Opinion

FROM THE CAPITAL

Fortescue cartel bid raises antitrust ire

Big iron-ore producers driving competitors out of the market not targets of Australia's competition watchdog

John Robertson

Companies are free to raise iron-ore production no matter how much damage they do to others in the industry. That is the free market at work. Cutting production, on the other hand, may be a crime. Into this legal and economic minefield has stepped the intrepid Andrew Forrest.

Speaking at an AustCham event in Shanghai on 24 March, the Fortescue Metals Group founder and current chairman Andrew Forrest has been reported as saying iron-ore producers should "act like grown-ups and just agree to cap their production".

The head of the Australian Competition and Consumer Commission (ACCC) was unimpressed. The guardian of Australian business competition swiftly warned of "civil and criminal penalties for both cartel conduct and attempts to engage in cartel conduct". The mere mention of the subject could land someone in hot water. Forrest need not actually achieve an agreement to precipitate action against him.

Chinese steel interests would have been pleased to see Australia's own competition regulator race to condemn the Forrest intervention. Australia's treasurer and self-proclaimed devotee of free markets similarly slapped down the idea despite a A$22 billion fall in annual iron-ore export revenues leaving a gaping hole in the Commonwealth budget.

In so promptly taking Forrest to task, the ACCC says it is primarily concerned with consumers and the impact of higher iron-ore prices on Australians' whitegoods and cars, not the welfare of the iron-ore industry.

The populist grab for headlines by the ACCC takes a simplistic view of how markets work. Sustained higher iron-ore prices would most likely cause a rise in the Australian dollar exchange rate. Higher iron-ore prices may result in cheaper white goods and cars with Australia on the verge of ceasing production of both. The ACCC and Forrest may have had more in common than either realised.

Usually, the ACCC worries about a cutback in the number of suppliers in an industry. A large grocery chain would oversee a loss of competition if it used its financial and pricing muscle to cut out alternative retailers, but the ACCC seems to care little that many small- and medium-sized iron-ore producers are being squeezed out of the market by the actions of the largest companies in the sector.

Waiting for the dust to settle… FMG boss Andrew Forrest can see a clear case for higher iron-ore prices

The Forrest comments could have been caused by loose lips, but there was no backing down. A day later, the chief executive of Fortescue took aim at the ACCC itself, citing section 51(2)(g) of its own Act which Fortescue says carves out price setting arrangements that are conducted wholly in overseas markets.

Fortescue has been one of the most outstandingly successful of Australia's mining companies in the past decade, having made its way from nowhere in 2004 to become the country's third-largest iron-ore producer.

Despite successfully developing a 165Mt/y mining operation, Fortescue is widely regarded as the highest-cost producer among the top three and the most highly geared. It has been reducing its costs – targeting US$40-45/t – and has managed its balance sheet in a manner few would have once credited, but some of the pressures remain. The company had wanted to refinance a portion of its debt earlier this month, but the issue had to be pulled from the market because the terms were less favourable than the company had been seeking.

Fortescue and Forrest would be big winners if iron-ore prices could climb US$20 or so. Nonetheless, the risks in such an overt move to rebalance the market make Forrest very brave or very foolish.

A bigger danger for Forrest than the ACCC comes from non-Australian authorities moving against Forrest individually, Fortescue or any other producers deemed to have participated in a conspiracy to ramp up prices. Memories have dimmed, but the extraterritorial reach of US antitrust laws put an earlier generation of mining executives at risk of being fined or jailed, and fearful of travelling overseas, because of their alleged involvement in a uranium price rigging conspiracy.

After the US government had placed an embargo on imports of uranium in the 1960s, foreign suppliers from France, South Africa, Australia, Canada and Great Britain decided to cut back and allocate the production and sale of uranium outside the USA. The combined effects of the US embargo and the producers' response precipitated a sevenfold increase in the uranium price during 1972-75.

When Westinghouse, the largest supplier of uranium to US nuclear power plants, could no longer fulfil its fixed-price contracts, a number of purchasers began legal proceedings for breach of contract. In response, Westinghouse filed an antitrust suit claiming treble damages against 29 US and foreign companies, including four companies operating in Australia – CRA, Mary Kathleen Uranium, Pancontinental Mining and Queensland Mines – making the US$7 billion action one of the most expensive law suits in US legal history.

Subsequently, mining executives became hyper-sensitive about any utterances that could be construed as restraining competition in any jurisdiction. When the aluminium industry faced its own cyclical slump in the early 1990s, companies cajoled governments to help rebalance the markets.

The governments of Australia, Canada, the European Union, Norway, the Russian Federation and the United States signed a memorandum of understanding (MoU) in January 1994 to "recognise that the world aluminium industry is facing a grave, exceptional and unforeseeable situation involving a considerable excess global supply of primary aluminium". The multilateral MoU was the shield to protect executives against prosecution under national laws once co-ordinated production cuts began and information tracking output and prices was collated and disseminated.

Today, governments are less likely to join forces in this way. Philosophically, times have changed. There is also, in the iron-ore case, an awkward separation between the interests of a small number of producing countries and a larger number of geopolitically, far stronger users. That leaves Fortescue isolated on a flimsy limb.

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