



# 2017 Ports Access and Pricing Review

Draft Report

May 2017

## Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this paper by **2 June 2017**.

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The Commission may also exercise its discretion not to publish any submission based on length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to: **2017 Ports Access and Pricing Review**

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## Glossary of terms

ACCC	Australian Competition and Consumer Commission
Access Seeker	A person who seeks the provision of a maritime service
Bulk	Cargo shipped in loose condition and of a homogenous nature eg grains, coal, iron ore
Bulk handling facility	Port facilities used to store, load and unload bulk cargo
Cape-size	Bulk carrier ships capable of carrying 180,000 to 220,000 tonnes, and which cannot pass through the Panama and Suez canals
CCA	Competition and Consumer Act 2010 (Cth)
Channel	A navigational pathway used by ships
Commission	Essential Services Commission, established under the Essential Services Commission Act 2002
Common user berth	A place for a ship to moor, which is available for all users
Containerised	General cargoes carried in a freight container
EMS	Essential Maritime Services
ESC Act	Essential Services Commission Act 2002
Maritime Services	All ports-related services covered by the MSA Act
Market power	Market power is the ability to raise price above cost or to exclude competitors
Minister	Minister for Transport and Infrastructure
MSA Act	Maritime Services (Access) Act 2000
Mtpa	Million tonnes per annum
Natural monopoly	A natural monopoly is a type of monopoly that exists when it is most efficient for a single firm (rather than multiple firms) to supply the entire market with a particular product or a service.
NCC	National Competition Council
Operator	Defined in section 10 of the MSA Act as a person who carries on a business of providing maritime services at a proclaimed port

Panamax	A mid-sized ship capable of passing through the Panama Canal, approximately 320m in length, 33.5m in width, and 12.5m in depth, and with a carrying capacity of 5,000 TEUs. The expansion of the canal now allows larger ships to pass through; these are known as New or Post Panamax and have a carrying capacity of 13,000 TEUs with lengths up to 427 metres.
Pilotage	Safely guiding a ship into or out of port, usually carried out by a pilot under the employment of the port authority
Prescribed period	A successive period of 5 years for which the Access Regime is in effect, as prescribed in the MSA Act
Regulated Services	The ports-related services in scope of the access regime under the MSA Act
Ring-fencing	Ring-fencing occurs when a portion of a company's assets or profits are financially separated without necessarily being operated as a separate entity
RMIP	South Australian Regional Mining and Infrastructure Plan
Stevedoring	The process of loading or unloading a ship
TEU	Twenty-foot Equivalent Unit. This is the general term for a 20-foot container. The nominal size of vessels is given in TEU and refers to the number of containers that can generally be carried
Up country	A term used to describe the location of grain storage facilities (including silos, sheds or bunker farms) that are not located at a port with a grain export terminal
Vertical integration	An arrangement in which a firm operates at multiple levels of a supply chain

# 1 Executive summary

## 1.1 Overview

The Essential Services Commission (**Commission**) is undertaking a review of access and price regulation of major commercial ports in South Australia (**Review**).

The Maritime Services (Access) Act 2000 (**MSA Act**) provides for the establishment of the South Australian ports access and pricing regimes. The purpose of those regimes is to provide for access to proclaimed ports on fair commercial terms, and to promote the economically efficient use and operation of, and investment in, ports infrastructure services. It is intended to protect the interests of ports users from the potential exercise of market power by port operators.

Specifically, the MSA Act allows for the regulation of 'Maritime Services' for all proclaimed ports. Within those services are 'Regulated Services' which are subject to access regulation (**Access Regime**) and 'Essential Maritime Services' (**EMS**) and 'Pilotage Services' (**Pilotage**) which are subject to price regulation (**Pricing Regime**).

Section 43 of the MSA Act requires the Commission to review the Access Regime during the last year of each prescribed period, and to make a recommendation to the Minister for Transport and Infrastructure (**Minister**) as to whether or not the Access Regime should continue for a further five years. The current prescribed period ends on 30 October 2017.

On the basis of the evidence available to the Commission at this time, the Commission's Draft Recommendation is that the current Access Regime should continue for a further five years.

Under the MSA Act, the Commission is authorised to make a price determination (**Determination**). The current Determination provides for price regulation through a price monitoring framework. As part of this Review, the Commission will decide whether or not the Pricing Regime should continue and, if so, the form of price regulation to be adopted.

On the basis of evidence available to the Commission at this time, the Commission's Draft Decision is that the current Pricing Regime, which takes the form of monitoring and public reporting, continue for a further five years.

In forming its views on the above matters, the Commission has considered:

- ▶ the legislative provisions and objectives of the MSA Act and the Essential Services Commission Act 2002
- ▶ stakeholder submissions and other evidence relating to the effectiveness of the regimes
- ▶ current and emerging industry conditions and policy developments, and
- ▶ the Commission's Better Regulation Framework, which is outcome-focused and promotes effective consumer protection at the least regulatory cost.<sup>1</sup>

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<sup>1</sup> The Commission's Better Regulation Framework is outlined in a fact sheet, available at <http://www.escosa.sa.gov.au/ArticleDocuments/260/20160811-Corp-RegulatoryApproachStatement-factsheet.pdf.aspx?Embed=Y>.

## 1.2 No evidence of the exercise of market power

To assess the ongoing need and effectiveness of the Access and Pricing Regimes, the Commission has sought to address the following two questions:

1. Does the structure of the market create the potential to exercise market power for the providers of Regulated Services, EMS and Pilotage services?
2. Based on the conduct and performance of those providers, is there evidence of market power being exercised?

A significant factor in the consideration of market power is the degree to which port alternatives (substitutes) exist. Substitutes may arise through interport competition – when two ports, with different owners, in the same or in different states or countries compete for the same cargo. It may also arise through intraport competition – when two or more terminal operators within the same port area compete for the same type of cargoes.

The Commission has tested the port industry for the potential for operators to exercise market power. Where no, or limited, substitutes exist, port operators will have greater potential to increase prices without giving rise to a significant, sustained, reduction in demand, which would increase profits. Where substitutes do exist, raising prices may lead to a demand decrease and impact on profits. This is likely to be different for different customers or products.

The Commission has concluded that, although there is the potential for market power to be exercised by port operators, there is no evidence to suggest that port operators are exercising such market power. The Commission has reached this conclusion after having regard to the following findings:

- ▶ Benchmarking of ports charges conducted by GHD Pty Ltd (GHD)<sup>2</sup> on behalf of the Commission, which indicates that ports charges in South Australia are competitive in comparison to other Australian ports.
- ▶ An analysis of Flinders Ports' regulatory accounts, which suggests it has not been earning excessive profits.
- ▶ Commercial information provided by Flinders Ports and Viterra, indicating that negotiations over ports charges have occurred over the current regulatory period and that ports users have been successful in achieving pricing outcomes that are below the listed price schedule.
- ▶ The absence of any access or pricing disputes in the current prescribed period.
- ▶ Submissions made by stakeholders that, generally, support the continuation of the current access and pricing arrangements.

## 1.3 Possible improvements to the Access and Pricing Regimes

In considering the objective of preventing the exercise of market power at the least regulatory cost, the Commission makes two additional Draft Recommendations for the Minister, as part of its Review. They are:

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<sup>2</sup> Refer to GHD report available at <http://www.escosa.sa.gov.au/ArticleDocuments/1024/20170424-PortsPricingAccessReview2017-BenchmarkingStudy-GHD.pdf.aspx?Embed=Y>.

► **Examine the alignment of the services in scope of the Access and Pricing Regimes**

The current Access and Pricing Regimes vary in the services that are included within them. This adds some complexity in understanding the regimes, and may confuse access seekers. It is the Commission's view that, as a starting principle, these services should be aligned. Furthermore, there is merit in revisiting the scope of ports infrastructure included in the regimes, as supply-chain dynamics and associated infrastructure can change over time.

On the basis of the above, the Commission recommends examining the alignment of the services in scope of the Access and Pricing Regimes.

► **Examine opportunities to better integrate transport infrastructure access regimes**

There may be merit in amalgamating similarly operating transport access regimes, including the South Australian Rail Access Regime, Tarcoola-Darwin Rail Regime and the Ports Access Regime. Such an approach recognises the fact that many access seekers require access to multiple modes of transport, and reflects previous stakeholder feedback on improving access regulation of South Australian transport infrastructure.

The Commission welcomes comments on this Draft Report. All submissions made will be considered by the Commission in finalising its position on the Review. The Final Report will be released in September 2017.



## 2 Introduction

The Essential Services Commission (**Commission**) is a statutory authority established as an independent economic regulator and advisory body under the Essential Services Commission Act 2002 (**ESC Act**).

The Commission has economic regulatory responsibility in the water, sewerage, electricity, gas, rail and maritime services, and a general advisory function on regulatory and economic matters. The ESC Act and various industry Acts together provide the Commission with those regulatory and advisory powers and functions.

Under the ESC Act the Commission has the primary objective of:

‘... protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services’.

### 2.1 Purpose of this Review

The Commission is undertaking a review of access and price regulation of ports in South Australia (**Review**).

The Maritime Services (Access) Act 2000 (**MSA Act**) provides for the establishment of the South Australian ports Access and Pricing Regimes. The purpose of these regimes is to provide for access to proclaimed ports on fair commercial terms, and to regulate prices.

Specifically, the Act allows for the regulation of ‘Maritime Services’ for all proclaimed ports. Within those services are ‘Regulated Services’ which are subject to access regulation (**Access Regime**), and ‘Essential Maritime Services’ (**EMS**) and ‘Pilotage Services’ (**Pilotage**) which are subject to price regulation (**Pricing Regime**).

Section 43 of the MSA Act requires the Commission to review the Access Regime within the last year of each prescribed period, and make a recommendation to the Minister for Transport and Infrastructure (**Minister**) as to whether or not the Access Regime should continue for a further five years.<sup>3</sup> The current prescribed period ends on 30 October 2017.

Under the MSA Act, the Commission is authorised to make a price determination (**Determination**). The current Determination provides for price regulation through a price monitoring framework. As part of this Review, the Commission will decide whether or not the Pricing Regime should continue and, if so, the form of price regulation to be adopted.

This Review therefore considers the following questions:

- ▶ Should the ports Access Regime continue for a further five-year period from 31 October 2017?
- ▶ Should the ports Pricing Regime continue for a further five-year period from 31 October 2017? If it is to continue, what form of price regulation should be adopted?
- ▶ If the regimes are to continue, can they be improved to make regulation more effective and efficient generally?

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<sup>3</sup> The decision to continue or to terminate the regime rests with the Minister for Transport and Infrastructure, upon receiving a recommendation from the Commission.

## 2.2 Structure of this Draft Report

This Draft Report consists of the following chapters:

- ▶ Chapter 1 is the Executive Summary.
- ▶ Chapter 2 covers the purpose and process of this Review, and includes the framework governing the regimes, including legislative and regulatory requirements.
- ▶ Chapter 3 includes the Commission's analysis of the effectiveness of the Access and Pricing Regimes, as well as its recommendations.
- ▶ Chapter 4 suggests potential enhancements to ports access and pricing regulation beyond the scope of section 43 of the MSA Act.
- ▶ Chapter 5 is the Conclusion, and summarises the Commission's recommendation to continue the Access Regime and its decision to continue the Pricing Regime.
- ▶ Chapter 6 sets out the Next Steps in this Review.

## 2.3 Review methodology

The Access and Pricing Regimes are intended to protect users of ports infrastructure services from the adverse effects of market failure, in particular, the exercise of market power by the providers of those services. Market power is the ability of a firm to raise, and sustain, the price of its good/service without any significant loss of demand. For example, a monopoly service provider may exclude entry, charge prices that are not efficient, or provide access on terms and conditions that do not meet users' requirements.

To assess the ongoing need and effectiveness of the Access and Pricing Regimes, the Commission has sought to address the following two questions:

1. Does the structure of the market create the potential to exercise market power for the providers of Regulated Services, EMS and Pilotage services?
2. Based on the conduct and performance of those providers, is there evidence of market power being exercised?

Market structures can create the potential to exercise market power. For example, customers may have few or no alternatives to the ports infrastructure services, or it may be uneconomic for firms to enter the market to compete with the existing providers. These structural conditions may provide port operators with the potential to exercise market power. The Commission has examined current and expected future market conditions to determine if there are likely to be any changes to the potential to exercise market power by the port operators, which may influence the need for the Access and Pricing Regimes. Appendix E of this Draft Report discusses the Commission's assessment of those market conditions.

Even if the potential to exercise market power is present, the nature of the Access and Pricing Regimes will depend on the risks to consumers of market power actually being exercised. If there is no evidence of the exercise of market power, it would be difficult for the Commission to recommend further consumer protections than those already afforded under the regimes. Such evidence includes the extent to which users are able to reach negotiated outcomes, evidence of profits earned by the regulated companies and the efficiency of prices charged, which may be informed by benchmarking and analysis of price trends.

It is also important for the Commission to consider alternatives to the existing Access and Pricing Regimes. In particular, even if the current regimes did not continue beyond 30 October 2017, the National Access Regime under Part III of the Competition and Consumer Act 2010 (Cth) (**CCA**) would provide alternative options for access regulation of ports services. The costs and benefits of the existing Access and Pricing Regimes must therefore be assessed against those alternatives.

The Commission's assessment of the evidence of the potential to exercise market power, whether or not it is or has been exercised, and alternatives to the existing Access and Pricing Regimes are discussed in sections 3.2 (Presence and exercise of market power), 3.3 (Access Regime), and 3.4 (Pricing Regime) of this Draft Report.

Assuming the current Access and Pricing Regimes were to continue, the Commission has also considered ways they could be improved to make regulation more effective and efficient (Chapter 4). The Commission has also recommended other initiatives that, although are not specifically in scope of the Access and Pricing Regimes, could assist to achieve the intended outcomes of those regimes.

## 2.4 The Review process

The Review commenced in October 2016 with the release of an Issues Paper for public consultation.<sup>4</sup> The Issues Paper set out the key questions regarding the need for continued price and access regulation, and sought views on any other issues of relevance.

In response to the Issues Paper the Commission received submissions from the following parties:

- ▶ Flinders Ports Pty Ltd (**Flinders Ports**)
- ▶ Grain Producers South Australia (**GPSA**)
- ▶ Iluka Resources Ltd (**Iluka Resources**)
- ▶ South Australian Freight Council (**SAFC**), and
- ▶ Viterro Operations Ltd (**Viterro**).

In addition, the Commission received one confidential submission.<sup>5</sup>

The Commission has been assisted by these submissions. The matters raised have been carefully considered and, where relevant, arguments and submissions have been referred to in this Draft Report, to assist stakeholders to understand the positions that have been reached. All submissions have been useful in understanding the competing viewpoints and informing the consideration of each of the relevant issues, and a failure to reference an argument or submission does not mean that it has not been taken into account.

In addition to these submissions, the following matters have been taken into account by the Commission:

- ▶ the legislative provisions and objectives of the MSA Act and the Essential Services Commission Act 2002 (**ESC Act**)

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<sup>4</sup> The Commission's *Ports Pricing and Access Review Issues Paper*, available at <http://www.escosa.sa.gov.au/projects-and-publications/projects/ports/ports-pricing-and-access-review-2017>.

<sup>5</sup> In the interests of transparent decision-making, it is the Commission's policy to make all submissions publicly available on its website, except where a submission contains confidential or commercially sensitive information. However, points contained in confidential submissions cannot be publicly tested and therefore may not be given the same weighting as published submissions.

- ▶ current and emerging industry conditions, including an assessment of the potential to exercise market power
- ▶ other evidence relating to the effectiveness of the regimes
- ▶ benchmarking of port charges in other Australian jurisdictions and the Commission's annual Ports Price Monitoring Reports
- ▶ the profitability of Flinders Ports
- ▶ State and National policy developments, and
- ▶ the Commission's Better Regulation Framework, which is outcome-focused and promotes effective consumer protection at the least regulatory cost.<sup>6</sup>

## 2.5 Context of the Review

### 2.5.1 Competition in maritime services

South Australian port infrastructure services are generally considered to be natural monopoly services. This is due to the high costs of duplicating the port infrastructure required to deliver those services, which significantly limits competition in ports services.

The absence of competition can adversely affect the long-term interests of consumers if a port operator possesses and exercises its market power through, for example, requiring unreasonable access terms and conditions or setting excessive prices. The current market power of South Australian port operators is discussed further in Chapter 3.

The lack of competition in port services, combined with the critical nature of ports to the functioning of upstream and downstream competitive markets (for example, shipping, logistics, import and export markets), led to the South Australian Government's decision to regulate those services in 1999.

The MSA Act provides for access and price regulation to prevent the exercise of market power by port operators, and to promote competition in those related markets where possible. The following sections describe how the MSA Act and the regimes it establishes seek to do this.

### 2.5.2 Maritime Services (Access) Act 2000

The MSA Act prescribes the services in scope of the Access and Pricing Regimes (Figure 1) and a requirement for the Commission to review the Access Regime within the last year of each prescribed period. If, having regard to the Commission's recommendation, the South Australian Government decides that the Access Regime should continue, a regulation must be made extending the period of its operation. If, however, the South Australian Government decides that ongoing access regulation is not necessary, and a regulation is not made, then the Access Regime will expire on 31 October 2017.

#### 2.5.2.1 Objects of the MSA Act

Section 3 of the MSA Act states that the objects of the Act are:

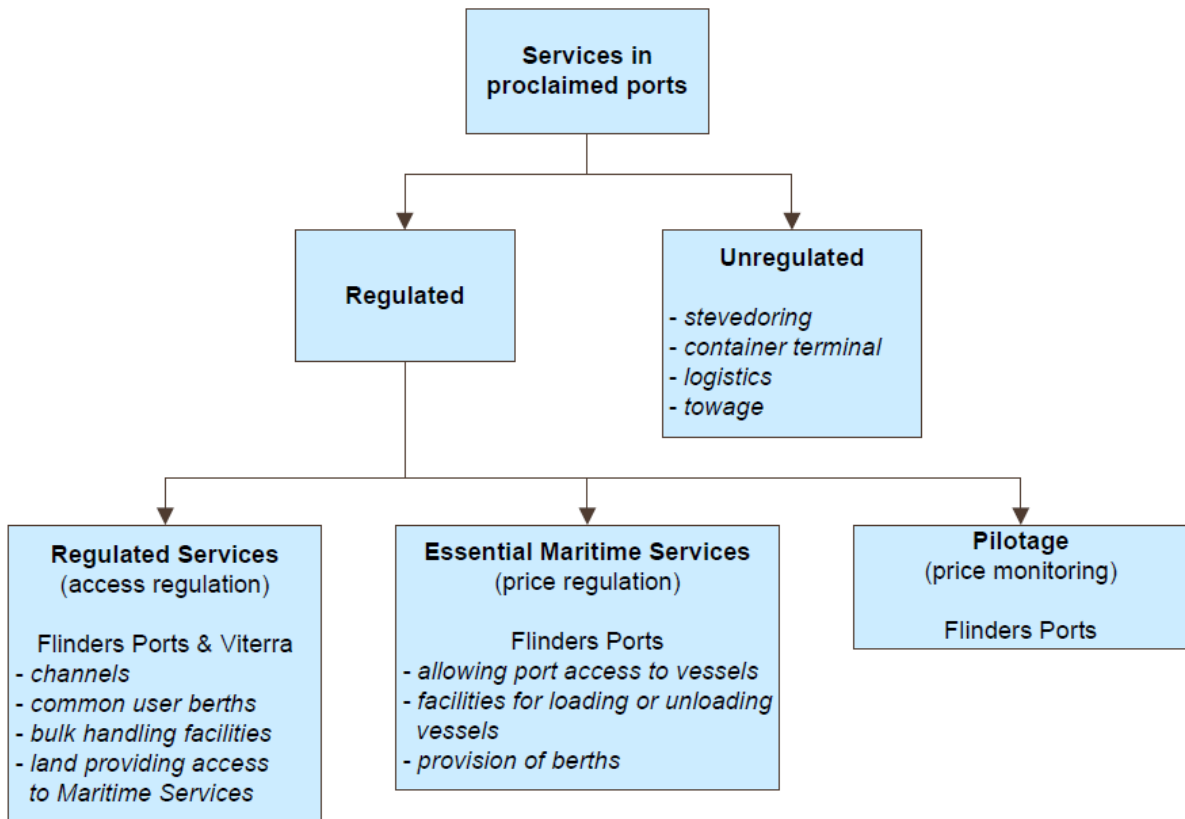
- ▶ to provide access to maritime services on fair commercial terms
- ▶ to facilitate competitive markets in the provision of maritime services through the promotion of the economically efficient use and operation of, and investment in, those services

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<sup>6</sup> The Commission's *Better Regulation Framework Fact Sheet*, available at <http://www.escosa.sa.gov.au/ArticleDocuments/260/20160811-Corp-RegulatoryApproachStatement-factsheet.pdf.aspx?Embed=Y>.

- ▶ to promote the interests of users of EMS by ensuring that regulated prices are fair and reasonable, having regard to the level of competition in, and efficiency of, the regulated industry, and
- ▶ to ensure that disputes about access are subject to an appropriate dispute resolution process.

Figure 1: Diagram of MSA Act coverage



### 2.5.2.2 Infrastructure covered

The Commission is the access and pricing regulator for the following six commercial ports in South Australia (Figure 2).

1. Port Adelaide
2. Port Giles
3. Wallaroo
4. Port Pirie
5. Port Lincoln, and
6. Thevenard

While all of the above ports are operated by Flinders Ports, some regulated services (for example, bulk loader services) are provided by Viterra. At this time, the Commission does not have a role in relation to other ports.

The decision on which ports should be subject to the Access and Pricing Regimes is a matter for the South Australian Government. The Access and Pricing Regimes allows for new port infrastructure services to be included and existing services to be removed, by proclamation.

Figure 2: Map of proclaimed South Australian ports



**2.5.2.3 Access Regime**

The Access Regime is established under Part 3 of the MSA Act. It provides a framework for the negotiation of access to regulated services and dispute resolution where access disputes arise and cannot be otherwise resolved between parties. Regulated services are declared by proclamation. The Access Regime has been certified, by the National Competition Council (NCC), as being an effective state-based access regime pursuant to Part III of the CCA for a period of 10 years (expiring 2021).<sup>7</sup>

Maritime Services falling within the scope of the Access Regime include:

- ▶ channels
- ▶ common user berths
- ▶ bulk handling facilities<sup>8</sup>
- ▶ berths adjacent to bulk handling facilities

<sup>7</sup> The purpose of certification is to provide exemption from declaration under Part IIIA of the CCA. Once a State or Territory access regime is certified as effective, access to relevant services is exclusively governed by that regime and the declaration provisions of Part IIIA are unavailable.

<sup>8</sup> These are defined in section 3 of the South Australian Ports (Bulk Handling Facilities) Act 1996 (currently operated by Viterra) but only in relation to conveyor belts (that is, storage areas are not included).

- ▶ land providing access to maritime services, and
- ▶ the Outer Harbor bulk loader at Port Adelaide.

The key elements of the Access Regime are described below.

#### *Access on fair commercial terms (Part 3, Division 2)*

The Access Regime establishes that an operator must provide regulated services on terms agreed between the operator and the customer, including as to price, or, if they do not agree, on fair commercial terms determined by arbitration under the MSA Act. A price will be regarded as a fair commercial term if it is regulated by a pricing determination under the ESC Act and the term is consistent with that determination.

#### *Negotiation of access (Part 3, Division 3)*

The MSA Act sets out the information that an access seeker may include in a written proposal to the access provider, for obtaining access or materially varying an existing access contract. The access provider must provide copies of any access proposal to the Commission, and to any industry participant that may be affected by the access that is proposed.

The access provider is required to negotiate in good faith with the access seeker, as are any other interested third parties affected by the proposal.

#### *Resolving access disputes (Part 3, Divisions 5-10)*

A dispute exists if the operator, the access seeker and any interested third parties have not agreed on terms for the provision of the proposed service within 30 days. In the event of a dispute, any party can refer the matter to the Commission. The Commission may first attempt to conciliate the dispute and, if unsuccessful, may appoint and refer the dispute to an arbitrator.<sup>9</sup> An arbitrator may make a binding access award.

### **2.5.2.4 Pricing Regime**

The Pricing Regime applies to EMS. Pursuant to section 4 of the MSA Act, EMS are defined as maritime services providing:

- ▶ or allowing for access of vessels to a proclaimed port
- ▶ ports facilities for loading or unloading vessels at a proclaimed port, or
- ▶ berths for vessels at a proclaimed port.

Although the provision of Pilotage is not an EMS, its charges are subject to a similar form of price regulation, as specified in section 8 of the MSA Act.

The current Pricing Regime allows port operators to set prices for those services, but it does so in the context of having the Commission monitoring those prices and publicly reporting on them.<sup>10</sup> Under the regime, an operator of a proclaimed port must maintain a schedule of EMS and Pilotage charges, and provide the Commission a current schedule and notice of any proposed changes to these charges. Where the Commission's price monitoring reveals that an EMS charge has increased by more than the change in CPI, the Commission requests the port operator to provide the Commission with justification

<sup>9</sup> The MSA Act requires an arbitrator to be a person who is properly qualified to act in the resolution of the dispute, is independent of the parties to the dispute, as well as the South Australian Government, and has no direct or indirect interest in the outcome of the dispute.

<sup>10</sup> The Commission's *Ports Price Monitoring Reports* covering the current regulatory period, available at <http://www.escosa.sa.gov.au/industry/ports/pricing-access>.

for such a change. The Commission's considerations of any real price increase, and the justifications provided, are discussed in annual ports price monitoring reports released by the Commission.<sup>11</sup>

The current pricing arrangements for EMS expire on 30 October 2017 and the Commission can, pursuant to section 6 of the MSA Act, use its powers under section 25 of the ESC Act to make a new price determination, in accordance with requirements set out in Part 3 of the ESC Act.

### 2.5.3 Essential Services Commission Act 2002

In carrying out this Review, the Commission is performing a function under the ESC Act. Section 6 of the ESC Act states that the Commission must:

- (a) *Have as its primary objective protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and*
- (b) *At the same time, have regard to the need to:*
  - (i) *Promote competitive and fair market conduct;*
  - (ii) *Prevent misuse of monopoly or market power;*
  - (iii) *Facilitate entry into relevant markets;*
  - (iv) *Promote economic efficiency;*
  - (v) *Ensure consumers benefit from competition and efficiency;*
  - (vi) *Facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and*
  - (vii) *Promote consistency in regulation with other jurisdictions.*

For the purpose of section 6(a) of the ESC Act, South Australian consumers are considered to be the immediate customers of Maritime Services. However, promoting economically efficient maritime services benefits markets that rely on those services and can assist in keeping prices of transported goods as low as sustainably possible.

Under section 25(2) of the ESC Act, the Commission may only make a price determination if authorised to do so by a relevant industry regulation or by regulation under the ESC Act. Pursuant to Part 2 of the MSA Act, the Commission is authorised to make a price determination relating to essential maritime industries. Part 3 of the ESC Act sets out the Commission's price regulation powers (see Appendix F).

Section 25(3) of the ESC Act specifies the range of regulatory approaches that the Commission can choose from in the making of a price determination, ranging from those that are not determinative in nature (for example, price monitoring), to those that are determinative (for example, price setting). These price regulation options are listed in section 3.4.8.

## 2.6 Access and Pricing Review 2012

The Commission previously carried out a review of the ports Access and Pricing Regimes in 2012 (**2012 Review**). While the 2012 Review has not been relied upon for the 2017 Review, an overview of the 2012 Review is included in Box 2.1 for information.<sup>12</sup>

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<sup>11</sup> The Commission's 2012 Ports Price Determination, available at [http://www.escosa.sa.gov.au/ArticleDocuments/686/120830-2012\\_PortsPriceDetermination-Final.pdf.aspx?Embed=Y](http://www.escosa.sa.gov.au/ArticleDocuments/686/120830-2012_PortsPriceDetermination-Final.pdf.aspx?Embed=Y).

<sup>12</sup> The Commission's 2012 Review, available at <http://www.escosa.sa.gov.au/projects-and-publications/projects/ports/ports-pricing-and-access-review-2012>.



### Box 2.1 - Overview of the 2012 Review

The Commission concluded that, although there was the potential for market power to be exercised by port operators in respect to the pricing of EMS, there was no evidence to suggest that port operators were exercising market power.

The Commission reached that conclusion after having regard to:

- ▶ the regulatory accounts of port operators
- ▶ a ports price benchmarking study conducted by GHD Pty Ltd (**GHD**)
- ▶ price movements of Maritime Services, and
- ▶ commercial information provided by Flinders Ports, as well as the absence of any disputes.

In light of the above, the Commission concluded:

- ▶ price monitoring was an appropriate form of price regulation and should be maintained for the following five-year regulatory period, and
- ▶ the existing access regulatory framework (that is, a negotiate-arbitrate framework) was appropriate and should continue for a further five-year regulatory period in its current form.

## 3 Continuation of Access and Pricing Regimes

This chapter sets out the Commission's reasoning for its Draft Recommendation to continue the Access Regime and its Draft Decision to continue the Pricing Regime, from 31 October 2017.

### Box 3.1 - The Commission's Draft Recommendations and Draft Decision

#### Draft Recommendations

- ▶ The current Access Regime should continue for a further five years
- ▶ The Minister should examine the alignment of the services in scope of the Access and Pricing Regimes, and
- ▶ The Minister should examine the integration of transport infrastructure access regimes.

#### Draft Decision

- ▶ If the current Access Regime is to continue for a further five years, the current Pricing Regime should also continue for a further five years.

### 3.1 Draft Recommendations

In considering the matters listed in section 2.4, the Commission has concluded that, while there is the potential for market power to be exercised by port operators, there is no evidence to suggest that port operators are exercising such market power. That evidence is discussed later in this chapter.

On this basis, and in assessing the costs and benefits of the current Access and Pricing Regimes, the Commission has concluded that, on balance, there would be no net benefit in ceasing the Regimes and moving towards alternatives at this time.

The Commission has formed the view that the continuation of the Access and Pricing Regimes for the next five years (from 31 October 2017) is the most appropriate regulatory response at this time. In arriving at this view, the Commission has considered the following for each regime:

- ▶ Is there a requirement for regulation at all?
- ▶ If so, is the current regime effective?
- ▶ Is there a better alternative to the current regime?

However, as part of this Review the Commission recommends two areas which could lead to possible enhancements to access and price regulation of ports, that the Minister may wish to consider. They are:

- ▶ to examine the alignment of the services in scope of the Access and Pricing Regimes, and
- ▶ to examine opportunities to better integrate transport infrastructure access regimes.

The remainder of this chapter discusses the Commission's considerations in arriving at these Draft Recommendations and Draft Decision.

## 3.2 Presence and exercise of market power

The Commission has examined expected future market conditions to determine if there are likely to be any changes to the potential to exercise market power by both Flinders Ports and Viterra, which may influence the need for the Access and Pricing Regimes. This includes the current, and expected, level of competition in maritime services and the level of demand for those services. Technological and other industry developments have also been considered, as they may have an influence in the supply of, or demand for, maritime services over the next five years.

Even if the potential to exercise market power is present, the nature of the Access and Pricing Regimes will depend on the risks to consumers of market power being exercised. If there is no evidence of the exercise of market power, it would be difficult for the Commission to recommend further consumer protections than those already afforded under the regimes.

The Commission has also had regard to policy developments and port-related developments in other Australian jurisdictions; those have been summarised in Appendices B to D.

These matters are discussed in the remainder of this section and form key inputs into the Commission's decision on the need for the Access and Pricing Regimes (discussed in section 3.3 and 3.4). Observations of current and future market conditions that are contextual to this Review, while not drivers of market power, are discussed in Appendix E.

### 3.2.1 Competition in maritime services

The two companies that dominate the provision of maritime services in South Australia are Flinders Ports and Viterra, although there are some proposals for new ports in the State (see section 3.2.1.3). As discussed below, both ports service providers are vertically integrated and operate both regulated and unregulated port activities. Although vertical integration can achieve efficiencies, it can create incentives for anticompetitive practices where market power can be leveraged to an upstream or downstream competitive market, in which the firm also operates. In those circumstances, there is an argument for economic regulation, as discussed below.

#### 3.2.1.1 Flinders Ports

Flinders Ports is a vertically integrated port operator, offering services subject to access and price regulation (EMS, Pilotage and Regulated Services) and unregulated services (for example, logistics). Flinders Ports faces some interport competition with interstate ports, for example with the Port of Melbourne.

Flinders Ports' involvement in downstream services can provide an incentive to leverage any market power from services subject to access/price regulation to other, competitive, services.

#### 3.2.1.2 Viterra

Viterra operates six bulk grain port terminal facilities: bulk handling facilities at Port Adelaide, Port Giles, Wallaroo, Port Lincoln and Thevenard, and the bulk loader at Outer Harbor. There may be minimal scope for competition for bulk handling facilities at these proclaimed ports.

Viterra operates other (unregulated) bulk storage and handling facilities and grain trading business, and is therefore a vertically integrated port operator for grain. An argument could be made that Viterra has the opportunity to use its regulated facilities to discriminate in the favour of its unregulated businesses. The Australian Competition and Consumer Commission (ACCC) has stated a similar view that, as a

vertically integrated port operator, Viterra has the discretion and incentive to favour its own trading arm, Glencore (the largest exporter from South Australia).<sup>13</sup>

### 3.2.1.3 New port proposals

There are several proposals for new ports in South Australia (Table 3.1). At this time these ports are not in operation and therefore do not offer alternative port solutions. Furthermore, it is unlikely they will be fully operational within the next prescribed period and therefore do not affect the Commission's assessment of market power.<sup>14</sup>

Table 3.1: New port proposals – South Australia<sup>15</sup>

Location and proponent	Key elements of proposal
Port Bonython, Spencer Gulf <i>Spencer Gulf Port Link, led by Flinders Ports</i>	<ul style="list-style-type: none"> <li>▶ bulk commodity port</li> <li>▶ 3km jetty with covered conveyor</li> <li>▶ load cape-size vessels to 180,000t</li> <li>▶ fully enclosed shed storage</li> <li>▶ approximately 25km rail connection to national railway line</li> <li>▶ capacity up to 75mtpa</li> </ul>
Lucky Bay, Eyre Peninsula <i>Spencer Gulf Trust</i>	<ul style="list-style-type: none"> <li>▶ bulk storage facility 1.5km inland</li> <li>▶ transhipment (barge) operation to load Panamax and possible cape-size vessels</li> <li>▶ capacity 1.5mtpa</li> <li>▶ original proposal for exporting iron ore, currently being re-scoped as a grain transhipment port</li> </ul>
Cape Hardy, Eyre Peninsula <i>IronRoad and Emerald Grain</i>	<ul style="list-style-type: none"> <li>▶ 1.5km jetty with covered conveyor</li> <li>▶ load cape-size vessels to 220,000t</li> <li>▶ open stockpile storage – 650,000t</li> <li>▶ 150km of rail from mine to port</li> <li>▶ grain capability</li> <li>▶ capacity up to 25mtpa</li> </ul>

<sup>13</sup> ACCC, Viterra application seeking capacity allocation system approval, Final Decision, 2015, p.4, [https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20Viterra's%20application%20to%20vary%20its%20capacity%20allocation%20system%20-%203%20December%202015\\_0.pdf](https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20Viterra's%20application%20to%20vary%20its%20capacity%20allocation%20system%20-%203%20December%202015_0.pdf).

<sup>14</sup> The South Australian Regional Mining and Infrastructure Plan estimates the time taken to develop a port is at least five years, p.32 [http://infrastructure.sa.gov.au/\\_data/assets/pdf\\_file/0011/132797/Regional\\_Mining\\_and\\_Infrastructure\\_Plan.pdf](http://infrastructure.sa.gov.au/_data/assets/pdf_file/0011/132797/Regional_Mining_and_Infrastructure_Plan.pdf)

<sup>15</sup> Based on information provided by the Department of Planning, Transport and Infrastructure, February 2017.

Location and proponent	Key elements of proposal
Walleroo, Yorke Peninsula <i>Sea Transport</i>	<ul style="list-style-type: none"> <li>▶ barging facility to service the grain industry</li> <li>▶ capacity currently unknown</li> <li>▶ Sea Transport have indicated they will seek sponsorship for a grain export facility</li> </ul>
Smith Bay, Kangaroo Island <i>KI Plantation Timber</i>	<ul style="list-style-type: none"> <li>▶ timber log transhipment (barge) operation</li> </ul>

### 3.2.2 Findings on market power

As stated in section 2.3, the Commission has considered the presence and exercise of market power for both Flinders Ports and Viterra, taking into account matters relevant to market structure and business conduct, which are discussed in the remainder of this section.

In summary, the Commission has concluded that both operators continue to have the potential to exercise market power, but the Commission has not found any evidence of this market power being exercised over the current prescribed period. Furthermore, from the evidence available, on balance, it is unlikely that the potential to exercise market power will change substantially over the next prescribed period.

The potential sources of competition that may limit the presence and exercise of market power include:

- ▶ Interport competition – when two ports, with different owners, in the same or in different states or countries compete for the same cargo.
- ▶ Intraport competition – when two or more terminal operators within the same port area compete for the same type of cargoes.
- ▶ Intraterminal competition – when two or more (stevedoring) companies compete within the same terminal.

According to the World Bank, intraport competition is favoured by both government and port users, but is not always feasible, being dependent on sufficient volumes of cargo to allow two or more operators to run profitable and effective businesses.<sup>16</sup> When intraport competition is muted or absent, the operators (whether public or private) may have an incentive to use their market power to charge high tariffs (particularly for captive cargoes). At this time there is no intraport or intraterminal competition in South Australia.

The South Australian Regional Mining and Infrastructure Plan (**RMIP**) (discussed in Appendix C) recognises that, where there is only a single port to service a region, considerable potential to exercise market power could be generated for the owner of the port. This can create a need for conditions to be placed on the entity controlling the port to prevent it from exercising market power when negotiating access conditions.<sup>17</sup>

<sup>16</sup> World Bank, Port Reform Tool Kit, Module 4, 2007.

<sup>17</sup> South Australian Government, *Regional Mining and Infrastructure Plan, 2014*, available at [http://infrastructure.sa.gov.au/\\_data/assets/pdf\\_file/0011/132797/Regional\\_Mining\\_and\\_Infrastructure\\_Plan.pdf](http://infrastructure.sa.gov.au/_data/assets/pdf_file/0011/132797/Regional_Mining_and_Infrastructure_Plan.pdf).

SAFC stated that there is the potential for market power to be exercised in ports services,<sup>18</sup> while Flinders Ports argues that it does not have market power, for reasons explained later in this section.<sup>19</sup> Viterra and SAFC stated there was no evidence to suggest that market power had been exercised over the current period.<sup>20</sup> The presence and exercise of market power for Flinders Ports and Viterra is discussed below.

### **Flinders Ports**

The Commission has concluded that Flinders Ports still has the potential to exercise market power, based on:

- ▶ the current market structure of maritime services, which has limited competition, particularly for bulk commodities, and
- ▶ a lack of substitutes for maritime services, at this time and into the next prescribed period.

However, the Commission has not found any evidence of Flinders Ports' market power being exercised over the current prescribed period.

The following discusses the Commission's position, taking into consideration Flinders Ports' statement that it does not have market power.

#### *Availability of substitutes*

Flinders Ports stated that, since 2012, it has seen the rise of alternative port options and proposals for new ports.<sup>21</sup> It noted other ports such as Darwin, Whyalla, Ardrossan, Port Bonython, Portland and Geelong provide alternative port solutions through connection to road or rail links.<sup>22</sup> Flinders Ports also refer to proposed ports such as Lucky Bay, Myponie Point and Cape Hardy as potential alternative South Australian port solutions to those operated by Flinders Ports.<sup>23</sup>

The Commission recognises that a significant factor in the consideration of market power is the degree to which port alternatives (substitutes) exist. For example, while Port Adelaide is the sole containerised port for South Australia, the Port of Melbourne is the key Australian containerised port, with land and rail links placing limits on the extent to which any Australian container port can seek to exercise market power. However, the availability of substitutes is based not just on the existence of an alternative port, but on overall transport costs. For example, in the case of bulk commodities, alternative ports are generally available to the port in closest proximity, but transport to alternative ports usually involves additional costs which may not be offset by lower port charges. The price of road or rail transport may therefore limit customers in some situations by making alternatives non-viable.

In the case of the new port proposals, the Commission notes that these ports are not in operation, and therefore do not offer alternative port solutions at this time (see section 3.2.1.3).

#### *Decrease in barriers to entry*

Flinders Ports recognised that the high capital cost of developing port infrastructure has historically been viewed as a barrier to entry into the market.<sup>24</sup> However, it stated that over recent years there has been an increasing use of tug and barge operations, which can be provided at a relatively low capital

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<sup>18</sup> Only SAFC in its submission, p.2, stated there was potential for market power to be exercised by port service providers, although GPSA, p.6 and Iluka, p.1 referred to the monopolistic nature of the State's port services in their submissions.

<sup>19</sup> Flinders Ports submission, p.3.

<sup>20</sup> For example, refer to Viterra, p.8 and SAFC, p.3 submissions.

<sup>21</sup> Flinders Ports submission, p.2.

<sup>22</sup> Flinders Ports submission, p.6.

<sup>23</sup> Flinders Ports submission, p.6.

<sup>24</sup> Flinders Ports submission, p.6.

cost and be used from a range of existing marine facilities. Flinders Ports stated that these provide alternative solutions and have reduced the barriers to entry for a range of cargo types.<sup>25</sup>

The Commission agrees that further use of tugs and barges may offer alternatives to Flinders Ports' infrastructure and reduce the potential for it to exercise market power to some extent. However, as discussed in Appendix E, there is a global trend towards increasing frequency of larger container vessel visits.<sup>26</sup> Tugs and barges are unlikely to offer alternatives in these instances.<sup>27</sup>

#### *Countervailing bargaining power*

Flinders Ports stated, as evidence that it does not have market power, that it has successfully negotiated a number of access and pricing arrangements for a range of products and users without any issues being raised.<sup>28</sup> This argument suggests that customers have some countervailing bargaining power, which limits the potential of Flinders Ports to exercise its market power.

The Commission has reviewed information submitted by Flinders Ports in support of its position, including information that indicates that a significant number of negotiations have been entered into below Flinders Ports published tariff rates. Data supplied by Flinders Ports suggests that around half of its throughput is linked to negotiated tariff rate arrangements. This provides some evidence that customers have some countervailing bargaining power. However, the Commission notes that this may be the case for some access seekers, but others may not have suitable alternatives, and therefore market power may still exist against those operators.

The Commission notes that, to date, no access dispute has been referred to it under the MSA Act. This may be seen as evidence that negotiations are occurring successfully. However, it may also represent evidence that access seekers may be unwilling to test the dispute resolution process, perhaps wary of resolution costs. The Commission cannot confirm which of these views is correct by observing the absence of disputes on their own.

The Commission also notes that Flinders Ports is continuing to expand into port logistics, and therefore further increasing its vertical integration, which may limit the bargaining power of customers.

#### *Flinders Ports is a price taker*

Flinders Ports contended that, as part of the overall port logistics cost chain, there are significant drivers to ensure that each cost component (transport, storage and handling of cargo to and through ports) is competitive to make the overall solution viable.<sup>29</sup>

The Commission agrees that there is a limit to the amount that Flinders Ports can charge certain access seekers before a transport solution is unviable. However, this only sets a 'ceiling' price and may vary on a case-by-case basis. For example, substitutability for port services may vary between customers and at different points in time. The ability to charge a price above the efficient price may still exist, and is a reflection of the potential to exercise market power.

#### *Commercial incentive to maximise throughput*

Flinders Ports stated that it has a commercial incentive to maximise throughput through its port infrastructure.<sup>30</sup> Central to this argument is the proposition that pricing above an efficient price would

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<sup>25</sup> Flinders Ports submission, p.6.

<sup>26</sup> Flinders Ports, Opportunities and challenges South Australia's Ports, CEDA 2016 Transport and Infrastructure Review, Adelaide October 2016; and Kidson, R. (et. al.), 2015, Impact of increasing container ship size on container handling productivity at Australian ports, Australasian Transport Research Forum 2015 30 September - 2 October 2015, Sydney, p.14 available at: [http://atrf.info/papers/2015/files/ATRF2015\\_Resubmission\\_6.pdf](http://atrf.info/papers/2015/files/ATRF2015_Resubmission_6.pdf).

<sup>27</sup> DPTI, personal communication, February 2017.

<sup>28</sup> Flinders Ports submission, p.7.

<sup>29</sup> Flinders Ports submission, p.7.

<sup>30</sup> Flinders Ports submission, p.3.

result in a decrease in throughput to Flinders Ports, which would reduce revenues and profits. The Commission notes that Flinders Ports, as a commercial business, has an incentive to maximise its profits. However, maximising profits is a function of quantity of demand (throughput) and price. The demand for ports services is dependent on the substitutability of port services. Where no, or limited, substitutes exist, Flinders Ports will have greater ability to increase prices without leading to any significant reduction in demand, which would increase profits. Where substitutes do exist, raising prices may lead to a demand decrease and impact on profits. This is likely to be different for different customers or products. The Commission therefore disagrees with Flinders Ports' general statement that it has an incentive to maximise throughput.

## Viterra

GPSA's submission raised concerns relating to the presence of Viterra's market power, citing Viterra's high proportion of grain storage across South Australia.<sup>31</sup> Viterra did not comment on whether or not it had the potential to exercise market power, but did state that it has not exercised market power over the current prescribed period.<sup>32</sup>

The Commission has concluded that Viterra has the potential to exercise market power, based on:

- ▶ The current market structure of maritime services, which has limited competition, particularly for bulk commodities, and
- ▶ A lack of substitutes for maritime services, at this time and into the next prescribed period.

However, the Commission has not found any evidence of Viterra's market power being exercised over the current prescribed period.

The following discusses the Commission's position, in response to points raised by Viterra in its submission.

### *Reasonableness of prices*

Viterra stated it charged reasonable prices for regulated services throughout the current prescribed period because its prices for port services are comparable with those in most other states.<sup>33</sup> The Commission recognises this is not, in itself, evidence that only efficient costs are being passed through to South Australian customers.

The reasonableness of Viterra's grain storage and bulk handling costs was raised by GPSA in its submission.<sup>34</sup>

### *Significant investment in supply chain infrastructure*

Viterra has stated that it has made significant investment in its port terminal infrastructure and in operational improvements affecting bulk loading facilities at its port terminals.<sup>35</sup> The Commission does not consider this as evidence against the exercise of market power, although it demonstrates some commitment to the long-term provision of ports services to customers.

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<sup>31</sup> GPSA submission, p.2 and p.6.

<sup>32</sup> Viterra submission, p.6.

<sup>33</sup> Viterra submission, p.6.

<sup>34</sup> GPSA submission, p.5. GPSA requested that the South Australian Government undertake an independent review into the grain supply chain. Since receiving GPSA's submission, the Commission has been referred an Inquiry into South Australian bulk grain supply chain costs, available at <http://www.escosa.sa.gov.au/projects-and-publications/projects/inquiries/inquiry-into-the-south-australian-bulk-grain-supply-chain-costs/inquiry-into-the-south-australian-bulk-grain-supply-chain-costs>.

<sup>35</sup> Viterra submission, p.6.



### *Continued provision of access*

In its submission, Viterra stated it has continued to provide open access to a range of exporters without any dispute which is evidence that it is not exercising market power.<sup>36</sup> That submission referred to a regulatory framework under the Port Terminal Access (Bulk Wheat) Code of Conduct (**Code**) imposed on Viterra (Box 3.2) in September 2014. The Code is a mandatory code under the CCA and is administered by the ACCC. The Code applies to all 'port terminal service providers' who provide port terminal facilities capable of handling bulk wheat.

The Commission notes that the Code provides some similar protections for customers as is intended to be provided by the Access Regime. However, the Code only applies to wheat exporters that use Viterra's terminals, not other users. Therefore, the ability for Viterra to exercise its market power is not removed by being subject to the Code. However, it is noted that access has been granted without any dispute. As discussed previously, the absence of access disputes is not itself evidence that market power is not being exercised.

#### **Box 3.2 - Overview of the Port Terminal Access (Bulk Wheat) Code of Conduct**

The Code commenced on 30 September 2014 and regulates the conduct of bulk wheat port terminal operators. It replaced the previous wheat port access regime under the Wheat Export Marketing Act 2008.

The regulations under the Code include:

- ▶ an obligation on all port terminal operators to negotiate in good faith with wheat exporters for access to port terminal services
- ▶ an obligation to comply with 'Continuous Disclosure Rules'
- ▶ obligations on port terminal operators not to discriminate or hinder access in the provision of port terminal services
- ▶ the ability for wheat exporters to seek mediation or binding arbitration on terms of access in the event of a dispute
- ▶ obligations relating to publishing and approval for port loading protocols for managing demand for port terminal services, and
- ▶ publishing requirements.

### *Continued increases in shipping*

Viterra provided evidence that there has been continued increases in grain and other commodities exported from its port terminals (Table 3.2)<sup>37</sup> in support of its view that it is not exercising market power. The Commission does not agree that the level of demand on its own is a dependable indicator of whether or not market power is being exercised, as there are many factors that impact demand (for example, consumer preference). Furthermore, in certain circumstances, increased demand may arise from market power being exercised to increase market share. For example, a port operator could adopt anti-competitive behaviour to remove a competitor from the market to acquire their customers' demand for services.

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<sup>36</sup> Viterra submission, p.7.

<sup>37</sup> Viterra submission, p.6.

Table 3.2: Exports from Viterra operated port terminals in South Australia (tonnes)<sup>38</sup>

Year	Grain ('000)	Salt / gypsum / mineral sands ('000)	Total ('000)
2012	5,857	2,487	8,343
2013	6,593	2,653	9,246
2014	5,877	2,814	8,691
2015	6,597	3,022	9,619
2016 (10 months only)	4,168	2,674	6,843

Note: This compares to a ten-year average of approximately 7.5 million tonnes.<sup>39</sup>

The Commission has examined expected future market conditions to determine if there are likely to be any changes to the potential to exercise market power by both Flinders Ports and Viterra. Both ports service providers are vertically integrated and operate both regulated and unregulated port activities. The Commission concluded that both operators continue to have the potential to exercise market power, but the Commission has not found any evidence of this market power being exercised over the current prescribed period. Furthermore, from the evidence available at this time, on balance, it is unlikely that the potential to exercise market power will change substantially over the next prescribed period.

### 3.3 Access Regime

On the basis of its findings, the Commission recommends the current Access Regime continue for a further five years. This section explains the Commission's Draft Recommendation, which has taken into account:

- ▶ the Access Regime's intended outcomes
- ▶ risks of ineffective access regulation
- ▶ observations relating to the market and the effectiveness of the Access Regime, and
- ▶ options available for regulation, and which one is the most appropriate.

#### 3.3.1 Intended outcomes

The purpose of the Access Regime is to provide for access to monopoly South Australian ports and maritime services on fair commercial terms. It is intended to achieve this through a negotiate/arbitrate framework which encourages the operator and customer to reach agreement on access terms in the first instance. In the event that agreement cannot be reached, the regime provides for a dispute resolution process.

Therefore, the main direct and observable outcome of a successful access regime will be the presence of commercial access agreements reached between the operator (in this case Flinders Ports and Viterra) and its customers.

Providing for fair commercial access to regulated ports and maritime services also promotes the economically efficient operation and use of, and investment in, infrastructure by which these services

<sup>38</sup> Viterra submission, pp.7-8.

<sup>39</sup> Viterra submission, p.8.

are provided. For example, using existing infrastructure where capacity exists, rather than creating new infrastructure, is an efficient outcome. This outcome is more difficult to measure, although some general observations can be made.

**3.3.2 Risks of ineffective access regulation**

In the absence of effective access regulation there is a risk that monopoly port service operators will exercise market power and either prevent access to their ports entirely, or only allow access on unfair terms and conditions (Table 3.3).

Table 3.3: Risk of ineffective access regulation

Risk	Possible scenarios where this may occur	Possible outcomes
Access to port services is denied	Port operator is competing in the same upstream or downstream market as the access seeker, and wishes to stifle competition	<p>Access seeker seeks alternative, higher cost, options. This could include duplication of infrastructure</p> <p>Higher costs could flow through to the end-users if the alternatives to using the ports services are more expensive</p> <p>If alternative options include interstate services, this could result in lost economic activity to the State</p> <p>Loss of revenue over time due to economic inefficiency decreasing throughput. This could reduce the quality of the service, or possibly result in the cessation of the service</p>
Access is granted, but under unfair terms and conditions	Port operator believes that customer has limited choice, and must use the service	<p>Unfair terms and conditions increase the costs to the end-user</p> <p>Potentially costly dispute processes (above the costs associated with the negotiate/arbitrate framework in the Access Regime)</p>

**3.3.3 Observations relating to the effectiveness of the Access Regime over the current regulatory period**

**3.3.3.1 Preventing the exercise of market power**

The Commission has established that the potential to exercise market power currently exists for port operators and that this position is unlikely to change markedly in the next prescribed period (section 3.2). However, it has found no evidence of this market power being exercised within this prescribed period. For example, under the current Access Regime, access has been provided to maritime services on fair commercial terms through the operator and customer reaching agreement on access terms.

It is not possible to directly attribute the non-exercise of market power, on its own, as evidence that the current Access Regime is effective. For example, it may be the case that market power would not have been exercised in the absence of the Access Regime. The case for alternatives to the Access Regime is discussed in the following sections.

### 3.3.4 What options are available, and which one is the most appropriate?

The Commission's Better Regulation Framework provides that a range of feasible policy options must be considered when establishing regulatory arrangements. Consideration should be given to alternatives, having regard to whether the existing regulatory regimes of other jurisdictions might offer a viable alternative.<sup>40</sup>

Furthermore, as explained in section 2.3, the Commission's decisions should be informed by an assessment of the effectiveness in meeting the identified objective, and the costs and benefits for the community as a whole.

In considering whether the current state-based Access Regime should continue for a further five years, it is important to recognise that other access regulation options exist and that the costs and benefits of retaining the state-based Access Regime should be assessed against those other options.

On this basis, the Commission has compared the benefits and costs of the current Access Regime against two alternatives:

- ▶ the National Access Regime, and
- ▶ a new state-based access regime.

In determining the most appropriate access regulation option, the Commission has drawn on the intended outcomes of the Access Regime (section 3.3.1), observations relating to the effectiveness of the Access Regime over the current period (section 3.3.3), the relevant provisions of the ESC Act, recent and emerging market developments (Appendix E), best regulatory practice and stakeholder submissions.

### 3.3.5 Benefits of the existing Access Regime

#### 3.3.5.1 Addresses market power

The Australian Government's 2015 Competition Policy Review recognised participants in port services chains have significant potential to exercise market power, and notes regulators and regulatory frameworks need to recognise this, including through the application of pricing oversight and, if necessary, price regulation.<sup>41</sup> The Commission agrees and, having regard to the market conditions discussed previously, its finding is that there is, and is expected to continue to be, the potential to exercise market power for providers of South Australian ports services.

SAFC agreed, and stated the current Access Regime was achieving its objectives and that it should continue in its current form.<sup>42</sup> It also stated that there was no justification for a more intrusive regime.<sup>43</sup>

It is not possible to directly attribute the absence of market power being exercised as evidence that the current Access Regime is effective. However, given the potential for the exercise of market power by

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<sup>40</sup> Council of Australian Governments (COAG), *Best Practice Regulation Principles*, 2007, p.1.

<sup>41</sup> Australian Government, *Competition Policy Review, Final Report, 2015*, p.208, <http://competitionpolicyreview.gov.au/final-report/>.

<sup>42</sup> SAFC submission, p.1.

<sup>43</sup> SAFC submission, p.2.

providers of ports services, there are grounds for continuing some form of access regulation at this time.

Furthermore, the absence of any evidence that market power is being exercised also supports a view that the prescriptiveness of access regulation does not need to increase at this time.

### **3.3.5.2 Flexibility to respond to local conditions**

Industries and jurisdictions have different characteristics, and regulatory principles are deliberately flexible in order to take these characteristics into account. The National Ports Strategy suggests outcomes of regulation need to be regional or state-based to be best able to respond to regional issues and the diversity in ports.<sup>44</sup> As a state-based regime, the Access Regime can be responsive to changes in South Australian economic conditions. For example, it provides a flexible negotiation framework, and infrastructure can be brought into or out of its scope through a known process as the need arises.

In its submission, Flinders Ports stated that there was no evidence to suggest that the current Access Regime requires changing to provide flexibility to address foreseeable trends.<sup>45</sup>

### **3.3.5.3 Provides certainty**

The Access Regime is known and understood by industry participants. This familiarity with the regime engenders certainty, making for a stable operating environment. Consistency, predictability and transparency of economic regulation are often sought by industry and consumers as a means of reducing their level of risk (reducing regulatory uncertainty). As discussed below, the alternative access pathways under the National Access Regime are less certain (in terms of the process for seeking access) than those of the Access Regime.

### **3.3.5.4 Stakeholder views**

No submissions raised concerns about the Access Regime, and most submissions supported no change to the current arrangements.

## **3.3.6 Costs of the existing Access Regime**

Any regulatory regime will have compliance costs for ports service operators, costs for access seekers to apply in accordance with the regime, and costs incurred by the regulator for overseeing the regime. Ultimately, all of these costs will be borne by the customers of the ports services.

The Commission sought information from stakeholders on the costs of the current Access Regime. Most were unable to provide quantifiable information.

Given its non-intrusive nature, the Access Regime is considered to have low compliance costs. This aligns with the Better Regulation Principles that regulation should 'avoid unnecessary compliance costs and restrictions on competition.'<sup>46</sup>

The Commission annually publishes its costs of administering the Access Regime. These costs cover activities including the receipt of lodged compliance reports, answering customer queries and conducting reviews such as this one. In the past five years, the average annual cost for the Commission has been approximately \$151,000. Table 3.4 shows the Commission's Access Regime related costs for each of the last five financial years. The expenses for the 2016-17 year are relatively higher than the previous year due to the costs associated with conducting this Review.

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<sup>44</sup> Infrastructure Australia and National Transport Commission, *National Ports Strategy, 2011*, available at <https://www.coag.gov.au/sites/default/files/National%20Ports%20Strategy.pdf>.

<sup>45</sup> Flinders Ports submission, p.9.

<sup>46</sup> COAG, *Best Practice Regulation, 2007*, p.1.

Table 3.4: The Commission's annual Access Regime costs

Year	Expense
2012-13	\$104,982 <sup>47</sup>
2013-14	\$156,094
2014-15	\$78,651
2015-16	\$102,191
2016-17	\$314,734

### 3.3.7 Benefits of the National Access Regime

The Access Regime fits within the broader National Access Regime, established under Part IIIA of the CCA and clause 6 of the Competition Principles Agreement (CPA). The National Access Regime is an alternative option for access under Part III of the CCA. The key elements of the National Access Regime are listed in Box 3.3.

#### Box 3.3 - The National Access Regime

The National Access Regime allows for a person to seek access to essential infrastructure services under four possible pathways:

- ▶ A party can seek 'declaration' of an infrastructure service by the Minister responsible for the CCA, subject to criteria set out in section 44G(2) of the CCA.<sup>48</sup> If the infrastructure services are declared, the infrastructure service provider is required to negotiate access with the access seeker. The ACCC acts as arbitrator should negotiations fail.
- ▶ Access may be sought under the terms and conditions of an access undertaking approved by the ACCC.
- ▶ Access may be sought for Government-provided infrastructure services under terms that have been established through a competitive tendering process approved by the ACCC.
- ▶ Access may be sought under the terms of a State or Territory-based access regime certified by the Minister responsible for the CCA as effective. The Access Regime under the MSA Act is a certified state-based regime.<sup>49</sup>

<sup>47</sup> In 2012-13 there was a transfer of accumulated ports regulation surpluses of \$657,000 from the Commission to the South Australian Government, which is not displayed on this table.

<sup>48</sup> Those criteria are:

- (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
  - (i) the size of the facility; or
  - (ii) the importance of the facility to constitutional trade or commerce; or
  - (iii) the importance of the facility to the national economy;
- (d) [repealed]
- (e) that access to the service is not already the subject of [an access regime that has been certified as effective unless there have been substantial modifications to the regime or the relevant principles since the regime was certified];
- (f) that access (or increased access) to the service would not be contrary to the public interest.

<sup>49</sup> The current Ports Access Regime has been certified by the National Competition Council (NCC) as an effective state-based access regime for 10 years from 9 May 2011. Consequently, the regime is not ongoing as such, implying a need to justify continuation to the NCC in lead up to 2021. The forthcoming regulatory period begins in 2017, so a recommendation to

Pathways 2 to 4 create specific frameworks that facilitate third party access to specified infrastructure services. If, for a particular infrastructure service, there are no approved arrangements under pathways 2 to 4, a party may request that the service be 'declared' under pathway 1. It is only in the case that there are no approved arrangements under any of pathways 2 to 4 that the declaration pathway can be used. The declaration pathway means the potential for access regulation of an essential infrastructure service always exists.

The terms and conditions of access can vary under any of the four access pathways, and the basis of access regulation can range from highly flexible to highly prescriptive, depending on the approved terms.

One potential benefit from replacing the Access Regime with one of the non state-based options under the National Access Regime is regulatory consistency across states. However, each jurisdiction has designed and implemented regional, focused and tailored legislation to address monopoly ports services in its state (Box 3.4). Therefore, at this time, this benefit would not be realised.

#### **Box 3.4 - Overview of Interstate regulatory regimes**

In the Northern Territory, the Utilities Commission's regulatory role relates to prescribed services provided by the port operator, and is also responsible for monitoring the prices of prescribed services.

Queensland has a certified ports access regime, but that regime is a facility-based access arrangement. The Queensland Competition Authority Act 1997 establishes a two-step 'declaration negotiation/arbitration' regime for the purpose of enabling third-party access to significant infrastructure.

New South Wales and Victoria have implemented price monitoring for certain port services at some ports. The New South Wales port price monitoring scheme applies to all ports in New South Wales and to all port operators. Port operators are required to publish information on charges, provide reports to the Minister, and publish notifications of price changes. Victoria applies price monitoring at certain ports on the basis that there is a potential for some port operators to exercise market power. Under the Victorian ports price-monitoring framework, port operators are required to maintain a published Reference Tariff Schedule, which provides a 'standing offer' of terms and conditions upon which prescribed services will be made available.

Ports in Western Australia are operated by four port authorities, which are semi-autonomous government trading enterprises, with their own boards of directors and management structures. As such, the Economic Regulation Authority's powers of economic regulation are not currently applied to the ports sector. Similar to Western Australia, Tasmanian ports are government-owned through the Tasmanian Ports Corporation. The ports are not subject to specific access regulation, nor is there regulation of fees and charges.

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extend for a further five years would lead to an end date of 2022, past the current certification term. Acquiring certification is a matter for the South Australian Government.

### 3.3.8 Costs of the National Access Regime

The administrative and compliance costs associated with the National Access Regime have been described by market participants as ‘substantial’,<sup>50</sup> and the decision-making processes have been described as ‘long’ and having an adverse effect on investment decisions.<sup>51</sup>

Under the declaration pathway of the National Access Regime, access providers may face costs relating to applications for declaration, as well as costs associated with the time taken in relation to submitting and responding to a declaration application. Direct costs of applications for declaration can include direct fees plus costs associated with writing and responding to applicants, management’s time, the use of consultants, and in some cases substantial legal costs.<sup>52</sup>

Access seekers and providers can also face costs associated with the time taken to submit and respond to a declaration application. These include losses due to uncertainty and delays. The time taken to resolve applications can extend to 12 months.<sup>53</sup>

Changing from the current Access Regime may also have transitional costs, including administrative costs.

A move to the National Access Regime may contradict one of the key considerations of regulation, which is to minimise regulatory cost. While not quantified, given these costs, and the potentially small benefit gained from moving to the National Access Regime, the Commission accepts that a move to the National Access Regime would not produce greater net benefits than the existing regime.<sup>54</sup>

### 3.3.9 Conclusion on the continuation of the Access Regime

The Commission has reached the draft conclusion that ports service providers have the potential to exercise market power, although there has been no evidence to suggest that this power has been exercised (section 3.2.2).

The Commission is unable to directly attribute the absence of market power being exercised, on its own, as evidence that the current Access Regime is effective (section 3.3.5.1). However, given the potential for the exercise of market power for providers of ports services, the Commission has formed the view that there are benefits in continuing access regulation at this time (section 3.3.5.1).

The Commission has concluded that any alternative access regime must have additional benefits, or reduced costs, in comparison to the current Access Regime for it to be a better regulatory option. On the basis of the Commission’s assessment of the potential costs and benefits of the alternatives (sections 3.3.7 to 3.3.10), it has reached the draft conclusion that, on balance, there would be no net benefits in moving to an alternative access regime at this stage, and that the current Access Regime continue for a further five years. This view is shared by Iluka,<sup>55</sup> and SAFC.<sup>56</sup>

## 3.4 Pricing Regime

On the basis of its findings, the Commission’s Draft Decision is the current Pricing Regime continue for a further five years. This section explains the Commission’s decision, which has taken into account:

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<sup>50</sup> Productivity Commission, *National Access Regime, 2013*, p.11, available at <http://www.pc.gov.au/inquiries/completed/access-regime/report>.

<sup>51</sup> Productivity Commission, *National Access Regime, 2013*, p.27.

<sup>52</sup> Productivity Commission, *National Access Regime, 2013*, p.238.

<sup>53</sup> Productivity Commission, *National Access Regime, 2013*, p.238.

<sup>54</sup> Productivity Commission, *National Access Regime, 2013*, p.272.

<sup>55</sup> Iluka submission, p.1.

<sup>56</sup> SAFC submission, p.1.



- ▶ the Pricing Regime's intended outcomes
- ▶ risks of ineffective price regulation
- ▶ observations relating to the effectiveness of the Pricing Regime, and
- ▶ what options are available, and which one is the most appropriate.

### 3.4.1 Intended outcomes

The primary purpose of the Pricing Regime is to protect the long-term interests of port customers by ensuring that prices are fair and reasonable. As discussed in section 3.4.4, there are several methods available to the Commission that can be used to assess whether or not this outcome is being achieved.

Prices play a large part in promoting the economically efficient operation and use of, and investment in, port infrastructure. As stated in section 3.3.1, using existing infrastructure where capacity exists, rather than creating new infrastructure, is an efficient outcome. As also stated in that section, these outcomes are difficult to measure, although some general observations can be made.

### 3.4.2 Risks of ineffective price regulation

In the absence of price regulation, there is a risk that monopoly port operators will exercise market power if they have it, and charge prices that result in the under-recovery, or over-recovery, of the efficient costs of providing port services (Table 3.5).

### 3.4.3 The current pricing-related controls

Under current regulatory arrangements, the pricing-related outcomes identified above are designed to be achieved through both the Ports Access and Pricing Regimes. Taken together, these regimes offer the following:

#### 3.4.3.1 A focus on reaching agreement on prices through commercial negotiations

The Access Regime provides a negotiate/arbitrate framework which promotes potential access seekers and port operators to reach a commercial agreement on accessing port services covered by the Access Regime (**Regulated Services**) in the first instance. This includes reaching agreement on prices for those services.

Table 3.5: Risk of no price regulation

Risk	Possible scenarios where this might occur	Possible outcomes
Operator charges prices leading to under-recovery of efficient costs	Port operator is competing in the same market as the access seeker, and wishes to stifle competition by undercutting its competitor's prices	<p>In the short-term, efficient competition in ports services is stifled</p> <p>In long-term, insufficient investment in ports services occurs, resulting in a loss of quality or cessation of these services, or a large increase in costs to retain service quality</p> <p>To recoup previous underinvestment, higher costs could flow through to end-users of ports services in the long-run, leading to increased prices for transported goods</p>
Operator charges prices leading to over-recovery of efficient costs	Port operator believes that customer has limited choice, and must use the service	<p>Access seeker seeks alternative, higher cost, options. This could include the duplication of infrastructure</p> <p>Higher costs could flow through to end-users of ports services leading to increased prices for transported goods</p> <p>If alternative options include interstate services, this could result in lost economic activity to the State</p> <p>Loss of revenue over time due to economic inefficiency decreasing throughput. This could reduce the quality of the service, or possibly result in the cessation of the service</p>

### 3.4.3.2 Pricing principles where an agreement cannot be reached

In the event that an agreement cannot be reached, and a dispute exists, the matter can be referred to arbitration where an independent third party (the arbitrator) can make a binding decision (or an award) relating to the price of access to a service. If such an instance arises, the arbitrator should take into account the pricing principles contained in section 32(2) of the MSA Act (Box 3.5).

**Box 3.5 - Pricing principles relating to the price of access to a service that the arbitrator should take into account when making an award.**

(2) The pricing principles relating to the price of access to a service are as follows:

- (a) that access prices should allow multi-part pricing and price discrimination when it aids efficiency
- (b) that access prices should not allow a vertically integrated operator to set terms and conditions that would discriminate in favour of its downstream operations, except to the extent that the cost of providing access to others would be higher
- (c) that access prices should provide incentives to reduce costs or otherwise improve productivity.

### **3.4.3.3 Provision of pricing-related information to assist an access seeker**

To assist in these commercial negotiations, the Access Regime requires a regulated operator to provide certain price information relating to a regulated service, to a prospective access seeker. The purpose of this requirement is to:

- ▶ allow the access seeker to determine whether or not to seek access, and
- ▶ avoid the risk that a regulated operator might disrupt or curtail access by not supplying or delaying the supply of information, or seek to influence price outcomes above fair commercial levels by supplying incomplete or misleading price information.

Section 8 of the MSA Act requires a regulated operator to maintain a schedule of current pilotage charges and to provide this schedule to a member of the public on request.

Section 12 of the MSA Act requires a regulated operator to provide preliminary information about regulated services to a potential access seeker if requested. Section 12(1)(b) requires they provide information about the price of regulated services, subject to guidelines issued by the Commission.

At this time, the Commission has issued a guideline that sets out the Commission's requirements for the price information that a regulated operator is to provide. This includes a requirement for a regulated operator to develop pricing information (in the form of a Price Information Kit), covering all regulated services that it provides in any proclaimed port. This Price Information Kit must include:

- ▶ the current price list for EMS and schedule of pilotage charges
- ▶ a statement as to the regulated operator's general pricing policies for any other regulated services, including indicative price ranges where appropriate, and
- ▶ a statement informing access proponents that if their requests involve new capital investments then the price information provided may require adjustment to reflect those additional capital costs, and noting that both parties will need to discuss such requests further in good faith.

There is also a requirement for a regulated operator to publish its Price Information Kit on its website, and have operating procedures in place that ensure access seekers are directed to its website.

In addition to the pricing-related requirements arising from the MSA Act described above, the Commission also used its powers under 25(2) of the ESC Act to make a price determination for the period 2012-2017 in respect of essential maritime industries within the meaning of the MSA Act.<sup>57</sup>

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<sup>57</sup> Under section 25(2) of the ESC Act, the Commission may only make a price determination if authorised to do so by a relevant industry regulation Act or by regulation under the ESC Act. Pursuant to regulation 3 of the Essential Services

As described in section 2.5.2.4, the Commission implemented a price monitoring framework, whereby it monitors, and reports on, prices for EMS. The purpose of these reports is to provide South Australian port customers, and the community, with information regarding certain port costs at South Australian proclaimed ports.<sup>58</sup> They also serve to inform the Commission of trends and drivers of ports prices. Under the present ports price monitoring regime, the Commission does not collect any data on actual ports charges that have been negotiated between ports users and Flinders Ports. These commercially negotiated charges may be below those published in the pricing schedule.

### 3.4.4 Observations relating to the effectiveness of the Pricing Regime over the current period

The following describes the Commission's observations relating to the effectiveness of the Pricing Regime over the current regulatory period, when compared to its intended outcomes.

#### 3.4.4.1 Intended outcome: fair and reasonable prices

The Commission has assessed this outcome by considering the following:

- ▶ the extent to which customers are entering into commercial agreements to use Maritime Services
- ▶ where agreements are being entered into, whether or not the commercially negotiated charges are below those in the published pricing schedule, and
- ▶ whether or not port operators have been earning excessive profits.

##### *The presence of customers entering into commercial agreements to use Maritime Services*

The extent to which customers are entering into commercial agreements to use Maritime Services provides an indication of whether or not the Pricing Regime is facilitating negotiated outcomes. As part of this Review, the Commission has received information from Flinders Ports and Viterra which indicates that ports users have been successfully entering into commercial contracts.

Furthermore, between 2012-2017 the Commission did not receive any dispute or complaints, relating to pricing. As mentioned in section 3.2.2 of this report, both Flinders Ports and Viterra raised the lack of disputes in their submissions.<sup>59</sup> That section of this Draft Report also notes the difficulty of relying solely on a lack of disputes as a conclusive indicator of success of access regulation. The same challenges arise in the case of price regulation. Furthermore, as previously discussed, it is recognised that some customers may have a reduced ability to use alternatives to Maritime Services.

However, when considered together, the absence of disputes and the presence of commercial agreements can be used as evidence to reasonably conclude that the current arrangements are allowing for commercial outcomes to be realised.

##### *Where agreements are being entered into, whether or not the commercially negotiated charges are below those in the published pricing schedule*

The presence of commercial agreements does not indicate whether or not efficient prices are being charged by port operators. Assuming that agreements are being entered into, whether or not the commercially negotiated charges are below those in the published pricing schedule provides some indication on the bargaining power of customers, and may be an indicator that more efficient prices are being charged. As part of this review, the Commission has received information, provided by Flinders

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Commission Regulations 2004, the Commission is authorised to make a price determination in respect of essential maritime industries, within the meaning of the MSA Act.

<sup>58</sup> The Commission's Price Monitoring Reports, available at <http://www.escosa.sa.gov.au/industry/ports/pricing-access/price-monitoring>.

<sup>59</sup> Flinders Ports submission, p.3; Viterra submission, p.7.

Ports and Viterra, which indicate that ports users had been successfully negotiating contracts below the published ports charges over the current regulatory period.

However, it is noted that not all customers will have the bargaining power to negotiate agreements at a price less than the published rates.

*Whether or not port operators have been earning excessive profits*

Although a significant number of commercial agreements are negotiated at a price less than the published price, it is still possible port operators are earning excessive profits.

In order to satisfy itself whether this is the case, the Commission undertook an assessment of regulatory accounts submitted by Flinders Ports. Based on that assessment, there is nothing to suggest that Flinders Ports has earned excessive profits over the current regulatory period.

The Commission has also taken into account benchmarking of ports charges<sup>60</sup> conducted by GHD<sup>61</sup> on behalf of the Commission, which showed that ports charges in South Australia are generally comparable to other Australian ports. Box 3.6 summarises the key findings of this study.

**Box 3.6 - Key findings of the 2017 Port Price Benchmarking Study**

- ▶ Over the last five years, published EMS port charges of the six South Australian proclaimed ports have increased the least compared with the other comparator interstate ports.
- ▶ Over the last five years, Pilotage charges around Australia have generally increased in excess of 20 percent, with the largest increases at the ports of Port Kembla and Sydney (New South Wales), and at the port of Fremantle (Western Australia). The Pilotage charge increase at South Australian ports (26 percent) is around the mid-point of the comparator ports.
- ▶ In terms of total port call costs in 2017, the South Australian proclaimed ports are generally in the lower range of total port call costs compared to the relevant interstate comparator ports which may suggest a combination of one or more of the following factors at play: competitive pricing, relatively low cost bases, and efficiencies given trade volumes and cargo mixes.
- ▶ The relative position of total port call costs of South Australian proclaimed ports has improved over the last five years (since 2012) due to the lower rate of increase in port charges compared with the other interstate ports.

These assessments are consistent with the finding arising from the Commission's price monitoring through the current period. Table 3.6 displays the recent price increases from the Commission's 2016 Ports Price Monitoring Report,<sup>62</sup> and Chart 3.1 shows the price movements for port charges compared to CPI since 2004-05.

<sup>60</sup> The study used similar methods, assumptions and framework as was used to undertake the 2012 port price benchmarking study.

<sup>61</sup> Refer to GHD report, available at <http://www.escosa.sa.gov.au/ArticleDocuments/1024/20170424-PortsPricingAccessReview2017-BenchmarkingStudy-GHD.pdf.aspx?Embed=Y>.

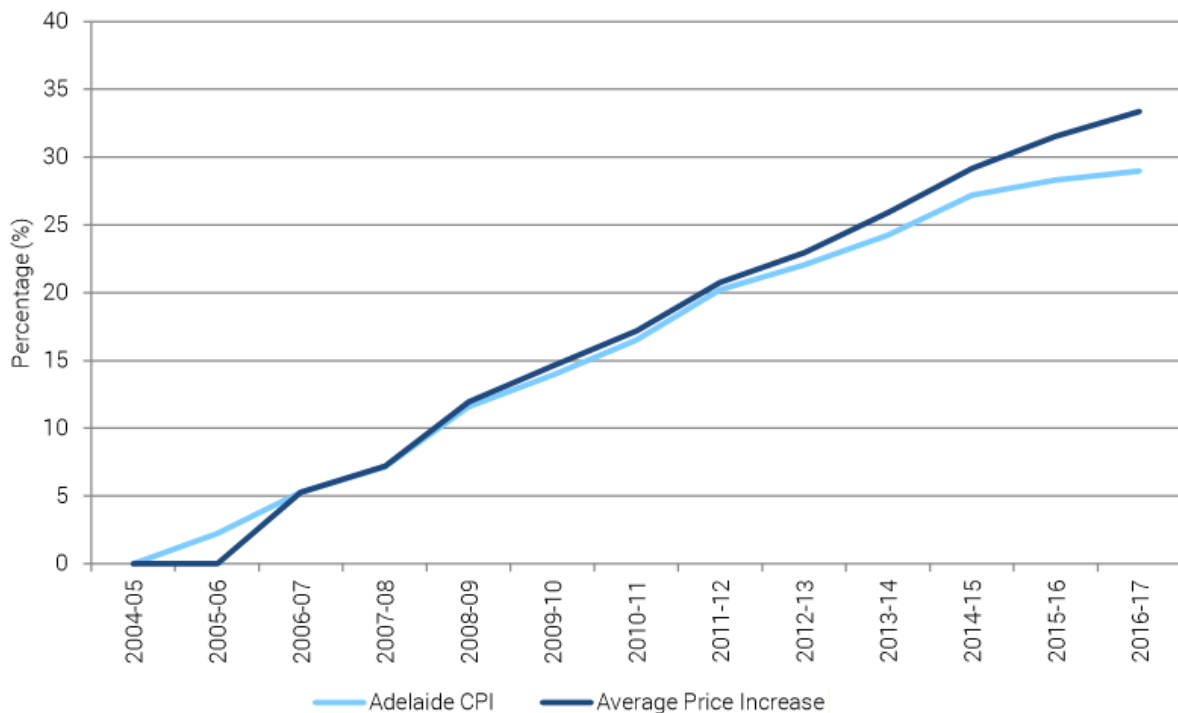
<sup>62</sup> The Commission's 2016 Ports Price Monitoring Report, available at <http://www.escosa.sa.gov.au/ArticleDocuments/1056/20161212-Ports-2016PortsPriceMonitoringReport.pdf.aspx?Embed=Y>, p.9.

Table 3.6: Port service charges - change and comparisons with CPI 2011-12 to 2016-17<sup>63</sup>

Port service	Average annual price increase	Increase above CPI
Cargo (EMS)	0.9%	0.2%
Harbour (EMS)	2.7%	2.0%
Navigational (EMS)	1.9%	1.2%
Pilotage	4.5%	3.8%

Over a longer period of 12 years, EMS prices have been broadly in line with CPI (Chart A). However, over the current regulatory period (2012-2017) EMS prices have increased by more than CPI. Flinders Ports has provided explanations for those price increases, which are reported in the Commission’s Ports Price Monitoring Reports.<sup>64</sup> The key drivers underpinning the above-CPI price increases for EMS were increased wage costs for all services, and the continued recovery of costs associated with the introduction of a Vessel Tracking System (VTS) through Navigational Service charges. These are briefly discussed below. These prices are not, in themselves, a reflection of the profitability of Flinders Ports, as reflected in the findings of the Commission’s profitability of Flinders Ports.

Chart A: Movement of cumulative average EMS prices relative to CPI (nominal)



Source: Flinders Ports and ABS CPI data

<sup>63</sup> Adelaide March 2015 to March 2016 annual CPI increase was 0.7 percent.

<sup>64</sup> The Commission’s Ports Price Monitoring Reports, available at <http://www.escosa.sa.gov.au/industry/ports/overview/ports-overview>.

### *Wage costs*

- ▶ Flinders Ports has previously advised that the above-CPI price adjustment to EMS and Pilotage charges reflects the outcomes of Enterprise Bargaining Agreements (**EBA**) negotiated between Flinders Ports and maritime unions. Flinders Ports entered into separate EBAs relating to EMS and Pilotage. The EBA relating to EMS runs from 2015 to 2018 and provides for a wage increase of two percent. The EBA relating to Pilotage runs from 2014 to 2018 and provides for an average wage increase of 3.5 percent.

### *Navigational Service Charges*

- ▶ The average annual price increase for Navigational Service charges has been 1.9 percent. Approximately half of this increase is attributable to the implementation of a new VTS, introduced to improve the safety of navigational operations at the ports.<sup>65</sup>

### *Pilotage costs.*

- ▶ There are various factors that can influence Pilotage costs, including, but not limited to: pilotage distance, salaries of pilots and boat crew, navigational hazards, and the number of vessel calls. Flinders Ports has advised that the key drivers underpinning above-CPI price increases for Pilotage has been increased wage costs and depreciation charges (associated with Flinders Ports' acquisition of two new pilot vessels needed to replace old vessels).

Flinders Ports has advised the Commission that ports users were consulted prior to the implementation of all price increases throughout the period, and that no concerns relating to these prices were raised. In addition, no concerns have been raised with the Commission over price increases following their publication by Flinders Ports.

In general, the Commission's assessments of the information provided by Flinders Ports to justify the real increases in both EMS and Pilotage charges during the current regulatory period have found no particular areas of concern. The 2017 Ports Price Benchmarking Study confirms that ports prices are at the low end of the range of interstate ports comparators and have increased the least over the past five years.<sup>66</sup>

In addition, in 2013 the Commission engaged BDO Australia Pty Ltd (**BDO**) to perform a review of the Regulatory Accounts of Viterra and Flinders Ports and provide advice to the Commission. This review was undertaken to provide assurance that the ring-fencing principles were being correctly applied and the desired outcomes achieved, in response to stakeholder concerns over the adequacy of the accounting ring-fencing arrangement to deal with anti-competitive behaviour.<sup>67</sup> BDO's final report indicated no area of concern.

Taken together, the above points indicate ports charges appear to have been fair and reasonable over the current regulatory period.

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<sup>65</sup> In 2013 the Australian Maritime Safety Authority issued a Marine Order under the Navigation Act 2012 which provides regulatory requirements for a VTS, which applies to Flinders Ports.

<sup>66</sup> Refer to GHD report, available at <http://www.escosa.sa.gov.au/ArticleDocuments/1024/20170424-PortsPricingAccessReview2017-BenchmarkingStudy-GHD.pdf.aspx?Embed=Y>.

<sup>67</sup> The Commission's 2012 *Ports Pricing and Access Regime*, p.47 <http://www.escosa.sa.gov.au/projects-and-publications/projects/ports/ports-pricing-and-access-review-2012>.

*Intended outcome: Economically efficient operation and use of, and investment in, ports and maritime infrastructure*

In the long-term, the economically efficient operation and use of, and investment in, ports and maritime infrastructure will be promoted by charging efficient prices for those services. Measuring this in the short-term largely relies on the assessments made in the section above.

The Commission has not received any complaints relating to underinvestment or overinvestment of port infrastructure as part of this Review, but, as discussed in Appendix E, there is some suggestion that there is significant investment required to develop South Australian ports to cater for trends in vessel sizes.

### 3.4.5 What options are available, and which one is the most appropriate?

In determining the most appropriate price regulation option, the Commission has drawn on the intended outcomes of the Pricing Regime (section 3.4.1), observations relating to the effectiveness of the Pricing Regime over the current period (section 3.4.4), the relevant provisions of the ESC Act, recent and emerging market developments (Appendix E), best regulatory practice and stakeholder submissions.

Having established that the Access Regime should continue in section 3.3.9, the pricing-related controls within that regime would, if agreed by the Minister, therefore continue for a further five years.

Therefore, with respect to the Pricing Regime, the only matters for the Commission to consider at this time are:<sup>68</sup>

- ▶ whether or not it should make another price determination and, if so, the form of price regulation to adopt, and
- ▶ whether or not it should amend the Price Information Kit.

To aid these considerations, the costs and benefits of those options are discussed below.

### 3.4.6 Benefits of the existing Pricing Regime

At this time, the Commission has concluded that the current price monitoring arrangements are beneficial to consumers of maritime services, and exist primarily to increase price disclosure under certain circumstances.

The current approach of requiring Flinders Ports to publish its EMS Prices, and the Commission monitoring price movements against CPI, was adopted following the 2007 Ports Access and Pricing Review (**2007 Review**). At that time, it was concluded that such an arrangement promoted price disclosure above that offered by the Access Regime, was simple to administer, and was standard practice used by both port operators and regulators.<sup>69</sup>

The Commission recognises that there are limitations to price monitoring: it has received submissions in previous reviews,<sup>70</sup> questioning whether or not the current price monitoring approach provides sufficient incentives for a port operator to improve both efficiency and productivity. In particular, it has been argued that the current approach does not adequately incentivise Flinders Ports to make efficiency gains as it allows for CPI increases without improvements in efficiency and/or productivity.

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<sup>68</sup> The Commission has made an observation about the scope of the Price Regime that applies under the MSA Act in Chapter 4.

<sup>69</sup> The Commission's *Ports Access and Pricing Review 2007*, available at: <http://www.escosa.sa.gov.au/projects-and-publications/projects/ports/ports-pricing-and-access-review-2007>.

<sup>70</sup> Select Committee on the Grain Handling Industry, Submission to the *2012 Ports Pricing and Access Review Draft Report*, 18 July 2012, p.2.



Evidence discussed earlier in this chapter indicates that Flinders Ports is acting relatively efficiently compared to other comparable port operators. While Flinders Ports is experiencing cost pressures similar to those of other port operators (for example, wages), price increases have been kept to a level below comparable ports.

It is the Commission's view that the benefits of the price disclosure arrangements in the current Pricing Regime, in addition to those benefits already offered through the Access Regime, include:

- ▶ The value of pricing information for access seekers. Open and transparent information exchange between parties can encourage commercial outcomes. While it is recognised that the price information requirements in the Access Regime, in conjunction with the Price Information Kit, could be sufficient to achieve this information exchange, there is likely to be some value in potential access seekers having this information prior to approaching port operators.
- ▶ Having information available to the public and the Commission, to monitor price trends. This includes a requirement that port operators explain price rises beyond general inflation, provides further information on drivers of price movements in the sector.

While it is difficult to quantify the benefits of ports price monitoring, the Commission notes that its price monitoring reports have been accessed via the Commission's website around 200 times a year over the current regulatory period.

### **3.4.7 Costs of the existing Pricing Regime**

It has not been possible to separate the costs directly attributable to the Price Regime from the other costs identified in section 3.3.6. However, the Commission estimates that approximately half of its average annual port-related costs (or approximately \$75,500 per year) relates to its port monitoring functions.

There is a question as to whether or not the current outcomes could be achieved at a lower cost. For example, the Commission has considered collecting and publishing price monitoring information less frequently than annually. This is discussed in section 3.4.9.

### **3.4.8 Benefits and costs of further price regulation**

Section 25(3) of the ESC Act specifies the range of price regulation approaches that are available to the Commission when making a price determination. These can range from those that are not determinative in nature (for example, price monitoring), to those that are considered more prescriptive (for example, price setting) (Box 3.7).

Considering the options in Box 3.7, the two broad approaches the Commission could adopt for South Australian ports charges would be to specify pricing principles for port services, or fixing prices for those services based on selected criteria (for example, maximum price or average revenue). The following sections discuss the benefits and costs of these approaches.

### **Box 3.7 - Price regulation options available to the Commission under the ESC Act**

25(3) A price determination may regulate prices, conditions relating to prices or price-fixing factors in a regulated industry in any manner the Commission considers appropriate, including:

- (a) Fixing a price or the rate of increase or decrease in a price;
- (b) Fixing a maximum price or maximum rate of increase or minimum rate of decrease in a maximum price;
- (c) Fixing an average price for specified goods or services or an average rate of increase or decrease in an average price;
- (d) Specifying pricing policies or principles;
- (e) Specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed or any other specified factor;
- (f) Specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the supply of goods or services;
- (g) Fixing a maximum average revenue, or maximum rate of increase or minimum rate of decrease in maximum average revenue, in relation to specified goods or services; and
- (h) Monitoring the price levels of specified goods or services.

#### **3.4.8.1 Benefits of pricing principles/price fixing**

The purpose of pricing principles is to provide guidance to service providers when setting prices. For example, pricing principles can provide guidance around the level and structure of prices. If pricing principles were to be specified by the Commission, they would have to be consistent with, and be an improvement on, those pricing principles in section 32 of the MSA Act (refer to Box 3.5).

Considering that the current Pricing Regime is meeting its intended outcomes, the absence of any evidence of pricing-related disputes, and the results of the profitability and benchmarking studies, the Commission believes there is no benefit in specifying pricing principles beyond those contained in the MSA Act at this time.

A potential benefit of price fixing is a greater assurance to customers that prices, set by the Commission, reflect efficient costs. However, the Commission has not cited evidence indicating that prices are significantly above efficient costs. The price benchmarking and profitability analysis discussed in section 3.4.4 supports that draft finding.

#### **3.4.8.2 Costs of pricing principles/price fixing**

There would be costs associated with specifying pricing principles and fixing prices. These costs would include development and ongoing costs, and could vary substantially depending on the level of prescription. For example, the setting of broad pricing principles may only require initial costs<sup>71</sup> to develop compared with price fixing which could include substantial development and ongoing costs, for example to ensure tariffs accurately reflect the actual efficient costs of the business.

The costs of these have not been estimated by the Commission. However, in a recent review conducted by Frontier Economics, it was found that the regulatory costs of undertaking cost-based water pricing reviews, where prices or revenue have been fixed by the regulator, are between \$1m and \$2.75m per

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<sup>71</sup> These costs would include costs for the Commission to establish and consult on these principles.

regulatory decision.<sup>72</sup> The cost of developing pricing principles is, however, likely to be much lower than that.

The pricing principles in the MSA Act allow for price discrimination (section 32). This means that prices for some port services could be priced differently according to customer.<sup>73</sup> While not a cost, this could complicate the fixing of prices for these services. The Commission therefore sees no benefit in fixing port prices at this time.

Given no real benefits of increasing the level of prescription of price regulation have been identified at this stage, these costs would outweigh the benefits for ports.

### 3.4.8.3 Other considerations

The Commission notes that the ACCC has recently stated that price monitoring on its own is not an appropriate form of price regulation, as it fails to ensure there is an effective constraint on monopoly pricing at Australian ports.<sup>74</sup> However, this view is made on the basis that price monitoring exists in the absence of any other form of regulation (for example, the potential for arbitration). That is not the case for the SA ports regime, as explained in this Draft Report. Furthermore, the ACCC recognises that price monitoring can be useful to increase transparency and address a high level of community concern.<sup>75</sup>

Flinders Ports stated it would continue to adopt pricing practices and enter into pricing negotiations to ensure satisfactory outcomes for port users without the need for price regulation.<sup>76</sup> It stated price regulation was not necessary, as the market in which it operates is mature with a range of countervailing pressures which ultimately result in negotiated, agreed, outcomes.<sup>77</sup>

The RMIP states any new ports will require 'price regulation' (including the methodology for calculating loading fee at the port).<sup>78</sup> This indicates that it is the South Australian Government's intention to continue to have some form of price regulation into the future.

### 3.4.8.4 Conclusion on further price regulation

On balance, with the information available to the Commission at this time, the continuation of a price monitoring regime, and the requirements relating to the Price Information Kit, provide the most targeted and proportionate price regulation framework to accompany the Access Regime in the MSA Act for the next five years. However, the Commission has proposed changes to the current price monitoring framework as discussed below.

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<sup>72</sup> Frontier Economics: *Improving Economic Regulation of Urban Water*, 2014, p.16.

<sup>73</sup> However, this cannot be anti-competitive. In such an instance this could be referred to the ACCC. Furthermore, the Act also covers such a scenario of cross-subsidising in section 32(2)(b).

<sup>74</sup> Simms R, Ports: What measure of regulation?, Ports Australia Conference, Melbourne, 20 October 2016, <http://www.accc.gov.au/speech/ports-what-measure-of-regulation>.

<sup>75</sup> Simms R, Ports: What measure of regulation?, Ports Australia Conference, Melbourne, 20 October 2016, <http://www.accc.gov.au/speech/ports-what-measure-of-regulation>.

<sup>76</sup> Flinders Ports submission, p.3.

<sup>77</sup> Flinders Ports submission, p.4.

<sup>78</sup> South Australian Government, *Regional Mining and Infrastructure Plan, 2014*, p.34, [http://infrastructure.sa.gov.au/\\_data/assets/pdf\\_file/0011/132797/Regional\\_Mining\\_and\\_Infrastructure\\_Plan.pdf](http://infrastructure.sa.gov.au/_data/assets/pdf_file/0011/132797/Regional_Mining_and_Infrastructure_Plan.pdf).

### 3.4.9 Form of price monitoring

Having established that there is overall value in price disclosure in the form of price monitoring, beyond that contained in the MSA Act provisions, the question is: what form should it take? As discussed earlier, to achieve the intended outcomes, the regime must monitor price trends and include a requirement for port operators to explain price rises.

The two matters that the Commission has considered are:

- ▶ the frequency of price monitoring, and
- ▶ the index to which to compare price rises.

#### 3.4.9.1 The frequency of price monitoring

The Commission has considered collecting and publishing price monitoring information less frequently. Due to the five-yearly regulatory cycles of the prescribed periods, the logical alternative to annual reporting would be to publish once every five years.<sup>79</sup>

Publishing its price monitoring reports once every five years could save the Commission, and therefore the government, up to \$200,000 during the prescribed period (a reduction of around 30 percent of the Commission's port-related costs). Cost savings for Flinders Ports has not been estimated.

The Commission has weighed up these savings against the benefits of regular disclosure of price monitoring information. Such benefits include the benefit to potential access seekers of having transparent pricing information prior to approaching Flinders Ports, and the provision of transparent pricing information to the public and other interested parties.

Furthermore, given the likely cost pressures on Flinders Ports in the next prescribed period due to increases in infrastructure to cope with larger vessels, there is benefit in the Commission monitoring prices annually during this time.

On balance, the Commission sees a net benefit in annual price monitoring and proposes to continue with the current annual price monitoring approach.

#### 3.4.9.2 The index to which to compare price rises

The Commission has used CPI (Adelaide) as an index to which to compare price rises. The Commission recognises that, while CPI is a broad-based index encompassing the cost of living for metropolitan households in Australia, it may not adequately reflect the rate of increase in cost inputs that a port operator faces (for example, wage costs as can be seen in Chart A). The Commission has made this point in previous reviews.<sup>80</sup>

While the Commission recognises that there are some inherent limitations to the current approach of monitoring ports charges against movements in CPI, it believes that limitations apply to other indices. For example:

- ▶ *CPI-x* (where x refers to an expected efficiency savings), similar to CPI, may not accurately reflect the rate of increase in cost inputs that a port operator faces.

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<sup>79</sup> Note that prices are only updated annually, so there would be no benefit to publishing price monitoring information more frequently.

<sup>80</sup> Refer to the Commission's 2012 Review, p.13.

- ▶ A *South Australia Ports Index*, tailored to reflect those costs specific to the ports industry, would more accurately reflect the rate of increase in cost inputs that a port operator faces. However, a disadvantage of using such an index is the potential for the regulated operator to manipulate the index by driving up its cost components over time, to ensure the highest cost increases can be realised.
- ▶ *The Producer Price Index*, the purpose of which is to measure inflation by industry to support the compilation of the Australian National Accounts and Balance of Payments,<sup>81</sup> is not specific to South Australia and, similar to CPI, may not accurately reflect the rate of increase in cost inputs that a port operator faces.

In addition, as noted in the GHD benchmarking study, there are also other factors driving pricing outcomes, many of which are difficult to quantify and unrelated to questions of market power.

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<sup>81</sup> Australian Bureau of Statistics, *6427.0 Producer Price Indexes, Australia*; available at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6427.0Explanatory%20Notes1Dec%202016?OpenDocument>.

## 4 Possible enhancements to access and price regulation of ports

The Commission has formed the view that there are some initiatives that may progress the objectives of access and price regulation of South Australian ports. These are discussed below.

### 4.1 State-wide transport regime

In its submission, SAFC reiterated its view presented in the Commission's 2015 South Australian Rail Access Regime Review (**Rail Review**) that there may be merit in amalgamating similarly operating transport access regimes, including the South Australian Rail Access Regime, Tarcoola-Darwin Rail Regime and the Ports Access Regime.<sup>82</sup> Such an approach recognises the fact that many access seekers require access to multiple modes of transport to move their product. Such a regime could, for example, set broad regulatory parameters to guide access negotiations and apply to all significant rail and port infrastructure in the State.<sup>83</sup> Alternatively, a review could be conducted with the aim of promoting greater consistency between the separate regimes, such as considering the scope of coverage of infrastructure and services included in the regime.

The Commission's Rail Review Final Report discussed the benefits and costs of a state-wide transport regime. The Commission concluded it was difficult to predict whether an encompassing access regime would result in a net benefit. However, it recommended the merits of a state-wide transport access regime should be explored. SAFC and the Department of Planning, Transport and Infrastructure (DPTI) stated they supported an investigation into such an amalgamation.<sup>84</sup>

In the Rail review, the Commission stated the primary benefit a state-wide transport regime would provide is a reduced need for market participants to navigate several potentially different regulatory regimes. This would include a reduction in complexity, and perhaps in cost.

In its submission to that review, Viterra commented that it *'strongly advocates for anything that would reduce regulatory burden and costs and incentivise investment in rail infrastructure in South Australia.'* These burdens and costs include those *'arising from current multi-levels of Federal and State regulation which places South Australia (specifically the grain industry) at a competitive disadvantage.'*<sup>85</sup>

The primary costs in initiating a state-wide transport regime would be the time and financial cost in development and implementation, and the uncertainty and lack of familiarity within the market of a new regime. Further, although reductions in ongoing costs could be expected from efficiencies gained in reduced complexity, it is difficult to predict whether or not this would actually be the case or what the scale of savings would be. Finally, a state-wide transport access regime may be less flexible to adapt to changes in particular industries than an industry-specific access regime.

In its submission to the Rail Review Issues Paper, SAFC referred to such a regime as a 'Strategic Supply Chain Infrastructure Access Regime,' and suggested that it should apply to all significant port and rail infrastructure in South Australia including *'elements that are currently excluded from coverage by existing regimes.'*<sup>86</sup> This is broadly consistent with a recommendation from the 2012 Select Committee on the

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<sup>82</sup> SAFC submission to Rail Review Issues Paper, available at <http://www.escosa.sa.gov.au/ArticleDocuments/354/20150407-SARailAccessRegimeReviewIssuesPaperSubmission-SAFreightCouncil.pdf.aspx?Embed=Y>.

<sup>83</sup> The Commission's *Rail Access Regime Review, Final Report* available at: <http://www.escosa.sa.gov.au/ArticleDocuments/358/20150907-SARailAccessRegimeReview-FinalReport.pdf.aspx?Embed=Y>.

<sup>84</sup> SAFC submission to the *Rail Access Regime Review, Final Report*, p.2; DPTI submission to the *Rail Access Regime Review, Final Report*, p.1.

<sup>85</sup> Select Committee on the Grain Handling Industry, *Final Report*, 2012, p.5.

<sup>86</sup> SAFC submission to the *Rail Access Regime Review, Final Report*, p.2.

Grain Handling Industry, which though relating specifically to grain transport, called for a review which would '*clarify the interaction between Commonwealth and State regulations to eliminate possible duplication and simplify the procedures that are imposed on industry participants.*'<sup>87</sup>

The matters raised in the Rail Review discussed above are relevant to the review of the Ports Access Regimes and therefore the Commission recommends that the Government examine the costs and benefits of greater integration of transport infrastructure access regimes in South Australia.

## 4.2 Level and type of infrastructure covered by the regimes

The Commission received stakeholder feedback on the suitability of the level and type of infrastructure covered by the Access and Pricing Regimes.

In its submission, GPSA stated there is a strong need for 'up country infrastructure' to be included in the regulatory regime. In support of this view it pointed to an additional 500,000 tonnes of storage capacity built by Viterra across various South Australian sites in 2016, which it stated exceeds the entire storage capacity of Viterra's nearest competitor. GPSA stated there has been very little activity from competitors in storage capacity which it believed indicates a significant increase in market share for Viterra.<sup>88</sup>

In contrast to this view, Flinders Ports stated there is no evidence that suggests 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. It warns that doing 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.<sup>89</sup>

The Commission's view is there is merit in revisiting the scope of port infrastructure included in the regimes, as supply-chain dynamics, and associated infrastructure, changed over time. It is noted the last time infrastructure was brought into the regimes was in 2001.<sup>90</sup> However, the Commission notes that decisions on these matters are to be made by the South Australian Government, as the scope of ports and services regulated under the MSA Act is determined through proclamation. Furthermore, this may be better considered as part of a broader supply-chain review.

## 4.3 Consistency of services in scope of the regimes

The current Access and Pricing Regimes vary in the services that are included within them. This adds some complexity in understanding the regimes and may confuse access seekers. It is the Commission's view that, as a starting principle, these services should be aligned as best as possible, as minimising the exercise of market power is the primary reason for both regimes.

On this basis, and to the extent that a case is made for port-specific Access and Pricing Regimes, the Commission recommends examining the alignment of the services in scope of the Access and Pricing Regimes to better aid the comprehension of the ports regulatory framework provided by the MSA Act. Given the Pricing Regime provides only a small benefit beyond the pricing-related protections offered by the Access Regime, one outcome could be to incorporate both regimes into one regime.

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<sup>87</sup> Select Committee on the *Grain Handling Industry, Final Report, 2012*, p.8.

<sup>88</sup> GPSA submission, p.2.

<sup>89</sup> Flinders Ports submission, p.3.

<sup>90</sup> This was via a proclamation made in 2001. DPTI has stated that the scope of the regimes is investigated on an as needs basis. That is, if DPTI becomes aware of a situation where there is potentially a third party access seeker, it would look to include the port in the regime.

## 5 Conclusions

On the basis of the evidence available to the Commission at this time, the Commission's Draft Recommendation is that the current Access Regime continue for a further five years.

The Commission has also made a Draft Decision that the current Pricing Regime continue for a further five years.

In forming its views on the above matters, the Commission has considered:

- ▶ the legislative provisions and objectives of the MSA Act and the ESC Act
- ▶ stakeholder submissions and other evidence relating to the effectiveness of the regimes
- ▶ current and emerging industry conditions and policy developments, and
- ▶ principles of best practice regulation.

Taken together, these matters emphasise the need to prevent the exercise of market power in the provision of Maritime Services at the least regulatory cost.

### 5.1 The potential to exercise market power

The Commission examined expected future market conditions to determine if there are likely to be any changes to the potential to exercise market power by both Flinders Ports and Viterra. Both ports service providers are vertically integrated and operate both regulated and unregulated port activities. The Commission concluded that both operators continue to have the potential to exercise market power. Furthermore, from the evidence available at this time, on balance, it is unlikely that the potential to exercise market power will change substantially over the next prescribed period.

### 5.2 No evidence of the exercise of market power

The Commission has concluded that although there is the potential for market power to be exercised by port operators, there is no evidence to suggest that port operators are exercising such market power. The Commission has reached this conclusion after having regard to the following findings:

- ▶ An analysis of Flinders Ports' regulatory accounts, which indicates it has not been earning excessive profits.
- ▶ Benchmarking of ports charges conducted by GHD on behalf of the Commission, which indicates that ports charges in South Australia are competitive in comparison to other Australian ports.
- ▶ The absence of any access or pricing disputes in the current prescribed period.
- ▶ Commercial information provided by Flinders Ports and Viterra, indicating that negotiations over ports charges have been occurring over the current regulatory period and that ports users have been successful in achieving pricing outcomes that are below the listed price schedule.
- ▶ Submissions made by stakeholders that, generally, support the continuation of the current access and pricing arrangements.



### 5.3 Possible enhancements to access and price regulation of ports

In considering the objective of preventing the exercise of market power at the least regulatory cost, the Commission has also made two additional draft recommendations as part of its Review. They are:

- ▶ to examine the alignment of the services in scope of the Access and Pricing Regimes, and
- ▶ to examine opportunities to better integrate transport infrastructure access regimes.

The Commission welcomes stakeholder feedback on its Draft Recommendations and its Draft Decision.

## 6 Next steps

The Commission seeks comments from all interested parties on the Draft Recommendations and Draft Decisions outlined in this Draft Report. Submissions are sought prior to **Friday, 2 June 2017**.

Following the period of public consultation, and after consideration of any comments received, the Commission will publish a Final Report in relation to the regulatory arrangements for access and pricing of ports services.

The Commission expects to publish that Final Report in September 2017.

## Appendix A: Section 43 of the MSA Act

- (2) The Commission must, within the last year of each prescribed period, conduct a review of the industries subject to this Part to determine whether this Part should continue to apply to those industries.
- (3) The Commission must give reasonable notice of the review in a newspaper circulating generally throughout the State inviting written submissions on the matters under review within a reasonable time specified in the notice.
- (4) The Commission must consider submissions made in response to the notice and other submissions made in the course of other forms of public consultation undertaken by the Commission in connection with the review.
- (5) On completing the review, the Commission must forward to the Minister a report on the review and the conclusions reached by the Commission as a result of the review and, in particular, must recommend either—
  - (a) that this Part should continue in operation for a further prescribed period; or
  - (b) that this Part should expire at the end of the existing prescribed period.
- (6) The Minister must have copies of the report laid before both Houses of Parliament and must have the Commission's recommendation published in the Gazette.
- (7) This Part expires at the end of a prescribed period unless—
  - (a) the Commission has, in the report of a review conducted during the prescribed period, recommended that it should continue in operation for a further prescribed period; and
  - (b) a regulation has been made extending the period of its operation accordingly.
- (8) In this section—*prescribed period* means—
  - (a) the period ending 30 October 2012; and
  - (b) each successive period of 5 years thereafter.

# Appendix B: Summary of ports regulation in Australia

## New South Wales

The New South Wales port price monitoring framework is contained in Part 6 of the Ports and Maritime Administration Act 1995. The price monitoring scheme applies to all ports in NSW (that is, Port Botany, Sydney, Harbour, Port Kembla, Port of Newcastle, Port of Eden and Port of Yamba) and to all port operators (Port Corporations and declared private port operators). Port operators are required to publish information on charges, provide reports to the Minister, and publish notifications of price changes.

New South Wales Treasury advises that in the event that the Government decides that the price monitoring scheme is insufficient to deter anti-competitive behaviour, it retains the ability to take steps that it considers appropriate in the circumstances. For example:<sup>91</sup>

- ▶ the Premier may refer concerns regarding the level of prices for a review by an independent government agency, such as the Independent Pricing and Regulatory Tribunal (**IPART**)
- ▶ the Government may amend Part 6 of the Ports and Maritime Administration Act to include more stringent price controls or to introduce sanctions to compel compliance, or
- ▶ the Government may, if it considers it appropriate, implement a State-based access and pricing regime.

New South Wales Treasury argues that both private and publicly owned port operators have strong incentives to comply with the price monitoring regime in the Ports and Maritime Administration Act. The private port operators in particular are subject to port stewardship obligations in the relevant port leases, the breach of which gives rise to a range of sanctions by the State.<sup>92</sup>

## Victoria

Victoria applies price monitoring at certain ports on the basis that there is a potential for some port operators to exercise market power. Following a review of ports regulation in Victoria in 2009, some Victorian ports are no longer subject to price monitoring.<sup>93</sup>

From 1 July 2010, the ports prescribed services subject to price monitoring have been limited to the provision of the following:

- ▶ berths, buoys or dolphins,<sup>94</sup> and of short term storage or cargo marshalling facilities in relation to container and motor vehicle cargoes, and
- ▶ channel services in the port of Melbourne channels (including the shared channels), and the port of Hastings channels only in respect of container or motor vehicle cargoes.

Currently, the Port of Melbourne Corporation (**PoMC**) is the only port operator subject to a price monitoring framework. The Port of Melbourne is Australia's largest container port.

Under the Victorian ports price-monitoring framework, port operators are required to maintain a published Reference Tariff Schedule, which provides a 'standing offer' of terms and conditions upon which prescribed services will be made available.<sup>95</sup> Port users may purchase regulated port services on

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<sup>91</sup> NSW Treasury, June 2015, p.12.

<sup>92</sup> NSW Treasury, June 2015, p.12.

<sup>93</sup> Productivity Commission, National Access Regime, p.278.

<sup>94</sup> A dolphin is man-made semi submerged maritime structure, usually installed to provide a fixed structure for temporary mooring, to prevent ships from drifting to shallow water, or to serve as a base for navigational aids.

<sup>95</sup> ACCC, Better Economic Regulation of Infrastructure, p.154.

the terms and conditions in the Reference Tariff Schedule, or may seek to negotiate other terms and conditions with the port operator according to their requirements.

The Essential Services Commission of Victoria (**ESCV**) released its Review of Victorian Ports Regulation: Final Report in August 2014.<sup>96</sup> The recommendations concerned whether or not prescribed port services should be subject to price regulation, and the form of that regulation. The assessment of market power entailed analysis of the potential for competition in the provision of the prescribed services within defined markets for channel services, container, and motor vehicle services. This analysis took into account the following factors:

- ▶ the existence of barriers to entry
- ▶ competition between ports, and
- ▶ countervailing market power.

ESCV assessed the available evidence regarding movements in the prices, service quality and profitability of PoMC's prescribed services, to ascertain whether there had been any exercise of PoMC's market power, in relation to the provision of prescribed services. The available evidence indicated that price movements have been in excess of CPI growth, but not substantially so, with the exception of the impact due to the introduction of the Port Licence Fee. Reported service-quality outcomes were observed either to have been stable or improved, and reported profitability does not appear to have been excessive.

Based on ESCV's assessment of market power (available evidence of movements in the prices, service quality and profitability of Port of Melbourne's prescribed services), and on an assessment of the current regime, ESCV recommended the form of regulation to apply to the prescribed services be a price-monitoring framework.

ESCV contends that its recommendations represent a reduction in the regulatory burden for the Port of Melbourne, and provide regulatory clarity in relation to how prescribed services will be regulated regardless of future ownership arrangements at the Port of Melbourne.

## Queensland

Under Queensland legislation, the Queensland Competition Authority (**QCA**) may regulate all the ports in Queensland if directed to do so, but only the business of the Dalrymple Bay Coal Terminal (**DBCT**) is presently subject to economic regulation by QCA. DBCT is one of the largest coal terminals in the world.

QCA's third party access role regarding DBCT is set out under the provisions of the Queensland Competition Authority Act 1997 (**QCA Act**). The QCA Act establishes a two-step 'declaration negotiation/arbitration' regime for the purpose of enabling third-party access to significant infrastructure, similar to that enacted in Part IIIA of the Competition & Consumer Act. Access providers of declared services have an obligation under the Act to negotiate with, and in certain circumstances provide access to, third parties seeking access to that service.

In March 2001, the handling of coal at the DBCT was made a 'declared service' for the purposes of the QCA Act. The QCA Act has provisions that allow the owner of a declared service to voluntarily submit a draft access undertaking to the regulator (in this case, the QCA) which sets out the terms and conditions upon which access will be granted to third-party access seekers. If the draft access undertaking meets certain criteria set out under the QCA Act, and is approved by the QCA, it will form

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<sup>96</sup> ESCV, *Review of Victorian Ports Regulation, Final Report, June 2014*, available at <http://www.esc.vic.gov.au/getattachment/3e8e4798-651e-4d11-8f4e-64284224a071/Final-Report-Review-of-Victorian-Ports-Regulation.pdf>.

the basis for the negotiation of terms and conditions concerning third party access to the service. These criteria include:

- ▶ promoting the economically efficient operation of, use of and investment in infrastructure by which services are provided, with the effect of promoting competition in upstream and downstream markets
- ▶ the legitimate interests of the owner or operator of the service
- ▶ the interests of people who may seek the service
- ▶ the public interest, and
- ▶ pricing principles.

Once the access undertaking is approved, should negotiations between the infrastructure owner and a third party access seeker fail to resolve all terms and conditions of access, the QCA must make its access determination, consistent with the approved access undertaking.

## Northern Territory

On 18 January 2016, the Northern Territory Utilities Commission (**Utilities Commission**) announced that Darwin Port Operations Pty Ltd had commenced as the private port operator for the Port of Darwin.<sup>97</sup>

The Utilities Commission's regulatory role relates to prescribed services provided by the private port operator, and involves approving an access policy and reporting in relation to material non-compliance with an access policy, and monitoring the prices of prescribed services. The Utilities Commission's role in port regulation is broadly divided into two categories: access policy and price regulation.

The Ports Management Act 2015 and Regulations provide a framework for the Utilities Commission to make a determination to the charges fixed by a port operator in relation to the provision of prescribed services. The Regulations provide that the determination must use price monitoring of the price levels of a prescribed service as the form of price regulation.

## Western Australia

Ports in Western Australia are operated by four port authorities, which are semi-autonomous government trading enterprises, with their own boards of directors and management structures. Ports are not a 'regulated industry' for the purpose of the Economic Regulation Authority Act 2003 and, as such, the Economic Regulation Authority (Western Australia)'s (**ERA's**) powers of economic regulation are not currently applied to the ports sector. However, the relevant Minister may direct the ERA to inquire into, or report on, non-regulated industries, including ports.<sup>98</sup>

There is no ministerial approval of port charges of the port authorities, nor is there independent regulatory oversight of port charges.

## Tasmania

Similar to Western Australia, Tasmanian ports are government-owned through the Tasmanian Ports Corporation. The ports are not subject to specific access regulation, nor is there regulation of fees and charges.

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<sup>97</sup> Utilities Commission, <http://www.utilicom.nt.gov.au/Ports/Pages/default.aspx>; ACCC Network, March 2016, p.18, <https://www.accc.gov.au/system/files/Network.pdf>.

<sup>98</sup> Section 38 of the Economic Regulation Authority Act 2003 (WA).

# Appendix C: Policy developments

## National Ports Strategy

The purpose of the National Ports Strategy, developed by Infrastructure Australia<sup>99</sup> and the National Transport Commission,<sup>100</sup> is to drive the development of efficient, sustainable ports and related freight logistics.

The National Ports Strategy proposes to strengthen the effectiveness of the framework within which commercial decisions are made, while ensuring that other significant issues are addressed; primary among those are governance issues related to the fragmented nature of some supply chains.

The National Ports Strategy recognises that there are significant differences between the operating and institutional environments for ports. Differences include location, the extent of integration of organisations in the supply chain, land transport arrangements, the markets they serve, and growth prospects. There are also differences within sub sectors, for example between grain ports and coal ports. Given this diversity, the National Ports Strategy suggests outcomes need to be tailored around what is most suitable for a particular region and port.

## Competition Policy Review

In 2013 the Australian Government established the Competition Policy Review (CPR) to examine Australia's competition policy, laws and institutions, to assess their fitness for purpose. In particular, the CPR set out to examine how appropriate the current competition policy settings are to face current challenges. This included consideration of port infrastructure.

The CPR states that significant reform of ports has been achieved, which has benefited users.<sup>101</sup> The CPR also concluded that various participants in many of the port services chains have significant market power, and that regulators and regulatory frameworks need to recognise this, including through the application of pricing oversight and, if necessary, price regulation.<sup>102</sup>

## South Australian Resources Infrastructure Taskforce

The Resources Infrastructure Taskforce (RIT),<sup>103</sup> which works with private sector stakeholders on options to facilitate key infrastructure projects and reports directly to the Minister for Mineral Resources and Energy and the Minister for Transport and Infrastructure, states best-practice access frameworks should:

- ▶ facilitate any necessary access to multiple industry sectors and commodities
- ▶ support commercial negotiations
- ▶ be clear, flexible and able to respond to and settle disputes quickly and easily
- ▶ minimise compliance costs
- ▶ consider and manage risk, and

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<sup>99</sup> Infrastructure Australia is an independent statutory body with a mandate to prioritise and progress nationally significant infrastructure.

<sup>100</sup> The National Transport Commission is an independent statutory body that contributes to the achievement of national transport policy objectives by developing regulatory and operational reform of road, rail and intermodal transport.

<sup>101</sup> Competition Policy Review, p.208.

<sup>102</sup> Competition Policy Review, p.208.

<sup>103</sup> The RIT is a group of government and business leaders focused on identifying and prioritising those infrastructure projects necessary to support South Australia's mining sector in the long term and to maximise the benefits for communities across the state.

- ▶ not deter supply chain infrastructure investment.

### South Australian 50 Year Ports Strategy

The South Australian Government is working with industry to develop a 50-year ports strategy to maximise economic opportunities for the State's ports assets. The strategy will also inform land use planning, which will help to ensure that produce is effectively and efficiently linked to markets.

The strategy will align to the National Port Strategy and build upon the recent work by the RIT. Work will focus on how regulatory frameworks can support future investment, with a spotlight on policy to develop export opportunities. The strategy is expected to be completed this financial year.<sup>104</sup>

### South Australia Regional Mining and Infrastructure Plan

The RMIP<sup>105</sup> states that the South Australian Government's desire is for commercially viable ports to be developed, which consolidate social and environmental impacts, and allow all users to access cost-effective shipping solutions.

The RMIP states that there is a need for collaboration in infrastructure delivery, to reduce the cost of developing and operating individual mines, especially for iron ore. The South Australian Government has identified three regions for port development:

- ▶ East Coast of Central Eyre area
- ▶ West Coast of Northern Yorke Peninsula area, and
- ▶ East Coast of Northern Eyre Peninsula area.

The Government also desires to pursue the development of multi-user high capacity ports, to support the loading of cape-size vessels.<sup>106</sup> The requirements for development of those ports include:

- ▶ a need to stop any potential exercise of market power
- ▶ the method of calculating loading fee to be charged at the port
- ▶ the conditions under which access to loading the port will be granted, and
- ▶ access to associated land facilities as part of the whole supply chain.

The RMIP recommends that infrastructure options should, if appropriate, focus on multi-user rather than single-user solutions. It also recognises that, if the number of port options available to mines in each cluster is limited to one, considerable market power will be generated for the owner of the port, creating a need for conditions to be placed on the entity controlling the port to stop any potential exercise of market power in negotiating access conditions for mines.

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<sup>104</sup> Refer to <http://dpti.sa.gov.au/news?a=253740>.

<sup>105</sup> South Australian Government, Regional Mining and Infrastructure Plan, 2014, [http://infrastructure.sa.gov.au/\\_data/assets/pdf\\_file/0011/132797/Regional\\_Mining\\_and\\_Infrastructure\\_Plan.pdf](http://infrastructure.sa.gov.au/_data/assets/pdf_file/0011/132797/Regional_Mining_and_Infrastructure_Plan.pdf).

<sup>106</sup> Currently no ports in South Australia are capable of fully loading cape-size vessels at the jetty in volumes sufficient for mining.



## Appendix D: Interstate developments

### Port of Melbourne

In 2016, the Victorian Government announced the Lonsdale Consortium as the leaseholder for the Port of Melbourne, the biggest container and cargo port in Australia. Only the port's commercial operations are leased. Lonsdale Consortium are responsible for managing and improving the port's operations to move goods efficiently. It will be obliged to maintain the port during the lease term so it is returned to public hands in good working order.

The Essential Services Commission of Victoria (**ESCV**) will oversee the pricing structure for port users. Annual tariff increases will be capped at CPI for a minimum of 15 years.<sup>107</sup>

### Port of Darwin

In 2016, the Northern Territory Government entered into a long term lease with the Landbridge Group to operate the Port of Darwin.<sup>108</sup> Under the lease, the Landbridge Group has day to day operation and control of the port, and is responsible for growing and developing port operations and infrastructure in line with growth in the Northern Territory economy.

The Ports Management Act 2015 imposes a legislative obligation on all designated port operators, including Landbridge, not to unreasonably hinder access to port services, or to unfairly discriminate between port users. As the port operator, Landbridge has the power to set port prices. The independent statutory regulator, the Northern Territory Utilities Commission, will undertake a price monitoring role. The Northern Territory Government reserves the right to regulate prices if there is evidence of inappropriate pricing behaviour.

### Port of Newcastle

In 2015, the National Competition Council (**NCC**) received an application under Part IIIA of the CCA from Glencore Coal Pty Ltd (**Glencore**) seeking declaration of the right to access and use the shipping channels provided by the Port of Newcastle.<sup>109</sup> Glencore stated that this application arose in the context of the New South Wales Government's privatisation of the Port of Newcastle in 2014 and a subsequent 60 percent price increase for coal ships using the shipping channels.<sup>110</sup>

Glencore also stated that 'the uncertainty associated with the lack of regulatory oversight over future port pricing at the Port of Newcastle is likely to have a particularly profound impact on marginal mining operations, given the resources downturn and increased uncertainty surrounding the global price of coal.'<sup>111</sup>

The Australian Minister for Finance decided not to declare the service on 8 January 2016, and Glencore applied for a review of this decision by the Australian Competition Tribunal. The Tribunal declared the shipping channel service under Part IIIA of the CCA on 16 June 2016.

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<sup>107</sup> Premier of Victoria, 2015, <http://www.premier.vic.gov.au/government-strengthens-port-regulatory-regime-with-additional-safeguards/>.

<sup>108</sup> Northern Territory Government, 2016, <https://nt.gov.au/industry/major-projects-in-NT/darwin-port-lease>

<sup>109</sup> National Competition Council, Application for declaration of shipping channel services at the Port of Newcastle (Application), 2016, <http://ncc.gov.au/application/application-for-declaration-of-shipping-channel-services-at-the-port-of-new/1>.

<sup>110</sup> National Competition Council, Application for declaration of shipping channel services at the Port of Newcastle (Application), 2016, <http://ncc.gov.au/application/application-for-declaration-of-shipping-channel-services-at-the-port-of-new/1>.

<sup>111</sup> National Competition Council, Application for declaration of shipping channel services at the Port of Newcastle (Application), 2016, <http://ncc.gov.au/application/application-for-declaration-of-shipping-channel-services-at-the-port-of-new/1>.

Port of Newcastle Operations (**PNO**) subsequently applied for judicial review of the Tribunal's decision by the Full Federal Court on 14 July 2016.

Glencore has since notified the ACCC of an access dispute between it and PNO in relation to the shipping channel service at the port. The dispute relates to the level of access charges, and access terms, set by PNO for users of the shipping channel service at the port.<sup>112</sup>

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<sup>112</sup> ACCC notified of an access dispute over charges at the Port of Newcastle, 16 November 2016, <https://www.accc.gov.au/media-release/accc-notified-of-an-access-dispute-over-charges-at-the-port-of-newcastle>.

## Appendix E: Market considerations

### Demand for ports services

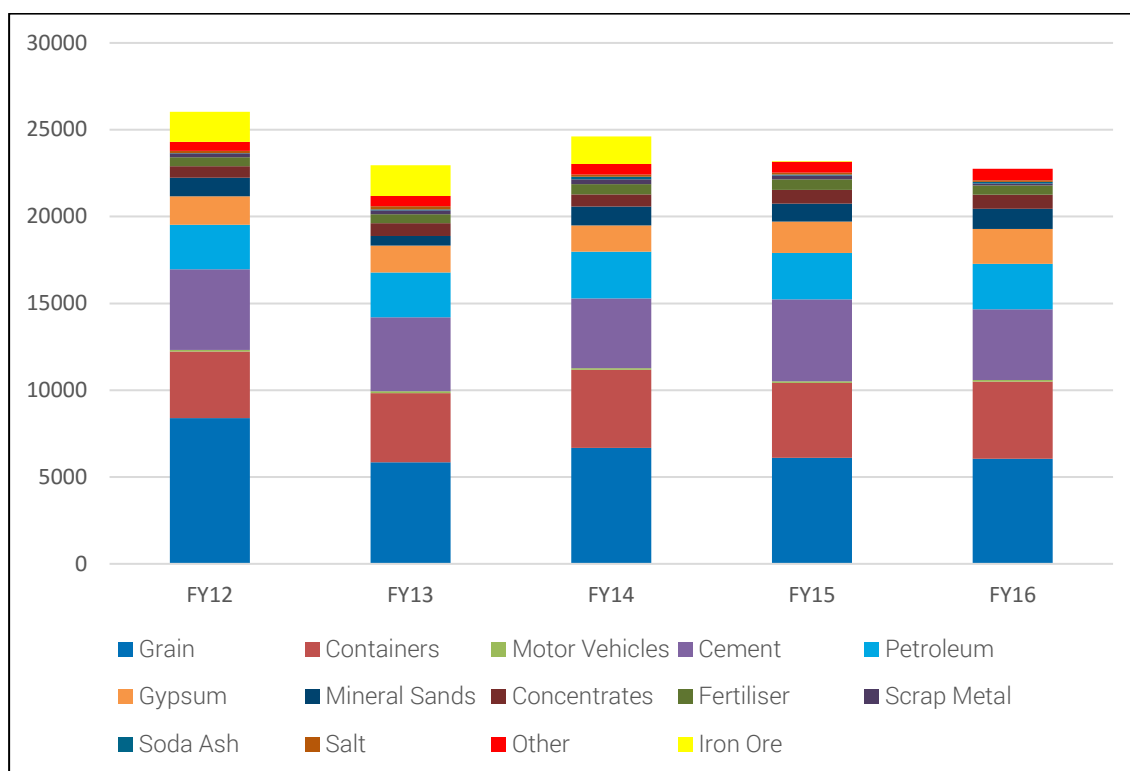
The demand for port services can impact the bargaining power of customers and port operators, and therefore the prices charged by port operators.

Shipping accounts for over 98 percent of Australia’s total trade, by weight.<sup>113</sup> In 2014-15, total trade in commodities through Australian ports was 1.3 billion tonnes, comprising 1.2 billion tonnes of exports and 135.4 million tonnes of imports. Non-containerised cargoes, which include coal, iron ore and the majority of grain exports, account for the majority of Australia’s total sea cargo. For example, in 2014-15, containerised cargo accounted for only 3.3 percent by mass.

During the period 2012-2017, South Australian shipping experienced a range of trade volume 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.

In 2015-16, 1,780 commercial ships visited South Australian proclaimed ports, accounting for 22.8 million tonnes of throughput.<sup>114</sup> For that year, grain was the most significant commodity handled, accounting for 26.6 percent of total throughput (by tonnage). Containers accounted for 19.5 percent of throughput, followed by cement at 17.9 percent. In total, grain, containers, and cement accounted for 64 percent of total throughput (Chart B).

Chart B: Cargo throughput (volume '000 tonnes)



Source: Flinders Ports

<sup>113</sup> Port Australia, Trade Statistics 2015, accessed 27 Feb 2016 from <http://www.portsaustralia.com.au/aus-ports-industry/trade-statistics/?period=15>.

<sup>114</sup> Flinders Ports, Cargo and ship stats, 2016.

In its submission, GPSA stated that it expected grain production to continue to increase (Box A).<sup>115</sup> However, Flinders Ports stated it does not anticipate any material change in the overall market in the 2017-2022 period.<sup>116</sup> It adds there is an expectation that the current emerging trends, such as vessel size increases, slower economic and trade growth, and additional port development proposals will continue to evolve.

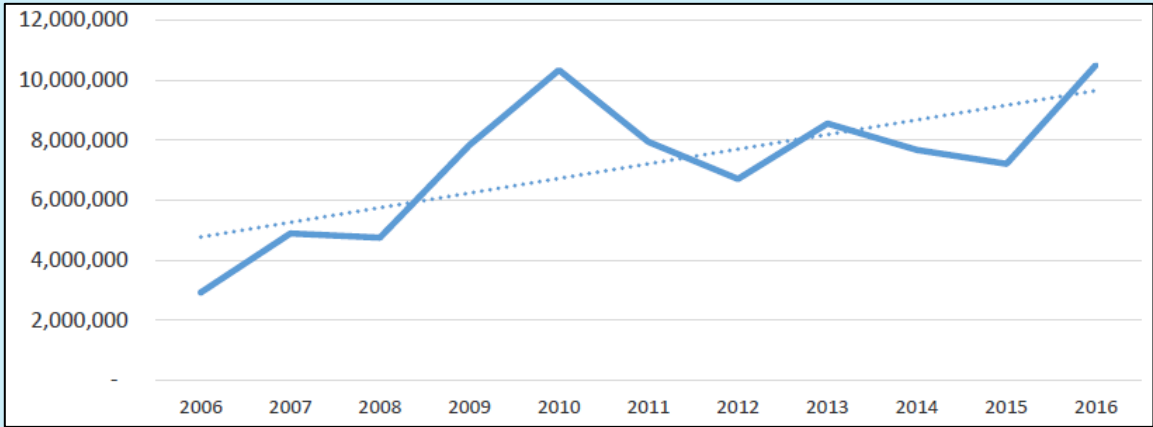
**Box A - Grain production and prices**

Since 2011, grain prices<sup>117</sup> in South Australia have moved within a band between \$200 and \$300 per tonne, until the second half of 2016, which saw prices fall below \$200 per tonne.<sup>118</sup> Globally, wheat supplies are considerably higher than the current level of demand, driving prices down.<sup>119</sup> Prices are predicted to remain low, especially if the Australian dollar rises.<sup>120</sup>

Grain production has, however, continued to grow in volume over recent years (Chart B). Good conditions for grain growing in Australia during 2016 resulted in large crop yields. For example, in December 2016, Viterra exceeded 860,000 tonnes of grain export, its second largest shipping month on record.<sup>121</sup>

According to GPSA, increases are not only due to timely rain events but also improved practices by grain producers and the use of grain varieties that are returning higher yields. It also stated research and development will continue to drive production increases.<sup>122</sup> Increased yields combined with low prices may increase demand for grain shipping.

Chart B: Grain production in South Australia (tonnes) (Source: PIRSA)



<sup>115</sup> GPSA submission, p.3.  
<sup>116</sup> Flinders Ports submission, p.2.  
<sup>117</sup> Price delivered end user.  
<sup>118</sup> Dairy Australia, Historical Grain Data Adelaide, November 2016 <http://www.dairyaustralia.com.au/Markets-and-statistics/Farm-inputs-and-costs/Hay-and-grain.aspx>.  
<sup>119</sup> Dairy Australia, International and national grain report, 2017, <http://www.dairyaustralia.com.au/Pastures-and-Feeding/Supplements/Hay-and-grain-report/International-and-national-grain-report.aspx>.  
<sup>120</sup> Ryan T.J, Agribusiness outlook for 2016-2017, Canstar, May 2016, <https://www.canstar.com.au/agribusiness/agribusiness-outlook-2016-2017/>.  
<sup>121</sup> Castello R, Records take a tumble as bumper crop rolls in, 5 January 2017, <http://www.adelaidenow.com.au/business/records-take-a-tumble-as-bumper-crop-rolls-in/news-story/dc06c0bcf240e76b4241a33f423380c0>.  
<sup>122</sup> Grain Producers SA submission, p.3.

GPSA stated South Australia, and in particular the Eyre Peninsula, is facing significant changes in transport and supply chain infrastructure. These changes include:

- ▶ review of the current rail agreement between Viterria and GWS – there are only two harvest seasons remaining for the current rail transport arrangement, and
- ▶ proposal for alternate port projects.

GPSA argues those projects will result in significant investment requests to government and other stakeholders for the port infrastructure and the supporting road and rail infrastructure. In addition, the competitive ports will introduce a new grain transport dynamic including impacts on the current rail network viability that needs to be further explored.<sup>123</sup>

Although not a large contribution to port throughput by volume, iron ore has been a relevant factor in the consideration of new port developments (Table 3.1). Iron ore prices are predicted to decrease in 2017 from current prices of around US\$79 per tonne. The Australian Government predicts prices will continue to decline to an average US\$53 in 2017 and US\$49 per tonne in 2018,<sup>124</sup> while other predictions are slightly more optimistic (for example, Goldman Sachs predicts prices will fall to US\$55 per tonne by the end of 2017).<sup>125</sup>

The Australian Government forecasts world trade in iron ore will grow by 4.5 percent in 2017, and that Australia's share of global seaborne trade in iron ore will increase in 2017. This suggests significant potential for increased volumes of shipping in 2017, although the impact on South Australian ports will be defined by local iron ore mining activity.

## Technological and industry developments

Technological and industry developments taking place in the ocean shipping sector are likely to impact South Australian ports into the near future, possibly during the next prescribed period. Significant developments include the application of information technology, increasing containerisation and increasing vessel size and integrated transport logistics.

### Application of information technology

The ports sector around the world is employing increasingly sophisticated information technology (IT) to manage logistics, with clear benefits to port operators.<sup>126</sup> The World Bank states that ports, if they are to remain competitive, must be key players in future IT logistics networks.<sup>127</sup> However, as with a move to greater supply chain integration, this has the potential to increase the incentive to exercise market power. For example, if a port operator has a monopoly on a necessary IT product, it may require access seekers to use that product as a prerequisite for access. At this stage the Commission has seen no such evidence relevant to Flinders Ports or Viterria.

### Containerisation

Containerisation currently accounts for about 60 percent of the value of goods shipped via sea, and has been steadily growing since containers were standardised in 1961.<sup>128</sup> Containerisation has increased

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<sup>123</sup> GPSA submission, p.5.

<sup>124</sup> Office of the Chief Economist, Resources and Energy Quarterly, December 2016, p.29, available at <https://industry.gov.au/Office-of-the-Chief-Economist/Publications/Documents/reg/REQ-December-2016.pdf>

<sup>125</sup> Business Insider, Here's the Goldman Sachs note that's got iron ore traders excited, 23 November 2016, available at <http://www.businessinsider.com.au/heres-the-goldman-sachs-note-thats-got-iron-ore-traders-excited-2016-11>.

<sup>126</sup> National Transport Commission, Opportunities for information technology systems to improve port-related supply chain performance, 2014, p.15.

<sup>127</sup> World Bank, Port Reform Tool Kit, 2007.

<sup>128</sup> World Shipping Council, History of Containerization, 2016, available at <http://www.worldshipping.org/about-the-industry/history-of-containerization>.

trade efficiencies through intermodalism, in which the same container can be transported with minimum interruption via different transport modes during its journey. In Australia, containerised trade has been growing faster than gross domestic product since the 1990s, and container port productivity has also improved faster than the wider economy.<sup>129</sup> Containerised trade in Australia is projected to increase by 5.1 percent a year over the next 15 years.<sup>130</sup>

The growth of containerised trade is relevant to South Australian ports as it relates to increases in vessels sizes which is placing pressure on Flinders Ports to develop its infrastructure (discussed below). It also has some relevance to the competition faced by Flinders Ports from tugs and barges, which are not designed to transport containerised goods.<sup>131</sup>

### Larger vessels

The increase in containerisation is directly related to the production and servicing of larger vessels. The number and size of post-panamax container vessels is forecast to continue to grow across the globe, further increasing the transport of containers.<sup>132</sup> Future growth in container throughput at Australia's ports is likely to result in increased frequency of visitation from very large vessels.<sup>133</sup> There is also pressure on ports to invest in infrastructure to accommodate those vessels.

Regarding bulk transport, planned mining activity in South Australia will require high capacity ports to support the loading of cape-size vessels.<sup>134</sup> Currently there are no ports in South Australia directly capable of fully loading cape-size vessels in volumes sufficient for mining in their current configuration, although there are some proposals currently under consideration (Table 3.1).

Both these issues are likely to require significant development of South Australian ports infrastructure; at a potentially significant cost. For example, Flinders Ports has estimated that, to maintain or improve South Australia's port performance in the face of future growth in container throughput, significant infrastructure investment is likely to be needed in the widening of channels, which may be as high as \$60 million.<sup>135</sup>

### Integrated transport logistics

Logistical service integration in the ports sector can include the consolidation of containers, documentation services, storage and distribution, and stevedoring. While integration can offer efficiencies such as economies of scale, which will flow through to customers as lower prices, it can also provide the operator with an incentive to leverage any market power from services subject to access/price regulation to other, competitive, services.

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<sup>129</sup> Bureau of Infrastructure, Transport and Regional Economics, Trend and forecasts for Australian container ports, 2014.

<sup>130</sup> Bureau of Infrastructure, Transport and Regional Economics, Containerised and non-containerised trade through Australian ports to 2032-33, 2014.

<sup>131</sup> DPTI, personal communication, February 2017.

<sup>132</sup> Flinders Ports, Opportunities and challenges South Australia's Ports, CEDA 2016 Transport and Infrastructure Review, Adelaide October 2016; and Kidson, R. (et. al.), 2015, Impact of increasing container ship size on container handling productivity at Australian ports, Australasian Transport Research Forum 2015 30 September - 2 October 2015, Sydney, p.14 available at: [http://atrf.info/papers/2015/files/ATRF2015\\_Resubmission\\_6.pdf](http://atrf.info/papers/2015/files/ATRF2015_Resubmission_6.pdf).

<sup>133</sup> Flinders Ports, Opportunities and challenges South Australia's Ports, CEDA 2016 Transport and Infrastructure Review, Adelaide October 2016; and Kidson, R. (et. al.), 2015, Impact of increasing container ship size on container handling productivity at Australian ports, Australasian Transport Research Forum 2015 30 September - 2 October 2015, Sydney, p.14 available at: [http://atrf.info/papers/2015/files/ATRF2015\\_Resubmission\\_6.pdf](http://atrf.info/papers/2015/files/ATRF2015_Resubmission_6.pdf).

<sup>134</sup> SA Regional Mining and Infrastructure Plan, 2104, [http://infrastructure.sa.gov.au/\\_data/assets/pdf\\_file/0011/132797/Regional\\_Mining\\_and\\_Infrastructure\\_Plan.pdf](http://infrastructure.sa.gov.au/_data/assets/pdf_file/0011/132797/Regional_Mining_and_Infrastructure_Plan.pdf).

<sup>135</sup> Flinders Ports, Opportunities and challenges South Australia's Ports, CEDA 2016 Transport and Infrastructure Review, Adelaide October 2016.

## Appendix F: Part 3 of ESC Act

### Part 3—Price regulation

#### 25—Price regulation

- 1) The Commission may make determinations regulating prices, conditions relating to prices and price-fixing factors for goods and services in a regulated industry.
- 2) The Commission may only make a price determination if authorised to do so by a relevant industry regulation Act or by regulation under this Act
- 3) A price determination may regulate prices, conditions relating to prices or price-fixing factors in a regulated industry in any manner the Commission considers appropriate, including—
  - a) fixing a price or the rate of increase or decrease in a price;
  - b) fixing a maximum price or maximum rate of increase or minimum rate of decrease in a maximum price;
  - c) fixing an average price for specified goods or services or an average rate of increase or decrease in an average price;
  - d) specifying pricing policies or principles;
  - e) specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed or any other specified factor;
  - f) specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the supply of goods or services;
  - g) fixing a maximum average revenue, or maximum rate of increase or minimum rate of decrease in maximum average revenue, in relation to specified goods or services;
  - h) monitoring the price levels of specified goods and services.
- 4) In making a price determination, the Commission must (in addition to having regard to the general factors specified in Part 2) have regard to—
  - a) the particular circumstances of the regulated industry and the goods and services for which the determination is being made;
  - b) the costs of making, producing or supplying the goods or services;
  - c) the costs of complying with laws or regulatory requirements;
  - d) the return on assets in the regulated industry;
  - e) any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries;
  - f) the financial implications of the determination;
  - g) any factors specified by a relevant industry regulation Act or by regulation under this Act;
  - h) any other factors that the Commission considers relevant.
- 5) In making a price determination under this section, the Commission must ensure that—
  - a) wherever possible the costs of regulation do not exceed the benefits; and
  - b) the decision takes into account and clearly articulates any trade-off between costs and service standards.

- 6) Subsections (3), (4) and (5) have effect in relation to a regulated industry subject to the provisions of the relevant industry regulation Act for that industry.
- 7) In this section—  
price includes a price range.

#### **26—Making and effect of price determinations**

- 1) Before making a price determination, the Commission may send a copy of a draft of the determination—
  - a) to the Minister and the industry Minister; and
  - b) to each regulated entity to which the determination will apply; and
  - c) to any other person the Commission considers appropriate.
- 2) A price determination must include a summary of the information on which the determination is based and a statement of the reasons for the making of the determination.
- 3) The Commission must—
  - a) send a copy of a price determination—
    - i. to the Minister and the industry Minister; and
    - ii. to each regulated entity to which the determination applies; and
    - iii. to any person who made a submission to an inquiry to which the determination relates and who has asked for a copy of the determination; and
  - b) ensure that copies of the determination are available for inspection and purchase by members of the public.
- 4) Notice of the making of a price determination must be published—
  - a) in the Gazette; and
  - b) in a newspaper circulating generally in the State; and
  - c) on the internet.
- 5) The notice must include a brief description of the nature and effect of the price determination, details of when the determination takes effect and how a copy of the determination may be inspected or purchased.
- 6) A price determination takes effect on the date on which notice of its making is published in the Gazette or a later date of commencement specified in the determination.
- 7) A price determination has effect until it is revoked or until an expiry date specified in the determination.
- 8) A price determination may be varied or revoked by subsequent determination.

#### **27—Offence to contravene price determination**

A regulated entity must not contravene a price determination or part of a price determination that applies to the entity.

Maximum penalty: \$1 000 000.





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