GLENCORE

Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT

20 June 2014

Dear Sir or Madam

Submission in relation to the Competition Policy Review Issues Paper

Glencore appreciates the opportunity to provide a submission in relation to the Australian Competition Policy Review ("**Review**") and in particular the Issues Paper released on 14 April 2014 ("**Issues Paper**"). This submission is made on behalf of the Glencore coal business in Australia.

Having regard to the scope of the Review and the high level nature of the Issues Paper, in this submission Glencore wishes to focus on three key areas set out in the Issues Paper:

Chapter 4: Potential Reforms in Other Sectors
Chapter 5: Competition Laws: Access to Infrastructure under the National Access Regime; and
Chapter 6: Administration of Competition Policy: How effective the ACCC and other competition regulators are and the types of institutional structures that can support the development and implementation of successful competition policies over time,

and whether Australian competition policy and institutional framework is "fit for purpose" in these areas.

This submission is based on our experience in relation to Glencore's coal business in Australia. Glencore may make further submissions on behalf of its other commodity business units in Australia or elsewhere in the world.

We are happy for our submission to be made public.

Yours sincerely

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GLENCORE

EXECUTIVE SUMMARY

This submission to the Australian Competition Policy Review ("**Review**"), and in particular the Issues Paper released on 14 April 2014 ("**Issues Paper**"), is made on behalf of Glencore's coal business in Australia. This business is a major user of export infrastructure on the East Coast of Australia.

This submission is based on the experience of Glencore's coal business in the utilisation of coal export infrastructure. Glencore recognises that in relation to other commodities or in relation to infrastructure with different commercial or operational characteristics, other considerations are relevant and other conclusions may be reached on appropriate policy outcomes.

Glencore may make further submissions on behalf of its other commodity business units in Australia.

KEY ISSUES

- Coal export infrastructure suffers from the economic problems caused by private ownership of "natural monopoly" infrastructure, particularly as previously State owned infrastructure moves into the private sector.
- The expected privatisation of further natural monopoly infrastructure will exacerbate these problems.
- Existing regulatory approaches have not been sufficient to prevent or resolve these problems.

RECOMMENDATIONS

Issue	**Recommendation**
National Access Regime	Retain National Access Regime ("**NAR**")
"Negotiate-arbitrate" model of regulation	Retain, but reform to ensure that negotiated outcomes do not undermine the effectiveness of the regulatory framework.
Declaration criteria	Adopt the Productivity Commission recommendations.
Certification of State access regimes	We do not oppose certification of a State access regime being a bar to the seeking of declaration under the NAR. However, the minister should have oversight of State access regimes with the ability to revoke certification at any time based on changes in the formal provisions or administration of a regime. Users should have the right to request a ministerial review with the ability to have decision reviewed where these are made under a State access regime which ceases to be certified. This issue may be unnecessary through the move to a Federal regulator and reform of the NAR.
Access undertakings	Glencore does not oppose the retention of access undertakings, but would highlight difficulties which arise with the current structure and would welcome consideration of alternative regulatory approaches.
Expansions	It should be possible to require the expansion of existing infrastructure by the owner of that infrastructure in order to overcome the difficulties posed by natural monopolies.
Future of access regulation	We believe there may be some efficiencies in a move from State based regulation to a single Federal regulator. In Glencore's view, such a move should be accompanied by the reform of the NAR.

Date of submission: 20 June 2014

1. Background

1.1 Glencore in Australia

Glencore's global coal operations are headquartered in Sydney recognizing the importance of Australia to our global operations. We employ over 8,000 people in Australia. Glencore is the world's largest exporter of seaborne thermal coal and one of the largest producers of metallurgical coal. In Australia, Glencore is the largest exporter, by volume, of coal. Approximately 85% of the coal Glencore mines is exported to global markets including Japan, South Korea, Taiwan, China and Europe.

Glencore's Australian operations compete with coal mines and other producers in other regions throughout the world. It is therefore critical that there is competitive, efficient and reliable port and rail infrastructure to deliver our products, as well as those of other Australian producers, to their global customers, or Australian exports will lose out to those from other countries.

Coal export infrastructure on the East Coast of Australia is generally shared infrastructure as opposed to the iron ore export supply chains on the West Coast of Australia. On the East Coast of Australia, our coal is exported in New South Wales through the Port Waratah Coal Terminal along rail infrastructure leased by the Australian Rail Track Corporation ("**ARTC**") in the Hunter Valley and via the Port Kembla Coal Terminal. In Queensland we operate and export through the Abbott Point Coal Terminal and also export through the multi-user Dalrymple Bay Coal Terminal and the RG Tanna Coal Terminal in Gladstone. We also have a significant interest in the new Wiggins Island Coal Export Terminal in Gladstone and will export through that terminal once it is complete. Below rail infrastructure is provided in Queensland by Aurizon Network.

1.2 The economic imperative in the current environment to ensure efficient supply chains

Mining, energy and resources play a considerable role in the economic prosperity of Australia. By 2012 Australia's mineral and fuels exports totalled $145.6 billion and accounted for around 48.5% of Australia's total exports. [1]

Australia's economic fortunes are heavily linked with a competitive and efficient resources sector. The competitiveness of the Australian resources sector is in turn heavily dependent on an efficient and cost competitive export supply chain and delivery of timely and coordinated (across the chain) export infrastructure. As noted by Henry Ergas and Joe Owen in their Minerals Council of Australia Document, "*Re-booting the Boom*", infrastructure regulation is important. In particular:

> *"ensuring efficient and effective regulation of export infrastructure constitutes a … priority area for reducing supply side constraints."* [2]

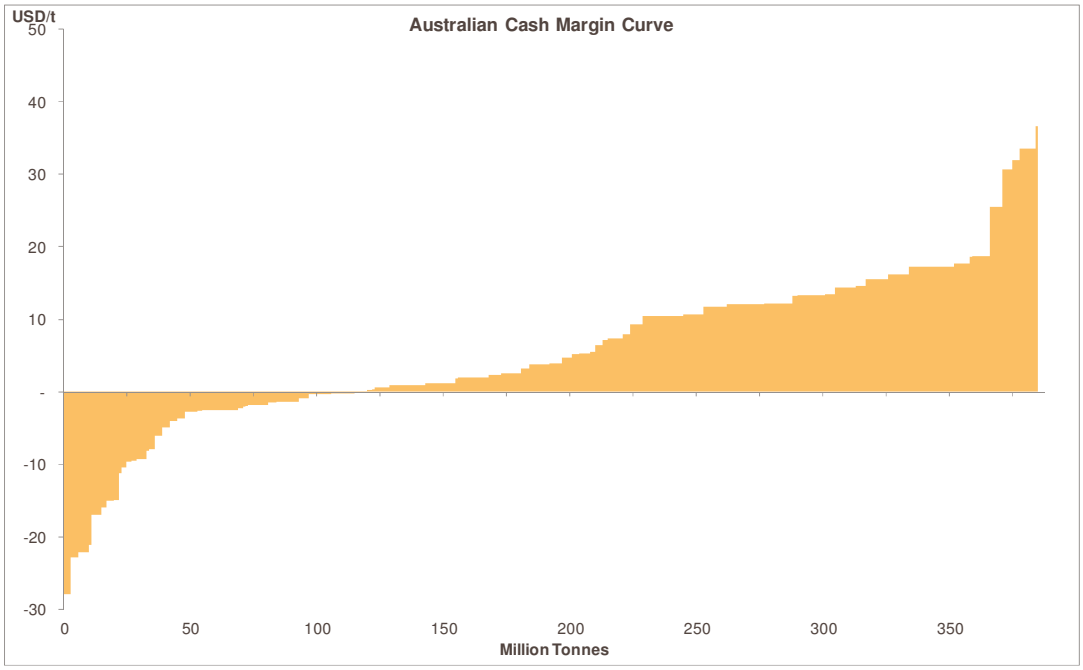
These issues have never been more critical given the relative decline of Australia's resource industries' international competitiveness having regard to:

- significant supply side cost increases arising from labour, energy and transportation costs and taxation imposts; and
- commodity price declines together with the decoupling of the previously inverse exchange rate-commodity price relationship.

[1] Trade at a Glance 2013, https://www.dfat.gov.au/publications/trade/trade-at-a-glance-2013/

[2] Minerals Council of Australia, Rebooting the boom: Unfinished business on the supply side, December 2012, p. 43

These changes have resulted in a situation in which, according to Glencore's internal modelling, nearly one third of Australian coal production is cash flow negative.



Source: Internal Glencore Analysis

Glencore accepts that the Australian mining industry should drive initiatives to rebuild its competitiveness. However, many of the factors mentioned above remain outside of our control and rely on the policy and regulatory settings being conducive to recovering our competitiveness. One important element of this is ensuring export infrastructure regulatory settings support the coal industry rather than those that seek to profit in the short term from exploiting the monopolistic position of specific coal infrastructure. In this regard, the Review is a very important opportunity for there to be a regulatory reset in Australia.

Glencore believes that the importance of getting the regulatory setting on infrastructure access right in order for Australia to maintain or grow its share of global demand for coal cannot be understated. Export coal mines in Queensland have until recently had rail and port charges that constituted 10% - 20% of Free on Board (FOB) costs. In Glencore's experience, the rail and port charges associated with recent expansions to the rail network or new port developments have shifted the proportion to around 30%-40% of FOB costs. Infrastructure charges for greenfield mines reliant on high cost extensions or new port developments are expected to represent more than 50% of FOB costs. [3]

In 2013, coal was Australia's second most valuable export after iron ore.[4] Coal exports rely on access to multi user infrastructure facilities which have traditionally been developed on that basis due to:

- individual users lacking the scale to support development of a dedicated facility;
- various approvals, land access; and
- government policy positions preventing development of multiple facilitates or requiring mandated shared access.

[3] Source: Glencore Internal Analysis

[4] Trade at a Glance 2013, https://www.dfat.gov.au/publications/trade/trade-at-a-glance-2013/

1.3 **Infrastructure asset sales and the dangers of sales without proper consideration of market dynamics and regulation**

At the time of the Hilmer Review, the port and rail infrastructure on the East Coast of Australia was either industry owned and operated or State owned and operated. This contained the problems arising from the natural monopoly status of this infrastructure. In addition, State imposed regulation of user owned and operated assets occurred through, for example, the imposition of lease conditions for coal terminals.

Public ownership is recognised by the Productivity Commission as being one potential solution to the natural monopoly problem. Glencore supports the user ownership model as it also addresses one key issue which arises from natural monopolies: the refusal of the owner to expand the capacity of the available infrastructure.

User owners have an incentive to expand the infrastructure capacity which they own in order to service their own needs, and any problems in relation to the distribution of access to expansions between existing and new users are comparatively easy to address through the imposition of "common user" provisions which require all access seekers to be treated equally. The problem of discrimination between existing and new users is a much easier problem to address than the failure by a non-aligned infrastructure owner to invest in expanding the capacity of an infrastructure asset.

Since the time of the Hilmer Review, the landscape has fundamentally changed through a privatization process which is likely to continue until all State owned coal infrastructure in Australia passes into private hands. This process will result in the transfer of very significant natural monopoly infrastructure into the hands of non-user private sector owners. In particular, the transfer of the rail track network and port assets into private sector hands has created or will create significant challenges in every coal supply chain on the East Coast. Therefore, the problems of access to natural monopoly infrastructure have become a much greater challenge.

Year	Infrastructure	Transaction
2001	Dalrymple Bay Coal Terminal	Sale to Prime Infrastructure
2002	Hunter Valley rail haulage	Sale of FreightCorp and National Rail to Patrick
2010	Central Queensland coal network Queensland and NSW rail haulage	IPO of Aurizon
2011	Abbott Point Coal Terminal	Sale to Adani
2013	Port Kembla port authority	Sale to NSW Ports
2014	Newcastle port authority	Sale to Hastings / China Mechants
Expected 2015	Gladstone port authority RG Tanna Coal Terminal	Planned privatisation of Gladstone Ports Corporation
Expected 2016	Hunter Valley rail track	Planned privatisation of Australian

Year	Infrastructure	Transaction
		Rail Track Corporation

While in principle we support privatisation, Glencore has experienced the consequences of privatisation across the East Coast of Australia in terms of infrastructure asset sales and the results are not mixed, they are almost always negative. In every instance of monopoly coal infrastructure being sold into private ownership in the last 15 years there has been an associated significant increase in the cost of access to use that infrastructure arising from both the imposition of higher access charges and/or the reallocation of risk back to the users of that infrastructure. These problems have arisen as a result of the failures of the regulatory regimes which have been imposed to fully deal with the problems which arise from natural monopoly infrastructure. The problems have arisen much more in Queensland than in New South Wales, since the rail track and port infrastructure in New South Wales currently remains user or Government owned. However, the privatisation of ARTC is likely to create similar challenges in New South Wales to those which have already faced Queensland.

As we have noted above, while in the short term the proceeds of those infrastructure sales may have boosted Government revenues, in the absence of sufficiently addressing regulatory and access terms, there is a longer term loss to the State and National economies through the inefficient use or expansion of those infrastructure facilities, and to Government coffers directly in terms of lost taxes and royalties and indirectly through lost economic activity. The example of the vessel queues off the Dalrymple Bay Coal Terminal in 2005 arising from then owner Prime Infrastructure declining to expand that facility on the returns proposed by the Queensland Competition Authority ("**QCA**") is a well-known example.

1.4 The current proposed wave of infrastructure asset sales creates a renewed risk

Glencore's concern in relation to the recent and upcoming privatisations is highlighted by recent experience in relation to Aurizon Network. It is particularly important that there is proper regulation being in place in relation to the possible sale of ARTC recognizing that a Commonwealth owned rail infrastructure asset has different incentives to expand and service its customers in a measured way (without seeking to stretch regulatory boundaries) compared to a private infrastructure monopoly that will have every incentive to seek the highest possible return. However, the proper regulation of the RG Tanna Coal Terminal and Gladstone port channel, which are likely to be subject to privatization, is also a key concern for Glencore. The stratospheric prices for infrastructure which have been paid in recent years highlight the willingness of new private infrastructure owners to price their infrastructure acquisitions taking into account the potential for considerable price increases or other ability to extract revenue from infrastructure users.

Glencore's experience is that in an effort to increase returns and reduce risk, private sector owners of monopoly infrastructure will always push the boundaries of regulatory regimes that are intended to protect the interests of the users.

1.5 Anti-competitive impact of inefficiencies in access to monopoly infrastructure

Potential loss of export efficiencies and decrease in Australia's productivity created by the behavior of owners of monopoly coal infrastructure are felt in two main ways. First, the inability of new or expanded mining projects to access monopoly coal infrastructure diminishes the ability

of new entrants to expand the supply of coal. This diminishes competition among coal miners to bring new production into service. Second, the ability of coal infrastructure owners to extract monopoly rent from the users of their infrastructure facilities diminishes the returns which are available to coal producers and hence reduces investment over the longer term, leading to reduced coal supply on the international seaborne coal markets and hence to reduced competition in those markets.

1.6 Conclusion on the current issues relating to the East Coast coal industry

Glencore is mindful of the diverse nature and the number of participants and shareholders in the coal industry in Australia. However, Glencore believes that in order to increase the productivity and competitiveness of the coal industry, there needs to be a review of access regulation as the largest competition issue facing the industry. This would be a nationally significant contribution to the Australian economy for the next 20 years and to ensure it is "fit for purpose" as the Review has sought on page iii of its Issues Paper.

2. Potential reforms in other sectors

In section 3.7 of these submissions, we suggest that the ability to "user fund" expansions of capacity provides a potential alternative to imposing any requirement on an infrastructure owner to fund expansions to its infrastructure. However, the funding of specific infrastructure within an integrated system poses challenges for potential financiers. One key issue is the tax treatment of capital contributions made to the infrastructure owner to fund their expansions. These are taxable to the infrastructure owner when received in the ordinary course of their business and the owner will often seek to recover the cash tax cost from the financier thus making user funding an inefficient alternative. There is no viable alternative where legal ownership must be retained by the monopoly infrastructure owner. A change to the tax legislation to rectify this issue would enable a much simpler and efficient approach to user funding of infrastructure and hence contribute to the viability of this approach.

3. Competition Laws and Access to Infrastructure

3.1 Productivity Commission's Recommendations on the National Access Regime

Glencore made two submissions to the Productivity Commission and the main points we set out in our submission dated 11 July 2013 remain relevant, in particular the desirability of:

- clarification of the declaration criteria:
- improved co-ordination within multi-user multi-owner systems;
- ensuring an effective expansion and extension process; and
- prevention of economic rent seeking.

3.2 Retention of National Access Regime

We support the Productivity Commission's view that the National Access Regime should be retained.

3.3 The "negotiate-arbitrate" model

In a "negotiate-arbitrate" framework where access seekers remain free to negotiate an access arrangement more favourable to the infrastructure owner, the ability of the infrastructure owner to favour an access seeker who is willing to agree to such an outcome defeats the purposes of a regulatory regime. Where there are capacity constraints, and particularly where the coal infrastructure provider is able to refuse to invest in new infrastructure, this model permits the extraction of monopoly rents from access seekers. Any individual access seeker has an incentive to agree to provide monopoly rents to the monopoly infrastructure owner if this will deliver access for its project. Hence, the regulatory constraints are eroded with the consent of the individual access seeker.

Glencore would suggest that an important constraint on the "negotiate-arbitrate" model should be to prevent an infrastructure owner favouring an access seeker willing to accept a negotiated outcome over another access seeker which relies on the regulated access seeking process. In particular, we suggest that one solution to the problem of forcing infrastructure investment is to permit "user funding" of infrastructure, and if that is the case then specifically discrimination between user funded expansions and infrastructure owner funded expansions should not be permitted.

3.4 Declaration criteria

We support the conclusions that the Productivity Commission has reached in relation to the declaration criteria in subsection 44G(2) of the CCA. In particular, we agree that the reformulation of the criterion set out in paragraph (b) in the manner which is suggested by the Productivity Commission would ensure that the declaration criteria more fully reflect the economic problems posed by natural monopoly infrastructure and should be adopted.

A test which is based purely on the private profitability of building competing infrastructure does not take account of the economic inefficiencies which arise by building two independent pieces of infrastructure where the same resources could create a greater amount of total infrastructure capacity through the building of combined, shared infrastructure.

3.5 Certification of state access regimes

We are not opposed to the Productivity Commission's suggestion that the existence of a certified State access regime should preclude the application of Part IIIA of the CCA, provided that the requirements for certification fully reflect all principles of the National Access Regime. However, there should be a broad discretion for the minister to revoke the certification of a State access regime not only where substantive changes are made to that regime but also based on the application of the State access regime in practice. The administration of a State access regime is at least as important as the formal terms of that regime. The users and access seekers who are subject to a State access regime should have the ability under the CCA to request that the minister should conduct a review of a State access regime. To the extent that a State regime ceases to be certified, it should also be possible to have decisions previously made under that regime reconsidered either by the ACCC or by a replacement State regime which does meet the requirements for certification.

3.6 Undertakings

Glencore is of the view that access undertakings can have a useful part to play in the regulation of access to infrastructure. However, there are difficulties with a voluntary access undertaking

regime. By placing the drafting of the access undertaking in the hands of the infrastructure owner, a voluntary access undertaking regime creates considerable difficulties both for users and regulators who seek to influence the terms of the access undertaking. The asymmetry created by the fact that the infrastructure owner can seek amendment of the access undertaking at any time means that it is unwise for users to consent to lengthy access undertaking periods, because there can be no guarantee that the infrastructure owner would not seek to revisit the terms of the access undertaking prior to the end of the undertaking period if the terms of the access undertaking prove to be adverse to the infrastructure owner. On the other hand, the users of the infrastructure and seekers of access to the infrastructure have no ability to trigger a review of the terms of the access undertaking. Shorter undertaking periods lead to considerable costs caused by constant review of access undertakings.

The process underway for the approval of Aurizon Network's UT4 Access by the Queensland Competition Authority provides an example of the drawbacks of a voluntary access undertaking process with insufficient regulatory controls. The approval process is not currently scheduled to be completed until March 2015, which is more than half way through the period of the UT4 Access Undertaking and does not leave much (if any) time prior to the commencement of the approval process for the UT5 Access Undertaking. At the same time it is possible Aurizon will further vertically integrate by taking a shareholding in a coal producer (Aquila) as well as investing in unregulated port and rail infrastructure for a competing coal producer (GVK). The coal industry is estimated to have spent more than $30 million over two years funding the exercise (based on the assumption that Aurizon's costs are fully paid for by industry, the industry submissions via the Queensland Resources Council run to several million dollars, each coal company is in turn spending significant sums on its own advisors and submissions, and the QCA is being funded by a 3c/t levy on coal by industry, amounting to more than $6m per year.)

Glencore believes that mandatory access undertakings are one approach which could be used where appropriate to help address these difficulties.

3.7 Regulatory power to direct expansions

Glencore recognises the difficulties which arise from a regulatory requirement for an infrastructure owner to conduct expansions of their infrastructure asset. However, in order for a regulatory regime to address the economic difficulties which confront the users of natural monopoly infrastructure, this may be an essential requirement.

Existing coal infrastructure capacity tends to be fully contracted. The reason for this is that infrastructure is generally not constructed unless the costs of doing so are able to be recovered from its future users. This is ensured by the entry into of long term "take or pay" contracts under which the users are responsible for at least the fixed costs of the infrastructure which they have a right to use. The lowest cost for users (and highest return for infrastructure owners) will result from the maximum possible utilization of the constructed capacity, and hence the most likely position is that all of the capacity of existing infrastructure will be fully contracted. There may from time to time be surplus capacity available where users have over-estimated their own capacity requirements. However, this availability of capacity tends to occur during periods of lower demand (for example, where prices are lower than expected). During periods of high demand, it is less likely that existing infrastructure will be available to new users. Hence it is essential for new users to be able to access expansions of infrastructure capacity. Where these are natural monopoly infrastructure assets this necessarily requires the expansion of the existing natural monopoly infrastructure assets. If the infrastructure owner cannot be compelled to undertake such expansion then in reality the access regime does not protect new or expanding users.

In relation to rail infrastructure, consideration should be given to applying the same regime to geographical expansions of the existing rail network. The existing access undertakings for ARTC and Aurizon Network recognise the requirement for third party infrastructure to be able to connect to existing rail networks. However, insufficient consideration is given to the fact that if third party networks are forced to operate independently of another rail network which they are attached to, this diminishes their economic viability. In order for the two networks to operate together in an integrated fashion, integrated train control and signalling is necessary. If the existing monopoly provider has an obligation to provide all such necessary services to third party owned rail infrastructure which connects to and essentially extends the existing rail network it is perhaps unnecessary to require that the existing monopoly owner should be forced to construct geographical expansions of their network. On the other hand, if such co-ordination cannot be imposed then an requirement to expand the existing network geographically becomes essential.

The ability to force expansions is a key protection to protect new and expanding users of monopoly infrastructure, and legal constraints on the ability of regulators to impose the requirement to expand on infrastructure owners are a key source of weakness in regulatory regimes. An example of such a weakness is the vague requirement in the QCA Act which requires the "legitimate business interests" of infrastructure owners to be considered. This produces considerable uncertainty given that in general the legitimate business interests of any company will include the maximization of its own profits, which is not consistent with the regulatory constraints which are necessary to prevent the economic consequences of a natural monopoly. Another weakness in the QCA Act regime's application to the central Queensland coal network is that geographical extensions to that network are not "declared" for the purposes of the QCA Act and hence are unregulated.

Glencore believes a more palatable alternative to forcing an infrastructure owner to invest in infrastructure expansions against its will would be to encourage or mandate the ability of users to fund expansions to an existing infrastructure asset. We would suggest that the user funders could bear some of the risks associated with the expansion (for example, the level of utilization of the expansion), while the infrastructure owner would be exposed only to the risks of the activities which it undertakes (for example, construction activities which the infrastructure owner undertakes or manages).

4. Administration of Competition Policy

4.1 Experiences in dealing with the ACCC and the QCA

Glencore's experience in dealing with each of the ACCC and the QCA is that they are staffed with diligent and well intentioned people. Glencore has always been impressed, including from our global experience, with the quality of people at the ACCC and the QCA. However we note that the QCA is hampered by its governing legislation which limits its powers to speed up or satisfactorily resolve the approach adopted by Aurizon in managing its regulatory regime.

Glencore has previously made submissions to the Productivity Commission in relation to its concerns with the Aurizon Network Access Undertaking process with the QCA. Glencore believes that the level of industry frustration is best summarized by the submission by the Queensland Resources Council ("**QRC**") working group dated 10 October 2013. [5]

[5] http://www.qca.org.au/getattachment/c5ddd8e4-2bdc-4371-a70c-bca603500a46/QRC-Submission-to-the-QCA-(Oct-13).aspx.

We would therefore consider that the QCA regime should be reviewed and updated to ensure that it is as effective as possible. We would regard this as being a good example of the need to undertake continuing reviews of the effectiveness of State access regimes as a condition of their continuing certification as being effective.

Future of access regulation

We believe that infrastructure access matters affecting the national economy might be more appropriately regulated and administered by a Federal competition agency. However, we also believe that the NAR legislation should be reviewed and updated to address some of the experiences and learnings from asset sales in the last ten years – in particular so as to provide regulators with a more effective ability to ensure privately owned multi-user infrastructure is not allowed to obtain unreasonable monopolistic advantage to the detriment of the broader economy.

5. Conclusion

Glencore appreciates the opportunity to make a submission to the Review and trusts that this submission might assist the Review in relation to its considerations. Competition policy reform is vital to protecting the national interest and promoting an on-going strong and attractive investment environment. With an increasingly sophisticated private sector investment in infrastructure which exhibits natural monopoly pricing and investment decision making, it is vital that competition laws are effective and cannot be easily circumvented. At the same time, simplified structures and regulatory regimes that reduce the cost burden to industry and provide clear "rules of the game" are vital to encouraging on-going investment into both the important resource sector and the infrastructure upon which it depends.

ENDS