

Glencore Coal

Submission to Competition Policy Review

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1 Key messages

1.1 The role of regulation

Effective regulation of private, non-industry owned coal infrastructure is essential. This is particularly important in light of the proposed sale of public assets such as coal terminals and rail networks on the East Coast of Australia. The present national access regime is practically ineffective given the High Court's interpretation of the declaration criteria. The current forms of access regulation which have been applied on an ad hoc basis are in some cases in a state of crisis. A reformed national approach is highly desirable.

Mining investment is capital intensive, long term and exposed to high risks including commodity and foreign exchange movement. Export rail and port infrastructure is essential for coal mining development. Infrastructure is a significant element of the FOB costs of coal, accounting for approximately 30% of the FOB costs for new mining developments. Investment in new infrastructure is also highly capital intensive, and decisions to underwrite investment through entering into take or pay access agreements result in large fixed costs over long periods. Having the ability to predict infrastructure availability and costs is essential in making appropriate investment decisions. Uncertainty of infrastructure costs or availability over the expected payback period of the investment diminishes the expected returns and lessens the ability for these returns to be forecast. Uncertainty undermines, if not destroys investment.

Glencore Coal believes that it is particularly important in the case of infrastructure to be privatised, that industry participants have recourse to access regimes as that will provide commercial confidence to make their long term mining investments in the face of possible sale by Governments of essential infrastructure. This is important for not just large miners, but also for the development of new mining operations with the attendant overall benefits of resultant jobs and economic growth for Australia.

1.2 The present situation

The historical development of coal mining infrastructure in Australia has resulted in multi-user infrastructure, developed by State and Federal governments and now in the process of passing into the hands of private owners. There is little practical possibility of establishing competing infrastructure to replace existing coal export infrastructure in most cases.

Privatisation of established coal infrastructure has always resulted in significant changes of behaviour by the new private owners. Privatisation of monopoly infrastructure has the potential to transfer returns from the users of the infrastructure to the owners of the infrastructure. Existing contractual relationships can by definition protect only existing customers, and may be insufficient even for existing customers. We have provided a brief history of the Australian coal infrastructure which has been privatised, which demonstrates a consistent pattern of behaviour in all cases. While not always a perfect solution, regulation has been the only constraint on these behaviours.

1.3 The consequences of regulatory failure

The returns on mining investment reflect the risks to which mining investment is exposed. Recent history has shown that the mining sector faces very considerable uncertainties due to the uncertainties arising from commodity prices and foreign exchange rates. Monopoly infrastructure providers are not exposed to anywhere near the same levels of risk as the mining sector. They are generally insulated from demand risk due to the long term and take or pay nature of their user agreements. In many cases, demand risk is effectively transferred to the users of mining infrastructure through the structure of access pricing, either explicitly or implicitly.

If returns are transferred from the mining sector to the private monopoly owners of infrastructure as monopoly rent, they are not available to investors in new mining capacity.

Given the high levels of risk associated with new mining investment, it is therefore likely that future mining investment will be significantly reduced.

The value to the Australian economy of mining investment which is contingent on infrastructure is much larger than the value of the infrastructure. A reduction in mining investment triggered by the ability of private monopolist infrastructure owners to extract monopoly rent is an inefficient economic outcome and a huge lost opportunity for the nation.

2 Recommendations

2.1 Application of Part IIIA

Consistent with the original Hilmer recommendations, Part IIIA should apply to certain kinds of mining infrastructure, including below rail infrastructure and port infrastructure.

Glencore Coal's view is that Part IIIA should be applied to

- below rail infrastructure, particularly existing below rail infrastructure and extensions of and expansions to that infrastructure;
- port terminal infrastructure; and
- port authority activities including rights to approve the construction of new terminals, control of vessel movements and port channel access.

2.2 Declaration Criteria

The current access declaration criteria as interpreted by the High Court render access regulation practically ineffective. Significant change is required to render access regulation effective and make it "fit for purpose" in the current environment. We do not believe that the current approach of attempting to define specific tests that are applied to infrastructure in all cases is workable.

We suggest providing the decision maker with a greater discretion to consider all appropriate factors in making their decision, including those factors specifically by legislation including the history of the infrastructure. In particular, this would include whether it has been publicly owned and then privatised. In this situation, our recommended changes safeguard the interests of private owners and do not affect the commercial certainty for those infrastructure owners in developing their own infrastructure in the mining industry in Australia.

Further detail is set out at section 6 of these submissions.

2.3 Operation of national access regime

We believe that a robust national scheme with a single regulator applied to all relevant infrastructure has the capability of improving the effectiveness and transparency of regulation. While we recognise that moving to such a model would require co-operation between the Federal Government and the States, we consider that this is a model worth further investigation.

3 Scope of submission

The Panel has invited further comment on the classes of mining sector infrastructure to which Part IIIA should be applied in the future, and the costs and benefits which are likely to arise from the application of access regulation to that infrastructure. The comments below are based on Glencore Coal's experience of utilising multi-user coal handling infrastructure in New South Wales and Queensland.

The Panel has also invited comment on whether Part IIIA should be confined in its scope to categories of bottleneck infrastructure identified by the Hilmer review. The categories of coal handling infrastructure which we submit should be subject to Part IIIA are freight rail networks and ports, which were identified as bottleneck infrastructure, and therefore we would not object to Part IIIA being confined to the kinds of bottleneck infrastructure identified by the Hilmer review.

Glencore Coal has not provided any submissions on infrastructure (such as electricity infrastructure) which is utilised by the mining industry but is not coal handling infrastructure. Glencore Coal is of the view that Part IIIA should be applied to such other infrastructure in order to secure appropriate competition outcomes.

4 Application of Part IIIA to mining infrastructure

Category of infrastructure	Relevance of Part IIIA
<p>Above rail – i.e. provision and operation of rail rolling stock</p> <p>Glencore Coal’s view is that Part IIIA should not be applied to above rail infrastructure which operates in a competitive market.</p>	<p>Currently, in both New South Wales and Queensland the above rail market is able to function as a relatively competitive market. Because of the regulation of the rail networks in both cases, additional rail operators have been able to enter the market. There are considerable challenges in establishing a new heavy haul rail operation, as a new operator will have to invest very significant amounts in rolling stock as well as ancillary infrastructure, such as provisioning and maintenance facilities. However, as the entry of Pacific National into the Queensland market, and the entry of Aurizon Operations and Glencore Rail into the New South Wales market have proven, this is achievable.</p> <p>The current ability of the above rail market to function competitively is fundamentally dependent on the appropriate regulation of the below rail infrastructure. The owner of the below rail infrastructure would, in the absence of regulation, be in a position to control the above rail market. Therefore, the maintenance of effective regulation of the below rail infrastructure is essential to the classification of the above rail market as competitive. This is particularly the case in Queensland where the owner of the below rail network, Aurizon Network, is vertically integrated with a rail operator, Aurizon Operations.</p>
<p>Below rail – i.e. provision and operation of the rail track and associated services.</p> <p>Glencore Coal’s view is that Part IIIA should be applied to below rail infrastructure, particularly existing below rail infrastructure and extensions of and expansions to that infrastructure.</p>	<p>Background</p> <p>The existing rail networks which are utilised for coal haulage in New South Wales and Queensland are the legacy of previous State and Federal government investment underwritten and funded by the access charges paid by the coal industry. In New South Wales, ARTC currently operates the Hunter Valley rail network. In Queensland, the Central Queensland Coal Network is operated by Aurizon Network, part of the privatised Aurizon business.</p> <p>Existing rail networks</p> <p>The existing rail networks are in our view a classic example of a natural monopoly. It is very much more cost effective to increase rail track capacity through the expansion of an existing rail line rather than the building of a new rail line. For example, the addition of passing loops to an existing rail line will increase the tonnage throughput capacity of that existing rail line. However, a competing below rail operator cannot produce new capacity by building passing loops in isolation – an entire new rail line must be built, which is obviously many times more expensive. The price of rail access on the relevant route can be set by the owner of the existing infrastructure to be below the cost of duplicating the line, while still generating a substantial monopoly rent because of the much lower actual cost of adding the additional capacity to the existing network.</p> <p>An expansion of the capacity an existing rail network forms part of that network is only able to be undertaken with the consent of the owner of that existing rail network. Therefore, expansions of the capacity of an existing network should be regulated in a similar fashion to the existing capacity of that network.</p> <p>New rail networks</p> <p>In considering new sections of rail network, a distinction should be drawn between sections of rail network which are intended to function as an</p>

Category of infrastructure	Relevance of Part IIIA
	<p>extension of an existing rail network and sections of rail network which will be independent of any existing rail network.</p> <p>Where the new section of rail network is intended to function essentially as an extension of the existing rail network it is highly unlikely that it will be able to be constructed and operated without the co-operation of the owner of the existing network, even if the owner of the existing network is under a regulatory obligation to permit another rail network to connect to its existing network. Glencore has direct experience of this situation through its involvement in the proposed development of the Surat Basin Rail project. This project would have involved the building of around 200km of track linking in to the existing Aurizon Network rail network. The most effective operation of the two networks occurs when train control occurs in an integrated fashion across the two networks. If this is not done, then the extension network has to operate in isolation, even if physically connected to the other network. That would mean that:</p> <ul style="list-style-type: none"> • rather than being able to traverse the two networks without stopping, trains would have to halt at the boundary between the two networks until the controller of the network the train is about to enter has an available train path; • it would be necessary to build a number of holding roads at the boundary between the two networks to accommodate these trains; and • the cycle times of trains traversing both networks would be increased, meaning an increased amount of rolling stock and crewing is necessary to achieve the same tonnage throughput as on a journey of the same length over a single network. <p>Therefore, given that the acquiescence of the existing network owner will be necessary to allow integrated train control, the owner of the existing network is in a strong position to determine if the extension network is able to proceed, even if the existing network owner is under an obligation to permit the two networks to be physically connected. It might be possible to alleviate these difficulties by requiring the owner of the existing rail network to provide train control services to any network which connects in to its existing network, but this is not currently a requirement which is placed on any rail network operator.</p> <p>Aurizon</p> <p>In Queensland, Aurizon operates both as an above rail operator and a below rail operator. As identified by the Hilmer review, where the owner of monopoly infrastructure is vertically integrated with a potentially competitive market – as Aurizon Network is with Aurizon Operations – the monopoly infrastructure owner may have an incentive to exclude competitors from the monopoly infrastructure as well as charging monopoly rents. We also note that Aurizon now owns a 15% interest in Aquila, which is a user of the Central Queensland Coal Network. This degree of vertical integration makes the case for access regulation of the Central Queensland Coal Network that much stronger. If Aurizon, or other parties, were to obtain similar vertically integrated positions in relation to other infrastructure, such as Gladstone Port Corporation, then similar considerations would also apply.</p>
<p>Port coal export terminals</p> <p>Glencore Coal's view is that Part IIIA should</p>	<p>In New South Wales, the coal production from the Hunter Valley has, so far as it has been exported, all gone through the Port of Newcastle. Coal is also exported through Port Kembla, but practically Hunter Valley coal could not be exported through Port Kembla. In Queensland, there has been a greater geographic spread of coal production, with the major coal ports</p>

Category of infrastructure	Relevance of Part IIIA
<p>be applied to port terminal infrastructure.</p>	<p>being the Ports of Gladstone and Hay Point, with coal export also occurring at the Port of Abbot Point and to a much lesser degree the Port of Brisbane. At the Ports of Newcastle, Hay Point and Gladstone there are multiple coal terminals within the same port.</p> <p>The construction of an additional coal terminal within an existing port has occurred on several occasions. At the Port of Hay Point, BHP Billiton has constructed its own coal terminal which sits alongside the Dalrymple Bay Coal Terminal. At the Port of Newcastle, the Newcastle Coal Infrastructure Group constructed the NCIG terminal. At Gladstone the Wiggins Island Coal Terminal has been constructed by an industry owned company. Glencore has been directly involved in the construction of WICET as the largest single customer of the new terminal. In each case, these terminals have largely accommodated additional demand for infrastructure facilities, rather than competing with existing infrastructure facilities to service existing demand.</p> <p>The construction of a new port terminal is a very difficult undertaking. All operating export coal mines will by definition already have port capacity, and these contracts are likely to have a long duration with renewal rights. Therefore, new coal terminals are likely to be underpinned primarily by new or expanding capacity. This presents considerable challenges to the proponents of such a terminal, particularly given the need to co-ordinate the development of the relevant mines with the development of the coal terminal and other related infrastructure, such as rail infrastructure. In addition, the sites available for the construction of new coal terminals are limited. For example, in the case of WICET the agreement of the State government and Gladstone Ports Corporation to make the site available for the construction of WICET was dependent on WICET accepting various requirements in relation to the construction and operation of the terminal, including the adoption of a Terminal Access Protocol. In addition, obtaining appropriate environmental and development consents for the construction of a coal terminal can also present challenges.</p> <p>Given the difficulties involved in constructing a competing coal terminal, Glencore would consider that access regulation is warranted – particularly in the case of a privatised terminal. A coal terminal which has been constructed by a State government has benefitted from the exercise of the State's powers and capacity to bear risk in a way which a private terminal is never likely to do. In the ownership of the State, the port terminal would not have been operated in a monopolistic or anti-competitive fashion and thus customers may have been more willing to contract with it than would have been the case had they been dealing with a potential private sector monopolist.</p>
<p>Port authority – including rights to approve the construction of new terminals, control of vessel movements and port channel access</p> <p>Glencore Coal's view is that Part IIIA should be applied to port authority activities including rights to approve the</p>	<p>The construction of an entirely new port precinct is unlikely to occur on the East coast of Australia. The siting of a new port is highly constrained by physical and human geography. Therefore, this would suggest that the case for an application of an access regime to ports is the strongest of all categories of coal infrastructure.</p> <p>The operator of a port is able to determine many matters of great commercial significance to the terminals which operate within that port and the wider supply chains in which those terminals participate. The capacity of the port will depend on dredging and other activities which the port operator is responsible for. The day to day operation of the port depends on the operator providing services to the vessels using the port, such as tug boats, or dictating the terms on which those services can be provided. The operator of the port would also have the responsibility of scheduling of</p>

Category of infrastructure	Relevance of Part IIIA
construction of new terminals, control of vessel movements and port channel access.	<p>vessels which is of key commercial significance to all supply chains which operate through the port. In addition, the owner of the port may have the ability to control development of further terminals within the port.</p> <p>Given that all ports on the East coast of Australia have been developed by the States, and given that there is effectively no possibility of developing new ports in competition with them, we would submit that there is a strong case for the application of a strong access regime to the operators of those ports.</p>

5 Costs and benefits of access regulation

5.1 Summary

Of the infrastructure used by the coal industry on the East coast of Australia which we would suggest be subject to access regulation, the majority is either currently subject to some form of access regulation or is in government ownership or both. We would therefore suggest that making this infrastructure subject to access regulation is likely to involve little cost to the existing infrastructure owners but produces the benefit of avoiding monopolistic behaviour under a different ownership in the future. An improvement in an existing regulatory framework may in fact produce benefits for all parties.

We set out below our more detailed thoughts on the costs and benefits which arise from the imposition of regulation. Importantly, we also set out the incidence of the costs and benefits – since that should also be taken into account in considering these issues.

5.2 Costs

Cost	Incidence	Analysis
Administration of an access regime	The incidence of the costs of administering an access regime varies. Typically, the customers will always bear their own costs. The owner of the infrastructure may be permitted to include their costs of administering the regime within the costs which they can recover from their users. The authority operating the regime may be publicly funded, as the ACCC is, or may be funded through the imposition of a levy on the users of the infrastructure – as the QCA is in the context of the Aurizon Network undertakings.	We are very familiar with the costs associated with the administration of an access regime. In particular, the legal and other costs of the Aurizon Network access undertaking regime that are borne by industry are considerable. We are certainly supportive of access regulation being administered in a way which is less costly and less time consuming. However, as the customer of regulated access regimes, and hence the party which ultimately bears the cost of administering the regime, we consider that the costs of doing so are preferable to the impacts which would arise if no such regime was operated.
Inefficiency of allowing multiple users	Infrastructure owner or existing user	Where additional users are permitted to use infrastructure this may create operational inefficiencies. This is much more likely to be the case where a single user operation moves to become a multi-user operation as compared to the addition of a further user to an operation which already has multiple users. The inefficiencies can be reduced through co-ordinated supply chain planning which will benefit all of

Cost	Incidence	Analysis
		the users of the system, and which we would submit should be encouraged by access regulation.
Inability of an existing infrastructure owner to extract monopoly rent	The existing infrastructure owner	The infrastructure owner will be constrained by access regulation from imposing monopoly rents on its users.
The inability of the developer of new infrastructure to impose high enough charges to justify the building of new infrastructure may inhibit the construction of new infrastructure.	A developer of new infrastructure, potential users of new infrastructure	This cost will only arise where the access regulation imposes a price which is too low to justify the construction of new infrastructure. Access regulation may overcome this problem either by allowing higher rates of return for new or expanding infrastructure or by permitting alternative funding for new or expanding infrastructure, such as user funding.

5.3 Benefits

Benefit	Incidence	Analysis
Inability of an existing infrastructure owner to extract monopoly rent	Users of existing infrastructure	This is the converse of the cost that is imposed on the infrastructure owner.
Process for gaining access to infrastructure is more clearly defined.	New and expanding users of infrastructure and their customers.	In the mining sector, it is key for the development of new projects that access to all existing infrastructure is available in a co-ordinated way.
Increased co-ordination in the planning of capacity across different kinds of infrastructure	Operators and users of the relevant infrastructure, and their customers.	Access regulation can promote a co-ordinated approach to the operation of infrastructure. In an unregulated environment the owners and operators of different kinds of infrastructure operating in a single supply chain may focus on maximising their own revenue rather than acting in a way which would be most economically efficient for the entire supply chain.
Promotion of a competitive market in other infrastructure	New entrants into the competitive market that is promoted, users of infrastructure and their customers.	Regulation of one type of infrastructure may be necessary for a competitive market to exist in another kind of infrastructure. For example, the existence of a competitive market in above rail infrastructure depends on the effective regulation of below rail infrastructure.
The availability of new or expanded infrastructure at a regulated price permits the development of other upstream and downstream infrastructure.	Users of the new or expanded infrastructure and the new upstream and downstream infrastructure, and their customers.	For example, the expansion of a rail network's capacity may enable the building of a mine, the expansion of an above rail operation and the expansion of a port terminal.
Avoiding anti-competitive behaviour by a vertically integrated owner of different kinds of infrastructure.	Customers of the vertically integrated owner.	As identified by the Hilmer review, where an owner of monopoly infrastructure is vertically integrated with an interest in non-monopoly infrastructure or market, the behaviour of the monopolist may extend beyond

Benefit	Incidence	Analysis
		the extraction of monopoly rents and into anti-competitive behaviour in relation to the non-monopoly infrastructure or market.

6 Declaration criteria

6.1 Summary

We believe that the Panels' formulation of criterion (b) risks overstating the likelihood that competing infrastructure will constrain the monopolistic behaviour of the incumbent service provider and excluding the application of an access regime in circumstances where it would be of public benefit. We suggest an alternative approach which gives the decision maker the responsibility of determining whether it is appropriate to declare the relevant infrastructure taking into account all relevant factors, including economic efficiency and also the history of the infrastructure's development.

6.2 Existing criteria and the approach of the High Court

In Glencore Coal's original submissions, we were supportive of the Productivity Commission's proposed approach to criterion (b) applying a test where the facility would be declared where it provided the infrastructure service over the declaration period at least cost. We note that this proposal has not been supported by the Panel. We note that the Panel favours retention of the existing test with the proviso that the development of an additional facility by the incumbent service provider should not satisfy the test. Glencore Coal is of the opinion that the interpretation placed on the existing wording of criterion (b) by the High Court in the Pilbara Rail Case is incompatible with an effective regulatory regime.

The High Court has ruled that criterion (b) is to be approached by determining whether "anyone" could duplicate the relevant facility in a way which is privately profitable. The term "anyone" was interpreted broadly, so as to include any person at all, including even the incumbent service provider, who would almost certainly never actually develop a new facility to compete with its existing facility. The Court stated " 'anyone' includes existing and possible future market participants". The High Court indicated that the returns necessary to satisfy the private profitability test could vary from case to case, including according to the nature of the facility. The Court also indicated that if there was a person which "could develop the facility as part of a larger project it would be necessary to consider the *whole* project in deciding whether the development of the alternative facility, as part of that larger project, would provide a sufficient rate of return".

Based on the High Court's formulation of the private profitability test, in determining whether or not to declare particular infrastructure, it appears that the decision maker must satisfy themselves that there is nobody in the world who is a current or possible future market participant who could develop competing infrastructure (on any scale) to compete with the existing infrastructure, whether that infrastructure is built in isolation or when it is taken together with any possible hypothetical larger project of which it could form part, and make a return equivalent to their cost of capital, whatever that is.

We would submit that the High Court's interpretation has rendered the current formulation of the test untenable from a practical perspective, even if the Panel's recommendation that the incumbent service provider should be excluded from the definition of 'anyone' removes the most glaringly egregious aspect of the decision. The High Court interpretation would render criterion (b) virtually impossible ever to satisfy and is completely inconsistent with the economic rationale of a national access regime and the public benefits that it creates. It also creates a criterion which it is almost impossible for any decision maker to administer because of the virtual impossibility of obtaining sufficient evidence to form a view that the criterion is satisfied – since effectively the decision maker must assess the capacity of every possible

market participant in the world to construct a new facility, in a wide range of possible scenarios whether in isolation or as part of a wide range of possible broader projects.

6.3 Panel's observations

The Panel identifies in its findings the difficulty of assessing total market demand for the services, and its recommended formulation of criterion (b) excludes any consideration of potential demand for the services from the application of the test. However, this broadens the ability of an existing service provider to argue against declaration by removing from the consideration of the decision maker the likely levels of demand for a competing facility. If the existing service provider can identify any scenario in which a particular level of demand for the services could result in an economic duplication of the facility by any party, then the existing facility would be exempt from declaration. For example, the owner of a port terminal could point to the fact that based on 100 million tonnes per annum of demand for an alternate facility, then it would be economic to develop that facility, notwithstanding that there was only 25 million tonnes per annum of demand in any reasonably foreseeable circumstance. Whilst we can appreciate that it is a difficult task to identify total market demand for infrastructure in the abstract, to ignore the likely levels of demand unfairly benefits the incumbent service provider.

6.4 Glencore's suggested approach

The purpose of the declaration criteria is to identify infrastructure to which regulation should be applied. The approach of the existing legislation is to attempt to identify a formula which can be applied in all cases to determine whether the national access regime should be applied to the relevant infrastructure. We would submit that it is not possible to capture all of the factors which should be taken into account in a decision to apply the national access regime in a single formula, no matter how well constructed. The primary purpose of the national access regime is an economic one, to prevent the economic inefficiencies which can arise from the problem of natural monopolies. However, Glencore would submit that, even were it possible to perfectly define a set of criteria which would identify natural monopolies, those criteria would be insufficient because they would not take account of the history of the development of the relevant infrastructure, which is highly relevant to the economic impact of the decision to impose access regulation on the infrastructure. For example, we would regard it as being highly significant to the decision to impose regulation whether the infrastructure has been developed by a private party who has borne the cost and risk of that development without government support, or whether the infrastructure has been developed by government before being sold to a private owner as an existing multi-user monopoly, or with some other form of government support.

Rather than attempting to identify and define every possible factor which would be relevant to a decision to apply the national access regime and including them in the legislative framework, we would suggest that the decision maker should be given discretion to identify the relevant criteria in each particular case. Rather than an exhaustively defined formula, an inclusive list of criteria should be provided to the decision maker. An appropriately reformulated private profitability test could form one of those criteria. We would also submit that the circumstances of the development of the infrastructure should also be included as a factor.

It might be argued that a reformulation on the basis that we have suggested would reduce the transparency and predictability of the criteria. However, we do not believe that this is the case. The existing criteria already include a public benefit test, and therefore we do not believe that the existing criteria provide any greater certainty or transparency than our reformulated approach. The reformulated approach does mean that the decision maker will have the scope to make the appropriate decision in the circumstances and to balance more appropriately the interests of infrastructure owners and access holders and seekers.

7 Construction of competing export coal infrastructure

7.1 Summary

In our view, in most if not all cases competing below rail and port infrastructure will never be constructed to replace capacity which is provided by existing coal export infrastructure. It is possible, although in most cases unlikely, that competing below rail or port infrastructure will be constructed to service new or expanding users. We would therefore submit that in most cases existing below rail and port infrastructure in the mining sector should be subject to access regulation. The factors which lead us to these conclusions are set out below.

7.2 Factors relevant to the ability to construct competing infrastructure

Factor	Explanation
Developments of mining infrastructure depend on co-ordination of development across the coal chain	<p>Existing export coal mining operations are serviced by existing coal export infrastructure. The nature of contracts for coal export infrastructure is that they are long term or even evergreen contracts. Therefore, production from existing operations at current levels is generally committed to using existing coal export infrastructure under existing agreements. The development of new coal export infrastructure is therefore dependent on the development of new coal export operations which are not subject to any agreements to use existing coal export infrastructure, either through the expansion of existing coal mining operations or the development of entirely new greenfield operations.</p> <p>However, the entire capacity of existing coal export infrastructure is also typically contractually committed to servicing existing coal export customers. Therefore, the development of any type of new coal export infrastructure depends on the co-ordinated development not only of new mining infrastructure but also all other types of coal export infrastructure throughout the relevant coal supply chain. For example, the development of the WICET terminal has also depended on the expansion in the capacity of the associated below rail infrastructure through the Wiggins Island Rail Project (WIRP) as well as the various associated mining projects.</p> <p>Therefore, in assessing the likelihood of competing infrastructure being developed, account must be taken of the likelihood of developing the associated expansions in coal mining projects and other required coal export infrastructure. The interrelationships between the various coal projects and the associated infrastructure, in particular the rail and port infrastructure, heighten the risks of each of the developments. In addition, the need for multiple interrelated projects to be financed simultaneously means that the total amount of finance to be raised can be very high. Given the interrelationships between the various projects, financiers will regard their risks as being inseparable and treat them effectively as a single project when determining their overall exposure, which means that each individual project can face significant difficulties in raising finance.</p>
Assessment of coal export returns in the context of market and macro-economic variability	<p>The export coal market experiences significant variability in economic return driven by the variability of commodities prices and the variability of the Australian dollar exchange rates. The prospects of development of new coal export infrastructure are highly dependent on the prevailing rates of return which are assumed for the coal export sector when making the assessment of the likelihood of development of the new coal export infrastructure.</p> <p>Given this variability, the likelihood of competing infrastructure being developed during any particular period is also likely to be highly variable. Although in theory the development of new coal projects and the associated infrastructure could occur at any point in time irrespective of the then prevailing rates of economic return, in reality new coal export capacity</p>

Factor	Explanation
	<p>is only developed during periods of higher economic returns.</p> <p>Therefore, in assessing the likelihood of competing infrastructure being developed during any particular period, regard should be had to the prevailing market and general macroeconomic conditions which are reasonably likely to prevail during that period.</p>
Physical and regulatory constraints on the ability of another party to develop competing infrastructure	<p>Coal export infrastructure is subject to considerable physical and regulatory constraints.</p> <p>An example of a physical constraint is that the majority of export coal is shipped from Australia in Cape-size vessels, i.e. dry bulk vessels which are too big to pass through the Panama canal. There are only a certain number of harbours on the East coast of Australia which can accommodate Cape-size vessels. Another example of a physical constraint would be the much greater difficulty of building rail infrastructure over steep gradients as compared to flat terrain.</p> <p>An example of a regulatory constraint is that the development of rail infrastructure is dependent on the ability to acquire the necessary land holdings on which to build the infrastructure. Since the beginnings of the railway industry, this process has depended on the willingness of government to exercise its powers of compulsory acquisition in order to acquire the necessary corridor for development.</p> <p>Mining developments are obviously also subject to considerable regulatory constraints which introduce considerable timing risk in their development. For example, the grant of a mining lease will typically depend on the reaching of agreement with all of the affected landowners or if agreement cannot be reached proceeding through a legal dispute resolution process.</p> <p>Finally, coal projects and coal export infrastructure will all be subject to the normal environmental and development approval processes.</p> <p>Therefore, when assessing the likelihood of competing infrastructure being developed, and the timescale within which it will be developed, the physical and regulatory constraints which are faced by the developer of the infrastructure (and the related coal projects and other coal infrastructure) should also be taken into account.</p>
Difficulty of competing with an owner of existing infrastructure	<p>As mentioned above, it is frequently less expensive for the owner of existing coal export infrastructure to expand the capacity of that infrastructure than for the developer of the existing infrastructure to develop that infrastructure from scratch. This places the owner of existing infrastructure in the position of always being able to price just below the price able to be offered by a new entrant and thus restrain new participants from entering the market.</p> <p>Even in the above rail sector, which Glencore recognises is now functioning as a more competitive marketplace in both New South Wales and Queensland, Aurizon Operations (or QR as it then was) was able to maintain a monopoly position in heavy haul rail in Queensland for a long time by ensuring that it outcompeted other entrants on price whenever there was a danger of it losing its monopoly. The achievement of a competitive market depended on Glencore and Rio Tinto jointly bringing Pacific National into the Queensland market.</p> <p>This problem is particularly acute when the existing infrastructure was constructed by the State as a multi-user facility and then sold to the private sector. As the original proponent of the building of the infrastructure, the State would have been much better able to assume the risks of that</p>

Factor	Explanation
	<p>development because of its greater resources. In addition, the State would have been a trusted counterparty of the original users of the infrastructure, since there would have been no perceived risk of the State behaving as a monopolist due to the State's having a wider interest in economic development rather than only the returns able to be generated by the relevant infrastructure. These advantages place the owner of privatised infrastructure in a particularly advantageous position, given that the existing customers of the infrastructure will typically have considerable sunk investments made on the basis of their original expectations about the availability of the infrastructure.</p> <p>Therefore, in assessing the likelihood of a competing facility being built, account should be taken of the pricing power of the existing service provider and its ability to vary its pricing so as to render newly developed infrastructure uncompetitive.</p>
Development of mine production and related coal export infrastructure may be uneconomic below a certain scale	<p>The economics of coal export depend in many cases on the economies of scale. It may be uneconomic to develop certain coal resources without being able to achieve a certain level of production. Similarly, it may be uneconomic to develop coal export infrastructure without a certain level of throughput.</p> <p>Therefore, in assessing the likelihood of a competing facility being built, account should be taken of the likely levels of throughput that the facility is likely to be able to service and thus the scale of facility which is likely to be able to be developed.</p>

8 History of privatisations in the coal sector

8.1 Privatisation timeline

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 Rail Track Corporation

8.2 DBCT

As part of the privatisation process in 2001, the Queensland government imposed QCA regulation on the new owners of the terminal. What then occurred was a protracted process involving several decisions between 2004 and 2006 by the QCA on various access undertakings proposed by Prime Infrastructure, the owners of the terminal. If the terminal had been unregulated then the result would certainly have been much worse for the users of the terminal, and Prime Infrastructure would certainly have been in a position to extract monopoly rents as a result of its ownership of the terminal.

Despite the fact that the DBCT terminal was subject to regulation, the users of the terminal were forced to agree to an increase in the regulated rate of return in order to achieve outcomes which were necessary for industry, including expansion of the capacity available at the DBCT terminal.

8.3 Aurizon Network

Aurizon Network was privatised as part of a vertically integrated below and above rail infrastructure provider. Since privatisation, Aurizon has also acquired an interest in a coal producer which utilises its rail network, and has evinced a strong interest in acquiring port infrastructure.

Aurizon Network is subject to access regulation by the Queensland Competition Authority in respect of its existing network only. Its behaviour both in relation to expansions and extensions to that network and in relation to the access undertaking process are indicative of the risks which face the users of that infrastructure.

In the case of both the Goonyella to Abbot Point Expansion and the Wiggins Island Rail Project, Aurizon refused to proceed with an expansion to its network unless the users of that expansion underwrote a rate of return higher than the regulated return approved by the QCA. Aurizon Network has exploited the failure by the regulatory process to provide a regulated path to expansion in order to avoid the regulated rate of return applying to these projects, and users have been forced to collude in this process.

The current access undertaking renewal process (UT4) has demonstrated both the ways in which privately owned infrastructure providers will attempt to escape from meaningful regulation, and also the inability of the current Queensland regulatory system to deal effectively with an incumbent monopoly infrastructure provider. Despite the fact that the previous access undertaking originally expired at the end of June 2013, we are still likely to be at least 6 months away from the resolution of the terms and pricing for the current regulatory period – which is itself due to expire no more than two years after these matters are settled.

The draft access undertaking which Aurizon Network first submitted to the QCA in 2013 demonstrates the ultimate ambitions of a private infrastructure owner. The submissions made to the QCA by industry, including the Queensland Resources Council, provide fuller details of the egregious nature of Aurizon's proposals. Noteworthy aspects include:

- Erosion of meaningful ring fencing of the above and below rail businesses, beyond even incentives created by the existing common ownership, full financial integration and shared directors of these businesses.
- 36% average tariff increases with no increase in service.
- Ability of Aurizon Network to determine the future development of coal production as part of the allocation of capacity on the network.

8.4 APCT

The Abbot Point Coal Terminal was privatised through a sale to Adani without the imposition of regulation. At this port the users have had to institute costly and lengthy arbitration proceedings under the terms of the existing user agreements to prevent unwarranted price increases by Adani, resulting in the expenditure of millions of dollars in legal fees – despite the users' position ultimately being vindicated.

8.5 Port Kembla

The privatisation by NSW of Port Botany and Port Kembla has resulted in the private entity New South Wales Ports becoming the landlord of the Port Kembla Coal Terminal. Whilst the terms of the existing lease constrain the ability of NSW Ports to extract additional returns, any requests for modifications or waiver of the strict terms of the lease have been met with requests for rental increases amounting to \$3/tonne (i.e. a several fold increase on existing rental levels).

8.6 Port of Newcastle

We have already been advised by the new private operator of Newcastle that we should expect significant increases in channel and wharfage charges. These are not justified by any further investment or additional services which are being provided.

8.7 Gladstone Port Corporation

The Queensland government is giving every indication that it will privatise GPC shortly after the next state election. There appears to be every possibility that GPC will be privatised as a single vertically integrated monopoly, without any regulatory regime being imposed. The privatised GPC will therefore in the future have multiple conflicting interests, including as the channel operator, operator of the RG Tanna coal terminal, landlord of WICET, the LNG terminals and other terminals within the harbour. These conflicts of interest produce concerns above and beyond the concerns one would expect from the ownership of private monopoly infrastructure – and if GPC were to be acquired by Aurizon, these concerns would be massively amplified.

8.8 Australian Rail Track Corporation

We also expect that in the near future ARTC may also be privatised by the Federal government. ARTC operates the heavy haul rail network which is the most significant item of monopoly infrastructure in the Hunter Valley coal chain.

Whilst in the past the access undertaking operated by the ACCC has been sufficient to provide a reasonable degree of certainty in relation to the provision of access by ARTC, it has not been subject to being tested by an aggressive private owner and suffers from some of the same structural weaknesses as the Aurizon Network access undertaking – for example, an inability to force ARTC to expand capacity on its network.

9 Hunter Valley Coal Chain Co-ordinator

At pages 131-132 of the Draft Report, the Panel expresses the view that bulk ports with a few large customers would be constrained from abusing their monopoly power by the market power of those customers. In making this observation, the Panel refers to the success of the Hunter Valley Coal Chain Co-ordinator, which benefits from the participation of the port terminals which are owned by Port Waratah Coal Services and Newcastle Coal Infrastructure Group.

Participation in the HVCCC is largely voluntary (except in the case of ARTC which is subject to some constraints under its access undertaking). We would draw the Panel's attention to the fact that both PWCS and NCIG are owned by the coal industry. Glencore Rail

participates in the HVCCC and is also industry owned. There is no guarantee that large customers can force their service providers to participate in such a forum. The best illustration of this can be seen in Queensland, where despite significant efforts being made by large customers of the various infrastructure providers, such as Glencore, Rio Tinto and Anglo American, it has proved impossible to establish any body with a similar remit or functions to the HVCCC.

Furthermore, whilst the HVCCC provides a valuable forum for co-operation in relation to capacity forecasting, planning and performance monitoring, it does not itself have any power to take investment decisions. All decisions in relation to infrastructure investment and day to day operation remain with the individual participants in the coal chain, who could at any time choose to leave the HVCCC and renounce any role for the HVCCC in relation to their infrastructure (leaving aside the limited functions for the HVCCC which are currently mandated by the ARTC access undertaking).

We would therefore urge the Panel not to conclude that it is unnecessary to impose regulation on bulk commodity ports which are privatised. Despite the fact that the users of these facilities may be major customers – they do not necessarily have any market power in the market for the provision of port facilities. In fact, the existing projects owned by these customers are likely to be beholden to the existing infrastructure for their continued operation.

10 Rail freight – competition from road transport

The Panel observes that structural separation might not be required on some low volume routes. It makes this observation in the context that road transport may in some circumstances be able to compete with rail freight. However, in the case of coal and some other commodities, the ability of road transport to provide a competitive alternative is limited or absent. For example, frequently project approvals require that coal is only transported by rail freight. We would therefore suggest that the Panel clarifies that vertical integration should be avoided where there road transport does not provide effective competition to rail freight.