AngloAmerican

Real Mining. Real People. Real Difference.

SUBMISSION
COMPETITION POLICY REVIEW

Anglo American Metallurgical Coal Pty Ltd submission to the Competition Policy Review Panel

June 2014

Table of Contents

1. Executive summary

Anglo American Metallurgical Coal Pty Ltd (**Anglo American**) welcomes this opportunity to present its views to the Competition Policy Review Panel regarding the current state of competition law within Australia.

Anglo American is one of the major global mining companies with significant coal interests in Australia.

The Competition Policy Review is especially topical in light of the numerous recent Federal, State and Territory policy initiatives aimed at privatising major multi-user and shared infrastructure assets that are vital for the natural resource supply chain. In particular, the Queensland Government has announced that it will consider privatising the Port of Gladstone and the Port of Townsville. Anglo American ships a significant amount of coal through the Port of Gladstone and therefore has a close interest in its potential privatisation.

While Anglo American fully supports the economic reasoning behind the privatisation of state assets, it believes that it is necessary to ensure that appropriate regulation is in place prior to the privatisation to ensure continued access to the asset at reasonable and economic rates and to prevent the abuse of natural monopolies. Such abuse can include "economic hold-up" where the natural monopolist refuses to expand the capacity of infrastructure unless users agree to uneconomic rent. This is particularly so where the private owner is also vertically integrated throughout the supply chain, in that instance the monopolist not only has the ability to demand uneconomic rent from access holders, it has an incentive to do so as well.

Anglo American believes that this is particularly important in light of the legal interpretation of Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**National Access Regime**) that has been adopted by the High Court in respect of the Fortescue Metals Group application for the declaration of the Pilbara railways in 2012.[1] This decision casts significant uncertainty over whether rail and port infrastructure can be the subject of a declaration under Part IIIA. Anglo American supports the need for separate consideration to be given to the appropriateness of regulation, and the form of regulation, for different forms of ownership structures. For example, the vertically integrated railways of the Pilbara need to have separate consideration from the multi-user networks which have developed in the Queensland and New South Wales coal networks.

Anglo American sees a number of ways that the National Access Regime can be modified in order to operate more effectively when constraining the power of a natural monopolist and promoting competition in Australian markets. While Anglo American agrees with the majority of the findings made by the Productivity Commission in its Final Report on its review of the National Access Regime,[2] Anglo American's views differ in certain areas. These are outlined in more detail below.

2. The importance of access regimes

In over a decade since the 2001 Productivity Commission review of the National Access Regime, the Australian mining industry has grown exponentially. In 2001 access regimes were still a relatively new and developing concept and it has become increasingly clear that the workability of multi-user access regimes is clearly essential to the competitiveness of Australian mining. There are a number of significant barriers which prevent every new mining project from constructing infrastructure exclusively for that project, including the prohibitive cost of large transport or export facilities, the need for significant economies of scale for the viability of a project, the extensive approvals regime at all levels of Australian government and the impediment of dealing with multiple land owners

[1] *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal; National Competition Council v Hamersley Iron Pty Ltd; National Competition Council v Robe River Mining Co Pty Ltd* (2012) 86 ALJR 1126.
[2] Productivity Commission, *Inquiry Report No. 66: National Access Regime* (25 October 2013).

across significant distances. As such, the Regime is vital to the international competitiveness of Australian mining.

Initially a large number of multi-user facilities were government-owned, however, the recent trend has been towards privatisation. Prior to this trend many investments were made on the understanding that access to export facilities was guaranteed, or at least, that the government entity would allow for access on a relatively non-discriminatory basis. Privatisations can, and have, resulted in ownership of significant natural monopoly infrastructure being transferred to vertically integrated companies, such as Telstra and Aurizon Limited, who may have an incentive to refuse access, to provide access on unfavourable terms or to place unreasonable conditions on expansion. Without government regulation, access to critical export infrastructure could be restricted or prevented and drastically affect the ability of Australian miners to remain competitive in the dynamic global industry. This could harm existing miners and also deter potential investment and investors from entering the Australian market. The recent significant decrease in commodity prices has engendered a sharp focus on costs and efficiencies. This, and the expectation of increased medium to long term production necessitating expanded capacity in several regulated supply chains, has highlighted the importance of effective access regimes. In short, the existence of workable National Access Regime is almost more important now than at any time in the history of the Regime.

Anglo American supports the Regime. However, Anglo American sees opportunities for this review to develop and extend the operation of the Regime in ways which facilitate the competitiveness of Australian mining and ensure continued investment in mining and infrastructure, which has been a significant driver of economic growth in Australia.

An interesting case study can be made of the operation of Queensland ports. **Table 1** sets out the Queensland coal export terminals in terms of ownership structure, name plate and the status of third party access. The table contains a column which categorises each port into one of the following:

(a) **Legislated access** – where the terminal is subject to regulation under a statutory third party access regime;[3]

(b) **Contractual access** – where the terminal owner / operator is subject to a third party access regime which has been imposed upon it under contractual obligations (for example, under a clause in a lease between the relevant government and the infrastructure owner / operator); or

(c) **No regime** – where the terminal is not subject to either a legislated or contractual third party access regime. This does not necessarily mean that there is no third party who has obtained access. There is a separate column which identifies whether the owner / operator of the facilities has given third party access (a point which becomes important when considering the Productivity Commission's final approach to declaration criterion (a), the "competition test").

Table 1: Coal Export Terminals in Queensland

Terminal and Nameplate	Ownership	Legislated or contractual access?	Third Party access	Comments
Abbott Point Coal Terminal (APCT)	Privatised (Adani)	No regime	There are currently a number of users	The pricing provisions of the contracts were

[3] For the purposes of this table legislated access does not include the circumstances where the facility might be the subject of a declaration under Part 5 of the QCA Act. It only includes facilities which are currently regulated under legislation. This exclusion has been made because the High Court's adoption of the private profitability test has introduced a high level of uncertainty as to which assets may be the subject of a declaration.

Terminal and Nameplate	Ownership	Legislated or contractual access?	Third Party access	Comments
(50 mtpa)			who have access under contracts entered into prior to the privatisation	subject to a lengthy arbitration
Hay Point Coal Terminal (44 mtpa)	Private (BMA)	No regime	No	No contracted capacity has ever been granted
DBCT (85 mtpa)	Privatised - 99 year lease from Queensland Government	Legislated access under the QCA Act	Yes	Legislated regulation was a requirement of privatisation
Wiggins Island Coal Export Terminal (WICET) (27 mtpa under construction)	Private - multi-owned by coal producers	Contractual access regime	Terminal Policy (WITAP)	WITAP required by Government in approvals and is binding on owner/operator by contract. There is a process of Deed of Assumption which allows third parties to directly enforce the WITAP against the owner / operator
RG Tanna Coal Terminal (68 mtpa)	Government-owned (Gladstone Ports Corporation)	No regime	Yes	The pricing structure is complex and based on NPV valuations contained in contracts between the port and customers
Barney Point Coal Terminal	Government-owned (Gladstone Ports Corporation)	No regime	Yes	The terminal is expected to be closed in 2015

In putting third party access arrangements in place prior to privatisation, a government fundamentally has two options:

(a) making the facility subject to a facility-specific access regime under legislation; or

(b) imposing contractual obligations upon the owner / operator of the facility to ensure third party access.

Anglo American was, and remains, strongly supportive of the fact that the Queensland Government required full access and price regulation of DBCT prior to granting the 99 year lease (currently held

by Brookfield). The continued access by Anglo American to DBCT at reasonable rates has been essential to Anglo American in exporting coal from Queensland.

In Anglo American's view, the Competition Policy Review Panel should ensure that legislation specifically provides that any access regime developed for critical export facilities prior to privatisation should address the following key principles:

(a) **Clear and non-discriminatory access rules to current capacity**: access should be provided to existing users on a non-discriminatory basis under transparent and clear standard access agreements;

(b) **Prohibition on over-contracting**: there should either be an outright prohibition on overcontracting capacity or financial penalties for the owner doing so as consequences for early users can be significant;

(c) **Expansions**: there should be clearly defined rules in respect of the expansion of the asset, including circumstances when expansions should be undertaken to create access to the expansion capacity by existing and new users and clear rules in respect of the return on the capital cost for the expansion (supported by clear legislative power to direct mandatory expansions if necessary);

(d) **Coal chain master planning**: to ensure the maximisation of the throughput of the rail and port supply chains, it is essential to have an appropriate framework in place in respect of the coordination of the systems and centralised planning. This may need to be facilitated by government as centralised coordination will not occur where there is separate ownership of the rail and port because incentives are not sufficiently aligned to ensure coordination; and

(e) **Pricing**: as railways and ports do exhibit natural monopoly characteristics, one of the significant issues is whether pricing is economically efficient. Prices should be based on either direct pass through costs with a return (where owned by industry) or an efficient weighted averaged cost of capital (**WACC**) established by an independent regulator.

3. Scope of the National Access Regime

While Anglo American agrees with the Productivity Commission's finding that the National Access Regime exists primarily to protect against lack of effective competition from natural monopolies, Anglo American warns against unnecessarily restricting the scope of the National Access Regime. Specifically coming into an economic period where privatisations are likely to be prevalent, it may be extremely difficult to determine the competitive tensions within any given market before the point of privatisation.

As was recognised years previously by the Hilmer Committee, and subsequently in the Productivity Commission's Draft Report, there are significant efficiency benefits that privatisation can bring but 'privatisation without appropriate regulation may entrench the anti-competitive structure of the former public monopolies'. Anglo American directs the Competition Policy Review Panel to an obvious example, the privatisation of the vertically integrated Aurizon Group of companies in Queensland. The major concern with vertical integration of a natural monopolist is that there is a clear incentive to refuse access to access seekers, to provide access on unfavourable terms or to place unreasonable conditions on expansions such that business opportunities (eg, mining exporters in Anglo American's position) become potentially unviable due to the costs associated with transport.

Further, Anglo American notes that retrospective regulation post-privatisation is bound to struggle to appropriately address the power held by the natural monopolist, as the regulator has already lost transparency regarding capacity and operation of the relevant facilities. Specifically, Anglo American sees that this is because:

(a) privatisation decreases the involvement of the regulator or government;

(b) Section 46 of the CCA does not prohibit monopoly pricing per se (ie, an infrastructure owner who engages in monopoly pricing but no vertical foreclosure or discrimination amongst users is unlikely to be in breach of the prohibition on misuse of market power) and is generally considered to be ineffective in facilitating third party access to infrastructure (although Anglo American notes that this point might fall under further scrutiny from the Competition Policy Review Panel); and

(c) once an asset has been privatised without access arrangements it is difficult for a government to make the asset subject to third party access regulation as it raises difficult issues of sovereign and regulatory risk, particularly if that same government is looking to privatise further assets in the future.

Anglo American notes that the Productivity Commission specifically suggested ensuring that appropriate access regimes are in place prior to the point of privatisation, a finding that Anglo American strongly supports. However, Anglo American believes that in order to limit the risk of inappropriate or untimely regulation the National Access Regime should have as broad a scope as possible to ensure that regulation is drafted for the issue in question, rather than ignored because the scope doesn't quite cover it. As such, restricting the application of the National Access Regime (as opposed to allowing discretion on the part of regulators and Ministers) unnecessarily weakens the National Access Regime.

4. The declaration criteria

Anglo American broadly supports the recommendations of the Productivity Commission in relation to the declaration criteria.

In particular, Anglo American strongly supports the Productivity Commission's redrafting of:

(a) **Criterion (a), the 'competition test'**. While Anglo American notes that the Productivity Commission's findings on criterion (a) raise the threshold that access seekers have to prove, Anglo American acknowledges that the restated test does reflect the true market dynamics at the point in time when the application for declaration is made. This gives fair consideration to infrastructure owners and operators who are already providing access on commercial terms, as long as those commercial terms are not anti-competitive, and prevents the imposition of unnecessarily high overheads or management costs. Anglo American strongly supports the Productivity Commission's findings on this point; and

(b) **Criterion (b), the 'uneconomic to duplicate' test**. The Productivity Commission's suggestion to restate the test as a slightly altered form of the 'natural monopoly' test in order to address shortcomings with that test is well thought out and should be adopted by the Competition Policy Review Panel. It corrects the 'private profitability' test created by the High Court of Australia in the Pilbara rail disputes, which only served to give an incumbent natural monopolist greater power in certain situations.

However, Anglo American does not agree with all the suggestions made by the Productivity Commission in relation to the declaration criteria. Specifically, Anglo American believes that the Productivity Commission has taken an inappropriate approach to criterion (f), the public interest test.

In its Final Report, the Productivity Commission found that the public interest test would be better drafted as a positive requirement on an access seeker. That means that any potential access seeker must specifically prove that access is in the best interests of the public, rather than the current test which requires the access provider to prove that access is not in the best interests of the public.

Anglo American strongly disagrees with this suggestion. The negative drafting of the public interest test reflects the economic position that the promotion of competition and efficient investment in infrastructure is considered to be in the public interest. It follows that if criteria (a) and (b) are

satisfied then access is in the public interest unless the access provider can prove that there is some other public interest which overrides this conclusion.

This issue is not merely an issue of semantics but effectively shifts the onus of proof from the access provider to the access seeker. Anglo American does not believe that it is appropriate to develop a potential further hurdle, when the clear operation of the test should occur to prevent access where that would detriment the public, rather than only allowing it where an access seeker can show some connection to a public benefit (even if it is purely the need to promote competition in an Australian or international market).

Anglo American also urges the Competition Policy Review Panel to address these recommendations quickly and decisively. Without a definite legislative and regulatory response, industry and infrastructure owners are left with no certainty regarding the application of the declaration criteria (and, therefore, the application of the National Access Regime) as the standing approach is that proposed by the High Court of Australia, while the legislative approach in the future is more likely to reflect the comments of the Productivity Commission. Either way, until there is certainty on the interpretation of the declaration criteria, Anglo American believes that major long-term investment decisions will be overly conservative, or made in light of the ongoing regulatory uncertainty.

5. Non-vertically integrated infrastructure

While Anglo American has made specific comments in relation to vertically integrated access providers (eg, the Aurizon Group of companies), it must be noted that regulation is just as important for non-vertically integrated natural monopolists as well. Anglo American submits that any instance involving monopoly pricing poses a risk to a market's economic efficiency and productivity, and subsequently a risk to Australia's competitiveness on the world stage.

Anglo American notes that an infrastructure owner's incentive to engage in monopoly pricing is not necessarily affected by whether it is vertically or non-vertically integrated. A vertically integrated monopolist may use prices to alter upstream or downstream competition (and assist the profit margins of its related entities) which might increase its motive, but this does not mean that non-vertically integrated monopolists do not have incentives to engage in monopoly pricing.

As such, while vertical integration should be constrained by regulation (or, as Anglo American has suggested previously, removed prior to privatisation), it is not the only form of natural monopoly that regulators need to monitor. A major focus of the Productivity Commission's recommendations involved protection against vertical integration, and in light of this Anglo American urges the Competition Policy Review Panel not to ignore the economic risk potentially posed by non-vertically integrated entities. Specifically, Anglo American does not agree with the comments of the Productivity Commission in its Draft Report that where a natural monopolist is not vertically integrated, a different form of intervention might be more appropriate, including utilising the effect of other provisions of the CCA.

Anglo American does not believe that regulation as important for international competitiveness, and efficiency and productivity should be left to fall within general regulation such as section 46 of the CCA or prices surveillance laws.

Section 46 of the CCA has historically proven to be ineffective in dealing with third party access issues and general prices surveillance rules do not usually allow for full price regulation (as they are generally considered to be a light-handed form of price regulation).

Anglo American submits that entities should not be allowed to fall within weaker regulation purely because they are not vertically integrated. Economic loss to users, and subsequently consumers, can occur without vertical integration and must be covered by strong and capable regulation.

The economic loss from monopoly pricing is not merely a monopoly rent transfer issue with no practical effect; it feeds directly into the international competitiveness of Australian mining companies (and subsequently the Australian economy).

6. Need to protect against "economic hold-up"

Anglo American has made submissions on a number of occasions to a number of different regulators and independent bodies that a major role of the National Access Regime (and its approved counterparts, such as the provisions in the *Queensland Competition Authority Act 1997* (Qld)) is to protect against "economic hold-up" on expansion and extension of regulated infrastructure by owners and operators. This essentially involves a situation where a monopoly service provider refuses to expand the service to add additional capacity unless users pay rent that is dramatically more than the regulated rate of return. This has an extremely negative impact on any industry, as it can have the effect of stunting growth during boom times, or simply making otherwise viable projects unattractive for major companies due to the drastically increased overheads.

Anglo American agrees with the recommendations of the Productivity Commission in both its Draft Report and its Final Report on the National Access Regime that the ACCC (or other relevant regulator) should have a clear power to direct capacity expansions and that the ACCC should provide specific guidelines for the use and control of this power.

In its Final Report (at page 92) the Productivity Commission found that:

> …where there is economic hold-up between a service provider and access seekers, there is potential for the problem to be addressed through non-regulatory solutions… Long-term contracts between service providers and access seekers can be negotiated prior to the latter making substantial investments, thereby facilitating investment in dependent markets. Alternatively, if there are potentially substantial gains from access that cannot be achieved through negotiations between different parties, the service provider might be willing to buy out the access seeker - bringing to market previously untapped economies of scale and scope.

Whilst Anglo American agrees that commercially negotiated agreements are preferable to regulated outcomes, it believes that sometimes it is necessary to impose a prescriptive regime even when the negotiation environment and the issues involved are complex. The examples referred to by the Productivity Commission of negotiating expansion capacity within multi-user commodity supply chains is, in fact, an example of when prescriptive mechanisms may be necessary.

A case study is the negotiation of expansions and extensions in Queensland between coal producers and Aurizon Network. Where parties' interests are not aligned, relying on voluntary commercial agreements between the parties to facilitate expansions causes conflict and subsequent delays. There is an incentive for the owner to engage in tactical delays to any voluntarily agreed expansion project in order to force more favourable access conditions from the user or users. This represents a particular risk to miners when commitments have already been made to mine expansion projects. This may include access prices significantly higher than the market price. Anglo American has previously noted examples of where regulated assets were not expanded until users agreed to returns above the regulated returns (in circumstances where there was little or no evidence that the owner faced higher risks than on the brownfield assets), specifically:

(a) the Goonyella to Abbot Point Expansion (**GAPE**) on the Aurizon Network; and

(b) the Wiggins Island Rail Project (**WIRP**) also on the Aurizon Network.

In an attempt to create an alternate funding mechanism and reduce the risk of "economic hold-up" by Aurizon Network, the coal producers sought the inclusion of a user funding regime in the access regime. The 2010 Access Undertaking (**UT3**) required Aurizon Network to submit for approval a standard agreement known as the Standard User Funding Agreement (**SUFA**). SUFA has been the subject of negotiations between the coal producers and Aurizon Network for almost 3 years and,

while the regulator and stakeholders continue to have extensive discussions has still not reached a conclusion.

Anglo American acknowledges that the issues involved in SUFA are very complex and that some issues will depend on the particular expansion / extension being funded. However, Anglo American believes that the time and effort spent in establishing a standard form of contract upfront will significantly decrease the number of issues in contention when a particular transaction does present itself. The alternative to the prescriptive mechanism contained in SUFA is a general negotiation / arbitration form of regulation. In the view of Anglo American, a negotiate / arbitrate form of regulation would have been ineffective as the negotiation would have taken years and been unsuccessful and any arbitration would have taken a further considerable period of time. A process of 3 or 4 years to negotiate and arbitrate a particular expansion process is unworkable.

The advantage of SUFA is that all issues other than transaction-specific issues have already been negotiated between the coal producers. Therefore, Anglo American reiterates that there are circumstances where government intervention by way of prescriptive mechanisms is necessary to ensure that owners of monopoly infrastructure cannot engage in 'economic hold-up' of expansion and extension projects.

Anglo American supports the Productivity Commission's Final Report findings that the ACCC should publish guidelines on how it will use its mandatory expansion powers. However, Anglo American does believe that the ACCC should also be given the power to require a mandatory access undertaking in respect of a service which has been declared. This allows for the pro-active management of issues rather than leaving issues to a negotiate / arbitrate process which may take years to resolved.