be desirable, before any expert is retained, for the parties to attempt to agree on the question or questions proposed to be the subject of expert evidence as well as the relevant facts and assumptions. The Court may make orders to that effect where it considers it appropriate to do so.

7. CONFERENCE OF EXPERTS AND JOINT-REPORT

7.1 Parties, their legal representatives and experts should be familiar with aspects of the Code relating to conferences of experts and joint-reports (see clauses 6 and 7 of the Code attached in Annexure A).

7.2 In order to facilitate the proper understanding of issues arising in expert evidence and to manage expert evidence in accordance with the overarching purpose, the Court may require experts who are to give evidence or who have produced reports to meet for the purpose of identifying and addressing the issues not agreed between them with a view to reaching agreement where this is possible ("**conference of experts**"). In an appropriate case, the Court may appoint a registrar of the Court or some other suitably qualified person ("**Conference Facilitator**") to act as a facilitator at the conference of experts.

7.3 It is expected that where expert evidence may be relied on in any proceeding, at the earliest opportunity, parties will discuss and then inform the Court whether a conference of experts and/or a joint-report by the experts may be desirable to assist with or simplify the giving of expert evidence in the proceeding. The parties should discuss the necessary arrangements for any conference and/or joint-report. The arrangements discussed between the parties should address:

(a) who should prepare any joint-report;

(b) whether a list of issues is needed to assist the experts in the conference and, if so, whether the Court, the parties o r the experts should assist in preparing such a list;

(c) **t**he agenda for the conference of experts; and

(d) arrangements for the provision, to the parties and the Court, of any joint-report or any other report as to the outcomes of the conference ("**conference report**").

Conference of Experts

7.4 The purpose of the conference of experts is for the experts to have a comprehensive discussion of issues relating to their field of expertise, with a view to identifying matters and issues in a proceeding about which the experts agree, partly agree or disagree and why. For this reason the conference is attended only by the experts and any Conference Facilitator. Unless the Court orders otherwise, the parties' lawyers will not attend the conference but will be provided with a copy of any conference report.

7.5 The Court may order that a conference of experts occur in a variety of circumstances, depending on the views of the judge and the parties and the needs of the case, including:

(a) while a case is in mediation. When this occurs the Court may also order that the outcome of the conference or any document disclosing or summarising the experts' opinions be confidential to the parties while the mediation is occurring;

(b) before the experts have reached a final opinion on a relevant question or the facts involved in a case. When this occurs the Court may order that the parties exchange draft expert reports and that a conference report be prepared for the use of the experts in finalising their reports;

(c) after the experts' reports have been provided to the Court but before the hearing of the experts' evidence. When this occurs the Court may also order that a conference report be prepared (jointly or otherwise) to ensure the efficient hearing of the experts' evidence.

7.6 Subject to any other order or direction of the Court, the parties and their lawyers must not involve themselves in the conference of experts process. In particular, they must not seek to encourage an expert not to agree with another expert or otherwise seek to influence the outcome of the conference of experts. The experts should raise any queries they may have in relation to the process with the Conference Facilitator (if one has been appointed) or in

accordance with a protocol agreed between the lawyers prior to the conference of experts taking place (if no Conference Facilitator has been appointed).

7.7 Any list of issues prepared for the consideration of the experts as part of the conference of experts process should be prepared using non-tendentious language.

7.8 The timing and location of the conference of experts will be decided by the judge or a registrar who will take into account the location and availability of the experts and the Court's case management timetable. The conference may take place at the Court and will usually be conducted in-person. However, if not considered a hindrance to the process, the conference may also be conducted with the assistance of visual or audio technology (such as via the internet, video link and/or by telephone).

7.9 Experts should prepare for a conference of experts by ensuring that they are familiar with all of the material upon which they base their opinions. Where expert reports in draft or final form have been exchanged prior to the conference, experts should attend the conference familiar with the reports of the other experts. Prior to the conference, experts should also consider where they believe the differences of opinion lie between them and what processes and discussions may assist to identify and refine those areas of difference.

Joint-report

7.10 At the conclusion of the conference of experts, unless the Court considers it unnecessary to do so, it is expected that the experts will have narrowed the issues in respect of which they agree, partly agree or disagree in a joint-report. The joint-report should be clear, plain and concise and should summarise the views of the experts on the identified issues, including a succinct explanation for any differences of opinion, and otherwise be structured in the manner requested by the judge or registrar.

7.11 In some cases (and most particularly in some native title cases), depending on the nature, volume and complexity of the expert evidence a judge may direct a registrar to draft part, or all, of a conference report. If so, the registrar will usually provide the draft conference report to the relevant experts and seek their confirmation that the conference report accurately reflects the opinions of the experts expressed at the conference. Once that confirmation has been received the registrar will finalise the conference report and provide it to the intended recipient(s).

8. CONCURRENT EXPERT EVIDENCE

8.1 The Court may determine that it is appropriate, depending on the nature of the expert evidence and the proceeding generally, for experts to give some or all of their evidence concurrently at the final (or other) hearing.

8.2 Parties should familiarise themselves with the *Concurrent Expert Evidence Guidelines* (attached in Annexure B). The Concurrent Evidence Guidelines are not intended to be exhaustive but indicate the circumstances when the Court might consider it appropriate for

concurrent expert evidence to take place, outline how that process may be undertaken, and assist experts to understand in general terms what the Court expects of them.

8.3 If an order is made for concurrent expert evidence to be given at a hearing, any expert to give such evidence should be provided with the Concurrent Evidence Guidelines well in advance of the hearing and should be familiar with those guidelines before giving evidence.

9. FURTHER PRACTICE INFORMATION AND RESOURCES

9.1 Further information regarding Expert Evidence and Expert Witnesses is available on the Court's website.

9.2 Further information to assist litigants, including a range of helpful guides, is also available on the Court's website. This information may be particularly helpful for litigants who are representing themselves.

J L B ALLSOP
Chief Justice
25 October 2016

Annexure A

HARMONISED EXPERT WITNESS CODE OF CONDUCT[2]

APPLICATION OF CODE

1. This Code of Conduct applies to any expert witness engaged or appointed:

   (a) to provide an expert's report for use as evidence in proceedings or proposed proceedings; or

   (b) to give opinion evidence in proceedings or proposed proceedings.

GENERAL DUTIES TO THE COURT

2. An expert witness is not an advocate for a party and has a paramount duty, overriding any duty to the party to the proceedings or other person retaining the expert witness, to assist the Court impartially on matters relevant to the area of expertise of the witness.

CONTENT OF REPORT

3. Every report prepared by an expert witness for use in Court shall clearly state the opinion or opinions of the expert and shall state, specify or provide:

   (a) the name and address of the expert;

   (b) an acknowledgment that the expert has read this code and agrees to be bound by it;

   (c) the qualifications of the expert to prepare the report;

   (d) the assumptions and material facts on which each opinion expressed in the report is based [a letter of instructions may be annexed];

   (e) the reasons for and any literature or other materials utilised in support of such opinion;

   (f) (if applicable) that a particular question, issue or matter falls outside the expert's field of expertise;

   (g) any examinations, tests or other investigations on which the expert has relied, identifying the person who carried them out and that person's qualifications;

   (h) the extent to which any opinion which the expert has expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;

   (i) a declaration that the expert has made all the inquiries which the expert believes are desirable and appropriate (save for any matters identified explicitly in the report), and that no matters of significance which the expert regards as relevant have, to the

[2] Approved by the Council of Chief Justices' Rules Harmonisation Committee

knowledge of the expert, been withheld from the Court;

(j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;

(k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and

(l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

SUPPLEMENTARY REPORT FOLLOWING CHANGE OF OPINION

4. Where an expert witness has provided to a party (or that party's legal representative) a report for use in Court, and the expert thereafter changes his or her opinion on a material matter, the expert shall forthwith provide to the party (or that party's legal representative) a supplementary report which shall state, specify or provide the information referred to in paragraphs (a), (d), (e), (g), (h), (i), (j), (k) and (l) of clause 3 of this code and, if applicable, paragraph (f) of that clause.

5. In any subsequent report (whether prepared in accordance with clause 4 or not) the expert may refer to material contained in the earlier report without repeating it.

DUTY TO COMPLY WITH THE COURT'S DIRECTIONS

6. If directed to do so by the Court, an expert witness shall:

(a) confer with any other expert witness;

(b) provide the Court with a joint-report specifying (as the case requires) matters agreed and matters not agreed and the reasons for the experts not agreeing; and

(c) abide in a timely way by any direction of the Court.

CONFERENCE OF EXPERTS

7. Each expert witness shall:

(a) exercise his or her independent judgment in relation to every conference in which the expert participates pursuant to a direction of the Court and in relation to each report thereafter provided, and shall not act on any instruction or request to withhold or avoid agreement; and

(b) endeavour to reach agreement with the other expert witness (or witnesses) on any issue in dispute between them, or failing agreement, endeavour to identify and clarify the basis of disagreement on the issues which are in dispute.

ANNEXURE B

CONCURRENT EXPERT EVIDENCE GUIDELINES

APPLICATION OF THE COURT'S GUIDELINES

1. The Court's Concurrent Expert Evidence Guidelines ("**Concurrent Evidence Guidelines**") are intended to inform parties, practitioners and experts of the Court's general approach to concurrent expert evidence, the circumstances in which the Court might consider expert witnesses giving evidence concurrently and, if so, the procedures by which their evidence may be taken.

OBJECTIVES OF CONCURRENT EXPERT EVIDENCE TECHNIQUE

2. The use of concurrent evidence for the giving of expert evidence at hearings as a case management technique[3] will be utilised by the Court in appropriate circumstances (see r 23.15 of the *Federal Court Rules 2011* (Cth)). Not all cases will suit the process. For instance, in some patent cases, where the entire case revolves around conflicts within fields of expertise, concurrent evidence may not assist a judge. However, patent cases should not be excluded from concurrent expert evidence processes.

3. In many cases the use of concurrent expert evidence is a technique that can reduce the partisan or confrontational nature of conventional hearing processes and minimises the risk that experts become "opposing experts" rather than independent experts assisting the Court. It can elicit more precise and accurate expert evidence with greater input and assistance from the experts themselves.

4. When properly and flexibly applied, with efficiency and discipline during the hearing process, the technique may also allow the experts to more effectively focus on the critical points of disagreement between them, identify or resolve those issues more quickly, and narrow the issues in dispute. This can also allow for the key evidence to be given at the same time (rather than being spread across many days of hearing); permit the judge to assess an expert more readily, whilst allowing each party a genuine opportunity to put and test expert evidence. This can reduce the chance of the experts, lawyers and the judge misunderstanding the opinions being expressed by the experts.

5. It is essential that such a process has the full cooperation and support of all of the individuals involved, including the experts and counsel involved in the questioning process. Without that cooperation and support the process may fail in its objectives and even hinder the case management process.

[3] Also known as the "hot tub" or as "expert panels".

CASE MANAGEMENT

6. Parties should expect that, the Court will give careful consideration to whether concurrent evidence is appropriate in circumstances where there is more than one expert witness having the same expertise who is to give evidence on the same or related topics. Whether experts should give evidence concurrently is a matter for the Court, and will depend on the circumstances of each individual case, including the character of the proceeding, the nature of the expert evidence, and the views of the parties.

7. Although this consideration may take place at any time, including the commencement of the hearing, if not raised earlier, parties should raise the issue of concurrent evidence at the first appropriate case management hearing, and no later than any pre-trial case management hearing, so that orders can be made in advance, if necessary. To that end, prior to the hearing at which expert evidence may be given concurrently, parties and their lawyers should confer and give general consideration as to:

   (a) the agenda;

   (b) the order and manner in which questions will be asked; and

   (c) whether cross-examination will take place within the context of the concurrent evidence or after its conclusion.

8. At the same time, and before any hearing date is fixed, the identity of all experts proposed to be called and their areas of expertise is to be notified to the Court by all parties.

9. The lack of any concurrent evidence orders does not mean that the Court will not consider using concurrent evidence without prior notice to the parties, if appropriate.

CONFERENCE OF EXPERTS & JOINT-REPORT OR LIST OF ISSUES

10. The process of giving concurrent evidence at hearings may be assisted by the preparation of a joint-report or list of issues prepared as part of a conference of experts.

11. Parties should expect that, where concurrent evidence is appropriate, the Court may make orders requiring a conference of experts to take place or for documents such as a joint-report to be prepared to facilitate the concurrent expert evidence process at a hearing (see Part 7 of the Expert Evidence Practice Note).

PROCEDURE AT HEARING

12. Concurrent expert evidence may be taken at any convenient time during the hearing, although it will often occur at the conclusion of both parties' lay evidence.

13. At the hearing itself, the way in which concurrent expert evidence is taken must be applied flexibly and having regard to the characteristics of the case and the nature of the evidence to be given.

14. Without intending to be prescriptive of the procedure, parties should expect that, when evidence is given by experts in concurrent session:

(a) the judge will explain to the experts the procedure that will be followed and that the nature of the process may be different to their previous experiences of giving expert evidence;

(b) the experts will be grouped and called to give evidence together in their respective fields of expertise;

(c) the experts will take the oath or affirmation together, as appropriate;

(d) the experts will sit together with convenient access to their materials for their ease of reference, either in the witness box or in some other location in the courtroom, including (if necessary) at the bar table;

(e) each expert may be given the opportunity to provide a summary overview of their current opinions and explain what they consider to be the principal issues of disagreement between the experts, as they see them, in their own words;

(f) the judge will guide the process by which evidence is given, including, where appropriate:

(i) using any joint-report or list of issues as a guide for all the experts to be asked questions by the judge and counsel, about each issue on an issue-by-issue basis;

(ii) ensuring that each expert is given an adequate opportunity to deal with each issue and the exposition given by other experts including, where considered appropriate, each expert asking questions of other experts or supplementing the evidence given by other experts;

(iii) inviting legal representatives to identify the topics upon which they will cross-examine;

(iv) ensuring that legal representatives have an adequate opportunity to ask all experts questions about each issue. Legal representatives may also seek responses or contributions from one or more experts in response to the evidence given by a different expert; and

(v) allowing the experts an opportunity to summarise their views at the end of the process where opinions may have been changed or clarifications are needed.

15. The fact that the experts may have been provided with a list of issues for consideration does not confine the scope of any cross-examination of any expert. The process of cross-examination remains subject to the overall control of the judge.

16. The concurrent session should allow for a sensible and orderly series of exchanges between expert and expert, and between expert and lawyer. Where appropriate, the judge may allow for more traditional cross-examination to be pursued by a legal representative on a particular issue exclusively with one expert. Where that occurs, other experts may be asked to comment on the evidence given.

17. Where any issue involves only one expert, the party wishing to ask questions about that issue should let the judge know in advance so that consideration can be given to whether

arrangements should be made for that issue to be dealt with after the completion of the concurrent session. Otherwise, as far as practicable, questions (including in the form of cross-examination) will usually be dealt with in the concurrent session.

18. Throughout the concurrent evidence process the judge will ensure that the process is fair and effective (for the parties and the experts), balanced (including not permitting one expert to overwhelm or overshadow any other expert), and does not become a protracted or inefficient process.