2017 Ports Pricing and Access Review

Essential Services Commission of SA Issues Paper – September 2016

Flinders Ports Response

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1.0 Introduction

The Essential Services Commission of South Australia (**ESCOSA**) has sought responses to its 2017 Ports Pricing and Access Review Issues Paper dated September 2016 (**Issues Paper**). The review being undertaken by ESCOSA is consistent with that previously undertaken in 2012 (and prior to that in 2007).

As operator of the six South Australian ports which are the subject of ESCOSA's pricing and access regulation, Flinders Ports welcomes the opportunity to provide input to assist ESCOSA in undertaking the review.

The Issues Paper indicates that the key issues to be considered by ESCOSA in undertaking the review are:

(a) Is regulation necessary?
(b) If so, are there any changes to the current pricing and access regimes that should be considered?
(c) Is the effort required to undertake re-certification a relevant factor to consider when weighing up the costs and benefits of the various regulatory options relevant to the review?
(d) Are there any other issues relevant to the decision to continue, or discontinue, regulation?

2.0 Executive Summary

2.1 <u>Flinders Ports' experience since 2012</u>

The Issues Paper states that ESCOSA 'will examine if market or regulatory environments have changed since the time of the previous review, or are likely to change during the next five-year period, to determine the appropriateness of regulation'.

Since ESCOSA's previous review in 2012 Flinders Ports has:

- Experienced a range of trade volumes movements such as the commencement and subsequent decline in the iron ore export trade, fluctuating grain volumes (seasonal impacts) and a slowing in container growth,
- Undertaken additional capital investment across the regulated ports and services, including development of an additional new fuel facility at Outer Harbor, Port Adelaide, construction of additional cargo hardstand areas and commencement of a pilot boat replacement program. In addition, Flinders Ports has maintained its on-going annual capital upgrade and maintenance program as required to support the continued provision of regulated services and facilities.
- Modified the port pricing model to seek a more balanced pricing outcome reflective of its true cost drivers,
- Continued to keep the industry informed of price changes and has been open to negotiate appropriate access arrangements whilst not comprising port management safety or operational efficiency, and
- Seen the rise of alternative port options and proposals for new ports.

2.2 <u>Outlook – 2017 and beyond</u>

Flinders Ports does not anticipate any material change in the overall market in the 2017-2022 period. There is however an expectation that the current trends emerging such as vessel size increases, slower economic and trade growth and additional port development proposals, will continue to evolve and the impacts factored into long term planning outcomes.

Flinders Ports, within this environment will however continue to invest in its port infrastructure and related assets. For example, Flinders Ports' Capital Development Plan anticipates that at least some of the following will occur by 2022:

- Widening of the existing Port Adelaide outer channel and relocation of navigational beacons to accommodate the increasing vessel sizes now emerging,
- Continuation of the Pilot Vessel replacement program,
- Redevelopment and upgrade of port infrastructure at a number of berths within Port Adelaide and at regional ports such as Port Giles, Port Lincoln and Port Pirie.

2.3 Key matters

With the above in mind Flinders Ports makes the following points:

(a) Flinders Ports has, since 2012, continued to meet port user requirements from a pricing and access perspective. This is evidenced by the fact that:

(i) during this period Flinders Ports has negotiated a number of new and renewed agreements relating to port access and pricing; and

(ii) no disputes have been raised throughout the period and in fact since the regulatory regime was introduced.

Flinders Ports will continue to adopt pricing practices and enter into pricing negotiations to ensure satisfactory outcomes for port users, without the need for price regulation;

(b) Flinders Ports is not aware of any evidence to support a suggestion that Flinders Ports has made excessive profits between 2012 and 2017 and it is unlikely that Flinders Ports will be in any position to make excessive profits in the next 5 years for the reasons outlined in this response;

(c) Flinders Ports does not have market power, i.e. the ability to operate independently of market constraints, in any part of its ESCOSA regulated activities. There are a number of competitive constraints on Flinders Ports including alternative port facilities and solutions, countervailing power from end customers and the commercial incentive to maximise throughput over the berth. Further, Flinders Ports is not aware of any valid suggestion that, to the extent that it was assumed to have market power, Flinders Ports has engaged in any type of conduct that could be construed as a misuse of market power;

(d) To the extent that an access regime exists, that regime should only apply to those services provided by facilities which exhibit 'natural monopoly' features. While it is arguable that the services that are currently the subject of ESCOSA regulation have these features, there is no evidence to support the expansion of the access regime to apply to the services that are currently not regulated. To do so would not be consistent with the approach of other access regimes throughout Australia and would allow for 'free-riding' by third parties resulting in a chilling effect on future investment;

(e) Flinders Ports needs flexibility in recovering its total costs across ports, cargoes and services. It also needs to respond in commercial terms to proposals from its customers and to negotiate price/volume/service packages that meet the needs of both parties; and

(f) Flinders Ports has continued to and will continue to undertake significant investment in core regulated port infrastructure and to enhance its service delivery model and to meet port user demands and requirements.

2.4 <u>Flinders Ports' position on the key questions raised in the Issues Paper</u>

(A) Is regulation necessary?

Pricing regulation:	**No**. The market in which Flinders Ports operates is a mature one, with a range of countervailing pressures which ultimately result in (negotiated) agreed outcomes.
Access regulation:	**No in principle**. That said, Flinders Ports accepts that the existing access regime may be perceived as providing a "safety net" for port users to utilise if port users feel genuinely aggrieved, notwithstanding the absence of any disputes over the last 10 years.

(B) If so, are there any improvements and alternatives to the current pricing and access regimes that should be considered?

If regulation is to continue then there is no supporting evidence to suggest that it should be modified or altered.

(C) Is the effort required to undertake re-certification a relevant factor to consider when weighing up the costs and benefits of the various regulatory options relevant to the review?

As the re-certification process will require liaison between State and Commonwealth governments, others may be best placed to consider the effort required generally. Flinders Ports is firmly of the view that if the regime is continued beyond 2017, then certification of the regime should be extended as soon as possible. This will provide regulatory certainty for all parties involved and will continue to ensure efficient investments and negotiated agreements. A change to the regulatory regime however will create uncertainty, additional cost and inefficiency.

(D) Are there any other issues that should be considered?

There is no supporting evidence or argument to support any expansion or inclusion of other port or port related assets or services within the regime.

More detailed information to support Flinders Ports' views is set out below

3.0 Background

In responding to ESCOSA's 2012 Pricing and Access Review, and having regard to the environment that had existed over the previous 5-years and that no pricing or access disputes had been raised, Flinders Ports:

- Noted that the regulatory regime was not a "big stick" threat that was necessary to ensure that outcomes achieved were fair and reasonable,
- Accepted that the regulatory framework provides a "safety net" provision for port users to utilise if port users feel genuinely aggrieved,
- Argued that if the regime was retained then there was no justification or support for the regime being extended beyond its existing scope, and
- Proposed that pricing regulation was not required but if retained it should be so in its then current (price monitoring) form.

ESCOSA concluded from its 2012 review that:

- Price regulation of Essential Maritime Services by way of a price monitoring regime should continue beyond 30 October 2012 for a further five-year regulatory period, and
- The ports access regime should continue beyond 30 October 2012 for a further five-year regulatory period and in its (then) current form.

In coming to these conclusions, ESCOSA found:

(i) In relation to the Pricing Regime review:

- That the regulatory accounts provided by the regulated entities indicated that no excessive profits were being earned,
- Port pricing benchmarking undertaken by independent consultants indicated that the rate of increase in port charges had not been any greater than other ports - in fact that the differential in port charges in South Australian ports relative to other Australian ports had narrowed,
- Price movements for maritime services subject to price regulation over the 5-year period to 2012 had generally reflected Consumer Price Index (CPI) increases except where special circumstances existed, and
- Sufficient evidence had been provided on a confidential basis that indicted that negotiations over port charges had occurred over the regulatory period and that had resulted in mutual agreement between parties.

(ii) In relation to Access Regime review;

- There was no evidence to suggest that broadening the services the subject of the access regime was warranted,
- That the negotiation and information framework set out in Part 3 of the *Maritime Services (Access) Act* (**MSA Act**) and the *Ports Industry Guideline 1: Access Price Information* were adequate for facilitating access, and further should commercial negotiation fail then the conciliation arbitration process set out in Part 3 of the MSA Act was sufficient for resolving access disputes, and
- No persuasive argument existed for the introduction of a more intrusive form of ring-fencing arrangement going forward.

It is Flinders Port position, based on experience over the period since the 2012 review concluded, that the finding reached by ESCOSA above will be equally relevant to the 2017 review.

4.0 Key issues:

In response to the key questions raised within the Issues paper, the following is provided:

Q1: Is there any evidence of misuse of market power by providers of regulated port infrastructure services?

Q2: Is there evidence of the Access Regime promoting greater competition in related maritime markets?

The assessment of market power has been a central theme of previous ports pricing and access reviews and is fundamental to the question of the need for continuing regulation. Flinders Ports notes that previous reports have outlined a number of factors which may limit the ability of a port operator to misuse market power, including:

- The extent of competition for port services through the existence of alternatives.
- Low barriers to entry or the threat of new entry if prices for marine services are set above competitive levels.
- The extent of countervailing bargaining power.
- The extent to which port charges comprise the total cargo value.

Flinders Ports is subject to a number of "competitive pressures" and these combined with an objective of long term financial stability ensures that Flinders Ports continues to behave in a responsible commercial manner when dealing with customers.

The following factors have been previously highlighted but are just as relevant to the question raised within the Issues Paper and support the position put by Flinders Ports in relation to its lack of market power:

- <u>Existence of alternatives:</u>

  Other ports such as Darwin, Whyalla, Ardrossan, Port Bonython (including the recent expansion of the port as a fuel import facility), Portland and Geelong – provide alternative port solutions directly or indirectly through connection to rail or road links. Physical port location is not the driver of competition amongst ports, rather the origin or location of the cargo catchment area. Recent port sales for Darwin and Melbourne have outlined the proponent's ability to compete for South Australian based cargo.

  In addition, the proposals recently announced associated with the development of additional ports such as Port Bonython, Lucky Bay, Myponie Point and Cape Hardy continue to highlight potential alternative South Australian port solutions to those operated by Flinders Ports. It is also noted that it is unclear whether the regulatory regime will apply to these alternative port options.

- <u>Barriers to entry:</u>

  Historically the view has been that the high capital cost of developing port infrastructure was a barrier to entry into the market. However over recent years the increasing use of tug/barge operations, which can be provided at a relatively low capital cost and be utilised from a range of existing marine facilities, for the export of various products has provided alternative solutions and worked to reduce this impediment for a range of cargo types.

- <u>Bargaining Power:</u>

Flinders Ports has successfully negotiated a number of pricing/access arrangements for a range of products and users without any issues being raised.

- Cargo Value:

  Flinders Ports is aware of the various cost components associated with the transport, storage and handling of cargo to and through the ports. Flinders Ports contends that as part of the overall port logistics cost chain there are significant drivers to ensure that each part is cost competitive therefore that the overall solution can work for a specific cargo.

Flinders Ports contends that:

- It does not have market power in the relevant market and that the countervailing pressures that have been identified are real and ensure that the pricing outcomes determined through the negotiation process are fair and reasonable to each party.
- It is not aware of any evidence to suggest that the Access Regime supports greater competition than would otherwise be the case.

Q3: Has economic regulation been successful? How should it be measured?

Q4: For those parties that have negotiated access, did the presence of the Access Regime facilitate commercial negotiations?

Flinders Ports will continue to seek to achieve long term sustainable returns for its shareholders and hence it is in the interest of the organisation to ensure that it takes into account a number of factors when determining an appropriate pricing model for use of a port facility. These factors include, capital investment made or additional capital required, level of services required and the impact on operating costs, the volume of trade and the associated shipping activity and the period over which the provision of services is required.

Flinders Ports operates within a mature market and its customers understand that acceptable commercial returns are required to ensure the long term sustainable delivery of the core services required to facilitate the movement of cargo through Flinders Ports' facilities.

An appropriate review of these factors with each specific customer enables a long term pricing strategy to be developed and subsequently agreed.

Whilst the Access Regime is generally noted in discussion with customers it is not a driving factor in reaching an agreed sound commercial outcome. This is achieved by agreeing the balance between the distribution of risk, the required service level and a fair value assigned to these service to ensure that the ultimate outcome (cargo movement) is achieved within the port user's ultimate business model.

Flinders Ports therefore contends that

- It is difficult to measure whether regulation has been successful given the strong record that Flinders Ports has over an extended period of time (now 15 years) of achieving balanced commercial outcomes across a very diverse range of port users and commodity trades without any disputes.
- Whilst general discussion in the context that all Flinders Ports operated ports are "open access", the commercial negotiations undertaken consider a wide range of issues which

ultimately provide access to the right facilities, at the right price and in accordance with port operating rules and safety standards.

Q5: What are the benefits or retaining regulation? What are the risks (if any) if it was to expire?

Q6: What are the current costs of the pricing and access regime (for example, costs of compliance and administration)?

Q7: Are there alternative approaches to achieving the intent of the regimes that are appropriate at this time?

In terms of pricing regulation Flinders Ports does not see any benefit in retaining regulation. The adverse consequences of letting pricing regulation expire are low as the market in which Flinders Ports operates is a mature one, with a range of countervailing pressures which ultimately result in agreed outcomes.

As regards access regulation, whilst noting that it does not believe it to be beneficial, Flinders Ports accepts that the existing access regime may be perceived as providing a "safety net" for port users to utilise if port users feel genuinely aggrieved, notwithstanding the absence of any disputes to date. This latter factor suggests that the adverse consequences of letting access regulation expire are also low.

The cost of regulation to Flinders Ports is not unsubstantial given the requirement to produce special annual Regulatory Accounts, quarterly reporting and the additional resources consumed addressing issues raised through the price monitoring reporting and pricing and access review process.

Flinders Ports questions whether there is a real net benefit with the current regime and asks ESCOSA to critically examine this issue when considering the future regulatory environment. In addition, the continued threat of a changing regulation model needs to be considered when assessing long term projects and regulatory risks.

Flinders Ports contends that:

- Given the history of successfully negotiated commercial outcomes between port users and Flinders Ports and the increasing maturity of the market in which these outcomes are achieved, the need for regulation has diminished.
- Without an access regime, the existing commercial model that has been successfully applied over an extended period of time will continue to achieve the desired outcomes.

Q8: Are there any key industry developments in the foreseeable future that may impact the need for, or type or, regulation?

Q9: Are any changes to the regime required to ensure they are suitable and flexible enough to cover trends and changes in the industry?

The shipping industry is currently going through a number of changes, with vessel sizes increasing as shipping lines pursue more cost effective solutions, pressure on charging and freight rates and the impact of economic factors in many trade regions around the world.

As a port operator, Flinders Ports continues to monitor these shipping industry and trade related trends to ensure that the services and infrastructure provided is appropriate and as required to meet demand.

In addition, the increasing emphasis on environmental sustainability and the impact that port operations can have on the marine environment are also factors that are constantly reviewed and monitored to ensure both compliance with existing requirements and in the context of planning for future port developments.

These factors require Flinders Ports to continue to consider its longer term plans, in particularly the development of infrastructure which by its nature has a long term impact both from an operational and capital expenditure perspective.

The regulatory regime, if required, needs to provide a consistent platform from which to consider these long term impacts. This provides certainty to the planning process and hence allows a long term perspective to be undertaken when matching the investment required to meet these changing trends against the requirement to deliver an appropriate return over an appropriate period of time.

At this stage, there is no evidence to suggest the current regulatory regime requires changing to provide flexibility to address foreseeable trends and changes in the market.

Q10: Is there a need for more regulatory consistency and/or clarity across the supply chain and transport modes?

No.

There is no evidence that suggests that more consistency or clarity is required or that the regime should be extended to apply to services provided by other facilities in the supply chain.

Q11: Is the level and type of infrastructure covered by the regimes suitable, having regards to the level of competition for the infrastructure services? Should there be inclusions or exclusions?

There is no evidence to support the inclusion of additional infrastructure services within the regime. As previously indicated port users and the port operator have successfully worked together to ensure the provision of the required facilities and services within agreed pricing parameters over the past regulatory period. This is evident in the trade activity levels achieved through the ports and no disputes being raised over the period and for over 10 years.

To extend the regime to services provided by facilities that did not exhibit natural monopoly characteristics would not be consistent with the approach of other access regimes throughout Australia and would allow for 'free-riding' by third parties resulting in a chilling effect on future investment.

Q12: What other issues are relevant to the decision to continue or discontinue regulation?

The key question is whether outcomes would have been different if the regime had not been in place over this past regulatory period.

Flinders Ports is of the view that the answer to this question is that they would not.

As outlined previously, Flinders Ports has made a large investment in port and port related infrastructure to ensure that port services and infrastructure meet customer demands. It also has a long term focus which requires it to work towards achieving a commercial return on this investment to meet sustainable returns to shareholder over the longer term.

As a result, Flinders Ports looks to achieve outcomes for port users which achieve both the outcome required and in line with the longer term objectives of the port operator. The success of this approach is evident in that there have been no disputes since the introduction of the regulatory regimes in 2001.

As regards the re-certification process, as this will require liaison between State and Commonwealth governments, others may be best placed to consider the effort required generally. Flinders Ports is firmly of the view that if the regime is continued beyond 2017, then certification of the regime should be extended as soon as possible. This will provide regulatory certainty for all parties involved and will continue to ensure efficient investments and negotiated agreements. A change to the regulatory regime however will create uncertainty, additional cost and inefficiency.