City Square
125 St Georges Terrace
Perth WA 6000
T +61 8 6321 2685
bhpbilliton.com

13 December, 2018

The Director
Investigations 2
GPO Box 2013
CANBERRA ACT 2013
By Email: investigations2@adcommission.gov.au

Dear Director

Investigation No. 473 – Ammonium Nitrate exported from China, Sweden and Thailand

On 10 August 2018, BHP lodged its preliminary submission on the Anti-Dumping Commission's (**ADC**) investigation into Ammonium Nitrate (**AN**) exported to Australia from the People's Republic of China (**PRC**), Sweden and The Kingdom of Thailand (**Thailand**) (the **Imported AN**).

In the August submission, BHP submitted that there is no reasonable basis for the imposition of duties on Imported AN because there is insufficient evidence to support the conclusion that the Imported AN is causing, or is threatening to cause, 'material injury' to the Australian industry producing AN (**the Australian AN Industry**). On 24 October 2018, the ADC's Preliminary Affirmative Determination (**PAD**) was published to the effect that there are sufficient grounds to support a finding that 'material injury', in the form of price depression, price suppression, reduced revenues, reduced profits and reduced profitability in the Australian AN Industry,[1] has been caused by Imported AN for the following reasons:

- Customers used the availability of Imported AN to negotiate lower prices in fixed term contracts;[2]
- Volumes of Imported AN have increased substantially since 2015-2016;[3] and
- Export prices of the goods from the PRC, Sweden and Thailand are substantially lower than the prices of goods exported from other countries.[4]

However, the ADC accepted that the Applicants had not established that they had lost sales volumes or experienced lower capacity utilisation as a result of the Imported AN.

Following the publication of the PAD, BHP commissioned an independent expert opinion from Frontier Economics (**Frontier**) to assess whether there was a proper basis for the ADC's findings given economic principles and the requirements of the *Customs Act 1901* (Cth) (**the Act**). This report is enclosed as **Annexure A** (**Frontier Report**).

BHP makes these submissions based on the Frontier Report and on the requirements of the Act.

1 Summary

The Frontier Report concludes that there are flaws in the ADC's findings in the PAD given relevant economic principles and the requirements of the anti-dumping provisions contained in Part XVB of the Act, including the Ministerial Direction on Material Injury made pursuant to s 269TA of the Act (**Ministerial Direction**).

In particular, Frontier's opinion is that:

[1] ADC, *Anti-Dumping Notice No.2018/166 – Preliminary Affirmative Determination,* pp 8 and14.
[2] ADC, *Anti-Dumping Notice No.2018/166 – Preliminary Affirmative Determination,* pp.10-12.
[3] ADC, *Anti-Dumping Notice No.2018/166 – Preliminary Affirmative Determination,* pp.10-11.
[4] ADC, *Anti-Dumping Notice No.2018/166 – Preliminary Affirmative Determination,* p.10.

- The pricing data relied upon by the ADC shows implausibly large variations in pricing for what are said to be like goods, casting doubt on the proposition that customers consider Imported AN to be perfectly substitutable for domestically produced AN. This in turn casts doubt on the ADC's finding that price undercutting by Imported AN has led to price falls for domestically produced AN.
- The ADC should assess injury to the Australian AN Industry by undertaking a 'counterfactual' analysis of the AN market with and without the Imported AN to isolate the effect of the Imported AN from impacts on prices, profits and costs caused by other factors.
- If a counterfactual analysis is undertaken, it can be seen that there are other factors which, according to standard economic analysis, could have been expected to cause prices and profits within the Australian AN Industry to fall even in the absence of the Imported AN.
- As the ADC has not undertaken such an analysis, it is not possible for it to draw conclusions about the effects of imports on prices and profits within the Australian AN Industry.
- In any event, the loss of profits or prices complained of, even if they could be attributed to the Imported AN, are within the normal ebbs and flows of the domestic industry. The Ministerial Direction directs that such injury is not 'material'.

BHP considers that because the ADC's assessment of 'material injury' fails to account for factors which have caused decreased profits and prices other than Imported AN, it is contrary to s 269TAE(2A) of the Act which expressly requires a decision-maker to account for whether an alleged injury is caused by 'a factor other than the exportation of those goods' and contrary to the Ministerial Direction as it is not based on fact.

BHP also reiterates its earlier submission that there is no reasonable basis upon which it could be determined that dumping duties should be imposed on the Imported AN. Protectionist tariffs are contrary to Australia's trade policy and Australia's international obligations under the General Agreement on Tariffs and Trade. BHP maintains that there is no sound legal or policy reason to impose anti-dumping duties in circumstances where the Australian AN Industry is highly profitable and has a dominant share of the domestic market for AN.

The above points are developed further below.

2 Failure to establish causal connection

The PAD is premised on a finding that domestic prices for AN have been 'undercut' by Imported AN which are 'like goods' to domestic production. BHP submits that the Frontier Report raises serious questions as to whether (a) the Imported AN and domestically produced AN are like goods; and (b) if there is any price undercutting resulting from the Imported AN. These questions flow from Frontier's finding that the pricing data relied upon by the ADC contains 'implausibly large' price variations, suggesting the data is not representative of 'like' goods. This finding is also consistent with Orica's submission to the effect that Imported AN is not a perfect substitute for domestic product:[5]

> *In the past, customers have sought local supply for a number of reasons, including:*
>
> - *Security of supply to reduce potential interruption to mine operations and to manage supply chain risk;*
> - *Quality of product to ensure consistent blast performance which results in operational benefits in productivity and safety;*
> - *Flexibility to meet surges or step changes in demand to capture profitable opportunities in their mining business.*
>
> *Experience shows that AN imports do not always deliver preferred blast outcomes. AN is subject to temperature cycling so it is not well suited to long sea voyages through high temperature and high*

[5] Orica submission, '*Investigation No.473 – Ammonium nitrate exported from P R China, Sweden and Thailand*' (22 August 2018), p.3.

humidity zones, which often result in caked product on arrival requiring considerable additional handling costs.

If the Imported AN was a true substitute for domestically produced goods, Frontier concludes that only very small changes to prices would be observed to entice consumers to purchase the Imported AN. The magnitude of such changes would be significantly less than the 7% to 22% claimed in this investigation, which again calls into question whether or not the Imported AN has caused these alleged price falls.

BHP concurs with Frontier's opinion that a 'counterfactual' analysis, which involves a comparison of price and profit outcomes that would have occurred 'with or without' Imported AN, is the appropriate method to assess whether or not the Imported AN has caused injury.

This becomes particularly relevant given Frontier's findings that prices and profits could have been expected to have fallen in the investigation period irrespective of the presence of Imported AN. Sections 3.4, 3.5.1 and 3.5.2 of the Frontier Report identify the factors other than Imported AN which could have been expected to have adversely affected the Applicants' profits, and prices. These factors include:

- Overcapacity in the domestic market and the 'effective price war' between Orica and Incitec Pivot in WA;[6]
- An overall decrease in demand for AN in Australia occurring independently of the presence of Imported AN; and
- Input cost increases which may not have been able to have been passed on to consumers via higher prices for reasons other than the presence of Imported AN.

The Frontier Report also notes that the ADC has used changes in the applicants' EBIT to assess changes in profitability. However, EBIT can change due to changes in factors entirely unrelated to price effects caused by the Imported AN, such as changes to capital expenditure and depreciation policies. Again, the PAD does not make any attempt to quantify these other factors.

BHP submits therefore that there is no evidentiary basis for the ADC to conclude that the Imported AN has caused injury to the Applicants in the form of a reduction in prices or profits. In making such a finding, the ADC must rely on facts and not mere allegations or conjecture.

The above matters are set out in further detail at sections 2.3, 2.4, 3.2, 3.3, 3.4, 3.5.1 and 3.5.2 of the Frontier Report.

3 Failure to establish 'material injury'

Frontier's opinion is that '*the ADC has not produced evidence that any of the kinds of injury identified even if attributable to dumping of like goods meet the threshold of being 'material'*.[7]

In particular, the Frontier Report notes that:

- The claims of price decreases of 7% to 22% as a result of Imported AN are questionable, and at least a proportion of the price decrease is due to factors other than Imported AN;
- Structural constraints limit imports of AN to around 5% of the total market. It follows that threats from buyers to import large volumes lack credibility and could not undermine prices for large orders;
- The ADC has not accounted for the increased demand that would flow from a decrease in domestic prices due in a true import parity pricing scenario; and
- The injury complained of is within the normal 'ebbs' and 'flows' observed within the domestic industry.

BHP concurs with this opinion and submits that the ADC has not identified any reasonable evidentiary basis for concluding that there exist reasonable grounds for a finding of material injury from Imported AN.

For further detail see sections 4.1 and 4.2 of the Frontier Report.

[6] Frontier Report, p.16.
[7] Frontier Report, p.21

4 Failure to comply with the Act

Section 269TAE(2A) of the Act requires that the Minister consider whether the alleged injury 'is being caused or threatened by a factor other than the exportation of those goods' and to then exclude this injury from that attributed to the Imported AN. The Commissioner is also bound to follow the Ministerial Direction which:

(a) requires that the Commissioner's assessment of 'material injury' be based on facts not assertions, unsupported by facts; and
(b) directs the Commission that 'material' injury must be greater than that likely to occur in the normal ebb and flow of business.

In the present case, the ADC:

- has not undertaken a counterfactual analysis;
- has not taken into account other factors which could have contributed to any injury suffered by the Australian AN Industry over the relevant period, so as to exclude those injury effects from the assessment of injury; and
- instead has attributed all injury to the presence of Imported AN.

It follows that in failing to properly assess causality and attributing the entire injury alleged to have been suffered by the Applicants to Imported AN, the ADC is acting contrary to s 269TAE(2A) of the Act and the Ministerial Direction.

Further, it is not possible for the ADC to assess the materiality of any injury allegedly caused by the Imported AN at the present time, given the ADC's failure to address causality. That is, until the extent of the injury actually caused by the Imported AN has been properly identified, it is not possible to assess whether that injury is 'material'.

5 Conclusion

BHP considers that the Frontier Report outlines critical concerns in relation to the ADC's approach to its assessment of causation and material injury in the current investigation. In the absence of reliable evidence and a robust methodology, BHP's view is that there is no proper basis for the imposition of duties on Imported AN, particularly in circumstances where suppliers of Imported AN are already constrained by the presence of domestic competitors who together retain a market share in excess of 90%.

Yours sincerely

Yours sincerely

BHP

Annexure A – Frontier Economics, *Opinion on Preliminary Affirmative Determination, Investigation 473 – Ammonium Nitrate* (26 November 2018)

See following pages

frontier economics

10 DECEMBER 2018

OPINION ON PRELIMINARY AFFIRMATIVE DETERMINATION

INVESTIGATION 473 – AMMONIUM NITRATE
PREPARED FOR BHP BILLITON IRON ORE PTY LTD

Disclaimer

CONTENTS

Tables

Figures

SUMMARY OF OPINIONS

We have been asked for our opinion on the Anti-Dumping Commissioner's preliminary affirmative determination (PAD) released in October 2018.[1] The PAD relates to exports of ammonium nitrate to Australia from China, Sweden and Thailand during the investigation period (April 2017-March 2018).

The PAD is issued under the *Customs Act 1901 (Cth)* (the Act) and its associated instruments.[2] Key to the imposition of dumping duties is that injury to the Australian industry must be causally related to identified dumping, and that any injury must be material – beyond the ordinary ebbs and flows of business.

The PAD states that the Anti-Dumping Commission's (ADC's) preliminary assessment was that exports of ammonium nitrate to Australia were at dumped prices and the dumping margins were not negligible. The Commissioner was also satisfied that there currently appeared to be sufficient grounds to support a finding that material injury had been caused by dumped goods from China, Sweden and Thailand. The basis for this was that:

- customers used the availability of imported ammonium nitrate to negotiate lower prices in contracts
- volumes of the allegedly dumped goods from China, Sweden and Thailand have increased substantially since 2015-16
- export prices of the goods from these three countries were substantially lower than the prices of goods exported from other countries.

The Commissioner therefore considered there were sufficient grounds to conclude that prices of the imported ammonium nitrate were undercutting Australian industry's prices. However, the Commission's preliminary assessment was that the applicants did not lose sales volumes to the dumped goods, nor experience lower capacity utilisation; and that the reduced market share during the investigation period was not material.

In our opinion, the Commissioner has no basis to conclude that prices or profits[3] have declined due to dumping, nor that any injury is material and beyond the normal ebbs and flows of business. We have formed this opinion because:

- The ADC has not compared price and profit outcomes with and without the alleged dumping. To demonstrate a causal relationship, injury to the Australian industry should be assessed by comparing the domestic industry's profit with the alleged dumping to the expected profit without the alleged dumping.
- The ADC's claim of reductions in domestic prices caused by lower import prices is undermined by:
  - implausibly large and unexplained variations in prices of imports, which casts doubt over whether imports are genuinely substitutable for domestically-produced like goods at similar prices
  - doubts about the credibility of importing a sufficient volume of ammonium nitrate to be a genuine constraint on domestic suppliers.

---

[1] Anti-Dumping Notice No. 2018/166, *Ammonium nitrate – 473 Exported from the People's Republic of China, Sweden and the Kingdom of Thailand: Preliminary Affirmative Determination and imposition of securities* (**PAD**)

[2] In particular, the Ministerial Direction on "material" injury made on 1 June 2012 under section 269TA of the Act.

[3] This may have a number of components as in the Act, including reductions in prices, volumes, revenues or market share. We use 'profit' to encompass all of these injury possibilities.

- There is no evidence of import substitution, and imports remain at a relatively insignificant level.
- There is evidence that the domestic industry's prices and profits would have fallen even without the alleged dumping in the investigation period, as:
  - domestic demand fell over the preceding 12 months, even with falling prices
  - the pricing of domestic producers was influenced by existing and future excess capacity – which appears to be widely-known within the industry
  - domestic producers had been facing input cost increases and producer-specific cost increases, at least some of which they were not likely to have been able to pass through to customers.
- To the extent that there have been any reductions in profit attributable to dumping, these reductions are well within the ordinary ebbs and flows of business profits in the domestic ammonium nitrate industry, and so do not constitute 'material' injury. As indicated, there is also uncertainty about the credibility of importers to supply sufficient volumes of equivalent-quality ammonium nitrate such that injury could be material.

We cannot draw conclusions on the finding of dumping (export prices below normal values) as there is a lack of published information about domestic prices and the normal value of the like good. Nonetheless, we are also of the opinion that the same issue of comparability between domestic sales and exports (as described above) is likely to be relevant to the analysis of dumping. In particular, imported ammonium nitrate for export can be of lower quality and so would reduce its expected selling price relative to goods sold domestically.

1 INTRODUCTION

1.1 Investigation 473 – Ammonium Nitrate

Australia's anti-dumping provisions are contained in Part XVB of the *Customs Act 1901 (Cth)* (the Act).

In June 2018, the Anti-Dumping Commissioner initiated an investigation into the alleged dumping of ammonium nitrate following an application by CSBP Limited (CSBP), Orica Australia Pty Ltd (Orica) and Queensland Nitrates Pty Ltd (QNP) under section 269TB of the Act.

Dumping occurs when goods exported to Australia are priced lower than their 'normal value', which is usually the comparable price in the ordinary course of trade in the exporter's domestic market.

In October 2018, a preliminary affirmative determination (PAD) was released[4] which stated that the Anti-Dumping Commission's (ADC's) preliminary assessment was that:

- exports of ammonium nitrate to Australia from China, Sweden and Thailand during the investigation period (1 April 2017 to 31 March 2018) were at dumped prices and the dumping margins were not negligible
- the volumes of dumped goods exported from China, Sweden and Thailand were not negligible (i.e. individually above three per cent of the total Australian import volume).

The Commissioner stated that he was satisfied that, based on the analysis to date and the size of the dumping margins, there currently appears to be sufficient grounds to support a finding that material injury has been caused by dumped goods from China, Sweden and Thailand.[5] This was based on a Commission finding that:

> *…there is sufficient evidence at this time to establish that it was necessary for the Australian industry to reduce prices to secure supply contracts. This has led to the Australian industry experiencing material injury in the form of price depression, price suppression, reduced revenues, reduced profits and reduced profitability.*[6]

1.2 The Act and material injury

The Commission's assessment and findings on 'injury' and 'causation' are required to be undertaken in accordance with section 269TAE of the Act.

[4] Anti-Dumping Notice No. 2018/166, *Ammonium nitrate – 473 Exported from the People's Republic of China, Sweden and the Kingdom of Thailand: Preliminary Affirmative Determination and imposition of securities* (**PAD**)

[5] PAD, p. 2.

[6] ibid., p. 14.

The Act sets out a range of factors the Commission must consider when firstly establishing whether injury has been caused by the exportation of the 'good'[7] and then secondly whether that injury has been caused by factors other than the dumping or subsidised goods.[8]

In particular, the factors that must be considered are:

a. the volume and prices of imported like goods that are not dumped; or

b. the volume and prices of importations of like goods that are not subsidised; or

c. contractions in demand or changes in patterns of consumption; or

d. restrictive trade practices of, and competition between, foreign and Australian producers of like goods; or

e. developments in technology; or

f. the export performance and productivity of the Australian industry.

A Ministerial Direction on "material" injury was made on 1 June 2012 under section 269TA of the Act. It describes and provides direction on factors that should be considered when the ADC makes a determination on injury and causation.

1.3 The task

We have been asked for our opinion on whether or not the ADC's findings in the PAD are justified having regard to:

- general economic principles
- any of the requirements of Part XVB of the *Customs Act (Cth) 1901.*

In the remainder of this report, we set out our analysis of:

- the ADC's pricing evidence (Section 2)
- the ADC's analysis of injury and other factors that could have contributed to the alleged injury (Section 3)
- the materiality of any alleged injury (Section 4).

7 Sub section 269TAE(1) of the Act

8 Sub section 269TAE(2A) of the Act

2 THE PRICING EVIDENCE

2.1 Ammonium nitrate and like goods

The applicants submit that ammonium nitrate is supplied to mining principals or to mining services providers via long-term and spot contracts arranged through competitive tender processes.[9]

The applicants claim that these tender processes, and the dual sourcing by mine operators and mining services providers, exposes the Australian industry to competition from imports. Customers are said to cite the availability of imported ammonium nitrate as the benchmark or alternative source to the local ammonium nitrate supplier.[10]

The applicants further claim that:

> *The selling prices for AN [ammonium nitrate] supply in Australia is relatively transparent with import volumes and prices observable in published ABS data; the market itself may be described as "price sensitive" as all parties operate in full knowledge of the availability and pricing for alternate supply.*[11]

The ADC finds that the physical likeness and commercial likeness of the products is sufficient to conclude that there is a domestic industry producing like goods.[12]

2.2 Economic principles relating to homogeneous goods

Economics predicts that goods that are homogeneous and sold in well-informed markets will tend to trade at the same price (adjusted for transport costs).[13] This is because where material differences in prices arises, it creates arbitrage opportunities – riskless opportunities for profit – which will correct pricing differences. For example, if goods in location A are priced 20% higher than goods in location B, a purchaser of goods in A could ship those goods to market B and make a riskless profit (given low transport costs). This will tend to equalise prices within the market.

We understand that the test used in dumping investigations is whether the imported goods are "like goods" to those produced domestically. This is very close to the idea of homogeneity of goods as they would be understood by an economist.

---

9 Applicants, Form B108 – Application for dumping and/or countervailing duties, p.13.

10 ibid, p. 22.

11 ibid, p. 23.

12 PAD, p. 4.

13 Known as the "law of one price". Stigler (1961) was one of the first economists to analyse why pricing dispersion can exist for homogeneous goods – a phenomenon he attributes to search costs. G. Stigler, "The Economics of Information", JPE, June 1961, No. 3, Vol LXIX. p. 213-225. It is, however, difficult to see how search costs or other informational barriers would be relevant to ammonium nitrate sales.

The significance of this principle is that we should carefully assess any finding that suggests there are large price differences between products that have been assessed as like. It could suggest that:

- the comparisons between imported and domestic prices alone will not be accurate
- if imported product is of inferior quality, or involves other transactions costs such as higher storage costs, then importers may have to price well below domestic goods to achieve any sales.

In these circumstances, claims from the domestic industry that the "threat" of lower import prices has forced lower prices for the domestic industry ("price undercutting") could be overstated.

2.3 Implausible price variances

The ADC indicates that it has compared FOB prices of exports from China, Sweden and Thailand with other export prices and concludes that: "there appears to be sufficient grounds to preliminary [sic] determine that the prices of the goods from these three countries are undercutting the Australian industry's prices."[14] The ADC also states that it considered evidence suggesting price reductions by the domestic industry of between 7 and 22 per cent.

We are restricted from analysis of the ADC's data as it is not published for confidentiality reasons. However, in our opinion, there are aspects of the evidence before the ADC that are, at best, unclear and suggest that relying on available pricing data for an injury finding is perilous.

2.3.1 Implausibly large price differences and unclear pricing trends

If we accept the applicants' claim that the product is price sensitive and that prices are widely observable, the price reductions of the kind postulated by the applicants are implausibly large.[15] Only very small price reductions would be required to induce user switching with homogeneous goods and low costs of searching out better deals (search costs).

In our opinion, the pricing evidence put forward by the applicants (relying on ABS import data) provides little evidence that import prices for similar products have fallen.

Imports from Sweden

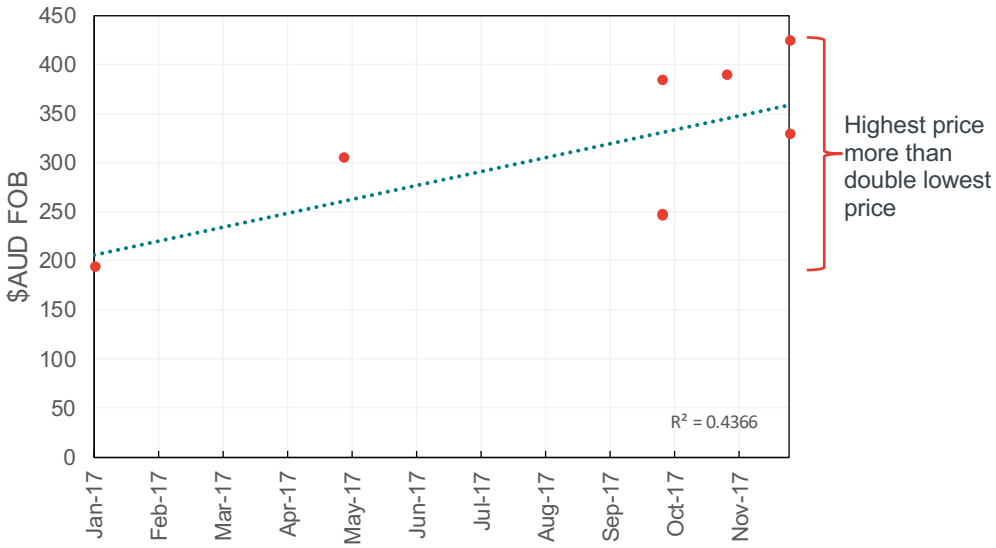
As an example, consider the following information supplied relating to Sweden. **Figure 1** shows how prices changed through 2017. This indicates that:

- prices appear to have increased through the course of 2017
- there are very large price deviations for supposedly near-identical products – with the maximum price being **118%** of the lowest price and prices in the same month (October) being more than **50%** apart.

[14] PAD, p. 13.

[15] Widely observable prices reduces problems associated with search costs, which are often given as a reason for why price dispersion can persist in markets with homogeneous products.

Figure 1: Sweden - FOB Export prices over time

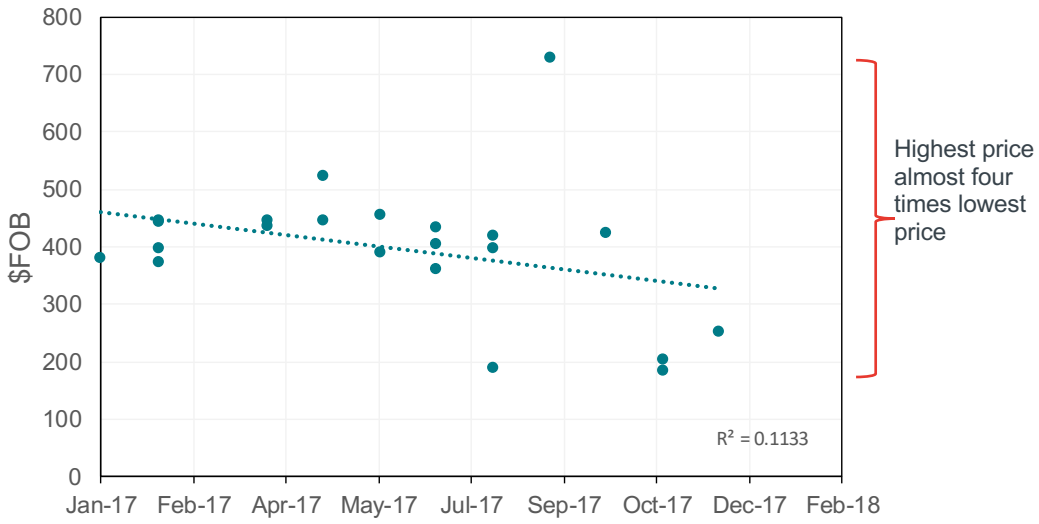


Source: Application Form B108 – page 34.

Imports from China

Similar discrepancies arise in the Chinese data. **Figure 2** indicates that prices appear to have been falling over the course of 2017, but the relationship is weak and affected by a couple of outliers. The gap between the highest and lowest price for Chinese imports is **296**%, despite occurring in successive months, and even if the high outlier is removed (at over $700 per MT) the gap is over 180%.

Figure 2: China - $AUD FOB Export prices over time

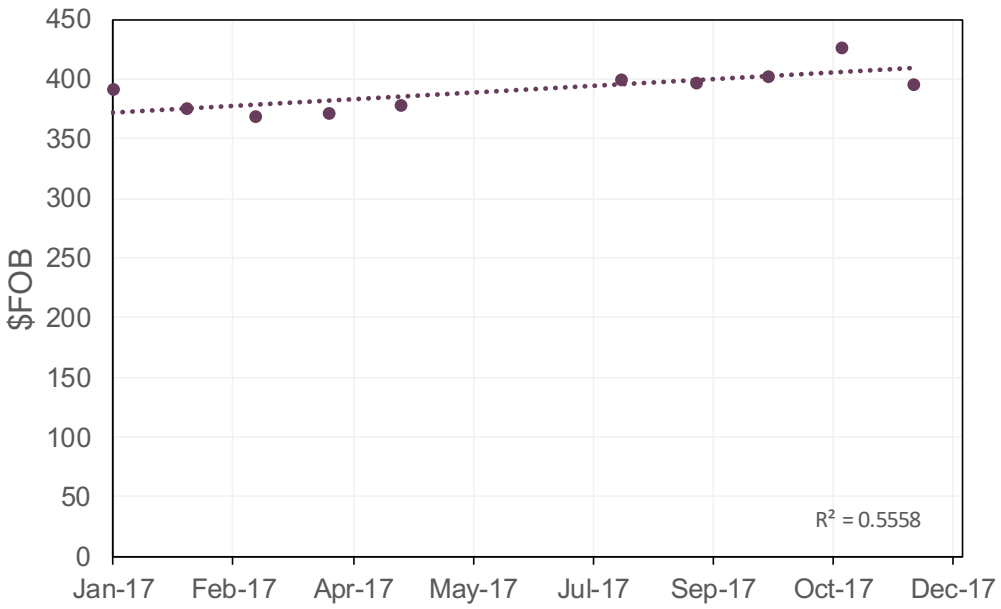


Source: Application Form B108 – page 34.

Imports from Thailand

The imports from Thailand show a tighter range of prices, but like Sweden show a pattern of increasing prices through 2017 (or at least no pattern of decrease).

Figure 3: Thailand - $AUD FOB Export prices over time



Source: Application Form B108 – page 34

It would not be surprising that there would be some price differences between different orders, to reflect different order sizes or changes in market prices. However, there appears to be little relationship between order size and price (see Annex B). The differences are therefore so large it brings into question the reliability of the pricing evidence. A further example is shown in **Table 1**, which highlights differences between the three countries under investigation. This indicates that:

- Export prices for China were almost **100**% higher than those from Sweden in January.
- Export prices for Sweden were more than **100%** higher than those from China in November.

Table 1: Price comparisons across countries

MONTH	PR CHINA QTY (MT)	PR CHINA PRICE $A	SWEDEN QTY	SWEDEN PRICE $A	THAILAND QTY	THAILAND PRICE $A
Jan 17	6009	**380**	6010	**195**	241	391
Nov 17	196	**194**	108	**391**	963	427

Source: Application Form B108 – page 34

Finally, the identification of normal selling prices in the Application does not suggest that prices in the domestic markets of the identified countries vary to anything like the same degree. Prices in all three countries vary within a range no larger than **17%**. In our opinion, this is a much more plausible range of price dispersion consistent with actual market behaviour than the data in Table B-2.1 in the Application.

Perhaps in recognition of this problem, the ADC noted that "During the course of the investigation, the Commission anticipates that it will obtain more detailed information to allow for a more precise comparison of export prices to the Australian industry's prices based on the density of the ammonium nitrate."[16] However, the ADC provides no further evidence or support in the PAD for the applicants' claims of price reductions applying to the same types of product.

2.4 Conclusion

The pricing data provided by the applicants indicates that the products in recorded volume information are not likely to be homogeneous or perfectly substitutable. There is no evidence that customers see imports as perfectly substitutable for domestic product and are chosen entirely on the basis of price. In our opinion, this casts doubt on the ADC's finding that the only reason that applicant's prices have fallen by between 7 and 22 per cent is competition from dumped imports.

[16] ADC, Consideration Report NO. 473, June 2018, p. 38.

3 FINDINGS ON PRICES AND PROFITS

3.1 Price and profits are determined by demand and supply

Injury can result from dumping that causes domestic price reductions. However, price changes do not occur in a vacuum. Market prices are determined by the opposing forces of demand and supply. Other things equal, increases in demand will increase prices, while increases in supply will result in falls in prices.

The relevance of this in a dumping application is that in assessing injury, we should be cognisant that prices in a market can fall because:

- demand has reduced at each price level (demand curve shifts left) due to exogenous changes such as availability of substitutes
- supply has increased at each price level (shifts right) due to exogenous changes such as lower input costs or more production capacity
- demand increases, but is offset by a larger increase in supply
- demand reduces, and is not offset by a larger reduction in supply.

Examples of this are further highlighted in Annex A.

3.2 A 'with and without' comparison

An injury finding requires a comparison between outcomes that have occurred with dumping to those that would have occurred in the absence of the dumping (a counterfactual).

Comparing the factual and counterfactual outcomes means that the ADC must be able to appropriately account for other factors that may have changed in the assessment period which could also have reduced profits or other measures of injury.

Ideal methods for comparing factual and counterfactual outcomes and assigning causality to different factors include regression analysis. Other less data intensive methods can be used (such as determining a counterfactual on the basis of a past trend, or examining correlations between prices and volumes and exported and like goods). Regardless of particular method adopted, clear presentation and analysis of the factual and counterfactual trend data is critical to effectively identifying injury and causation and promoting robust reasoning to support an injury and causation finding.

3.3 No pricing or profit baseline is identified

The ADC's finding that prices have fallen as a result of dumping does not specify the baseline for how prices would have evolved in the absence of the dumping. It states that:

> *Each application quantified the price reduction in terms of the absolute reduction in price…the applicants' estimates of the price reductions range between 7 per cent and 22 per cent.*[17]

By referring to an 'absolute reduction', we understand the applicants to mean the price in a preceding period. However, this is not useful for determining whether injury has occurred or is likely to occur; this requires a "with and without" perspective.

As discussed above, prices can increase or reduce depending on exogenous changes in demand or supply (or both).[18] The ADC appears to have given no consideration to this possibility. As discussed below, there are other reasons to expect price falls.

The ADC's analysis of profits suffers from the same flaw. There are two essential questions which the ADC must answer with respect to profits and profitability: Is the reduction in profits caused by dumping, and does it constitute material injury?

Aggregate industry profits are reported in Figure 3 in the PAD, which we replicate below.

Figure 4: Extract from ADC PAD

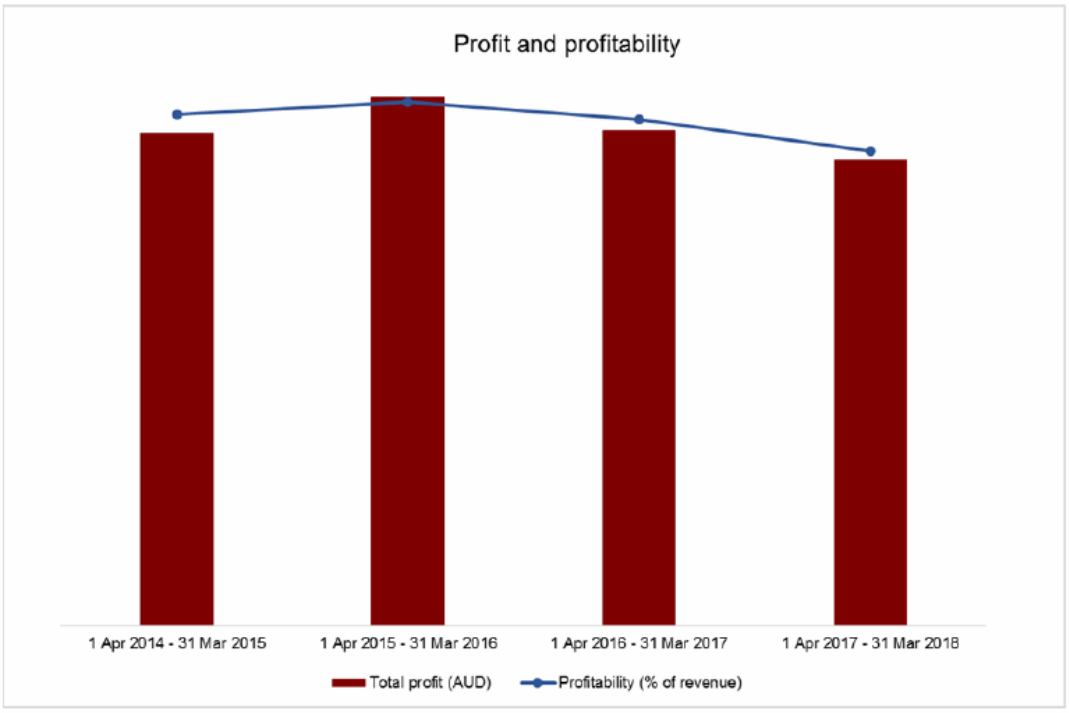


Figure 3: Applicants' total domestic profit and profitability (profit as a percentage of total domestic revenue)

Source: PAD, p. 13.

[17] PAD, p.12.

[18] Suppose, for example, that a baseline price reduction of 10% was expected given evidence of domestic and international over-capacity and past trends. Then, compared with prices in the absence of the alleged dumping, a finding that actual price reductions of 13% had been experienced would be significantly smaller and not consistent with a material injury finding.

The ADC does not specify what proportion of the fall in profit is attributable to dumping. Even the applicants do not claim that all EBIT reductions are due to imports, and that there are other factors impinging on profits:

> *Whilst it is recognised that not all EBIT reductions can be attributed to the influences of IPP, this remains a key factor on market pricing for CSBP's AN business.*[19]

In our opinion, an analysis of injury that does not take into account these other unstated factors is flawed.

A second issue with the analysis of profits is that the ADC does not specify how profit or profitability percentage is estimated for the purposes of this Figure. We understand that the measure of profit referred to by ADC is likely to reflect the use of earnings before interest and tax (EBIT), as this was put forward by the applicants.[20]

We have some reservations about the use of EBIT. This is because EBIT is affected by accounting treatments of capital items, as reflected in depreciation and amortisation expenses. EBIT profits can decrease merely as a result of increases in capital expenditure or changes to depreciation policies, as both can increase depreciation expenses which reduce measured profits. Without further information, it is not possible to conclude why profits have fallen (i.e. whether it is driven by changes in revenues, changes in costs, or both). Again this points to insufficient attention to the necessary causal connection between the alleged dumping and injury.

3.4 Prices would have been expected to fall

There are two pieces of evidence which suggest that prices would have been expected to fall in the absence of any alleged dumping:

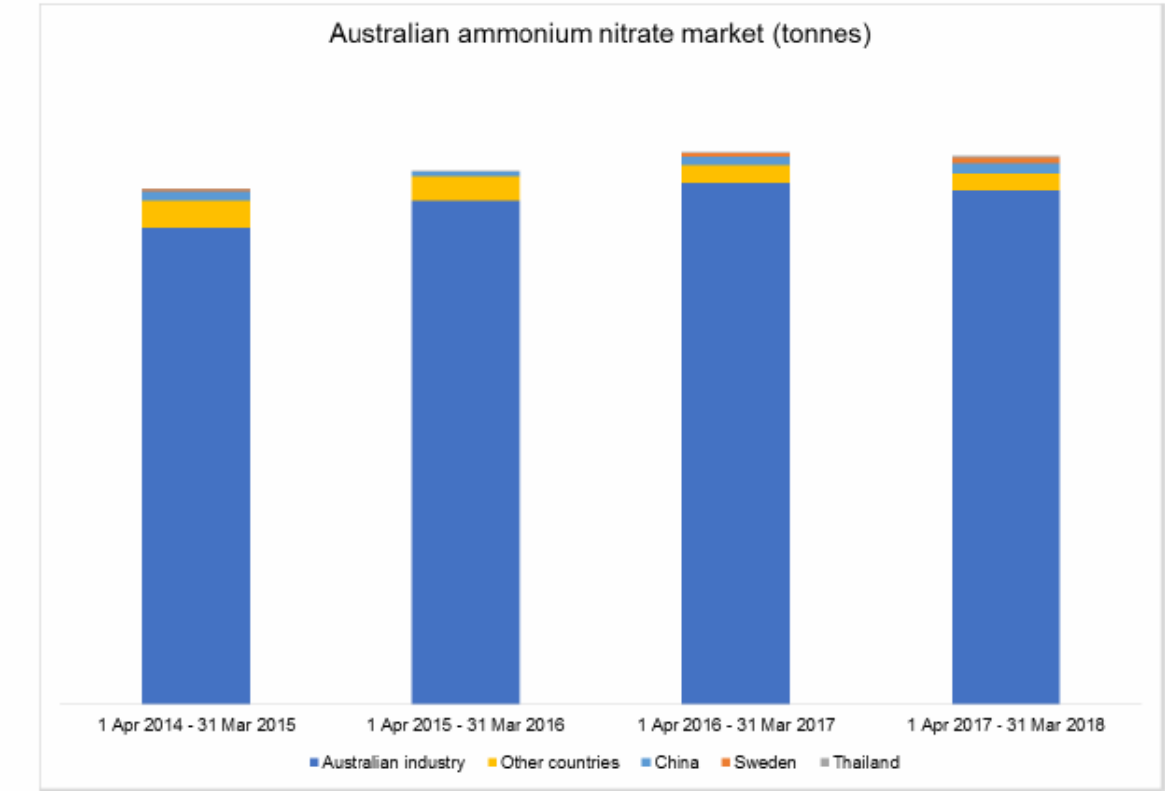
- The fall in demand for ammonium nitrate in Australia through 2017
- Existence of over-capacity in ammonium nitrate production

The fall in demand for ammonium nitrate is evident – though small – from Figure 1 in the PAD, which is replicated below.

19 CSBP, Letter to ADC 17 September 2018.

20 The applications claim a "14% diminution" in profits but it is unclear how this is measured. See Form B108, p. 27.

Figure 5: Domestic consumption of ammonium nitrate



Source: PAD, p. 5.

Given the scale of this figure is not included, it is not possible to provide further analysis of the scale of the fall. Orica's submission suggested a fall in the order of three per cent.[21] However, it should also be considered in light of the trend of increasing consumption over the preceding two years. This indicates that the fall in demand is non-trivial.

The existence of domestic over-capacity in ammonium nitrate appears to be widely accepted. For example, in June 2018 it was reported that:

[21] Orica letter, 22 August 2018, p. 2.

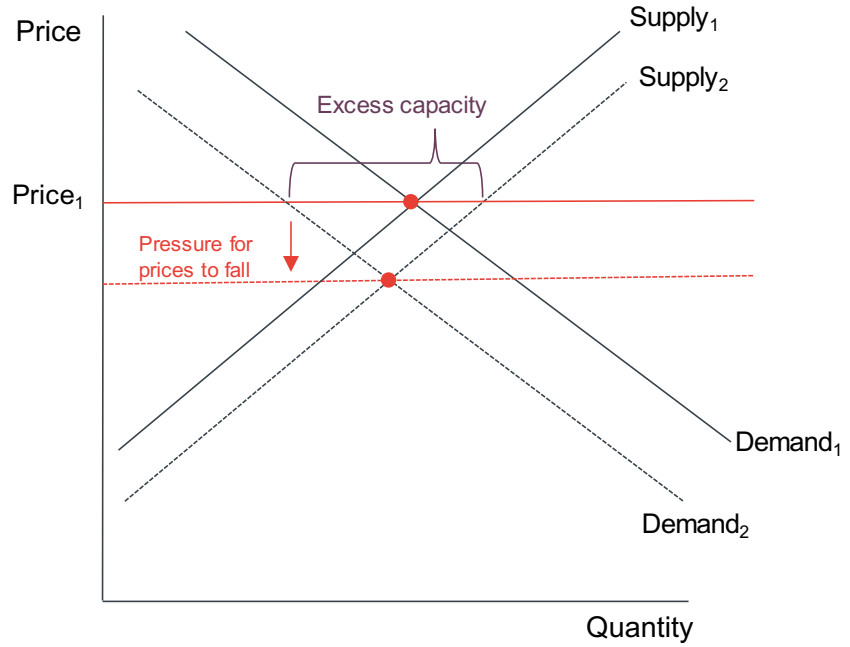
"The domestic ammonium oversupply has set in, with contract pricing coming under renewed pressure," Citi analyst Jakob Kang said.

"Incitec's losses in its WA business are a direct reflection of the excess capacity in the WA ammonium nitrate market given the start-up of Orica's Burrup plant. Oversupply in the west will likely be mirrored on the east coast with Orica's decision to restart its mothballed Yarwun lines."[22]

There is no evidence that the ADC has taken into account the existence of new excess capacity and the "effective price war" between Orica and Incitec Pivot for business in WA.[23]

Standard economic analysis indicates that a fall in demand and excess capacity caused by increasing supply potential will both contribute to falls in prices. The particular impact on prices and quantities will be determined by the size of shifts in the demand and supply curves, and their relative elasticities. In a stylistic way, this is highlighted in **Figure 6**; a shift in demand creates excess capacity because there is insufficient demand at the old price level to fully use existing capacity. This is compounded by a new source of supply which increases quantity supplied at each price level. There will be pressure for prices to fall, even in the absence of imports.

Figure 6: Falling demand and excess capacity lowers prices, without dumping



Source: Frontier Economics

[22] The Australian Newspaper, "Fortescue explosives deal goes to Incitec", 15 June 2018

[23] Ibid. Notwithstanding some delays in production from Burrup, the forthcoming increased capacity would be expected to have an impact on pricing now because contracts are struck covering periods of several years.

In our opinion, it is not possible for the ADC to draw a conclusion about the effect of imports on domestic prices and material injury without also taking into account these domestic competitive and demand factors.

3.5 Profits would have been expected to fall

3.5.1 Fall in demand and excess capacity

As discussed above, falling demand and excess capacity will tend to reduce prices, and therefore would be expected to lower revenues and profits.

3.5.2 Costs increased

In the PAD, the ADC notes that:

> *…the Australian industry experienced reductions in selling prices and was unable to 'adjust selling prices to reflect increases in production costs'…*

According to this statement, profits were reduced by two factors: reduced prices (allegedly caused by dumping) and higher costs. No information is provided about the relative contribution of each to the decline in profit.

There appears to be a misconception that increases in production costs should always be reflected in higher prices, and that dumping has prevented this pass through from occurring. According to economic principles, pass through of higher costs will depend on a range of factors, and (*inter alia*) will vary depending on whether the cost increase is industry-wide, and on the competitiveness of the market.[24] For example, if the market is competitive, increases in costs that are specific to individual firms will not be passed through as higher prices.

Information from the applicants indeed indicates that profit reductions were not solely caused by lower prices, but by some combination of higher input costs, unexpected plant shutdowns and lower prices. For example, Orica's recent ASX release regarding FY2017-18 suggests that:

[24] There is no scope for pass-through of firm-specific cost changes in a perfectly competitive market environment. See RBB Economics, *Cost pass-through: theory, measurement, and potential policy implications A Report prepared for the Office of Fair Trading*, February 2014

> *EBIT was further impacted by unplanned maintenance shutdowns at Yarwun and Kooragang Island as well as operational issues at the Burrup plant, resulting in increased sourcing and plant administration costs.*[25]

Orica further explains that some component of the input price increases related to gas, a key input. We understand from BHP that some contract arrangements would allow for pass through of higher input costs into prices. In that circumstance, higher input costs might not lower profits.

Nonetheless, other cost increases are firm specific. For example, other cost increases for Orica related to third-party purchases of ammonium nitrate (due to the operational issues experienced at its plants).[26] This also required shipping of ammonium nitrate from other locations.[27]

The ADC does not inform us of what proportion of the aggregate industry profit loss is due to the decline in prices, and which part is due to the increase in (firm specific) costs which would not be expected to increase prices even in the absence of dumping. It is unclear how the ADC can conclude on injury without making that distinction.

3.5.3 No fall in volumes

The ADC argues that the downward trend in the applicants' profit and profitability "coincides" with increasing volumes of the goods exported from China, Sweden and Thailand. However, elsewhere the ADC states that:

> *…the applicants did not lose sales volumes to the dumped goods…*[28]

This statement is not consistent with the ADC's first statement which implies that the domestic industry may have suffered from import substitution.[29] It appears that exports from China, Sweden and Thailand have displaced exports from other countries. This is confirmed in the application, which indicates that total import volumes are in fact lower than they were in 2015, as per **Figure 7**, and only **50%** of the level they were at in 2014.

---

[25] Orica 2018 Full Year Results Announcement, p.3., available at: file:///C:/Users/Admin/OneDrive/KWM11/Orica%202018%20Full%20Year%20Results%20Announcement.pdf

[26] Orica 2018 Full Year Results Announcement, p.3

[27] Ibid. p. 4

[28] PAD, p. 14.

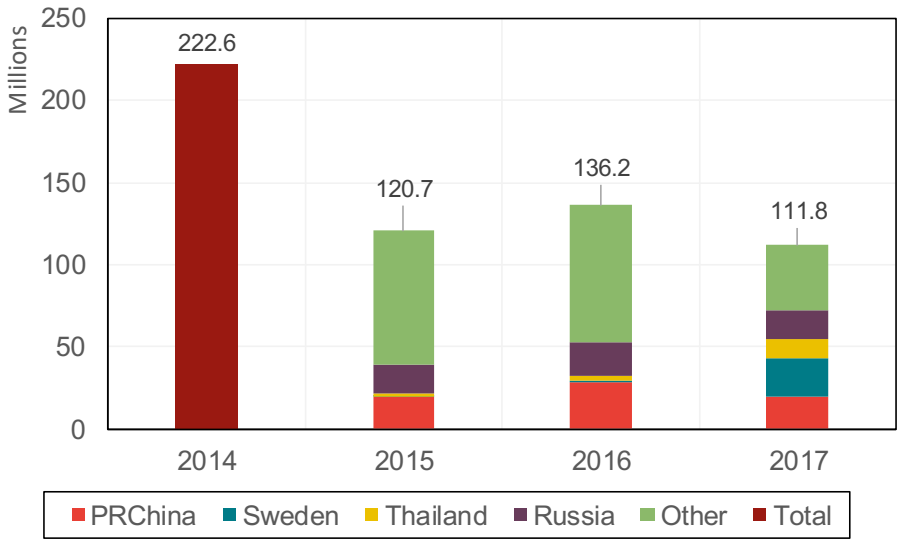
[29] Other statements in the PAD suggest that:

"the volumes of dumped goods exported from China, Sweden and Thailand were not negligible (i.e. individually above three per cent of the total Australian import volume)" (p. 3)

"…volumes of the allegedly dumped goods exported to Australia from China, Sweden and Thailand have increased substantially since 2015-16…"

"the volume of the goods exported to Australia from China, Sweden and Thailand at dumped prices increased since 2015-16…"

Figure 7: Import volumes of ammonium nitrate



Source: Form B.108, p.33 (citing ABS data)

Notes: 2014 data is in aggregated form only

Impact of import parity pricing

The application and the ADC's analysis appear to have proceeded on the basis that domestic producers engage in import parity pricing.[30] Import parity pricing is the practice of domestic producers responding to offers of imports by matching import prices to prevent losing volume.

As identified in Annex A, in a market with domestic firms import parity pricing, it is normal to expect that there is no import substitution due to price matching by domestic firms.[31] There should, however, be an increase in domestic sales in response to the lower prices; in any market where demand is downward-sloping we should expect to see this effect.[32]

We observe neither import substitution nor any increase in domestic sales. That we observe neither means that, in our opinion, increases in import volumes from China, Sweden or Thailand were not a potential explanation for loss of domestic profit. Rather, these simply replaced other import volumes with little effect on overall demand for ammonium nitrate in 2017 which, as highlighted in **Figure 5**, actually fell even with the lower domestic prices.

30 For example, CBSP letter to ADC, 2 September 2018.

31 If the market was competitive and prices determined by domestic or imported supply costs, then any lowering of import prices would be expected to reduce domestic demand and result in import substitution.

32 The strength of this effect is measured by the own-price demand elasticity. There would be no volume effect only if the elasticity was zero.

4 FINDINGS ON MATERIAL INJURY

4.1 Are the ADC's conclusions on material injury justified?

The ADC's conclusions on material injury were:

> *…there is sufficient evidence at this time to establish that it was necessary for the Australian industry to reduce prices to secure supply contracts. This has led to the Australian industry experiencing material injury in the form of price depression, price suppression, reduced revenues, reduced profits and reduced profitability.*[33]

The Ministerial Direction on Material Injury, made under s.269TA of the Act, provides direction on factors that should be considered when making a determination on injury and causation.[34] The Ministerial Direction includes the following:

- material injury is injury which is not immaterial, insubstantial or insignificant
- injury must be greater than that likely to occur in the normal ebb and flow of business
- there is no particular threshold, but identifying material injury will depend on the circumstances of each case.

The Direction also makes clear that it is not enough to assert that because there is dumping or subsidisation injury automatically follows, and that the identification of material injury is to be based on facts and not assertions unsupported by facts.

In our opinion, the ADC has not produced evidence that any of the kinds of injury identified even if attributable to dumping of like goods meet the threshold of being "material", for four reasons.

First, our opinion is that there is doubt about the claims of 7 to 22 per cent price reductions. Even if we accept these claims of price reductions, they do not bear directly on material injury as we have already identified that—at the least—a proportion of the reduction in profits and prices that have been experienced by the Australian industry is attributable to factors other than dumping.

Secondly, it is apparent that the injury experienced in relation to dumping is limited by difficulties with importing large amounts of ammonium nitrate. The ACCC's consideration of a possible acquisition by Wesfarmers in 2011 indicated that imports were limited by:

- Limits on port access
- Limited port storage facilities
- Product quality and consistency, particular as ammonium nitrate degrades with temperature and humidity

33 PAD, p. 14.

34 https://www.adcommission.gov.au/adsystem/referencematerial/Documents/ACDN2012-24.pdf

- Security of supply, as importation involves lead times and often multiple sources of imports.[35]

Our understanding is that imports have only ever consisted of about 5% of the total market and as a supplement to the short term supply variability. In these circumstances, threats from buyers that they would import large volumes of ammonium nitrate will lack credibility and so could not undermine prices for large orders.

Thirdly, the ADC has not considered why, if domestic producers are import parity pricing, we have observed decreases in volumes as prices have fallen. On the contrary, one would expect that, if these producers were facing a downward sloping demand curve, price falls should increase demand. This increase in demand would offset any injury experienced.

Finally, the ADC has also not indicated the reasons for its view that reductions in profits are material or greater than experienced in the usual ebb and flow of business. In our opinion, the reductions experienced are not greater than those in the usual ebb and flow. We now explain the reasons for this opinion.

4.2 The normal ebb and flow of business

The reference in the Ministerial Direction to consider the "normal ebb and flow" of business provides one further useful marker for distinguishing between material and immaterial injury.

In our opinion, changes in profits, volumes and prices attributable to dumping can be compared with past changes in these variables in periods unaffected by dumping.

An industry that regularly experiences large cyclical swings in prices or profits due to general economic conditions, or sells only to a few large buyers that switch regularly between sellers, would have a higher threshold for what would constitute material injury than an industry not facing those factors.

4.2.1 What is the normal ebb and flow in ammonium nitrate?

Profit variations

From the publicly-available information we have observed that the structure of the market is such that there are a few large suppliers and large buyers (miners), and there appear to be regular swings in profits from changes in contract arrangements. For example, recent negotiations regarding Incitec Pivot in Western Australia indicate that:

> *Incitec… won the Fortescue contract, which would mitigate previously flagged net profit losses, after it lost contracts at BHP and Gina Rinehart's Roy Hill to Orica in December and January, by $54m over the next four years…the (BHP and Roy Hill) contract losses left it facing a $116m hit to net profit.*[36]

Profit variations of this magnitude appear to be far more significant that those referenced by the ADC in Figure 3.

35 See https://www.accc.gov.au/system/files/public-registers/documents/MER11%2B5322.pdf, p. 14.

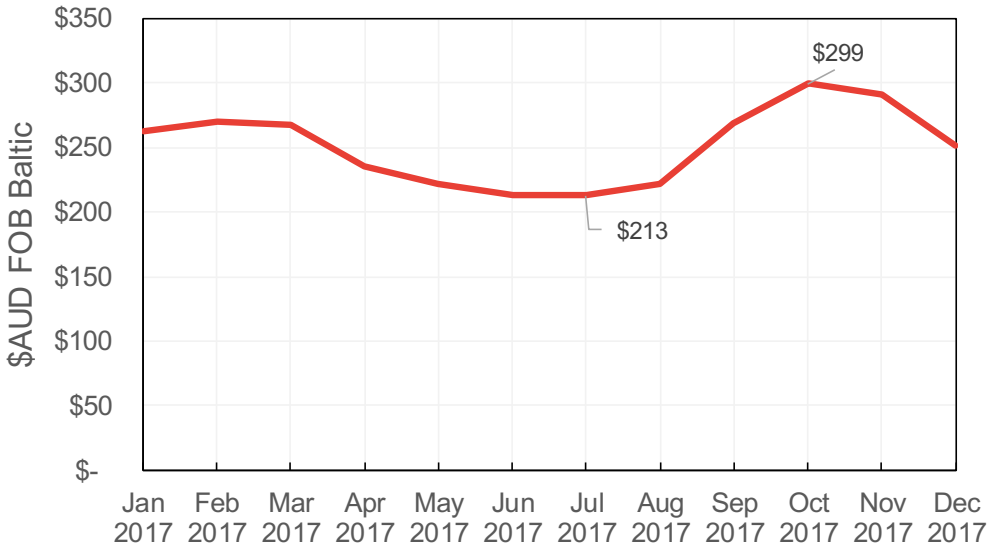
36 The Australian Newspaper, June 15, 2018

Price variations - outputs

A further indication of the normal ebbs and flows of business in the Australian ammonium nitrate market can be gleaned from price variations.

We understand that there is no spot market for domestic or imported ammonium nitrate. However, import prices may be observed from ABS data and other industry sources, and also observed in FOB price indexes (such as the FOB Baltic / Black Sea Price). These show considerable variation, with a difference of more than 40% between upper and lower price bounds for calendar year 2017, as shown in **Figure 8**.

Figure 8: Bulk AN prices, FOB Baltic (converted to AUD), Monthly, Actual



Source: BHP

Recent price increases

BHP has supplied us with two further price series.

- Average prices of imported ammonium nitrate (on an FOB basis).
- An import parity price series: this includes the costs of domestic shipments, which due to port fees, storage and transport add between $70 to $100 per tonne to the FOB price. These costs must be included when comparing imported versus domestic prices to ensure a realistic comparison between the two options.

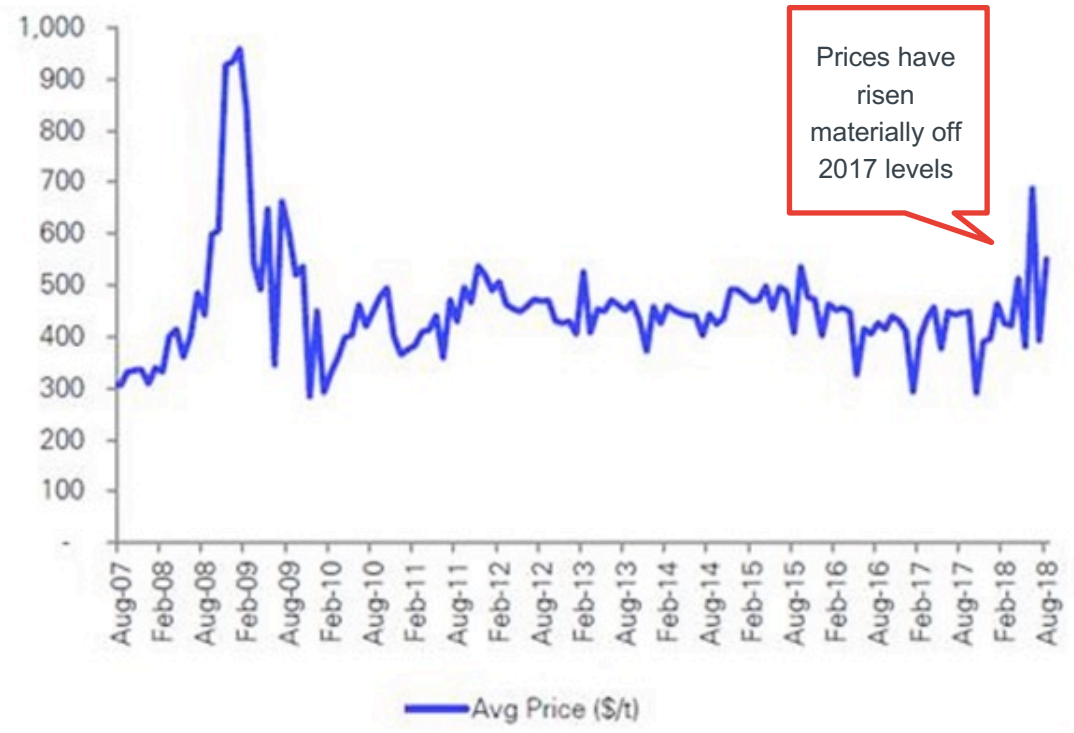
These series indicate that:

- Variations of $100 per tonne are not unusual over relatively short periods of time (a few months). This is equivalent to 15-20% price reductions and increases.
- There is little evidence of a sustained decline in price that is outside of standard variations that one might associated with price depression (or future suppression) caused by prolonged dumping.

Figure 9: AN import parity price ($AUD / T)

Source: Deutsche Bank

Figure 10: AN Import price ($AUD/T)



Source: Deutsche Bank

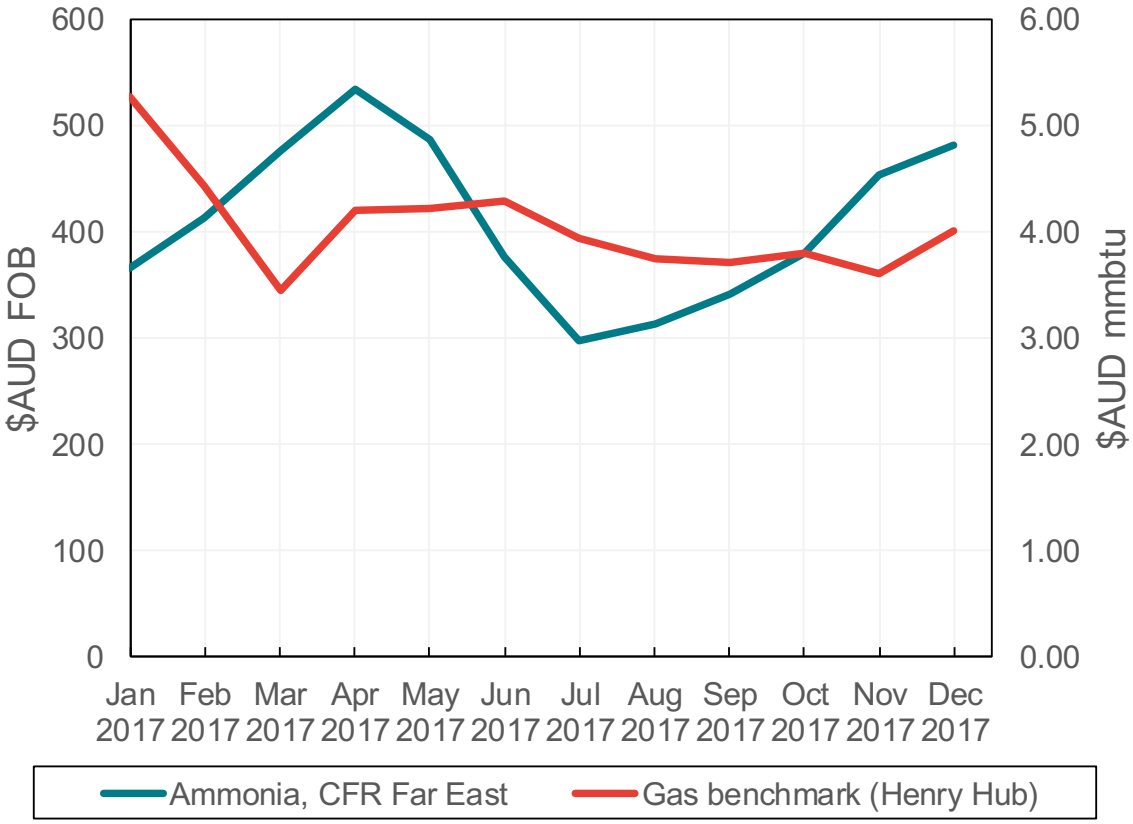
Indeed, this more recent evidence suggests that import prices appear to have increased over the last 12 months:

- By 10% measured in October 2018 year on year (import parity price)
- By 23% measured in August 2018 year on year (AN import price).

Price variation – inputs

Price variation for ammonium nitrate is also likely to be driven by key input costs – in particular ammonia and its input, natural gas. We understand that these input costs may form part of contracted prices between domestic suppliers and purchasers. However, these will also be expected to contribute to the variations in import prices that occur outside of contracted purchases. So, for example, where key input prices are low there are more likely to be profitable opportunities for importing (if such changes are not fully reflected in domestic prices).

Figure 11: Variations in ammonia and gas prices, 2017



Source: BHP

Both key input prices show variations of over 50% within 2017, which indicates a significantly level of variability which would (other things equal) be expected to result in material variations in profits.

Conclusion on ebb and flow

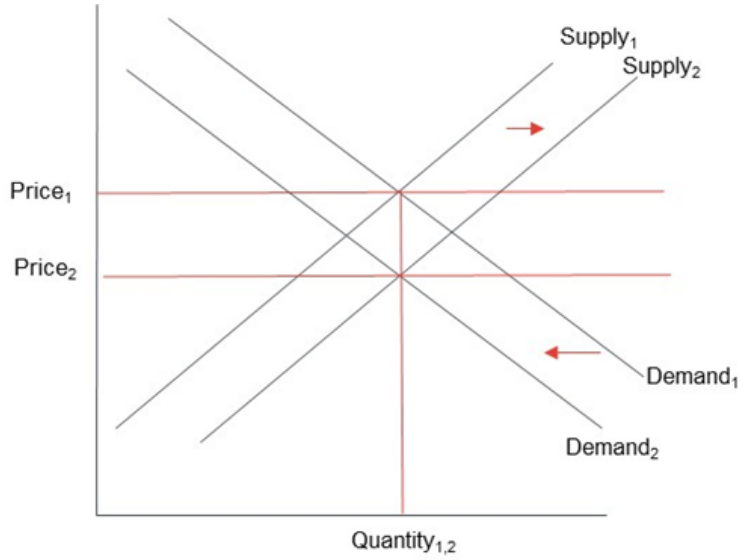
In our opinion, variations in profits caused by large customer contracts and regular price variations indicate that the changes in prices and profits identified by the ADC are likely to be well within the bounds of normal business variation for Australian ammonium nitrate suppliers.

A FACTORS DRIVING PRICE CHANGES AND IMPORT PARITY PRICING

Changes in demand and supply

In the following example, domestic prices fall entirely due to exogenous changes in demand and supply. There is no change in volume, yet prices fall. There is no dumping assumed.

Figure 12: Effect on price of an increase in supply and decline in demand



Source: Frontier Economics

Import parity pricing and volumes

Import parity pricing is a practice whereby a domestic producer (or producers) sets prices just less than the prevailing price of imports. Import parity pricing is observed under conditions of domestic market power.

If the domestic market is not competitive, domestic firms engaging in import parity pricing can experience injury even without significant falls in volumes, so long as the import prices are above the marginal costs of supply. In fact, one would expect firms operating in such an environment to increase volumes rather than reduce them, because they would be absorbing the additional demand induced by the lower price (as measured by the own-price elasticity of demand). Estimates of the demand elasticity in the United States market[37] range between -0.8 and -1.6 – meaning that for a 1% fall in price, demand increases of between 0.8% and 1.6% would be expected.

For a claim of injury to be credible under import parity pricing, there should be corroborating evidence of:

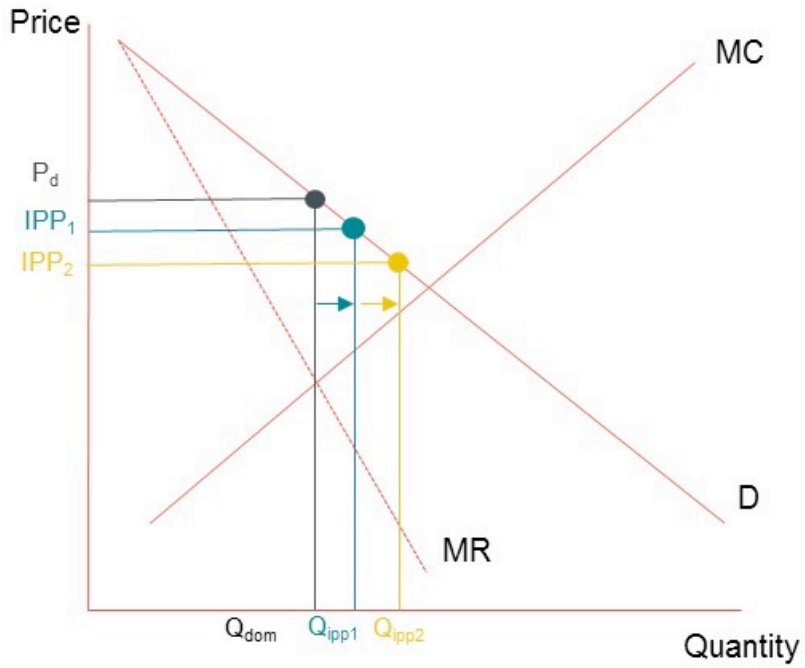
- price falls and

[37] See https://www.usitc.gov/publications/701_731/pub3338.pdf.

- volume increases reflecting absorption of additional demand created by lower import prices.

These points can be identified in **Figure 13**. Domestic prices in the absence of imports would be at P_d. Lower IPP prices increase domestic supply quantities (Q_{dom}) as supply is profitable (price > marginal cost) – to Q_{ipp1}. A reduction in IPP prices (to IPP_2) would be absorbed by the domestic producers. In this case, however, one would further expect some evidence of increasing domestic quantities (to Q_{ipp2}), given some elasticity in the demand curve.

Figure 13: Import parity pricing with market power in the domestic market

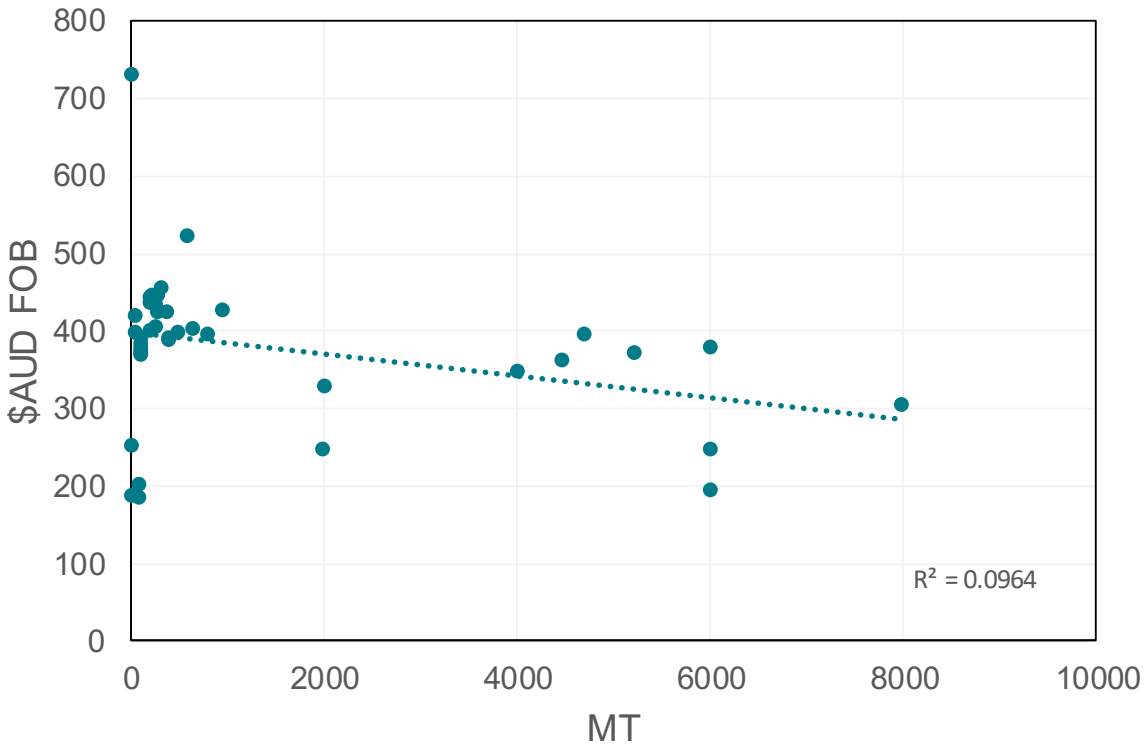


Source: Frontier Economics

B PRICES AND ORDER SIZE

An obvious reason for the large differences in prices reported for ammonium nitrate imports could be the size of order, where much larger orders would be expected to get lower prices. However, the data does not indicate any significant relationship between order size and price. Combining all of the data from China, Sweden and Thailand indicates that less than 10% of the observed variation in price could be explained by the order size ($R^2 < 0.1$).

Figure 14: Relationship between order size and price – combined data



Source: Source: Form B.108, p.34

frontier economics

BRISBANE | MELBOURNE | SINGAPORE | SYDNEY

Frontier Economics Pty Ltd
395 Collins Street Melbourne Victoria 3000

Tel: +61 (0)3 9620 4488
www.frontier-economics.com.au

ACN: 087 553 124 ABN: 13 087 553