



## Hunter Live – 15 February 2011 'Mining Services Virtual Consolidation'

The first Hunter Live event for 2011, 'Mining Services Virtual Consolidation', was held on 15 February 2011. The night was a fantastic success with more than 60 people attending, many of whom stayed well into the evening to enjoy some casual drinks after our expert panel had provided great insights into the current environment of contracting and tendering for mining services in the Hunter Valley.

For those of you who missed the session, here are a few brief details:

### **1 About 'Mining Services Virtual Consolidation'**

Hunter Live: 'Mining Services Virtual Consolidation' was run as a discussion panel comprising:

- (a) Frank Fulham – General Manager and Site Senior Executive of Austar Coal Mine;
- (b) Grant Case – Chief Operating Officer - Mining of UGM; and
- (c) Adam Gledhill – General Manager – Commercial of Inbye Mining Services.

Richard Suters, Special Counsel, Sparke Helmore moderated the session and Andrew Windybank, Corporate Partner, Sparke Helmore provided opening and closing remarks.

The central thesis for the evening was as there is significant outsourcing taking place in the Hunter Valley mining sector this is leading to 'virtual consolidation'.

### **2 The Topics Covered**

As an opening statement, Andrew Windybank commented that during Sparke Helmore's extensive experience advising the mining and mining services industries, Sparke Helmore had noticed a new trend emerging over recent years. Namely, the traditional approach of mine owners / operators purchasing assets and employing staff to undertake their mining operations had been heavily supplemented by a notable increase in outsourcing. Mine owners / operators were becoming more focused on contract management than in carrying out the constituent operations of mining related activities.

The discussion explored the concepts of:

- (a) virtual consolidation – comprising both:
  - (1) horizontal relationships between suppliers and service providers; and
  - (2) vertical relationships between suppliers/service providers and customers; and
- (b) trends in contractual risk allocation.

## 2.2 Proposition 1: Virtual Consolidation

- (a) 'Virtual consolidation', where the activities of different players become intertwined and dependent, despite the parties remaining separate businesses, is increasing.
- (b) There are two broad classes of virtual consolidation:
  - (1) vertical consolidation – where the service providers and suppliers become a virtual part of the business of the mine owner/operator; and
  - (2) horizontal consolidation – where there is integration and consolidation between the suppliers and service providers among themselves.
- (c) Frank Fulham commented that in his view outsourcing is becoming more prevalent due to the demand for appropriately skilled and talented labour. Retention, fluctuations in supply and demand and the specialisation of skills which are not permanent needs of mine owners / operators increase the benefits of outsourcing rather than 'keeping someone on the books' so their skills are available if and when the mine owner / operator requires them.
- (d) Grant Case explained there is a balancing act between the benefits and detriments of incumbency and the turnover of outsourcing providers can arise due to the perception of a lack of competition. This can be minimised by introducing performance targets and Key Performance Indicators. As a supplier / services provider it is beneficial not to 'tie' yourself to one mine owner / operator.
- (e) Adam Gledhill argued 'one-stop shops' can negatively impact on a goods or services provider if they over-extend themselves beyond their capacity or expertise. Horizontal consolidation may allow a provider to tender for work requiring skills or expertise beyond their capacity or skill-set.
- (f) Frank stressed that if a goods or services provider is seeking to sub-contract or provide goods or services through another entity this should be disclosed to the mine owner / operator up-front.

## 2.3 Proposition 2: The horizontal relationships between suppliers / service providers

- (a) There is a spectrum of formality in the relationships between suppliers and service providers. Some 'alliance' agreements are based on a hand-shake or other commercial understanding while others are fully documented in detailed and binding legal contracts.
- (b) Grant commented that identifying appropriate parties to work with is based on an initial attraction between businesses. What may commence as an informal agreement may progress to a more formalised agreement over time as the success of working together and the relationship between the parties builds.
- (c) Frank agreed mine owners / operators also have an interest in the underlying relationships between suppliers / service providers. In the event of a fall-out between the providers, it will be the mine owner / operator who has to 'pick up the pieces' as the breakdown in the relationship will negatively effect their business.

## 2.4 Proposition 3: Vertical Relationships with the Customer

- (a) The panel generally agreed that 'umbrella agreements' can have both positive and negative impacts and need to be chosen carefully and managed well to avoid some of the negative effects of incumbency.

- (b) There was a brief exploration of the concept of 'Alliance Contracting', a specific model which steps away from the traditional adversarial 'risk shifting' model towards a more collaborative and incentive driven approach. Alliance Contracting is underpinned by principles of good faith and trust, where risks and rewards are shared.
- (c) Frank stated that fully work-shopped alliances, where the parties can understand and appreciate the impact their actions have on the other party are possible if the right people are involved. Where personalities clash or previous contractual relationships have soured, this may require the removal of those individuals before the benefits of a successful Alliance Contract are possible. Frank related an example of a successful alliance in the mining industry.
- (d) As part of discussion following a question from the floor, one audience member commented that rather than requesting several contracts for small amounts of labour without management, mine owners / operators should consider requesting larger contracts where suppliers / service providers can invest in providing management on-site. The person argued that benefits and positive outcomes are increased where management can be provided on-site, but this is only possible if the scope of work is sufficiently large and certain to provide the necessary economic justification.

## **2.5 Proposition 4: Risk allocation**

- (a) Grant commented that the traditional 'risk shifting' model where suppliers / service providers are expected to bear all the risk inevitably increases the price. Where risk is appropriately allocated and shared between the mine owner and service provider, the price will reflect this.
- (b) Grant also commented that there can be a 'dis-connect' between the general procurement and tender people working out of 'head office' at a mining company and the people 'on-the-ground' at the mine site, particularly in matters of risk and requirements for the provision of the goods or services. This was a frustration for service providers.

## **3 Hunter Live**

### **3.1 About Hunter Live**

Sparke Helmore is pleased to host Hunter Live seminars and Hunter Live charity based social events throughout the year. The seminars are open to a range of participants and do not necessarily follow a set format.

Hunter Live is designed to facilitate a dialogue between Hunter based industry participants, charities, business groups, lawyers, accountants, business advisers, recruiters and other service providers. To date, Hunter Live has conducted forums on a range of issues including:

- (a) 'Hunter Innovation' - IT commercialisation;
- (b) 'End Game Considerations' - succession planning, industry consolidation and organic growth vs growth by merger or acquisition; and
- (c) 'Your Greatest Assets' - employee share schemes and employee incentivisation.

The aim of Hunter Live is to be innovative about the way information is presented and to give a voice to clients and friends of Sparke Helmore. The program was an initiative of the junior lawyers at Sparke Helmore.

### **3.2 Next Hunter Live?**

Our next Hunter Live will be in the area of estate planning and asset protection. Details will be emailed to our mailing list and posted on our website at [www.hunterlive.com.au](http://www.hunterlive.com.au).

**Sparke Helmore**  
**February 2011**