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Lodgment and Details

Document Lodged: Joint 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



REGISTRAR

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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.

IN THE AUSTRALIAN COMPETITION TRIBUNAL

ACT 2 of 2020

PORT OF NEWCASTLE OPERATIONS PTY LTD
(ACN 165 332 990)

Applicant

and

NEW SOUTH WALES MINERALS COUNCIL

Respondent

and others

Collective bargaining for access to Port of Newcastle

Joint expert report of Rhonda Smith, Euan Morton and Greg Houston

29 September 2021



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1. Introduction

1. This joint expert report has been prepared by Rhonda Smith, Euan Morton and Gregory Houston (the experts), in accordance with the directions of the Australian Competition Tribunal dated 14 September 2021. It summarises the principal areas of agreement and disagreement between the experts as relevant to these proceedings. Where there is disagreement, each expert provides a succinct statement explaining the basis for that disagreement.
2. The reports previously prepared by the experts in these proceedings are:
 - a. Expert report of Dr Rhonda Smith, *Authorisation for Collective Bargaining: NSW Minerals Council & 10 Coal Producers*, dated 22 April 2021 (Smith report);
 - b. Expert report of Euan Morton, *Public benefits of collective bargaining at Port of Newcastle*, dated 25 June 2021 (Morton report); and
 - c. Expert report of Gregory Houston, *Collective bargaining for access to Port of Newcastle*, dated 30 July 2021 (Houston report).
3. In accordance with the directions of the Tribunal, the experts held an initial conclave by video conference on Tuesday 21 September 2021. Subsequently, the experts exchanged draft and revised draft material for inclusion in this joint expert report and convened by video conference to discuss refinements to the structure and content of this report

1.1 Questions addressed by the experts

4. By way of context for the matters on which they agree and disagree, the experts provide below a summary of the questions addressed in their respective reports.
5. Dr Smith was asked to prepare a report in response to questions that may be summarized as being:¹
 - a. to define the relevant markets and set out the economic principles associated with the distinction between public and private benefits, and collective bargaining conduct; and
 - b. to apply those economic principles to determine the public benefits and detriments likely to arise as a result of the authorised conduct by coal producers.
6. Mr Morton was subsequently asked:²
 - a. to provide his opinion in respect of the expert report prepared by Dr Smith; and
 - b. to state how PNO might be expected to act in setting prices and negotiating access, given its economic circumstances and incentives.
7. Mr Houston was asked to prepare a report responding to that of Mr Morton, and the earlier report of Dr Smith, to which Mr Morton's report responds.³
8. There are some differences in the assumptions the experts were asked to make and/or available facts, ie:

¹ Australian Government Solicitor, *Independent expert report – ACT 2 of 2020 – Letter of instructions*, 16 April 2021, p 2.

² *Expert report of Euan Morton*, 25 June 2021, p 4; and Clifford Chance, *ACT 2 of 2020 – Independent expert report – Letter of instructions to Euan Morton*, 25 June 2021, p 3.

³ Clayton Utz, *ACT 2 of 2020: Application by Port of Newcastle Operations Pty Limited*, Letter of instruction to Greg Houston, 30 July 2021, para 6

- a. Dr Smith was asked to assume that in the context of community debate as to the future of coal mining, the outlook for Australian coal exports is uncertain,⁴ whereas Mr Houston was provided with forecasts of annual coal volumes expected to be exported from the port over the next 15 years that were generally 10 per cent higher than those applying in 2020;⁵ and
- b. Mr Morton was asked to assume that PNO intends to build a MDT⁶ at the Port within the short to medium future,⁷ whereas Mr Houston was asked to assume⁸ that PNO does not intend to undertake any capital expenditure in relation to the provision for any future channel improvements, additional berths or a container terminal⁹ in the period 2021-2025.

1.2 Structure of this report

9. The remainder of this report is structured as follows:
 - a. section 2 sets out the applicable economic framework and the economic considerations that apply in relation to the authorised collective bargaining conduct;
 - b. section 3 sets out the matters of agreement deriving from applying the economic framework described in section 2 to the facts and assumptions in relation to the authorised collective bargaining conduct;
 - c. section 4 sets out matters in relation to the economic framework and considerations applying on which Mr Morton does not agree with Dr Smith and Mr Houston, and Mr Morton's reasons for that disagreement; and
 - d. section 5 sets out the the matters of agreement and disagreement in relation to the likely effects of the authorised collective bargaining conduct
 - e. section 6 contains the experts' declarations, in accordance with those appearing in their earlier expert reports.

⁴ Australian Government Solicitor, *Independent expert report – ACT 2 of 2020 – Letter of instructions to Rhonda Smith*, 16 April 2021, p 3.

⁵ *Expert report of Greg Houston*, 30 July 2021, para 241.

⁶ Multi-purpose deepwater terminal.

⁷ Clifford Chance, *ACT 2 of 2020 – Independent expert report – Letter of instructions to Euan Morton*, 25 June 2021, p 3.

⁸ Clayton Utz, *ACT 2 of 2020: Application by Port of Newcastle Operations Pty, Ltd*, Letter of instructions to Greg Houston, 30 July 2021, para 9(p).

⁹ Simon Byrnes states that PNO will not proceed with the MDT until the restrictions under the Port Kembla, Port Botany and Port of Newcastle port commitment deeds (PCDs), which require PNO to pay compensation for containers diverted from Port Botany or Port Kembla to Port of Newcastle, are removed. See: Byrnes, S, *Third affidavit of Simon Byrnes*, 30 July 2021, paras 30-31, 33.

2. Economic framework and principles

10. In this section, the experts set out the areas of agreement in relation to:
- a. the applicable economic framework in assessing public benefits and detriments in the context of an application for authorisation; and
 - b. the economic considerations that apply when assessing the public benefits and detriments of authorised collective bargaining conduct.

11. Unless otherwise indicated, each of the experts agrees with the material set out in this section.

2.1 Applicable economic framework

12. The experts set out below the areas on which they agree in relation to the applicable economic framework in assessing public benefits and detriments in the context of an application for authorisation.

2.1.1 Matters of agreement

13. The assessment of public benefits and detriments arising in relation to the authorised conduct requires a comparison of two states of the world, being that with the authorised conduct (the factual), as compared to that without the authorised conduct (the counterfactual).¹⁰
14. Public benefits are consistent with – although not limited by – the concept of increased economic welfare or surplus, which is synonymous with increased economic efficiency.¹¹
15. Economic welfare or surplus arising in a particular market can be defined as the sum of:¹²
- a. the producer surplus, as measured by economic profits earned by the firm supplying the relevant goods or services; and
 - b. the consumer surplus, as measured by the total value less total cost to the purchaser of those outputs.
16. The total welfare standard applies the concepts of consumer and producer surplus on the basis that a dollar of consumer surplus is valued equally to a dollar of producer surplus.¹³
17. Under the total welfare standard, any change in economic conduct or outcome that has the effect of increasing total economic welfare or surplus results in a public benefit. The legal standard of ‘public benefits’ may give more weight to changes in economic surplus that fall to one party – such as consumers – as compared to those that falls to another party – such as producers.¹⁴
18. Any change in economic conduct or outcomes that has the effect of transferring economic surplus between a buyer and a seller (without increasing total economic surplus) represents a private benefit to the transferee and, correspondingly, a private disbenefit to the transferor.¹⁵

¹⁰ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 11; and *Expert report of Greg Houston*, 30 July 2021, para 21.

¹¹ *Expert report of Dr Rhonda Smith*, 22 April 2021, paras 29-31, 33.

¹² *Expert report of Dr Rhonda Smith*, 22 April 2021, paras 29-31, 33.

¹³ Church and Ware, pp. 28-29

¹⁴ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 33.

¹⁵ *Expert report of Greg Houston*, 30 July 2021, para 21; and *Expert report of Dr Rhonda Smith*, 22 April 2021, para 55.

19. The extent of economic welfare or surplus arising in any market – and so the potential for increases thereto – is difficult to measure directly.
20. The experts disagree on the economic principle set out below, as follows:
- a. Dr Smith and Mr Houston agree that an alternative and equally valid indicator of the potential for increased economic welfare to arise from a particular form of conduct is the extent to which output – in either its quantitative or qualitative dimensions – in any market is likely to increase, as compared to the counterfactual.¹⁶ Reliance on increased output as an indicator of public benefits involves the presumption that the economic value of any increased output is positive and exceeds the additional cost of its production; whereas
 - b. Mr Morton's opinion is that an alternative but incomplete indicator of the potential for increased economic welfare to arise from a particular form of conduct is the extent to which output – in either its quantitative or qualitative dimensions – in any market is likely to increase, as compared to the counterfactual. Reliance on increased output as an indicator of public benefits involves the presumption that the economic value of any increased output is positive and exceeds the additional cost of its production. The measure of output is incomplete in terms of assessing the impact on economic welfare to the extent that the transactions costs savings from a change in conduct in a particular market are of value elsewhere in the economy.
21. Increased output in any market – and the presumptive increase in economic surplus represented by that increased output – may accrue either:¹⁷
- a. in a static sense, where productive and allocative efficiency increase by reference to known market conditions; and/or
 - b. dynamically, where future productive and allocative efficiency will be increased in the face of changing market conditions, such as may arise through more efficient investment in that market.
22. A change in economic conduct or outcomes that enables, in relation to any market, the same output to be produced with fewer resources (ie, a productive efficiency gain) gives rise to:
- a. a presumptive increase in economic surplus in that market; but
 - b. a loss of surplus and economic income in the separate, dependent market for the corresponding input resources.
23. The experts disagree on the economic principle set out below, as follows:
- a. Dr Smith and Mr Houston agree that the offsetting effects described at paragraph 22 can be presumed to give rise to a net public benefit if the otherwise idle input resources are redeployed to generate economic income and surplus of at least the same value in the corresponding input resources market; whereas
 - b. Mr Morton's opinion is that the offsetting effects described at paragraph 22 can be presumed to give rise to a net public benefit if the input resources that are no longer required because of a reduction in transactions costs, as those resources can be expected to be of some positive value elsewhere in the economy.
24. The markets relevant for assessing the effect of the authorised conduct, as compared to counterfactual, entail:

¹⁶ *Expert report of Greg Houston*, 30 July 2021, para 45; and *Expert report of Dr Rhonda Smith*, 22 April 2021, para 31.

¹⁷ *Expert report of Dr Rhonda Smith*, 22 April 2021, paras 35-41; *Expert report of Euan Morton*, 25 June 2021, para 13; and *Expert report of Greg Houston*, 30 July 2021, para 41.

- a. the market for the service in relation to which the authorised conduct is taking place – being port access services; and
 - b. any related markets that may be indirectly affected by either:
 - i. changes in the market for the service – say, coal export volumes or mining investment; or
 - ii. the authorised conduct itself – say, management time, or legal services procured in the context of negotiations
25. The legal standard of ‘public benefits’ may well be wider than the economic specification of welfare and efficiency described above.¹⁸

2.2 Economic principles relating to collective bargaining

26. The experts set out below the areas on which they agree in relation to the economic considerations that apply when assessing the public benefits and detriments of authorised collective bargaining conduct.

2.2.1 Matters of agreement

27. The economic efficiency effects – whether of productive, allocative or dynamic form – of collective bargaining conduct can be organised into three categories, ie:
- a. those arising either directly in the market for the service in relation to which the authorised conduct takes place, or indirectly in any market that may also be affected by changes the authorised conduct;
 - b. those arising in relation to the transactions costs associated with the process of bargaining that is affected by the authorised conduct; and
 - c. those arising as a result of the risk of the authorised collective bargaining conduct ‘spilling over’ in the form of collusive conduct directed at one or more markets beyond the scope of those for which the collective bargaining conduct is authorised.
28. In relation to the potential efficiency effects described at paragraph 27.a, being those arising in the markets for the service or any related markets, the experts agree that:
- a. for collective bargaining to give rise to more efficient outcomes, there must be both:
 - i. a change in economic conduct, ie, the form and outcome of negotiations are improved; and
 - ii. an increase in the sum of consumer and producer surplus – as indicated by an increase in either the quantity or quality of output in the market for the service and/or one or more related markets that would not have arisen in the absence of the collective bargaining conduct;
 - b. absent any change to market outcomes of the type identified at paragraph 28a, collective bargaining conduct that alters the balance of bargaining power such that it causes only a redistribution of the gains from trade between buyers and sellers represents a transfer of economic surplus and so is not a public benefit under the total welfare standard;¹⁹

¹⁸ Expert report of Dr Rhonda Smith, 22 April 2021, para 32; *Expert report of Greg Houston*, 30 July 2021, paras 34, 42.

¹⁹ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 55.

- c. if demand for the service is highly price inelastic, small reductions in price are likely to have little to no effect on output of the service,²⁰ and so – relative to highly price elastic demand – are more likely to give rise to a transfer of economic surplus than an increase in efficiency or total welfare;
 - d. if demand for the service is highly price elastic, small reductions in price are likely to have a material effect on the output of the service, and so – relative to highly price inelastic demand – are more likely to give rise to an increase in efficiency or total welfare, as well as involving some transfer of economic surplus;
 - e. in general, the price elasticity of demand in a market is likely to be greater, the larger is the percentage change in price, with the consequence that large reductions in the price of the service may have more effect on the output of the service – relative to smaller reductions – however, this effect will also be diminished by the correspondingly smaller proportion represented by the price of the service, relative to the value of demand derived from dependent markets;
 - f. in general, demand in a market is likely to be more (less) price elastic (inelastic) the longer is the period of time over which it is assessed, with the consequence that changes in the price of the service applying over longer period of time – relative to a shorter period of time – are more likely to give rise to increases in efficiency or total welfare, as well as involving some transfer of economic surplus;
 - g. collective bargaining conduct is more likely to achieve an improved economic outcome – being terms that give rise to increased producer or consumer surplus as indicated by the quality or quantity of output – in circumstances where a common position, which may include a menu of compatible items,²¹ in the interests of all buyers can reasonably be expected to be agreed.²²
29. In relation to the potential efficiency effects arising in relation to the transaction costs associated with collective bargaining, the experts agree that:
- a. two forms of transaction costs effects arise, being the potential for:²³
 - i. a reduction in the transactions costs associated with the negotiation, monitoring and potential dispute resolution over the term of an agreement, as they apply in relation to both:
 - 1. members of the bargaining group, who can pool resources when interacting with a counterparty; and
 - 2. the counterparty itself; and
 - ii. an increase in the transactions costs of negotiation, because members of the bargaining group must negotiate internally and agree on a common position.
 - b. to the extent there may be any net reduction in such transactions costs – say, in the form of reduced management time or a reduced quantity of legal professional services necessary to participate in the negotiation process – then:
 - i. the immediate or static economic efficiency effect is:

²⁰ *Expert report of Euan Morton*, 25 June 2021, para 18.

²¹ King, S, *Collective bargaining in business: Economic and legal implications*, UNSW Law Journal, 36(1), 2013, p 125.

²² *Expert report of Greg Houston*, 30 July 2021, para 135.

²³ King, S, *Collective bargaining in business: Economic and legal implications*, UNSW Law Journal, 36(1), 2013, p 110, *Expert report of Dr Rhonda Smith*, 22 April 2021, paras 58, 61; and *Expert report of Greg Houston*, 30 July 2021, para 166.

1. to increase the surplus available to the party realising the resource cost savings, which is a private benefit; and
 2. to reduce the surplus available to the party supplying those management or professional services, which is a private disbenefit;
- ii. the potential future or dynamic economic efficiency effect may include:
1. increased efficient investment in production capacity and so future increases in output – say, in the form of expanded mining capacity and so output of export coal, which is a public benefit; and
 2. the redeployment of resources otherwise utilised in the negotiation process – such as management time or legal professional services – although Mr Morton disagrees with the opinion of Dr Smith and Mr Houston that the establishment of a public benefit requires those resources to be redeployed to an activity of at least similar value elsewhere in the economy for the reasons given in 23.b.
- c. the transactions costs effects arising in relation to intra-group negotiations are likely to be higher the greater is the heterogeneity of circumstances affecting the preferences of the buyer group as to the service being procured;²⁴
- d. the existence of a most favoured nation (MFN) clause in relation to the price element of the terms and conditions applying to the service being procured may allow some buyers to benefit from the negotiating effort of others without incurring the same extent of transactions costs;²⁵
30. In relation to the potential economic detriments arising in relation to collective bargaining, the experts agree that:
- a. collective bargaining increases the risk of collusive conduct between members of the bargaining group in relation to upstream or downstream markets in which the parties also compete,²⁶ but which extend beyond the market for which the authorised conduct applies – such as, in this context:
 - i. the downstream market for coal exports; and
 - ii. upstream markets involving the procurement of inputs, such as for labour, tenements, and construction and mining equipment;
 - b. the extent to which collective bargaining increases the risk of collusive conduct depends on the existence of factors that facilitate or discourage collusive conduct;²⁷
31. In relation to the risk of detriment to economic efficiency arising in relation to the circumstances applying in relation to a collective bargaining group, these risks will be:
- a. increased, where members of a bargaining group accept contractual terms that reflect commonly agreed parameters, which may include a menu of compatible items, as distinct from parameters

²⁴ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 61; and *Expert report of Greg Houston*, 30 July 2021, para 186.

²⁵ *Expert report of Greg Houston*, 30 July 2021, para 183.

²⁶ See, for example, King, S, *Collective bargaining in business: Economic and legal implications*, UNSW Law Journal, 36(1), 2013, p 125.

²⁷ See, for example, King, S, *Collective bargaining in business: Economic and legal implications*, UNSW Law Journal, 36(1), 2013, p 125.

that better reflect their specific circumstances and preferences that for whatever reason cannot be accommodated within a collective bargaining framework;²⁸

- b. increased (reduced) the greater is the degree of heterogeneity (homogeneity) as to relevant circumstances and preferences between different members of the bargaining group that cannot (can) be accommodated within a collective bargaining framework, such as by a menu of compatible items, and which apply in respect of the services for which the bargaining is taking place;²⁹ and
- c. increased where, to the extent diverse circumstances cannot be accommodated within a collective bargaining framework, such as by a menu of compatible items, collective bargaining creates pressure for uniformity between group members and may therefore reduce the incentives for innovation or the renegotiation of more favourable terms of a contract.³⁰

32. In relation to the risk of detriment to economic efficiency arising in relation to the circumstances applying in relation to a collective bargaining group:

- a. these risks will be reduced where members of a bargaining group participate voluntarily and so have the option of negotiating bilaterally in relation to potential benefits that are specific to their preferences but which cannot be accommodated by a menu of compatible items; however
- b. a bargaining group member contemplating the option of negotiating bilaterally must weigh the potential benefits of that option against the forgone benefits of remaining within the bargaining group and thereby strengthening the potential effectiveness of the collective conduct;³¹

²⁸ See, for example: King, S, *Collective bargaining in business: Economic and legal implications*, UNSW Law Journal, 36(1), 2013, p 110.

²⁹ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 61.

³⁰ King, S, *Collective bargaining in business: Economic and legal implications*, UNSW Law Journal, 36(1), 2013, p 133.

³¹ *Expert report of Greg Houston*, 30 July 2021, para 269.

3. Economic framework and principles applied

33. This section sets out the matters of agreement deriving from applying the economic framework described in section 2 to the facts and assumptions in relation to the authorised collective bargaining for port access services provided by PNO.
34. Unless otherwise indicated, each of the experts agrees with the material set out in this section.

3.1 Factual and counterfactual

35. The experts agree that the applicable factual and counterfactual can be described as:
- a. in the factual (ie, the future with authorisation), coal producers:
 - i. have the ability to discuss between themselves the terms and conditions of access to the port;
 - ii. have the ability to negotiate the terms and conditions of access collectively with PNO, in the circumstance where PNO reconsiders its stance in relation to collective negotiation in the face of reduced coal demand and so profits; but
 - iii. have the ability to negotiate bilaterally with PNO, but to date have chosen not to do so;³² and
 - b. in the counterfactual (ie, the future without authorisation), coal producers:
 - i. do not have the ability to discuss between themselves the terms and conditions of access to the port;
 - ii. do not have the ability to negotiate the terms and conditions of access collectively with PNO; but
 - iii. are willing to negotiate bilaterally with PNO.

3.2 Relevant markets

36. The experts agree that the services and associated charges directly affected by the collective bargaining conduct can be described as those for the provision of:
- a. navigation and/or shipping channel access services supplied by PNO at the port in relation to the export of the producers' coal, for which:³³
 - i. the applicable charge is a navigation services charge (NSC), payable by reference to the gross registered tonnage (GRT) of each visiting vessel; and
 - ii. the direct buyers of this service are vessel agents; however
 - iii. to the extent they bear its ultimate cost, the coal producers have an economic interest in the level of the NSC; and

³² See: Byrnes, S, *First affidavit of Simon Byrnes*, 15 March, para 81; and Byrnes, S, *Second affidavit of Simon Byrnes*, 25 June 2021, paras 20-21.

³³ *Ports and Maritime Administration Act 1995*, Part 5, Division 2, para 50.

- b. the availability of a site at which stevedoring operations may be carried out by PNO at the port in relation to the export of the producers' coal, for which:³⁴
 - i. the applicable charge is a wharfage charge (WCh), payable by reference to each tonne of producers' coal loaded onto a vessel; and
 - ii. the buyers of this service are coal producers.
37. For ease of exposition, when referring to these services in a context where there is no need to distinguish between them, the experts use the term 'port access services' market or primary market.
38. The experts note that scope of the authorised conduct provides for collective bargaining in relation to operational arrangements that may fall outside the scope of the port access services market described at paragraph 36.
39. Other markets that may be relevant for the public benefits and detriments assessment include:
- a. markets that are dependent on the services provided in the primary, port access services markets – such as markets encompassing, inputs to the coal production process, including the coal tenements market, or the sale of export coal loaded onto ships using the Port of Newcastle;³⁵
 - b. markets for transactions cost-related services – such as for management or legal services; and
 - c. markets potentially affected by the risk of collusive conduct that extends beyond the scope of the authorised collective bargaining conduct – such as markets encompassing inputs to the coal production process, or the sale of export coal loaded onto ships using the Port of Newcastle.³⁶
40. The purpose of identifying (at paragraph 39.a) and assessing one or more markets that are dependent on the primary, port access services markets is the potential for any change in the price or other terms of port access services brought about by the authorised conduct:
- a. to affect the quantity of port access services demanded by coal producers or vessel agents can be assessed by reference to the quantity of coal transported through the port; and
 - b. to affect the quantity of port access services demanded by coal producers or vessel agents that in turn gives rise to output changes in other markets in addition to the output change in the primary markets.

3.3 Nature of potential primary market efficiency effects

3.3.1 Matters of agreement

41. Public benefits will arise if a reduction in charges for or improvement in the quality of port access services (as compared with the counterfactual) gives rise to a change in the quantity of port access services demanded by coal producers or vessel agents that, in turn, either:³⁷
- a. in the near term, gives rise to an increase in mine production and so coal exports; or
 - b. in the longer term, arises by consequence of increased efficient investment in mine production capability and so future coal exports.

³⁴ *Ports and Maritime Administration Act 1995*, Part 5, Division 5, para 61.

³⁵ *Expert report of Euan Morton*, 25 June 2021, para 12; and *Expert report of Dr Rhonda Smith*, 22 April 2021, para 26.

³⁶ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 92; and *Expert report of Greg Houston*, 30 July 2021, paras 237, 253.

³⁷ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 31; and *Expert report of Greg Houston*, 30 July 2021, paras 73, 137.

3.4 Considerations affecting PNO's conduct

3.4.1 Matters of agreement

42. PNO's port access service involves use of a natural monopoly facility that all coal producers require in order to reach coal export markets.
43. PNO can be presumed to have an incentive to act so as to maximise its profits, assessed over the term of its lease, subject to the various constraints that it apprehends as applying.
44. The nature of the economic relationship between the coal producers and PNO can be described as one involving mutual dependence in combination with potential for the transfer of economic value between PNO and the coal producers, principally because:³⁸
 - a. the coal producers are dependent upon the port access services provided by PNO to realise the value of export coal revenues, since that coal is transported to overseas markets via the Port of Newcastle;
 - b. PNO is directly dependent upon the provision of port access services in relation to export coal being transported to overseas markets for approximately 70 per cent of its revenue, and indirectly dependent on export coal for a yet further proportion of its revenue – such as that derived from its leases of port land for the purpose of carrying out coal export-related activities; and
 - c. neither the coal producers nor PNO have any close substitutes available to them for the realisation of their respective revenue streams.
45. Setting aside the negotiation of charges for the port access service, PNO and the coal producers have a mutual interest in ensuring that there are no unnecessary impediments or disincentives for the export of coal through the Port of Newcastle under both the factual and counterfactual.³⁹
46. PNO's conduct in bargaining with coal producers in relation to the price and other terms applying to port access services can be expected to be constrained, to varying degrees, by:
 - a. PNO's strong medium term interest in encouraging efficient investment in and ensuing the economic viability of all activities associated with the production of export coal, from which the demand for port access services is derived;⁴⁰
 - b. the existence of approximately 50 per cent unused capacity at the Port of Newcastle, PNO's high dependence on export coal-related revenue and the 98-year lease term over which PNO is entitled to derive port access service revenues;⁴¹
 - c. the experts disagree on the economic principle set out below, as follows:
 - i. Dr Smith and Mr Houston agree that PNO's economic interest in minimising the extent of uncertainty in relation to the future terms and conditions for port access services so that efficient future investment in the production of export coal is encouraged;⁴² whereas
 - ii. Mr Morton's opinion is that PNO does not have a strong incentive to minimise uncertainty in relation to future prices for port access services within a range that it apprehends will not trigger regulatory intervention (see (e));

³⁸ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 16i, 20, 22; and *Expert report of Greg Houston*, 30 July 2021, paras 100, 109.

³⁹ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 16ii; *Expert report of Greg Houston*, 30 July 2021, para 25.

⁴⁰ *Expert report of Greg Houston*, 30 July 2021, para 100.

⁴¹ *Expert report of Greg Houston*, 30 July 2021, paras 100, 111.

⁴² *Expert report of Greg Houston*, 30 July 2021, para 100.

- d. the terms of the executed agents' deeds, which establish an upper bound on the applicable terms and conditions for port access services that may be agreed in the producer deed;⁴³ and
 - e. PNO's apprehension as to the risks of regulatory intervention in relation to the terms and conditions applying to port access services, by means of the declaration provisions of the national access regime and/or the invoking of New South Wales-specific regulatory measures and/or legislative amendments;⁴⁴
47. The NSC charge established in the existing Agents' Deeds lies between the arbitral determinations of the Australian Competition and Consumer Commission (ACCC) and the Competition Tribunal, being \$0.6075 and \$1.0058 per gross tonne for the NSC, respectively.⁴⁵ However, the price escalation and price review principles in the Agents' Deeds are different from those applying in the arbitral determinations of the ACCC and the Competition Tribunal.
48. The WCh charge applying to producer coal is \$0.0802 per revenue tonne⁴⁶ and has not been the subject of dispute by the coal producers, but does fall within the scope of services for which the producers are authorised to bargain collectively.
49. Since the WCh and NSC together represent a relatively small proportion of other coal production costs as well as the market value of export coal, the demand for PNO's port access service is highly price inelastic over a significant range of potential levels for the WCh and NSC.⁴⁷
50. On the evidence available to date, PNO's pricing conduct is not consistent with the presence of unconstrained market power.

3.5 Considerations affecting coal producers' conduct

51. Coal producers can be presumed to have an incentive to act so as to maximise their profits, assessed over the expected life of each existing mine.

3.6 Considerations affecting the bargaining context

52. Reflecting the combination of the mutual dependence and potential for the transfer of economic value between PNO and the coal producers, the most appropriate economic framework to apply to the negotiation for the purchase and sale of port access services at the Port of Newcastle is 'bargaining framework'.⁴⁸
53. Under a bargaining framework, the nature and extent of outside options will affect the extent of each party's bargaining power. In the context of the authorised collective bargaining conduct, the terms and conditions for port access services available under the existing Agents Deeds and nominated Schedule of Charges represent forms of outside option for both the coal producers and PNO.
54. The economic surplus that arises in relation to the provision of port access services falls to either coal producers or another form of producer, being PNO. Port access services are provided in an intermediate market that does not involve any final consumers.⁴⁹

⁴³ *Expert report of Greg Houston*, 30 July 2021, paras 112, 124.

⁴⁴ *Expert report of Greg Houston*, 30 July 2021, paras 98, 99.

⁴⁵ ACCC, *Access dispute between Glencore Coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd*, Final Determination: Statement of Reasons, 18 September 2018, p 7; Australian Competition Tribunal, *Application by Port of Newcastle Operations Pty Ltd [2019] ACompT 1*, 30 October 2019, para 609.

⁴⁶ Port of Newcastle, *Schedule of service charges*, Effective from 1 January 2020, p4.

⁴⁷ *Expert report of Greg Houston*, 30 July 2021, paras 145-147.

⁴⁸ *Expert report of Greg Houston*, 30 July 2021, para 102.

⁴⁹ *Expert report of Greg Houston*, 30 July 2021, para 52.

3.7 Considerations affecting transactions cost-related efficiencies

55. Economic considerations that are likely to increase the extent of any transactions costs savings associated with the negotiation, monitoring and potential dispute resolution over the term of an agreement from the coal producers bargaining collectively include:⁵⁰
- a. the more numerous are the number of parameters in relation to which bargaining takes place or disputes arise; and
 - b. the greater is the number of coal producers.
56. Economic considerations that may increase the extent of any additional transactions costs arising from the need for coal producers to agree a common position when bargaining collectively include the presence of different circumstances applying to each coal producer in terms of:⁵¹
- a. factors such as mine size, location and quality of coal reserves that cause relative differences in marginal and average costs – thereby affecting the potential for shut down in the face of highly cyclical international coal markets;
 - b. type and quality of coal produced, which affects its end market value;
 - c. the nature of the agreements under which export coal is sold, which can vary between a CIF or FOB price basis thereby affecting the incidence of the NSC; and
 - d. remaining mine life, which may influence the time-related preferences of coal producers.
57. The extent to which the economic considerations identified at paragraph 56 increase the transaction costs arising from collective bargaining also depends on the extent to which the diversity of interests as between one coal producer and another can be accommodated within the collective bargaining framework, such as by developing a menu of compatible items, across each of the potential terms of the port access service.
58. Public benefits will arise if any net reduction in transactions costs (as compared with the counterfactual) accruing over the life of the relevant agreements gives rise to either:
- a. an increase in the quantity or quality of port access services demanded by coal producers or vessel agents; or
 - b. a redeployment of those reduced resources elsewhere in the economy

3.8 Considerations affecting potential detriments

59. Economic considerations that are likely to increase the risk of the authorised collective bargaining conduct flattening any diversity in the interests and preferences of coal producers, and thereby leading to less efficient terms for the provision of port access services include:⁵²
- a. the extent to which there are diverse interests and preferences amongst the coal producers of the form identified at paragraph 56 that cannot be accommodated by opting out of the bargaining group; and
 - b. the extent to which any such diversity of interests and preferences as between one coal producer and another cannot be accommodated within a collective bargaining framework, such as by

⁵⁰ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 71; and *Expert report of Greg Houston*, 30 July 2021, para 173.

⁵¹ *Expert report of Greg Houston*, 30 July 2021, paras 186, 192.

⁵² *Expert report of Greg Houston*, 30 July 2021, paras 263-265.

developing a menu of compatible items across each of the potential dimension for the terms of the port access service.

60. Economic considerations that are likely to increase the risk of the authorised collective bargaining conduct 'spilling over' in the form of collusive conduct directed at one or more markets beyond the scope of the authorised conduct include:
- a. the existence of markets for the sale of export coal in which the coal producers' individual interests in those markets are more homogeneous, as distinct from differentiated; and
 - b. the existence of markets for the procurement of inputs in which the coal producers' individual interests in those markets are more homogeneous, as distinct from differentiated; and
 - c. in relation to all such dependent markets, the existence of factors that facilitate (or contrarily, reduce) collusive conduct.

4. Opinions of Mr Morton on economic framework

61. This section set out matters in relation to the economic framework and considerations applying on which Mr Morton does not agree with Dr Smith and Mr Houston, and the reasons for Mr Morton's disagreement.
62. Dr Smith and Mr Houston note that they have not had an opportunity to review and/or provide any responsive opinion to the material below.

4.1 Welfare and transaction cost effects

63. In Mr Morton's report,⁵³ Mr Morton endorsed the view that Dr Smith expressed concerning the welfare effects of efficiency increases. In particular, Mr Morton agreed with Dr Smith's statement that "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."⁵⁴
64. However, Mr Morton has a different interpretation of the meaning and application of the total welfare standard, as set out in the joint report to the views of Mr Houston and Dr Smith. Section 2.1 of the Joint Report states that the total welfare standard assumes that a dollar of consumer surplus is valued equally to a dollar of producer surplus. This means that all consumer (or buyer) and producer surplus gains and losses can be simply added together (or netted off as the case may be) so that the incidence of who gains and loses is of no consequence.
65. The difference of view arises in the interpretation of the value of resources that are saved to the extent that collective bargaining reduces transactions costs and enables resources to be of value elsewhere in the economy.
66. Mr Morton understands that Mr Houston and Dr Smith are of the view that if there is no change in output in the primary market but there are transactions costs savings, the resources that are displaced from the input market relevant for bilateral bargaining need to be redeployed in a way that is of equivalent value to the economy as their value prior to undertaking the collective bargaining.
67. In Mr Morton's opinion, this treatment in effect means that a total welfare standard is not applied because there can be no adverse effect in terms of losses for the input market. Where consumer surplus and producer surplus effects associated with a reduction in transactions costs from the collective bargaining offset each other, the value of the resources that are displaced only need to be of some positive value in the rest of the economy for total surplus to increase and for a public benefit to arise.
68. This proposition can be demonstrated as follows:
- a. In relation to the reduction in transactions costs assume: $\text{change in Surplus}^{\text{coal producers} + \text{PNO}} + (\text{offsetting}) \text{ change in Producer Surplus}^{\text{professional inputs for bargaining}} = 0$;
 - b. for the resources that are displaced elsewhere in the economy assume: $\text{change in Producer or Consumer Surplus}^{\text{elsewhere in the economy}} > 0$;
 - c. then Total Surplus change = $\text{change in Surplus}^{\text{coal producers} + \text{PNO}} + (\text{offsetting}) \text{ change in Producer Surplus}^{\text{professional inputs for bargaining}} + \text{change in Producer or Consumer Surplus}^{\text{elsewhere in the economy}} > 0$.

⁵³ *Expert report of Euan Morton*, 25 June 2021, para 13

⁵⁴ *Expert report of Dr Rhonda Smith*, 22 April 2021, para 42

69. This representation implies that Mr Houston and Dr Smith in effect assumes that there can be no loss for displaced resources when comparing their value with and without collective bargaining. I maintain this is not consistent with the total welfare standard. For collective bargaining to increase total surplus even when there is no change in output in the primary market but there are transactions costs savings then the resources that are displaced as a result of the collective bargaining only need to be of some positive value for there to be an increase total surplus.
70. Mr Morton maintains that it is reasonable to assume that the displaced professional resources would be of some reasonable positive value in the situation where collective bargaining applies.
71. Mr Morton also has a different interpretation of the extent to which an output change can be used to indicate a change in total welfare. An increase in output can be an indicator of a public benefit if the economic value of the change in output in a particular market exceeds the additional cost of its production as noted in the joint report. However, an output effect is an incomplete measure if there are impacts in other markets that need to be recognised or where there are other factors, such as externalities that are affected. For the circumstances applying here output changes in the market for port services and the input market for transactional services do not necessarily provide a complete measure of a change in total surplus or welfare from the realisation of transactional efficiencies because there is a need to take account of transactions costs savings, as a result of collective bargaining, that are of value elsewhere in the economy.

5. Effects of collective bargaining

72. This section sets out the matters of agreement and disagreement in relation to the likely economic efficiency effects of the authorised collective bargaining conduct for port access services provided by PNO.

5.1 Primary and/or dependent market efficiency effects

73. The experts form different opinions as to the likely effects of the authorised collective bargaining conduct in relation to the primary and/or dependent markets. Each expert sets out their opinion and the bases for that opinion below.

5.1.1 Dr Smith

74. In Dr Smith's opinion, there will be some public benefit in primary and/or dependent markets from authorised collective bargaining relative to bilateral negotiation:
75. Collective bargaining may increase the efficiency of the bargaining process by addressing the imbalance in bargaining power between the parties, asymmetry of information concerning supply costs, and any lack of bargaining skill/experience of individual parties.
76. While I agree that PNO's market power is constrained to some degree, it is not eliminated. Market power results in a dead weight loss (misallocation of resources). As discussed elsewhere in Dr Smith's report, PNO has some market power which affects its bargaining power.
77. In bargaining bilaterally, PNO can 'play off' individual coal producers against each other to transfer surplus from the coal producers to itself, notwithstanding the MFN provision in the Producer Deed.
78. Dr Smith does not agree that a common interest in maximising coal exports necessarily constrains PNO such that its bargaining power is not influenced by its market power. PNO controls the gateway for coal exports from the Hunter Valley region. If the demand for port access services is relatively inelastic, an increase in access fees will increase PNO's revenue more than it will adversely affect demand for its services. Further, to the extent that export demand for coal is relatively elastic, cost increases are likely to be at least partially absorbed by the coal producers. If this occurs, this reduces the ability of the coal producers to invest.
79. To the extent that authorised collective bargaining results in reduced fees for port access or a slower increase in these, producers' ability to invest is increased. If collective bargaining results in a more appropriate risk allocation and this means that there is greater certainty/less risk in decision-making in the future, this provides an incentive for more and/or more efficient investment.
80. The increased efficiency and increased investment resulting from authorised collective bargaining would be a private benefit. However, providing an increased incentive and ability to invest it results in a public benefit, possibly resulting in increased employment with flow - through benefits to the region and increased exports.
81. If collective bargaining resulted in more efficient supply of port services, including but not confined to lower access charges, this may benefit ship owners (speedier turn around times for example) which may help to support exports if export demand is relatively price elastic, which would be a public benefit.

5.1.2 Mr Morton

82. Prior to considering the effect of collective bargaining in relation to the primary and/or dependent market efficiency effects, Mr Morton has first addressed matters in relation to the application of the economic framework and principles which informs the opinions Mr Morton expresses.

Price elasticity of demand

83. Mr Morton considers that the price inelasticity of demand for PNO's port access services over a significant range of port prices reflects the combination of the following two factors:
- a. that the WCh and NSC together represent a relatively small proportion of other coal production costs as well as the market value of export coal; and
 - b. the high value of sunk investment by existing coal producers.
84. As a result, Mr Morton considers that, to the extent that demand constrains price:
- a. a change in the current or expected price of port access services is likely to have limited impact on demand for the service by existing Producers who have substantial sunk investment
 - b. however a change in the current or expected price of port access services can potentially have a greater impact on demand where:
 - i. Required investment is not yet sunk, and Producers will consider whether they are willing to invest in additional coal production
 - ii. Investment is required to maintain existing demand for the port access services as existing mines reach the end of their mine life

Incentives and strength of constraints on PNO

85. There is agreement between the experts that the service provided by PNO involves the use of a natural monopoly and that there are a range of factors that will constrain PNO's conduct in bargaining with coal producers in relation to price and other terms. However, the experts disagree as to the strength of these constraints. In Mr Morton's view, factors other than demand alone constrain PNO, but these factors do not necessarily provide a strong constraint on PNO, such as from increasing prices from their current level.
86. In relation to PNO's interest in encouraging additional demand for port access service from coal producers (include reference to paras from Joint Report):
- a. Mr Morton agrees 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, and accepting any consequential impact on volume, rather than maintaining lower prices in order to encourage additional volume⁵⁵ (Morton 2021, ¶19-20);
 - b. Hence Mr Morton considers that PNO's preference for higher port volumes alone will provide only a weak constraint on PNO's ability to significantly increase its prices under the Producers Deed.
87. In relation to the terms of executed Vessel Agents' Deeds providing an upper bound on the applicable terms and conditions for port access services that may be agreed in the Producer Deed:

⁵⁵ *Expert Report of Mr Morton*, 25 June 2021, paras 19-20, see also Synergies (2018), Port of Newcastle – Assessment of revocation application by Port of Newcastle Operations, 8 August 2018, section 2.3.3; Synergies (2019), Port of Newcastle – Assessment of revocation application by Port of Newcastle Operations Pty Ltd, 4 February 2019, section 2.5.1.

- a. Mr Morton is not aware of the extent to which vessel agents have executed Vessel Agents Deeds, nor of the final terms of any executed deeds. However, Mr Morton has reviewed PNO's pro-forma Vessel Agents Deed and notes that its terms in relation to the initial value, escalation and review of the NSC are the same as the terms of PNO's pro-forma Producers Deed;
- b. In Mr Morton's, that these terms offer only limited certainty and confidence as to future NSC charges, and provide considerable opportunity for PNO to significantly increase price.⁵⁶
- c. Mr Morton also considers that vessel agents will normally incorporate the NSC as a cost component of the shipping cost that is passed through to shippers. As a consequence, vessel agents will be less concerned with price increases than will Producers, provided that all vessel agents are subject to the same price increases.
- d. Hence, Mr Morton considers that the terms of executed Vessel Agents Deeds will provide only a weak constraint on PNO's ability to significantly increase its prices.
- e. Similarly, it could be said that the charges specified in PNO's published Schedule of Charges may provide an upper bound on the terms and conditions that could be agreed in the Producers Deed. However, PNO has a high degree of discretion in setting these charges, and Mr Morton does not consider that this will constrain PNO's ability to significantly increase its prices
- f. The uncertainty surrounding the interpretation of the price review provisions of the Vessel Agents Deed and Producers Deed mean that there is a heightened risk of disputation and arbitration if material price rises occur during the term of the contract.

88. In relation to PNO's concerns as to the risk of regulatory intervention:

- a. Mr Morton considers that the risks of regulatory intervention is unlikely to constrain PNO from significantly increasing its prices under the Producer Deed if executed.
- b. However, Mr Morton agrees that the risk of regulatory intervention will increase in the face of large price increases, and regulatory risk will ultimately constrain PNO from setting a profit maximising price.

Differences in pricing under deed vs ACCC and ACT decisions

89. While the initial NSC charge established in the existing Vessel Agents Deed and pro-formal Producers Deed lies between that determined by the ACCC and the ACT,⁵⁷ there are significant differences provisions for escalation and review under the Deeds compared to the ACCC and ACT determinations.

90. The ACCC⁵⁸ and ACT⁵⁹ determinations both provide for:

- a. an annual review including:
 - i. a revenue cap adjustment of charges to reflect changes in the volume of coal throughput at the port (which would result in charges decreasing if volumes rise or in charges increasing if volumes fall); and

⁵⁶ *Expert Report of Mr Morton*, 25 June 2021, paras 34-76.

⁵⁷ ACCC, *Access dispute between Glencore Coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd*, Final Determination: Statement of Reasons, 18 September 2018, p 7; Australian Competition Tribunal, *Application by Port of Newcastle Operations Pty Ltd [2019] ACompT 1*, 30 October 2019, para 609.

⁵⁸ ACCC, *Access dispute between Glencore Coal Assets Australia Pty Ltd and Port of Newcastle Operations Pty Ltd*, Final Determination: Statement of Reasons, 18 September 2018, pp.178-182.

⁵⁹ Australian Competition Tribunal, *Application by Port of Newcastle Operations Pty Ltd [2019] ACompT 1*, 30 October 2019, Annexure B, Clauses 6.2, 7.1, 7.2.

- ii. and a price adjustment for defined material changes events; and
- b. a five year review of charges using the pricing methodology specified in the determinations, including a specified approach for rolling forward the asset base.

91. In contrast, the Deeds provide for:

- a. an annual adjustment of the greater of CPI or 4% (Item 7(a)); and
- b. an additional increase may be applied where the increase is material (being more than 5%) and consistent with the Pricing Principles specified in the Deeds (Item 7(b)).

92. The Pricing Principles are specified in high level and uncertain terms, but in any case permit prices to be set in ways inconsistent with the pricing methodology under the ACCC and ACT determinations, including in relation to:

- a. the absence of any cost allocation principles limiting the costs considered under the deed to the cost of providing the navigation service,⁶⁰ which is an implicit feature of both the ACCC and ACT determinations;
- b. allowance for future depreciation of perpetual assets such as the channel,⁶¹ which would not be permitted under either the ACCC or ACT determinations; and
- c. no recognition of user contributions,⁶² which was required under the ACCC determination and the decision of the Full Federal Court⁶³.

93. For these reasons, Mr Morton considers that there is substantial opportunity for prices to increase under the Deeds to levels materially higher than would be permitted under the ACCC and ACT determinations. More significantly, the departures particularly concerning the absence of cost allocation principles could increase the risk of disputes emerging from price reviews.

Availability and attractiveness of outside options

94. Mr Morton considers that, in the absence of agreement on the terms of the Producer Deed, it is likely that producers will continue to ship coal through the Port of Newcastle under alternate available terms, including:

- a. a Vessel Agents Deed (if executed with the relevant vessel agent), which provides very similar arrangements as PNO's proposed Producer Deed. As discussed above, Mr Morton considers that the Vessel Agents Deed does not provide a strong constraint on PNO's ability to significantly increase prices (amongst other things because Producers are not parties to it); or
- b. if no Vessel Agents Deed is in place, the terms of the port's published schedule of charges⁶⁴ which is \$1.0580 per GT (excl GST) for the NSC, which is materially higher than the starting price under the vessel agents deed. PNO has the opportunity to review its scheduled charges at its discretion, and Mr Morton considers that there are only weak constraints on PNO's ability to significantly increase its scheduled charges.

95. While a coal producer could choose not to ship coal through the port, given the high inelasticity of demand over a significant range of port prices, Mr Morton considers this to be an unlikely outcome which, if it occurred, would be at a high cost to a coal producer as given the absence of an alternate

⁶⁰ *Expert Report of Mr Morton*, 25 June 2021, paras 47-53.

⁶¹ *Expert Report of Mr Morton*, 25 June 2021, paras 54-59.

⁶² *Expert Report of Mr Morton*, 25 June 2021, paras 60-64.

⁶³ Federal Court of Australia (2020), *Glencore Coal Assets Australia Pty Ltd v Australian Competition Tribunal* [2020] FACF 145

⁶⁴ See Port of Newcastle (2020), Schedule of Service Charges effective from 1 January 2020, p.4

means of exporting coal, it would effectively require the producer to cease production of coal for export.

96. Mr Morton considers that the attractiveness of these outside options differs between PNO and coal producers as follows:
- a. For PNO, the available outside options provide for either similar or higher prices in the short term with similar or higher ability to review prices in future. However, gaining producers' agreement to the pricing principles (which include a favourable outcome on matters long in dispute between PNO and the Producer,⁶⁵ such as the treatment of user funded assets and the treatment of depreciation on the channel assets) will reduce the regulatory risk of these price increases as regulators will generally not intervene in a commercially negotiated agreement);
 - b. For an individual coal producer, the outside options provide for the same, or higher prices to be applied, but have the advantage of preserving its ability to challenge PNO's pricing principles, including potentially seeking regulatory intervention if PNO does not agree to amended pricing principles. However, as can be observed from efforts by coal producers (particularly Glencore) to achieve regulation of PNO, there is a high cost to seeking regulatory intervention, which will be likely to create a disincentive for individual coal producers taking this path.
97. Given the above factors, Mr Morton considers that, under bilateral negotiations, PNO's outside options are materially more attractive than those of individual coal producers, weighting the balance of bargaining power towards PNO.

Effect of collective bargaining on balance of bargaining power

98. Mr Morton notes Mr Houston contends that collective bargaining will not change the balance of bargaining power as it does not change the outside options available to the parties, and therefore will not meaningfully change the constraints applying to PNO.⁶⁶
99. Mr Morton disagrees with this view, and considers that collective bargaining could assist Producers in effectively negotiating with PNO for the following reasons:
- a. Collective bargaining provides an opportunity to change the outside options available to coal producers as, acting collectively, coal producers have a greater opportunity to seek regulatory intervention in relation to PNO's pricing practices than they do individually, because in a collective bargaining environment:
 - i. If agreements are reached between PNO and the Producers they are likely to have improved terms, including in relation to price review,
 - ii. a single industry voice will be more influential with policy makers, and
 - iii. because the high cost of seeking regulatory intervention can be shared amongst the producers.
 - b. Collective bargaining can assist in reducing the asymmetry of information between coal producers and PNO, enabling coal producers to share information in relation to the negotiations;

⁶⁵ See, for example, New South Wales Minerals Council (2020), application for a declaration recommendation in relation to the Port of Newcastle, July 2020, pp.5-6. The application noted users' concerns with PNO's Deed and, specifically, users did not consider it reasonable having to double pay for past user funded channel dredging.

⁶⁶ *Expert Report of Mr Houston*, 30 July 2021, paras 115, 120.

100. Collective bargaining can allow a more effective pursuit of issues, through enhancing the negotiating capacity of the coal producers, including as a result of the sharing of the cost associated with appointing expert advisors.

Primary and/or dependent market efficiency effect

101. Mr Morton considers that:

- a. There is significant scope for improvement in the terms of the pro-forma Producer Deed in terms of creating increased future pricing certainty for users in order to avoid disputation and arbitrations;
- b. bilateral negotiations conducted to date have had limited impact in achieving sufficient amendment by PNO to materially increase future pricing certainty;
- c. 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,⁶⁷ and may result in some reduction in NSW coal production volumes,⁶⁸ although Mr Morton acknowledges that the extent of this impact is unclear.

102. Mr Morton's expert report identifies a range of matters where the pro-forma Producer Deed does not provide pricing certainty and permits PNO to significantly increase prices.⁶⁹ Each of these matters reflects areas where there is potential for improvement in the terms of the pro-forma Producers Deed.

- a. Mr Houston has pointed to the outcomes of the four month period prior to interim authorisation being granted, where PNO and producers engaged in active bilateral negotiations as demonstrating the limited scope for producers, acting collectively, to achieve more favourable bargaining outcomes. During these bilateral negotiations PNO agreed to the addition of non-discrimination provisions and provisions offering coal producers visibility of, and the opportunity to comment on, capital expenditure proposed to be incurred by PNO.⁷⁰ Mr Morton considers that the amendments that PNO agreed to make did not go sufficiently to materially improve future pricing certainty so as to materially reduce the prospect of future disputation and arbitration.

103. While Mr Morton is unable to predict the extent to which collective bargaining by coal producers will actually achieve more efficient contractual outcomes, Mr Morton considers that collective bargaining will present the best opportunity for coal producers to negotiate a balanced contract that will minimise the emergence of future disputes by better articulating the circumstances triggering future price adjustments and, in that event, quantifying the impact on future prices. Mr Morton also considers that collective bargaining is more likely to result in a Producers Deed that encourages increases in output from the coal industry, although although Mr Morton acknowledges that the extent of this impact is unclear and may be limited.

5.1.3 Mr Houston

104. In Mr Houston's opinion:

- a. there is limited scope for improvement in the terms of the pro forma Producer Deed to be achieved by means of collective bargaining that could not otherwise be achieved through bilateral negotiations; and

⁶⁷ *Expert Report of Mr Morton*, 25 June 2021, para 77(b)

⁶⁸ *Expert Report of Mr Morton*, 25 June 2021, para 77(c)

⁶⁹ *Expert Report of Mr Morton*, 25 June 2021, paras

⁷⁰ *Expert Report of Mr Houston*, 30 July 2021, paras 123-126.

- b. any potential improvements that may be achieved are unlikely to give rise to an increase in output in the primary or dependent markets in either the near or long term.

105. In forming this opinion, Mr Houston has had regard to the absence of evidence that:

- a. the terms of the pro forma Producer Deed – which are available in the absence of collective bargaining – reflect the unconstrained exercise of any market power or would induce any loss of output in any market;
- b. the authorised conduct will alter the bargaining power of coal producers to such an extent that more favourable negotiating outcomes will be achieved; and
- c. that changes in negotiated outcomes by consequence of the authorised conduct will give rise to the prospect of increased output in any market.

106. Mr Houston has also had regard to the existence of evidence that:

- a. the prevailing and future agreed levels of the NSC – as reflected in the Agents Deeds – have been established at levels consistent with PNO being constrained by the apprehension of a threat of regulatory intervention;⁷¹
- b. PNO is highly dependent on coal export activities as its principal source of revenue and will continue to be so over the medium term, irrespective of the outlook for the wider coal industry;⁷² and
- c. the Port of Newcastle has ample excess channel capacity and PNO has a strong interest in encouraging efficient investment in and ensuring the economic viability of all activities associated with the production of export coal, over the 98-year term of its lease.⁷³

107. Drawing these observations together, in Mr Houston's opinion:

- a. there is no clear evidence that the authorised conduct has or is likely to give rise to a material improvement in the terms of the pro forma Producer Deed;
- b. even if the authorised conduct was likely to give rise to more favourable terms, the highly inelastic nature of demand for port access services means that any such outcome would not give rise to a discernible increase in output;⁷⁴ and
- c. the insignificance of port access charges relative to the magnitude of cyclical fluctuations in the markets for export coal implies that the authorised conduct cannot be expected to alter upstream mining investment decisions and so increase efficiency or output in the near or long term.⁷⁵

5.2 Transactions-cost related efficiency effects

108. The experts form different opinions as to the likely effects of the authorised collective bargaining conduct in relation to transactions-costs related efficiency effects. Each expert sets out their opinion and the bases for that opinion below.

⁷¹ *Expert report of Mr Houston*, 30 July 2021, para 98.

⁷² *Expert report of Mr Houston*, 30 July 2021, para 109.

⁷³ *Expert report of Mr Houston*, 30 July 2021, para 100.

⁷⁴ *Expert report of Mr Houston*, 30 July 2021, paras 147, 151, 283.

⁷⁵ *Expert report of Mr Houston*, 30 July 2021, para 162.

5.2.1 Dr Smith

109. In Dr Smith's opinion, authorised collective bargaining is likely to result in a net decrease in transaction costs and so some public benefit resulting from the efficiency gains, although they may be modest.
110. Dr Smith's Report identifies a number of factors that will affect the extent of the efficiency gains from collective negotiation compared to bilateral negotiation (paragraphs 70-74).
111. Authorised collective bargaining is likely to reduce the input of time and resources in the bargaining process relative to numerous individual negotiations with PNO and so reduce transactions costs of the individual coal producers.
112. However, at least some of this saving will be offset by the additional transactions costs incurred due to the producers needing to arrive at an agreed bargaining position. As agreed, this will reflect the degree of diversity of views of the coal producers with respect to issues relating to port services. The circumstances of individual coal producers differ resulting in different decisions concerning matters such as to how much to produce, the timing of changes in output and the amount of investment. However, it seems likely that their views in relation to port access services are less diverse - their aim is to export the desired amount of coal as quickly and as cheaply as possible. If this is correct, then any increase in transaction costs is likely to be relatively small.
113. There will also be a saving in transaction costs by PNO to the extent that it is no longer be negotiating separately with each coal producer. These resources are available to be productively employed in other markets and so this will be a public benefit.
114. The extent of the saving in transaction costs is reduced the greater the degree to which individual coal producers opt out of the authorised collective bargaining.
115. Some, though less, of cost saving will still be available even if PNO refuses to negotiate collectively. This is because the authorisation to collectively bargain enables the coal producers to discuss a common approach even if ultimately individual producers negotiate separately.
116. Although the MFN provision in the Producer Deed ensures that all producers obtain the best deal negotiated, there may still be multiple negotiations and it is assumed that the MFN relates only to access fees but the authorisation allows negotiation of other terms of access.

5.2.2 Mr Morton

117. Mr Morton considers that collective bargaining will provide for potential reductions in transaction costs associated with the negotiation of the Producer's Deed, both as a result of reductions in costs for:
- a. Coal producers, who can pool resources when interacting with PNO and negotiate more efficiently with PNO; and
 - b. PNO, who will be able to negotiate with a single collective group of producers, rather than in a series of bilateral negotiations.
118. In addition, in the event of agreement being reached on the Producers Deed (assuming it were to be executed largely in its current form), the large and uncertain range within which prices may be set in compliance with the Pricing Principles, together with 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 services, increases the likelihood of pricing disputes arising.⁷⁶ In the event that collective bargaining did not result in an improved agreement on these issues, it would nevertheless allow for such disputes to be

⁷⁶ *Expert Report of Mr Morton*, 25 June 2021, para 77(e)-(f)

collectively resolved rather than through a series of separate arbitrations addressing the same issues, which could significantly reduce the transaction costs of dispute resolution under the Producer Deed.

119. Mr Morton considers that the different circumstances applying to each mining producer, as identified in paragraph 56 are unlikely to result in significant differences in the commonality of the coal producers' interests insofar as their requirements for the Producer's Deed is concerned. This reflects that these differences, including differences in the type and quality of coal, mine size and location, quality of coal reserves, or the nature of the agreements under which coal is sold do not impact on the nature of the service that coal producers require from PNO, which is to provide facilities to enable the loading of coal onto vessels for export, although they may affect preferred contract duration. The most substantive issues addressed by the Producers Deed relate to the price for the service, including in relation to the price escalation and review, pricing principles and dispute resolution (and perhaps to a lesser extent, initial price), however the non-discrimination provisions in the Deed prevent material differences between individual Producer Deeds.
120. As a result, Mr Morton considers it likely that the cost savings and associated efficiency improvements resulting from collective bargaining, including associated with the negotiation, monitoring and potential dispute resolution over the term of an agreement, will exceed the efficiency costs involved in coal producers negotiating internally to reach a common position (including any efficiency costs of compromises amongst them to reach agreement) and as such enables an efficiency improvement.

5.2.3 Mr Houston

121. In Mr Houston's opinion, there is no clear basis on which to conclude that the net effect of the authorised conduct will cause either an increase or a decrease in transaction costs. This ambiguity derives from:
- a. the additional transactions costs likely to be incurred by consequence of the requirement for intra-group discussions between coal producers that exhibit multiple, relevant heterogeneous characteristics;⁷⁷
 - b. the potential for duplication of costs in circumstances where producers first need to negotiate internally to reach a common position and then subsequently engage in bilateral negotiations with PNO;⁷⁸
 - c. the relatively limited scope of terms remaining to be negotiated in the Producer Deed, since a pro forma version is available under both the factual and the counterfactual;⁷⁹ and
 - d. non-discriminatory pricing clause included in the pro forma Producer Deed, which implies that, under the counterfactual, some producers may be able to avoid costly negotiations by relying fully on the actions of others, thereby reducing the transaction cost savings that may arise under collective bargaining.⁸⁰
122. In terms of the empirical evidence available to inform the potential for transactions costs savings, none suggests that the collective bargaining conduct would be likely to reduce the extent of transaction costs in negotiating the terms of the pro forma Producer Deed. To the extent any such evidence may become available, it would need to address both the resource saving and the costs of coordination for the bargaining group and weigh their relative effects.⁸¹

⁷⁷ *Expert report of Mr Houston*, 30 July 2021, para 286.

⁷⁸ *Expert report of Mr Houston*, 30 July 2021, para 179.

⁷⁹ *Expert report of Mr Houston*, 30 July 2021, para 182.

⁸⁰ *Expert report of Mr Houston*, 30 July 2021, para 183.

⁸¹ *Expert report of Mr Houston*, 30 July 2021, para 181.

123. In any event, the transactions cost effects of the authorised conduct are likely to be immaterial, relative to the magnitude of cyclical fluctuations in the markets for export coal, and would be very unlikely to result in an increase in coal throughput at the Port of Newcastle.⁸² Further, for any potential net reduction in transactions costs to amount to a public benefit, it needs to be presumed that the resources saved are redeployed to generate economic income and surplus of at least the same value.

5.3 Detrimental efficiency effects

124. The experts form different opinions as to the likely detrimental efficiency effects of the authorised collective bargaining conduct. Each expert sets out their opinion and the bases for that opinion below.

5.3.1 Dr Smith

125. Dr Smith agrees that there is a risk that authorised collective bargaining may result in inappropriate exchanges of information and hence anti-competitive effects in input markets and in the export market for coal.
126. However, for the reasons explained in her report (paragraphs 91-94), in her opinion the risk of collusive conduct in other markets is small and consequently so is the detriment or public disbenefit.
127. In addition, it has been suggested that collective negotiation may disadvantage smaller mining companies and/or companies with different interests from those engaged in collective negotiation. This would be a private detriment but presumably others better served by agreeing a common position would achieve a private benefit.
128. There would be a public detriment if this resulted in net decrease in demand for inputs and/or a net decrease in exports. The extent of any such detriment is affected by the extent of the difference between the coal producers in relation to matters relating to port services. If those differences are small, then any detriment will be small.
129. In addition, at least in relation to wharfage charges, PNO has provided a MFN undertaking. Also, those producers who do not expect to benefit from the collective position can opt out and negotiate, although this would reduce the benefits from transaction cost savings.
130. In Dr Smith's opinion while there is a risk that some coal producers will be disadvantaged by collective bargaining, that risk is small.

5.3.2 Mr Morton

Risk of that diversity of interests will not be recognised in agreements

131. Mr Morton considers that there is a low risk that collective bargaining will result in the diversity of coal producers interests not being adequately recognised in Producers Deeds. This reflects that:
- a. As described above, the different circumstances applying to each mining producer are unlikely to result in significant differences in the commonality of the coal producers' interests insofar as their requirements for the Producer's Deed is concerned;
 - b. In Mr Morton's experience from viewing collective bargaining negotiations, a range of measures can be adopted to accommodate individual interests in a collective bargaining framework. For example, collective negotiation could result in a menu of options. Alternatively, collective negotiation could extend to the development of an agreed pro-forma contract, with finalisation of individual contracts managed through bilateral discussions. This would provide an opportunity for

⁸² *Expert report of Mr Houston*, 30 July 2021, para 288.

individual coal producers to address their specific requirements prior to executing a Producers Deed;

- c. In any case, in the event that any coal producer feels that its interests are not being effectively addressed through the collective negotiation, they are free to exercise their option to negotiate bilaterally.

132. In Mr Morton's opinion, the issue of materiality of the transactions costs savings should be assessed in absolute rather than relative terms. Accordingly, whether or not transaction cost savings are material in the context of the overall value of exports from the Producers is not relevant.

Risk of collusive conduct

133. Depending on a range of circumstances, it is possible that collective bargaining can increase the risk of collusion in particular markets. Mr Houston has identified a number of markets that may be affected by collusion and asserted that the authorised conduct materially increases the risk of collusion.

134. In order to assess whether the risk of collusion is increased from collective bargaining in each of the markets under consideration, it is:

- a. first necessary to assess the likelihood of collusion in each of the markets under consideration amongst the Producers or a subset of them; and
- b. then assess the incremental impact of the collective bargaining authorisation on the likelihood of that collusion, having regard to (amongst other things):
 - i. all of the other opportunities parties intending to collude have to plan and interact with one another and
 - ii. any other factors that are particular to the collective bargaining authorisation that make collusion less likely (including for example, the risk that collusion would imperil future collective bargaining applications).

135. Mr Morton considers that there are a number of factors that would need to be established in order to form the view that the collective bargaining authorisation would lead to a material increase in the risk of collusion, including:

- a. It is far from clear that collusion is likely in any of the markets Mr Houston asserts would be exposed to an increased risk of collusion. For example, even leaving aside the risks and consequences of being prosecuted for colluding, demonstrating the financial profitability of collusion is likely to be challenging. For example, in relation to the coal export market, for collusion to be profitable, in circumstances where Producers are unable to reduce cost in the short term in response to a reduction in volume, then the reduction in volume needs to produce a price increase of approximately the same size of the output reduction. In the context of the global thermal coal market, in my view, this is a very strong assumption.
- b. The major producers dominate the industry's output (eg Glencore is responsible for approximately 40% of Hunter Valley output)⁸³ and several have a significant presence in other resources markets, including the coal industry. In my opinion, this complicates an assessment of the payoffs from collusion in the markets Mr Houston has identified. For example, inputs for mining operations are commonly national (or international) markets and may be procured centrally by major Producers – the incremental benefit from collusion for these Producers is unclear. Collective bargaining authorisation is potentially available to smaller producers for these matters.

⁸³ <https://www.glencore.com.au/dam/jcr:debca499-980f-4b72-b8cc-21a3fdd08e5a/glencore-australia-2021-corporate-profile.pdf>

- c. The risks and consequences for collusion are significant. Even if these can be overcome, it is relevant that the Producers interact in multiple forums. To the extent that the Producers may rely on collective bargaining for other aspects of their operations (whether in the Hunter Valley or elsewhere), it makes it more unlikely that they would rely on collective bargaining as the vehicle to collude as it would make future authorisations even more unlikely. As such, the availability of these other forums makes it more unlikely that collective bargaining would be used as a vehicle for that collusion.

136. In summary, in order to assess the impact of the collective bargaining authorisation on the risk of collusion, it is first necessary to understand risk of collusion and then assess how that risk is increased through the collective bargaining authorisation. If the risks of collusion are significant, which has not been demonstrated, then the question becomes whether the collective bargaining authorisation facilitates a heightened risk of collusion, particularly having regard to the other opportunities that are available to the parties to engage in that activity. Mr Morton does not perceive that collective bargaining will increase the risk of collusion to any material degree.

5.3.3 Mr Houston

137. In Mr Houston's opinion, the authorised conduct materially increases the risk of collusive conduct by coal producers in relation to the export market for thermal coal. It is highly likely that a coordinated reduction in supply by a group of inframarginal producers exporting coal from the Port of Newcastle would affect the world price of thermal coal, giving rise to inefficient outcomes in related markets.⁸⁴ The risk of collusive conduct of this form should therefore be carefully assessed as a potential, material detriment of the authorised collective bargaining conduct.
138. Similarly, there is a potential risk for the authorised collective bargaining conduct to present opportunities for coal producers to engage in collusive conduct in relation to procurement decisions in local input markets, such as for labour, tenements, and mining equipment.⁸⁵
139. Further, the authorised conduct is likely to restrain the individual preferences of coal producers when negotiating the terms of port access services, potentially leading to less efficient contractual arrangements. In Mr Houston's opinion:⁸⁶
- a. the interests of coal producers are unlikely to be compatibly aligned on all parameters the subject of negotiation; so that
 - b. the individual interests of coal producers must be restrained to reach a unified position for the purpose of collective bargaining; and
 - c. dominant producers are likely to be able to obtain the terms most favourable to them, marginalising smaller producers and reducing non-price competition.
140. Although the authorised collective bargaining conduct is voluntary, it can be presumed that there will be continuing pressure for individual coal producers to conform with the majority. This is consistent with the prospect of the additional benefits of remaining a member of the bargaining group, particularly in the context of potential gains from tacit collusion.⁸⁷
141. Finally, collective bargaining may increase information asymmetry between PNO and coal producers, because the interests and preferences of individual coal producers will not be revealed to PNO or

⁸⁴ *Expert report of Mr Houston*, 30 July 2021, paras 246-248.

⁸⁵ *Expert report of Mr Houston*, 30 July 2021, paras 253.

⁸⁶ *Expert report of Mr Houston*, 30 July 2021, para 259.

⁸⁷ *Expert report of Mr Houston*, 30 July 2021, para 269.

considered in negotiations, thereby discouraging individual outcomes that may otherwise have been agreed.⁸⁸

5.4 Conclusion

142. The experts form different opinions as to the aggregate of the effects of the authorised collective bargaining conduct described in sections 5.1 to 5.3 above, in relation to the primary and/or dependent markets. Each expert sets out their opinion and the bases for that opinion below.

5.4.1 Dr Smith

143. In Dr Smith's opinion:

- a. the authorised collective bargaining is unlikely to result in a small risk of collusive activity outside of the authorised conduct and is unlikely to result in much detriment to smaller mining companies and/or those with different interests.
- b. It is likely to result in increased efficiency in relation to:
 - i. the decision making of the producers, including encouraging increased investment and/or better informed investment decisions; and
 - ii. a net saving in transaction costs thereby releasing resources for redeployment.

144. While the public benefits may be relatively small, they are sufficient to outweigh the detriments.

5.4.2 Mr Morton

145. In Mr Morton's view:

146. The authorised collective bargaining is likely to result in increased efficiency on the basis that:

- a. there is significant scope for improvement in the terms of the pro-forma Producer Deed in terms of creating increased future pricing certainty, which may encourage increased efficient investment, although the extent of this is unclear; and
- b. collective bargaining is likely to lead to an efficiency saving in transaction costs associated with the negotiation, monitoring and potential dispute resolution over the term of an agreement.

147. The risk of economic detriments occurring as a result of the authorised collective bargaining is small as:

- a. the different circumstances applying to each mining producer are unlikely to result in significant differences in their requirements for the Producers Deed and, in any case they are likely to be able to be accommodated in a collective bargaining framework. Moreover, Producers are free to exercise their option to negotiate bilaterally if their interests cannot be satisfactorily addressed in a collective bargaining framework; and
- b. the authorised conduct is unlikely create an increased risk of collusive activity to any material degree.

148. While the public benefits may be small, the detriments are likely to be smaller, leading to a net public benefit from the authorised conduct.

⁸⁸ *Expert report of Mr Houston*, 30 July 2021, paras 266-267.

5.4.3 Mr Houston

149. In Mr Houston's opinion, across the three categories of efficiency effects identified in this report:

- a. there is no economic evidence to suggest that collective bargaining is likely to give rise to an increase in the output of a primary or dependent market, and so the potential for public benefits;
- b. there is no clear economic basis to conclude that transactions costs will be either higher or lower under collective bargaining; and
- c. the authorised conduct increases the risk of collusion by coal producers in relation to both the export market for thermal coal and local input markets, while also suppressing the interests of individual coal producers that could otherwise be pursued in bi-lateral negotiations.

150. Accordingly, there is no clear basis on which to conclude the authorised collective bargaining conduct would be likely to give rise to any net public benefit.

6. Declarations

151. In accordance with the requirements of the Code, the experts declare that they have made all inquiries that they believe are desirable and appropriate, and that no matters of significance that they regard as relevant have, to their knowledge, been withheld from the Tribunal.



Rhonda Smith
29 September 2021



Euan Morton



Greg Houston