

OFFICIAL



Ports

2022 Ports Access Regime and Price Determination Review: *Stage one*

DRAFT Report

May 2022

OFFICIAL

Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this draft report. Written comments should be provided by 8 July 2022.

It is the Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

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: **2022 Ports Access Regime and Price Determination Review**.

It is preferred that submissions are sent electronically to: escosa@escosa.sa.gov.au

Alternatively, submissions can be sent to:

Essential Services Commission
GPO Box 2605
Adelaide SA 5001

Telephone: (08) 8463 4444
Freecall: 1800 633 592 (SA and mobiles only)
E-mail: escosa@escosa.sa.gov.au
Web: www.escosa.sa.gov.au

Table of contents

Glossary of terms	2
1 Executive summary.....	4
1.1 Draft recommendations and findings of stage one.....	4
1.2 Next steps.....	5
2 The review.....	7
2.1 Purpose of review.....	7
2.2 Essential facilities and the objectives of an access regime	7
2.3 Operation and coverage of the MS Act	9
2.4 Participants and users of the access regime	14
2.5 Process and submissions to the review	15
3 Economic characteristics of regulated and essential maritime services	17
3.1 Demand.....	17
3.2 Substitutes.....	19
3.3 Sunk costs and economies of scale and scope.....	21
4 Competitive analysis.....	22
4.1 Structural barriers to entry for new port infrastructure	22
4.2 Competition conditions according to main cargo types	23
5 Risks from integration with related markets.....	29
5.1 Contextual considerations.....	29
5.2 Integration into related markets.....	30
5.3 Observations on risks	32
6 Why the access regime should continue in operation.....	34
6.1 Decision criteria	34
6.2 Competition and costs	35
6.3 Summary of stakeholder views	36
6.4 The Commission's draft recommendation	37
7 The need for, and form of, a price determination under the ESC Act.....	39
7.1 Is there a need for a price determination?.....	39
7.2 What should the form of any price determination be?.....	39
7.3 Proposed price determination to include price and financial performance monitoring.....	42
8 Draft findings and recommendations	45
8.1 Next steps.....	45
Appendix A: Stakeholder suggestions for improvements.....	46
Appendix B: Proclamation of regulated services.....	47
Appendix C: Further information relating to the price determination.....	49

Glossary of terms

ACCC	Australian Competition and Consumer Commission
CCA	<i>Competition and Consumer Act 2010</i>
Commission	Essential Services Commission of South Australia
CPA	Competition Principles Agreement
Customer	A person who seeks the provision of a maritime service
ESC Act	<i>Essential Services Commission Act 2002</i>
Essential maritime services	Essential maritime service means a maritime service consisting of— (a) providing or allowing for access of vessels to a proclaimed port; or (b) providing port facilities for loading or unloading vessels at a proclaimed port; or (c) providing berths for vessels at a proclaimed port
FACT	Flinders Adelaide Container Terminal Pty Ltd
Fair commercial terms	Access on fair commercial terms is defined in the MS Act as follows. (1) A regulated operator must provide regulated services on terms— (a) agreed between the operator and the customer; or (b) if they do not agree, on fair commercial terms determined by arbitration under this Act. (2) A term as to the price at which regulated services are to be provided will be regarded as a fair commercial term if the price is regulated by a pricing determination under the ESC Act and the term is consistent with that determination
Flinders Ports	Flinders Ports Pty Limited. Upon privatisation certain assets of Ports Corp were transferred to Flinders Ports
FPH	Flinders Ports Holdings Pty Ltd
GPSA	Grain Producers SA
GRA	Gypsum Resources Australia Pty Ltd
Guideline 1	Port Industry Guideline No. 1. This guideline sets out requirements for a regulated operator to provide certain information to a customer
Guideline 2	Port Industry Guideline No. 2. This guideline sets out operational and financial reporting requirements to be provided to the Commission
Maritime services	A service provided on a commercial basis of any of the following kinds: (a) providing or allowing for access of vessels to a proclaimed port;

	<p>(b) a pilotage service facilitating access to a proclaimed port;</p> <p>(c) providing berths for vessels at a proclaimed port;</p> <p>(d) providing port facilities for loading or unloading vessels at a proclaimed port;</p> <p>(e) providing for the storage of goods at a proclaimed port;</p> <p>(f) providing access to land in connection with the provision of services of any of the kinds mentioned above,</p> <p>but does not include any of the following:</p> <p>(g) a towage service for facilitating access to a proclaimed port;</p> <p>(h) a bunkering service provided at a proclaimed port;</p> <p>(i) a service for the provisioning of vessels (including the supply of electricity and water) within a proclaimed port;</p> <p>(j) a service for the removal of waste from vessels at a proclaimed port</p>
Minister	Minister for Infrastructure and Transport
MS Act	<i>Maritime Services (Access) Act 2000</i>
NCC	National Competition Council
Ports Corp	South Australian Ports Corporation
Price determination	A determination under the ESC Act regulating prices, conditions relating to prices and price-fixing factors for goods and services
Proclaimed port	A port declared by proclamation to be subject to the MS Act
QUBE	QUBE Ports Pty Ltd
Regulated maritime services	Maritime services at a proclaimed port are those that are declared by proclamation to be regulated services. Proclaimed regulated services are outlined in Appendix B
Regulated operator	A person or operator who is subject to the access regime prescribed by the MS Act. Current regulated operators are Viterra and Flinders Ports
SAFC	South Australian Freight Council
Viterra	Viterra Operations Pty Ltd

1 Executive summary

The Essential Services Commission (**Commission**) has reviewed whether or not the South Australian ports access regime, established under the *Maritime Services (Access) Act 2000 (MS Act)*, should continue to apply from 31 October 2022. It has also reviewed the need for, and form of, a price determination to be made under the *Essential Services Commission Act 2002 (ESC Act)*. The Commission's draft recommendation is that the regime should continue in operation for a further five years, and its draft finding is that the Commission's price determination should expand to include both price and financial performance monitoring for the same period.

The Commission called for submissions on the ports access regime and price determination in December 2021 and six stakeholders put forward submissions. The Commission also considered the final report of the National Competition Council (**NCC**) confirming the recertification of the South Australian ports access regime, which made recommendations for the Commission to consider. As a number of the issues raised were broader than the scope of the review required by sections 43 and 6 of the MS Act, the Commission has decided to undertake a two-stage review process. Notification of this approach was published on the Commission's website on 31 March 2022.

Stage one has involved a review of both the access regime and the price determination. The Commission must, under section 43 of the MS Act, provide a report to the Minister for Infrastructure and Transport (**Minister**), recommending that the access regime continue to apply, or not, for a further five-year period. The current price determination (allowed for under section 6 of the MS Act) expires on 30 October 2022, so stage one has also involved a review of the need for, and form of, a price determination under the ESC Act.

Stage two of the review will involve a general assessment under section 9 of the MS Act, with a view to determining whether or not regulation (or further regulation) is required.

1.1 Draft recommendations and findings of stage one

Section 43 review of the access regime

The Commission's draft recommendation is that the access regime should continue to apply to **regulated maritime services**, and that the regime should continue in operation for a further five years from 31 October 2022. The recommendation is based on the following considerations and evidence.

- ▶ The decision criteria adopted has been that the access regime should continue to apply if it is required for at least one regulated maritime service and if it results in greater benefits than costs.
- ▶ The majority of regulated maritime services tend to exhibit natural monopoly features that can create barriers to entry. While these barriers can vary across geographic and product markets, there are sufficient reasons to conclude that they are high and, in some cases, likely to be insurmountably so. This can create the incentive and ability for market power to be exercised by a regulated operator in ways that are anti-competitive and limit competition in upstream or downstream markets.
- ▶ It is clear that some degree of inter-port competition exists, and this can provide a competitive constraint on the regulated operator. But, in some cases, factors such as transport costs and switching costs are sufficiently high such that inter-port substitution is unlikely to provide an effective constraint on the potential misuse of market power, which could limit opportunities for access to infrastructure facilities and limit competition in upstream or downstream markets.
- ▶ Most stakeholders supported the access regime's role in providing a regulatory backstop to protect customers seeking access against the potential misuse of market power by regulated

operators. The fact that the arbitration mechanism has been drawn on in the event of a recent dispute is a practical demonstration of the access regime in operation.

- ▶ The regime is a low-cost form of protection that supports commercial negotiation. Without the current state-based regime, some stakeholders pointed to uncertainty about the type, nature and timing of any access protections available. Such uncertainty can have an effect on the use and operation of, and investment in, the maritime sector supply chain.
- ▶ While compulsory access can, in theory, weaken incentives for the regulated operator to invest in infrastructure, it is not evident that this has been the case to date.

It is noted that some stakeholders have suggested that certain changes could improve the operation of the access regime. These issues will be considered during stage two of the review.

Section 6 review

The Commission's draft finding is to make a price determination in relation to **essential maritime services** under the ESC Act. The need for, and proposed form of, that determination is outlined below.

- ▶ In general, essential maritime services have high barriers to entry and customers face high switching costs. Together these features can create the incentive and ability for the regulated operator to misuse market power, which may limit competition in upstream and downstream markets and diminish the efficient use and operation of, and investment in, maritime services. In the absence of regulation, inter-port competition is unlikely to provide a sufficient competitive constraint. This suggests that some form of price determination for essential maritime services under the ESC Act is needed. Consistent with this, there was stakeholder support for the continuation of the Commission's current 2017-2022 price determination.
- ▶ The ESC Act allows for regulation of prices and conditions relating to prices or price-fixing factors under sections 25(4) and 25(5). The Commission's proposed price determination for 2022-2027 is to include price and financial performance monitoring. Where markets may not be competitive, monitoring schemes can enhance transparency and provide a means of observing and understanding the performance of a firm, industry or market. The Commission's proposal expands on the current price monitoring scheme, enabling more information collection to assist in determining whether current regulation is effective, and a greater level of transparency, which helps to facilitate competitive markets through more informed negotiations and commercial decision making. Both these outcomes help to protect the long-term interests of users of maritime services.
- ▶ Given there are risks from Flinders Ports Pty Ltd (**Flinders Ports**)'s integration with related markets, a proportionate increase in the monitoring of these risks appears worthwhile. Accordingly, the Commission's proposed monitoring scheme will collect information on bundled services (to the extent relevant).
- ▶ In practical terms, the proposed price and financial performance monitoring scheme will involve: (1) the publication of an annual price monitoring report (as currently occurs), and (2) the publication of an annual financial performance report. The latter will document trends in Flinders Ports' actual revenues, costs and profits. The proposed scheme will complement the access regime, and is not expected to raise administration costs or weaken investment incentives.

1.2 Next steps

The Commission seeks stakeholder views on this draft report on **stage one** of the review by 8 July 2022. The Commission would be pleased to meet with stakeholders. If you or your organisation wish to meet with Commission staff, please use the contact details on the inside cover of this draft report. The

Commission aims to publish its final decision on the access regime and the price determination (stage one) in October 2022.

The timing of **stage two** of the review is still being determined. Stakeholders will have the opportunity to make submissions as part of that process.

2 The review

2.1 Purpose of review

The Essential Services Commission (**Commission**) is the regulator of the access regime that applies to **regulated** maritime services at proclaimed ports and the price determination that applies to **essential** maritime services at proclaimed ports. Its role is established under the *Maritime Services (Access) Act 2000* (**MS Act**¹) and the *Essential Services Commission Act 2002* (**ESC Act**²).

The purpose of the Commission's current review is:

Stage one:

1. To assess the current access regime with a view to making a recommendation to the Minister for Infrastructure and Transport (**Minister**) in accordance with section 43 of the MS Act, as to whether the regime should continue in operation for a five-year period, with the current period concluding on 30 October 2022.
2. To assess the need for, and form of, any price determination to be made by the Commission under the ESC Act. The current price determination expires on 30 October 2022.

Stage two:

3. To conduct a general assessment under section 9 of the MS Act, with a view to determining whether or not regulation (or further regulation) is required.

The Commission last assessed items 1 and 2 during its 2017 review,³ which recommended to the Minister that the regime continue in operation. The recommendation was accepted. At the same time, the Commission determined that annual price monitoring of essential maritime services should continue for a further five years (in line with the prescribed period for the access regime).

2.2 Essential facilities and the objectives of an access regime

Australia's national competition policy includes guiding principles that form a framework for states and territories to create regulatory access regimes for competitive access to significant infrastructure facilities.⁴ Under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**)⁵ (known as the national access regime), regulatory protections may be available for those seeking access to significant infrastructure services. The four pathways to gaining access under the national access regime are: declaration, voluntary access undertaking, competitive tendering for public infrastructure, or through **a certified state-based access regime**.⁶

¹ The MS Act can be accessed here: [https://www.legislation.sa.gov.au/_legislation/lz/c/a/maritime%20services%20\(access\)%20act%202000/current/2000.82.auth.pdf](https://www.legislation.sa.gov.au/_legislation/lz/c/a/maritime%20services%20(access)%20act%202000/current/2000.82.auth.pdf).

² The ESC Act can be accessed here: https://www.legislation.sa.gov.au/_legislation/lz/c/a/essential%20services%20commission%20act%202002/current/2002.14.auth.pdf.

³ Commission, *2017 Ports Access and Pricing Review*, September 2017, pp. 1-60, available at <https://www.escosa.sa.gov.au/ArticleDocuments/1026/20170911-2017PortsAccessAndPricingReview-Final.pdf.aspx?Embed=Y>.

⁴ Council of Australian Governments, *Competition Principles Agreement*, 1995, available at <https://federation.gov.au/about/agreements/competition-principles-agreement>.

⁵ The CCA is available at <https://www.legislation.gov.au/Details/C2020C00079>.

⁶ Productivity Commission, 'National Access Regime', *Inquiry Report*, No. 66, 25 October 2013, pp. 4-5, available at <https://www.pc.gov.au/inquiries/completed/access-regime/report/access-regime.pdf>.

In South Australia, a certified state-based access regime is in place that applies to regulated maritime services, which are of significance to the South Australian economy. The state-based regime was re-certified in November 2021 for a period of 10 years.⁷ Certification precludes access through the national access regime (for example, through declaration or a voluntary undertaking).

The state-based access regime meets the Competition Principles Agreement (CPA), as agreed to by the South Australian Government in 1995 and amended in 2007.⁸ In doing so, it promotes consistency in access regulation with other jurisdictions, and satisfies clause 6(3)(a) of the CPA, which states that:⁹

For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

(i) it would not be economically feasible to duplicate the facility;

(ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

The CPA states that Commonwealth legislation is not intended to cover state-based facilities that are covered under a state-based regime, to the extent the regime is determined by the National Competition Council (NCC) to be effective. Furthermore, the CPA highlights that there may be a range of approaches to state-based access regime legislation that may reasonably meet the various criteria set out in the agreement.¹⁰

2.2.1 Objectives of the MS Act and the ESC Act

The current access regime (Part 3 of the MS Act) and any price determination (provided for under section 6 of the MS Act and made under the ESC Act) must promote the following objects of the MS Act:

- ▶ 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
- ▶ to protect the interests of users of essential maritime services 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.

The MS Act states that access is to be on the basis of 'fair commercial terms' and it allows for two mechanisms to promote this object through the MS Act: (i) access through commercial agreement or, in the event of dispute, arbitration; and (ii) a price determination made by the Commission under the ESC Act.

⁷ The National Competition Council (NCC)'s recommendation for re-certification applied given that the Treasurer did not publish a decision on the NCC's recommendation within 60 days. National Competition Council (NCC), *Application for certification of the South Australian Ports Access Regime (Final recommendation and decision)*, 30 November 2021, pp. 1-127, available at <https://ncc.gov.au/application/application-for-certification-of-the-south-australian-ports-access-regime/5>.

⁸ Section 6(2) of the CPA.

⁹ Section 6(3) of the CPA.

¹⁰ Section of 3(b) of the CPA.

The access regime, as well as any price determinations made under the ESC Act and provided for by section 6 of the MS Act, must also meet the Commission's objectives as specified in the ESC Act. These objectives require that the access regime and the price determination must:

- ▶ 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
- ▶ at the same time, have regard to the need to:
 - promote competitive and fair market conduct
 - prevent misuse of monopoly or market power
 - facilitate entry into relevant markets
 - promote economic efficiency
 - ensure consumers benefit from competition and efficiency
 - facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment, and
 - promote consistency in regulation with other jurisdictions.

The access regime has its origins in Australia's national competition policy reforms of the 1990s. Those competition reforms involved corporatisation and privatisation, with a key aim to improve efficiency, and in November 2001, Flinders Ports Pty Ltd (**Flinders Ports**) purchased the assets of the South Australian Ports Corporation (**Ports Corp**) and was granted 99-year leases of seven South Australian ports.

In practice, the goal of the current regime was to provide certainty to the lessee prior to the sale and also to foster competition.¹¹ As stated in the South Australian Government's recertification application to the NCC, it considered that freedom to negotiate access to channels, ports and associated maritime services is vital to enable effective competition in upstream and downstream markets.¹²

2.3 Operation and coverage of the MS Act

This section outlines key legislative and operational features of the MS Act, and describes the access regime as well as the information exchange and reporting requirements.

2.3.1 Negotiate-arbitrate

Part 3 of the MS Act sets out the current access regime. The regime establishes a negotiate-arbitrate framework that provides a regulatory backstop option to improve a customer's position in commercial negotiations with regulated operators for access to regulated maritime services, so as to promote

¹¹ Hon. KT Griffin MLC, *South Australian Government Gazette*, 9 November 2000: 'An access regime assists not only the future owner or lessee of a business in providing certainty prior to divestment but is also central to fostering competition by providing the basis on which that competition can occur where a monopoly may otherwise continue or occur later. In our public consultation process we also picked up a lot of concern about whether open commercial access to the ports would continue. This bill will in fact ensure that it does. Furthermore, a state-based access regime already applies to the Bulk Handling Facilities that were previously owned by Ports Corp and which are now owned by SACBH. This regime will be retained and incorporated into the expanded arrangements.'

¹² NCC, pp. 32-33, and South Australian Government, *Application for the extension under section 44NA of the Competition and Consumer Act 2010*, pp. 22-24, available at https://ncc.gov.au/images/uploads/SA_Ports_Access_Regime_-_Application.pdf.

competition in upstream and downstream markets. The current regulated operators under the regime are Flinders Ports and Viterra.

The access regime has three key elements:

1. It establishes that a regulated operator must provide access to regulated maritime services on fair commercial terms (which as mentioned earlier, can be achieved through commercial agreement for access or, in the event of dispute, arbitration; and/or a price determination made by the Commission under the ESC Act).
2. A regulated operator is required to negotiate in good faith with customers, as are any parties involved in, or affected by, access negotiations. Copies of access proposals must be provided to the Commission, and to any industry participants that may be affected by the access that is proposed.
3. If terms of access have not been agreed within 30 days of a proposal, the negotiation will be considered a dispute and any party can refer it to the Commission. The Commission may first attempt to conciliate the dispute and, if unsuccessful, may appoint an arbitrator. In making an award, an arbitrator is bound by certain requirements, including various operational, contractual and economic principles, and some specific pricing principles.

Importantly, the access regime does not seek to guarantee that every commercial access negotiation will lead to an agreement.

Negotiate-arbitrate access frameworks are a feature of various natural monopoly industries in South Australia, such as in rail and water,¹³ and in some interstate industries.¹⁴ Moreover, negotiate-arbitrate frameworks are not unique to third party access regulation.¹⁵

2.3.2 The arbitration mechanism under the access regime has been utilised

There has been one dispute and arbitration under the MS Act, which took place in 2020-21.

2.3.3 Information provision

Information exchange is an important part of commercial negotiations for access. Section 12 of the MS Act requires that a regulated operator provide certain information, including price information, to a customer in order to allow that party to determine whether or not to seek access, and to avoid the risk that a regulated operator might disrupt or curtail access by not supplying or delaying the supply of information.

Current information requirements are set out in the Commission's Port Industry Guideline No. 1 (**Guideline 1**).¹⁶ A regulated operator is required to publish a price information kit, which includes a price list, pricing policies, a schedule of pilotage charges (that applies to regulated operators in which this is relevant), and a list of regulated services at each proclaimed port (proclaimed ports are those that are declared by proclamation to be subject to the MS Act). The price information kit is to be published on the operator's website.

¹³ Railways (Operations and Access) Act 1997, AustralAsiaRailway (Third Party Access) Act 1999, and Part 9A of the Water Industry Act 2012.

¹⁴ Examples include New South Wales water infrastructure access, Western Australia railway access, and Queensland railway access (through undertakings).

¹⁵ Productivity Commission, *National Access Regime*, p. 119.

¹⁶ Commission, *Ports Industry Guideline No. 1*, May 2010, pp. 1-9, available at <https://www.escosa.sa.gov.au/ArticleDocuments/226/100324-PortsGuidelineNo1-AccessPriceInformation.pdf.aspx?Embed=Y>.

2.3.4 Reporting requirements

Section 42 of the MS Act requires that the regulated operator maintain separate accounts for regulated services and unregulated services, including separate accounts for each port, and these must be made available for inspection by the Commission. The MS Act requires that accounts and records must be prepared in line with the Commission's Port Industry Guideline No. 2 (**Guideline 2**), which outlines the operational performance statistics and financial accounting reporting to be provided to the Commission (including guidance on transparency on cost allocation and asset values to be reported).¹⁷

2.3.5 Price determination

Section 6 of the MS Act provides for the Commission to make a price determination in respect of essential maritime industries under part 3 of the ESC Act. This is a discretionary power of the Commission. Any such price determination may, for convenience, have a term of five years to be consistent with the prescribed period for the access regime. However, there is nothing precluding a determination expiry date prior to the end of the prescribed period.

In addition to having regard to the factors set out in the MS Act and ESC Act, a price determination must have regard to price regulation factors as set out in section 25 of the ESC Act, along with the procedural requirements of section 26.

For example, sections 25(4) and (5) of the ESC Act provide that:

- ▶ In making a price determination, the Commission must (in addition to having regard to the general factors specified in Part 2) have regard to:
 - the particular circumstances of the regulated industry and the goods and services for which the determination is being made;
 - the costs of making, producing or supplying the goods or services
 - the costs of complying with laws or regulatory requirements;
 - the return on assets in the regulated industry;
 - any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries;
 - the financial implications of the determination;
 - any factors specified by a relevant industry regulation Act or by regulation under this Act;
 - any other factors that the Commission considers relevant.
- ▶ In making a price determination under this section, the Commission must ensure that:
 - wherever possible the costs of regulation do not exceed the benefits; and
 - the decision takes into account and clearly articulates any trade-off between costs and service standards.

Under the Commission's current 2017-2022 price determination, Flinders Ports (the regulated operator to which this section of the MS Act applies) must publish on its website a schedule of published prices, prior to the commencement of each financial year. Flinders Ports must provide a copy of those

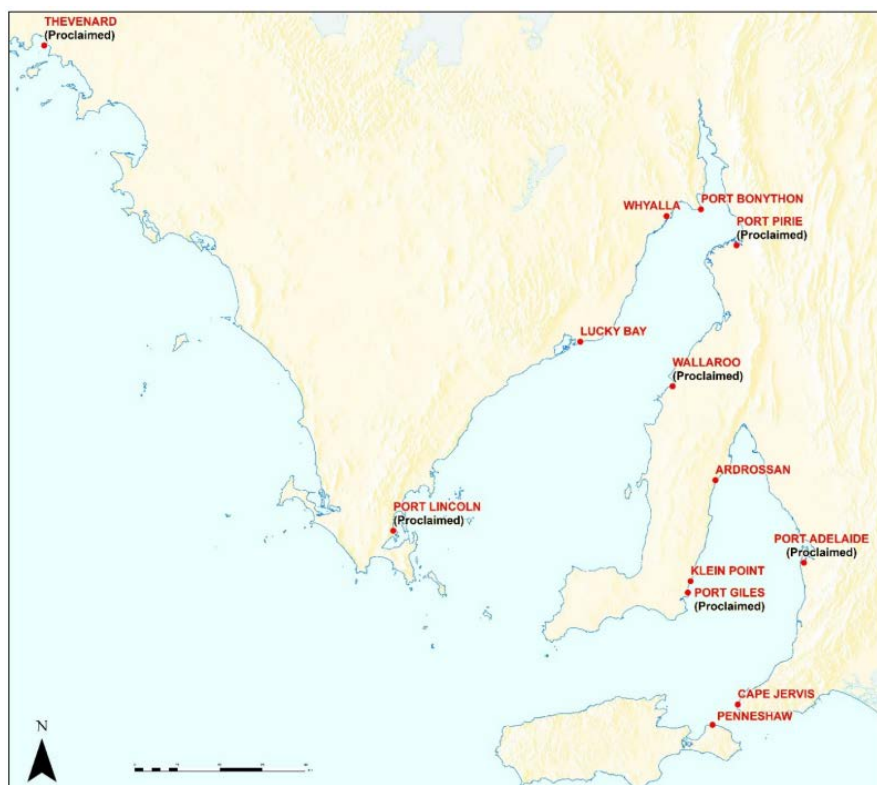
¹⁷ Commission, *Ports Industry Guideline No. 2*, May 2010, pp. 1-67, available at <https://www.escosa.sa.gov.au/ArticleDocuments/226/100415-PortsGuidelineNo2-RegulatoryAccounts.pdf.aspx?Embed=Y>.

published prices to the Commission and provide accompanying reasons for any increases.¹⁸ The Commission monitors published prices and reports on them annually.¹⁹

2.3.6 Coverage of services under the MS Act

There are currently six proclaimed ports that are declared to be subject to the MS Act, and therefore are subject to the access regime and the price determination: Port Adelaide, Port Giles, Wallaroo, Port Pirie, Port Lincoln and Thevenard.²⁰ Figure 1 shows proclaimed ports, as well as certain other operational ports that are unregulated by the MS Act (including Lucky Bay, Whyalla, Port Bonython, Klein Point, Cape Jervis, Penneshaw and Ardrossan).²¹

Figure 1. Proclaimed ports in South Australia (Source: South Australian Government)



Regulated maritime services are maritime services at a proclaimed port that are declared by proclamation to be regulated services. This includes:

- ▶ access of vessels to the port and harbour, including channels and certain common user berths
- ▶ pilotage services that facilitate access to the port

¹⁸ Commission, *Ports price determination: 2017-2022*, October 2017, pp. 1-4, available at <https://www.escosa.sa.gov.au/ArticleDocuments/1139/20171009-Ports-AccessAndPricingReview-PriceDetermination2017-2022.pdf.aspx?Embed=Y>.

¹⁹ For example, see Commission, *Ports Price monitoring report 2021*, October 2021, pp. 1-6, available at <https://www.escosa.sa.gov.au/ArticleDocuments/592/20211029-Ports-Price%20MonitoringReport-2021.pdf.aspx?Embed=Y>.

²⁰ Section 5 of the MS Act states that the Governor may, by proclamation, declare any one or more of the following ports to be subject to the MS Act: (a) Port Adelaide; (b) Port Giles; (c) Wallaroo; (d) Port Pirie; (e) Port Lincoln; (f) Thevenard; (g) any other port declared by regulation to be capable of being brought within the application of this Act. A proclamation under the MS Act may define the boundaries of the proclaimed port.

²¹ South Australian Government, *Application for the extension under section 44NA of the Competition and Consumer Act 2010*, pp. 9-10.

- ▶ access to land in connection with certain maritime services, and
- ▶ access to port facilities (buildings, wharves and jetties, plant and equipment, but not stevedoring plant and equipment) installed at certain berths at proclaimed ports (where the equipment is designed principally for handling grain).

The full list of berths and services proclaimed as regulated maritime services is provided in Appendix B. Proclaimed berths primarily include common user berths. Historically, single user berths were perceived to have less need for protections under the access regime, given the long-term leases involved and the size and market power of the users of those berths.²²

Essential maritime services are defined in section 4 of the MS Act. They are maritime services that:

- ▶ provide or allow for access of vessels to a proclaimed port
- ▶ provide port facilities for the loading or unloading vessels at a proclaimed port, or
- ▶ provide berths for vessels at a proclaimed port.

Examples of essential maritime services include navigational aids, channels, harbour control (but not pilotage or towage), berths, wharves, jetties, berth pockets, mooring structures, mooring and unmooring provisioning connections (but not provisioning), fenders, and cargo loading and unloading (marshalling) areas (but not loading and unloading itself).

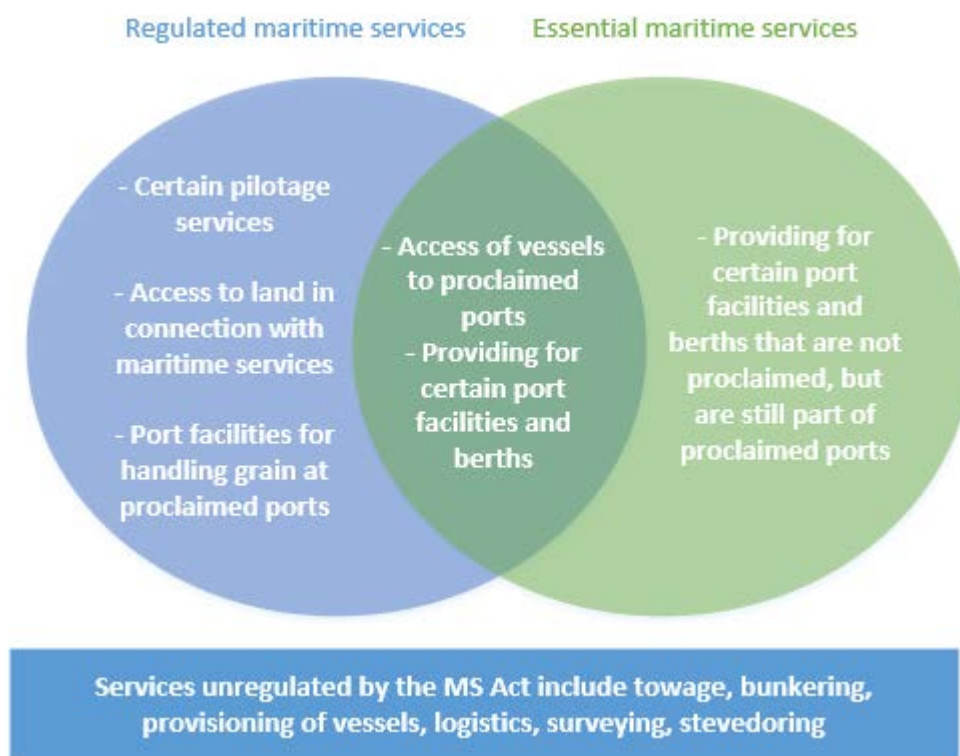
Essential and **regulated** maritime services have a degree of overlap including services that provide for vessel access to berths and channels, as shown in Figure 2. There are, however, services that do not overlap. For instance, there are regulated maritime services that are not essential services, such as access to pilotage²³, bulk grain loading facilities and land in connection with proclaimed berths and services, and there are essential maritime services, that are not regulated services, such as those relating to berths that are not proclaimed (ie many single user berths).

There are also many services that are neither regulated nor essential maritime services. These include (but are not limited to) stevedore, towage, pilotage, bunkering, logistics and distribution services. Services that are not proclaimed under the MS Act can potentially be covered under alternative access frameworks, as parties may lodge an application for declaration of the service under Part IIIA of the CCA (although there are a range of criteria that would need to be met including that the service is of national significance).

²² For example, Hon. KT Griffin MLC, *South Australian Government Gazette*, 9 November 2000: 'It [the access regime] is not proposed to regulate facilities that are currently used by a single entity under an existing agreement where there is little prospect of, or need for, competition. The Port of Klein Point which is used only by ABC [Adelaide Brighton Corporation] as a source of limestone for its cement making operation in Port Adelaide is an example, along with other berths in Port Adelaide which are the subject of current single user agreements such as the Sea-Land container terminal and Penrice berth, and in Regional ports the Pasmenco [now Nyrstar] berth at Port Pirie. It is not intended to provide third party access to these particular berths through the access regime, but other berths in most ports (including Port Pirie) will be subject to the third party access regime.'

²³ While pilotage is not defined as an essential maritime service, section 8 of the MS Act specifically requires the regulated operator to maintain a current schedule of pilotage charges, provide those charges to the public (on request), and provide to the Commission a copy of any new proposed pilotage charges including a description of the changes and the reasons for them.

Figure 2. Coverage of services under the MS Act (indicative only)



2.4 Participants and users of the access regime

Participants can be categorised into three groups: regulated operators, customers, and end customers.

There are currently two regulated operators:

- ▶ Flinders Ports operates the six proclaimed ports outlined above and the regional port at Klein Point (which is not proclaimed). Flinders Ports was established in 2001 when it acquired port assets, a 99-year land lease and port operating agreements from the South Australian Government as part of privatisation. Flinders Ports is a wholly owned subsidiary of Flinders Ports Holdings Ltd (FPH). FPH own and operate Flinders Adelaide Container Terminal (FACT). FPH is the head company of an integrated supply chain business of which there are multiple parts, including Flinders Ports, FACT, Flinders Logistics, Flinders Warehousing and Distribution, and HydroSurvey Australia.
- ▶ Viterro Operations Pty Ltd (Viterro) owns and operates bulk grain loading facilities at five of the six proclaimed ports. Viterro operates other (unregulated) bulk storage and handling facilities and a grain trading business and is therefore a vertically integrated port operator for grain. It has a substantial market share of the commercial grain storage capacity in South Australia.

The customers under the regime tend to be shipping lines and grain merchants or growers. For example, on arriving at port a shipping line typically pays for regulated and essential maritime services, such as access of vessels to the port and berths, including navigation services, certain pilotage services, harbour services and certain cargo services. In terms of access to regulated bulk loading facilities (including conveyor belts), the main customers seeking access include grain merchants as well as grain growers and mineral producers.

The end customers are the importers, exporters, and parties engaging in domestic sea trade. It should be noted that all costs in the transport supply chain are typically passed through to end customers.

Those end customers will pay (often via freight forwarders or agents) the shipping line and the logistics and transport companies.

2.5 Process and submissions to the review

In December 2021, the Commission called for submissions on the access regime and the price determination. Submissions were received from:

- ▶ Grain Producers SA (**GPSA**), the industry body for South Australian grain growers²⁴
- ▶ Viterra (regulated operator)²⁵
- ▶ Flinders Ports (regulated operator)²⁶
- ▶ Gypsum Resources Australia Pty Ltd (**GRA**), a company exporting gypsum through the port at Thevenard (who accesses conveyor facilities at Thevenard)²⁷
- ▶ The South Australian Freight Council (**SAFC**), a freight and logistics industry body,²⁸ and
- ▶ QUBE Ports Pty Ltd (**QUBE**), a logistics, transport and stevedore company.²⁹

Two-stage process

In March 2022 the Commission determined that a two-stage approach to the review would allow it to consider the suggestions by stakeholders and the NCC, a number of which were broader in scope than the legislative remit of sections 43 and 6 of the MS Act, while at the same time allowing it to meet the statutory requirements of these sections prior to the expiry of the current access regime and price determination in October 2022.

A summary list of the suggestions raised by stakeholders to improve the access regime is summarised in Appendix A. The full submissions (where not confidential) are available on the Commission's website.

Stage one approach

The access regime should continue to apply if it is required for at least one regulated maritime service and if it results in more benefits than costs. A price determination is required if an operator has an

²⁴ GPSA, *Submission to 2022 Ports Pricing and Access Review*, pp. 1-3, February 2022, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21845/20220331-Ports-PricingAndAccessReview2022-Submission-GPSA.pdf.aspx?Embed=Y>.

²⁵ Viterra, *Submission to 2022 Ports Pricing and Access Review*, pp. 1-4, February 2022, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21845/20220331-Ports-PricingAndAccessReview2022-Submission-Viterra.pdf.aspx?Embed=Y>.

²⁶ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, February 2022, pp. 1-4, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21845/20220331-Ports-PricingAndAccessReview2022-Submission-FlindersPorts.pdf.aspx?Embed=Y>. Flinders Ports provided an attached research report prepared by Synergies Economic Consulting on their behalf. See Synergies, *2022 ESCOSA Review – Report on Selected Economic Matters*, January 2022, pp. 1-36, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21845/20220331-Ports-PricingAndAccessReview2022-Submission-FlindersPorts-SynergiesReport.pdf.aspx?Embed=Y>.

²⁷ GRA, pp. 1-17.

²⁸ SAFC, *Submission to 2022 Ports Pricing and Access Review*, pp. 1-6, February 2022, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21845/20220331-Ports-PricingAndAccessReview2022-Submission-SAFC.pdf.aspx?Embed=Y>.

²⁹ QUBE, *Submission to 2022 Ports Pricing and Access Review*, pp. 1-87, February 2022, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21845/20220331-Ports-PricingAndAccessReview2022-Submission-%20QUBE.pdf.aspx?Embed=Y>.

incentive and ability to exercise market power – the form of any price determination depends on the benefits to both customers and end customers and the regulatory costs imposed on the operator.

The structure of this report is as follows:

- ▶ Chapter 3 describes the economic characteristics of regulated and essential maritime services. The nature and level of demand as well as inter-port substitutes are outlined.
- ▶ Chapter 4 examines competitive conditions across proclaimed ports. The analysis considers barriers to entry and inter-port competition. This informs the need for an access regime and a price determination.
- ▶ Chapter 5 discusses the risks from Flinders Ports' integration with related entities.
- ▶ Chapter 6 summarises the overall evidence on why the access regime should continue and explains the Commission's draft recommendation.
- ▶ Chapter 7 discusses price and financial monitoring, including the Commission's draft proposal.

3 Economic characteristics of regulated and essential maritime services

Port infrastructure facilitates the import and export of goods and allows resources to move to where they are valued most in the economy. In doing so, it can support the expansion of local industries and promote economic growth. In 2020-21, the direct value of South Australia's international trade in goods was \$23.7 billion, equivalent to the value of one-fifth of the size of the local economy.³⁰

Regulated and essential maritime services are provided to ship operators to enable them to arrive, load, unload and depart proclaimed ports. In addition, regulated maritime services are provided to certain end customers to allow them access to bulk grain loading facilities. While these types of services together account for a small value relative to sea trade, they are critical nodes in the transport supply chain. This section of the report outlines the nature of the demand and supply of regulated and essential maritime services. It discusses sources of customer value, substitutes to these services, and the primary characteristics of technology and cost that determine competitive conditions at proclaimed ports.

3.1 Demand

3.1.1 Nature of service

The demand for regulated and essential maritime services is, in effect, a form of derived demand. This flows from the demand for transportation services, which, in turn, is the result of the demand and supply of goods and commodities from exporters, importers and businesses engaging in domestic trade. The quantity demanded of regulated and essential maritime services is determined by a range of factors. This includes available inter-port substitutes and alternative transport modes.

In South Australia, end customer demand tends to come from miners, manufacturers, retail and distribution firms, and agricultural producers.³¹ Ultimately, these customers require the transportation of goods from origin to destination. When scaled against transport supply chains, the price of regulated and essential maritime services can be considered a minor proportion of total transport costs.³²

3.1.2 Throughput at proclaimed ports

Indicators of cargo throughput at proclaimed ports can provide a measure of demand, given that regulated and essential maritime services are inputs to aid a ship to arrive, unload, load and depart.

Total annual throughput at Flinders Ports' ports in South Australia has generally fluctuated between 23 and 25 million tonnes over the past decade, following an increase in volumes between 2010 and 2013 (Figure 3).³³ While imports of container freight and bulk products have grown over the past decade, exports of container freight, grain, and bulk non-grain freight have decreased over the same period. The latter have also contributed to the annual volatility in throughput from year to year.

Over the past three years, cargo throughput has been lower than average despite a recent expansion in capacity at Port Adelaide (due to widening the one-way shipping channel and extending common user berths). In part, the recent outcomes reflect low grain throughput in 2019 and 2020, a fall in exports of

³⁰ Australian Bureau of Statistics, *5220.0 Australian National Accounts: State Accounts 2020-21*, Table 5. Available at: <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-state-accounts/latest-release>.

³¹ This chapter focuses on goods cargo. There is also demand associated with cruise ships. While cruise demand has increased over the past decade, it remains a relatively minor share of channel and ports usage.

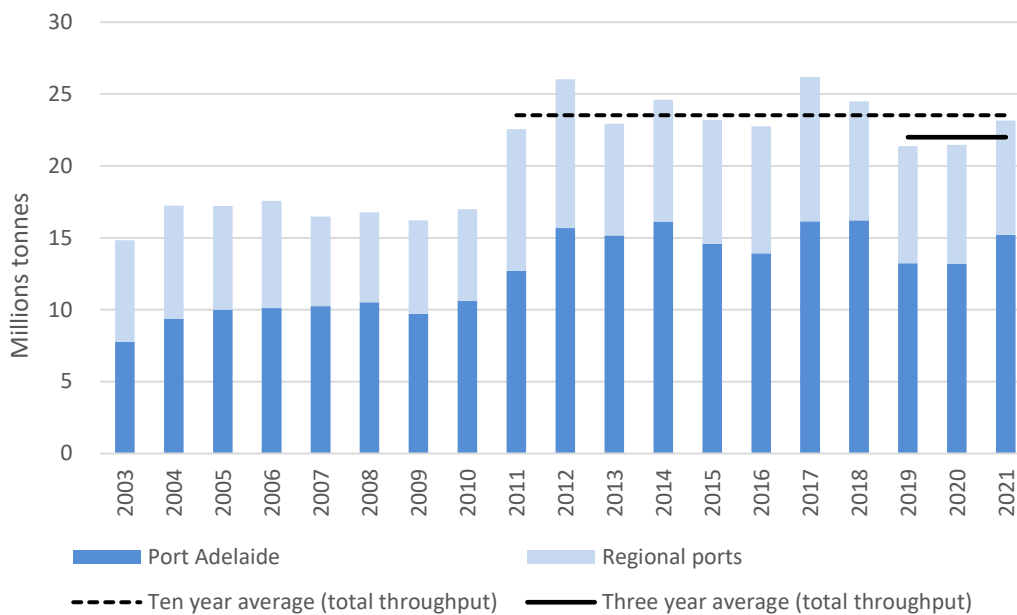
³² Estimates suggest that for containers it can be as low as 5 percent of the total. Synergies, p. 28.

³³ The increase in total throughput in 2011 and 2012 was reportedly facilitated by an expansion in port capacity.

both mineral resources and containerised freight, and disruptions associated with COVID-19. (For a description of cargo throughput types, see Box 1.)

The origin and destination of cargo throughput from Flinders Ports' ports is a mix of coastal domestic trade and international trade. To place domestic trade into context, the volume of coastal domestic trade to, from and within South Australia in 2018-19 was approximately 13 million tonnes,³⁴ which was equivalent to more than half of Flinders Ports' volume of total throughput in the same year.³⁵

Figure 3. Volume of total throughput at Flinders Ports³⁶ (Sources: Flinders Ports, Ports Australia)



Looking ahead, the outlook for overall cargo throughput at proclaimed ports will depend on a range of factors, such as economic conditions locally and nationally (particularly for container trade and bulk imports); global demand for food, wine, and mineral commodities; shipping connectivity in South Australia; and the performance and development of new and existing port facilities. Flinders Ports proposes to invest approximately \$550 million over the next 20 years to maintain existing levels of cargo throughput at proclaimed ports (to avoid cargo trade being lost to other ports).³⁷

Box 1. Cargo passing through proclaimed ports in South Australia

Container freight is estimated to account for half of total throughput, the vast majority of which passes through Port Adelaide. Imported containers consist of goods for the retail, manufacturing and construction sectors, whereas exported containers tend to consist of wine and agricultural products. A key characteristic of container freight in South Australia is the relatively high number of empty containers imported for their subsequent use in exporting freight.³⁸

³⁴ BITRE, 'Australian sea freight 2018-19', Statistical report, *Department of Infrastructure, Transport, Regional Development and Communications*, July 2021, p. 21, available at <https://www.bitre.gov.au/sites/default/files/documents/asf-2018-19.pdf>. Data includes throughput at Klein Point (a port that is not proclaimed).

³⁵ A practical example is the ship named Acacia. In 2017-18, this ship carried cement and gypsum, calling in at Thevenard, Adelaide, Melbourne, Sydney and Brisbane. BITRE, *Australian Sea freight 2018-19*, pp. 72-74.

³⁶ Data is on a financial year basis. Data includes throughput at Klein Point.

³⁷ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, 17-18.

³⁸ Synergies, pp. 30-36, Flinders Ports, *Submission to Productivity Commission*, 21 February 2022, pp. 15-16, available at https://www.pc.gov.au/_data/assets/pdf_file/0008/336833/sub055-maritime-logistics.pdf, and

Bulk freight consists of two main categories: non-grain freight and grain freight. Of the non-grain freight passing through proclaimed ports, there are three main types: dry bulk, bulk liquids and break-bulk.³⁹ These (non-grain) forms of bulk cargo together account for about one-third of total throughput at Flinders Ports' ports. In terms of grain freight, this accounts for between 15 and 20 percent of throughput and is a key contributor to annual volatility. The majority of throughput at regional ports, such as Wallaroo, Port Giles and Port Lincoln, consists of grain.

3.2 Substitutes

3.2.1 Inter-port substitution

There are three main possible dimensions of substitution for regulated maritime services and essential maritime services: competition from existing ports, new ports and alternative land transport options.

The region for which a port has a transport cost advantage is known as the port's hinterland. At some distance from a port there can be hinterland areas where substitution becomes feasible; goods may be transported by road or rail direct to points close to the end customers' final destination, or to and from competing intra- or inter-state ports for subsequent transport onwards to the final destination. The key point is that, where land transport costs are reasonable and inter-port substitution is possible, this can affect the level of demand for regulated and essential maritime services and therefore create competitive pressures on charges. Table 1 documents existing and prospective intra- and inter-state ports and associated key cargos (reported by Flinders Ports).

Table 1. Potentially competing ports, by key cargo type, as reported by Flinders Ports⁴⁰

Competing ports	Grain	Mineral resources	Other cargoes
Existing ports			
Port of Melbourne			Containers, car carriers
Geelong Port	✓	✓	Project cargo
Port of Newcastle		✓	Project cargo
Port of Portland	✓	✓	
Port of Darwin		✓	Fertiliser
Lucky Bay (SA)	✓		
Whyalla (SA)		✓	Cement, project cargo
Port Bonython (SA)			Oil and gas
Prospective ports			
Wallaroo (T-Ports) (SA)	✓		
Cape Hardy (SA)	✓	✓	Fertiliser

BITRE, 'Waterline 67', Statistical report, *Department of Infrastructure, Transport, Regional Development and Communications*, December 2021, p. 15, available at https://www.bitre.gov.au/sites/default/files/documents/water_067.pdf.

³⁹ Bulk liquids consist of imported fuel, oil and gas, and are imported through Port Adelaide via specialised berth facilities. Dry bulk consists of a range of mineral resource and manufactured products, such as cement/clinker, fertilizers, limestone, soda ash, copper ore and mineral sands, and these products predominantly move through Port Adelaide, Point Klein, Port Pirie and Thevenard. Break-bulk freight consists of a diverse range of goods, including cars, livestock, timber and chemicals, and are moved largely through Port Adelaide.

⁴⁰ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 29-39, and Synergies, p. 24.

Competing ports	Grain	Mineral resources	Other cargoes
Port Playford (Port Augusta) (SA)		✓	Fertiliser, project cargo
Port Spencer (SA)	✓		

3.2.2 South Australia's shipping connectivity

A key factor relating to inter-port substitutability is the degree to which ships may choose to call (or not) at ports in South Australia. Bulk freight transported to and from South Australia tends to be chartered on non-container vessels on a shipping route specific to the cargo owners' supply chain requirements. Chartered vessels can call at single or multiple ports in Australia and overseas locations. For example, a single international vessel may call at multiple ports in Australia including Adelaide.⁴¹

The degree of shipping connectivity for container vessels tends to be different to that for chartered vessels. Container trade is global: international container shipping lines wish to limit the number of stops, and the size of ship to be used is dictated by the smallest port to be visited on any particular shipping route. Ultimately, a container shipping line's decision on which ports to call at depends on demands from end customers, available and planned shipping routes, and the size, capability and facilities of ports (including channel depths).

The Port of Adelaide is the only major container freight port for South Australia. It is relatively small (accounting for approximately 6 percent of national container volumes in 2019-20) and is located at a substantial distance from major population centres on the east and west coast of Australia and from the major container ports in Australia where international shipping lines call. As a result, the Port of Adelaide has historically found it challenging to attract container shipping services, and this has led Flinders Ports to widen the one-way shipping channel and extend berths, for example.⁴²

In spite of these challenges, the port has attracted international shipping services over the past decade,⁴³ with seven international services currently calling at port on a regular basis,⁴⁴ and global indices showing that the Port of Adelaide's shipping connectivity has trended higher since 2012.⁴⁵ Reports indicate that the container services calling are those that are on their way past Adelaide, or on their way to or from Melbourne.⁴⁶ Ships have been attracted due to: (i) the population centre being located nearby, which can provide a natural captive hinterland,⁴⁷ (ii) marketing efforts undertaken by Flinders Ports,⁴⁸ (iii) expanded capacity at the port, which has enabled the arrival and departure of larger vessels,⁴⁹ and (iv) positive network externalities (as more customers have used the port and throughput volumes have increased, more shipping lines have likely chosen to service the port).

⁴¹ For example, the international bulk liquids tanker Alexander Spirit, which in 2017-18 called in at Adelaide, Albany, Brisbane and Cairns. BITRE, *Australian Sea freight 2018-19*, pp. 72-74.

⁴² Synergies, pp. 32-36, FTA / APSA interview with Stewart Lammin, 10 February 2018, available at <https://www.ftalliance.com.au/advocacydetail/995>, and Flinders Ports, *Submission to Productivity Commission*, p. 4.

⁴³ Port of Melbourne, *Port of Melbourne 2020 Container Logistics Chain Study*, July 2021, p. 28, available at <https://www.portofmelbourne.com/wp-content/uploads/Port-of-Melbourne-2020-Container-Logistics-Chain-Study-Report-Web.pdf>.

⁴⁴ Synergies, p. 35.

⁴⁵ UNCTAD, *Liner Shipping Connectivity Index*, available at: <https://unctadstat.unctad.org/EN/Index.html>.

⁴⁶ Synergies, pp. 32-36.

⁴⁷ For example, see *ACCC v NSW Ports Operations Hold Co Pty Ltd [2021] FCA at 1553*.

⁴⁸ Synergies, pp. 32, and *ACCC v NSW Ports Operations Hold Co Pty Ltd [2021] FCA at 816 and 817*.

⁴⁹ Stewart Lammin, *Planning for expansion: Outer Harbour Channel Widening Project*, Future of freight: Embracing Change SAFC/ICHCA Conference, 31 October-1 November 2018, available at

3.3 Sunk costs and economies of scale and scope

Technology and cost are known to influence competitive pressures. Many regulated and essential maritime services, such as access to channels, berths and bulk grain loading facilities, have high fixed and low variable costs, indicative of services that exhibit economies of scale. Furthermore, economies of scope can arise when a regulated operator offers a range of complementary access services.⁵⁰

There is also limited salvage value for certain regulated operator infrastructure (such as for harbour channels). These sunk cost characteristics are further reinforced by the fact that companies in the maritime supply chain have large asset-specific sunk investments at, or in close proximity to, proclaimed ports.⁵¹

Taken together, these various features indicate that a regulated operator may have an incentive and ability to exercise market power in provision of access and in setting pricing for some services, due to natural monopoly characteristics of port infrastructure and high customer switching costs.⁵²

(For a discussion relating to pilotage services, which are a little different to channels and berths, please see Box 2.)

Box 2. Entry barriers in the provision of pilotage services

Pilotage is compulsory under section 35 of the *Harbors and Navigation Act 1993*.⁵³ Pilots board ships to provide captains with critical guidance when entering a port. Pilotage services that facilitate access at proclaimed ports are a regulated maritime service. These services require significant location-specific licensing and training.⁵⁴ These requirements can make it a service that is not economically feasible to duplicate. Consistent with this, operators of many ports in Australia and internationally choose, or have regulations, to be serviced by a single supplier.⁵⁵

<http://www.safreightcouncil.com.au/userfiles/Conference%202018/presentations/1030%20Thur%20RB2&3%20Stewart%20Lammin%20FlindersPorts.pdf>, and Flinders Ports, *Submission to Productivity Commission*, pp. 4-5.

⁵⁰ The economy of scope can manifest through reduced transaction costs for a ship operator (who requires multiple regulated and essential maritime services to arrive, load, unload and depart the port), and also through the role of complementarity in service delivery (the performance of one element depends on the performance of other elements).

⁵¹ For example, this includes manufacturing operations at Port Pirie; GRA's conveyor facilities at Thevenard; warehousing, transport and/or distribution facilities such as those for Flinders Warehousing and Distribution and Symons Clark Logistics; stevedore offices and facilities such as those leased or owned by QUBE, DP World and SA Shipwrighting; and rail facilities such as One Rail's yards at Port Adelaide Flat.

⁵² Network effects (which were noted in section 3.2) can be indicative of the cost and demand attributes of a natural monopoly position. Joskow P, 'Regulation of Natural Monopoly', *Handbook of Law and Economics*, Volume 2, ed. Mitchell and Shavell, pp. 1229-1248, 2007.

⁵³ The Harbors and Navigation Act can be found here: https://www.legislation.sa.gov.au/_legislation/lz/c/a/harbors%20and%20navigation%20act%201993/current/1993.41.auth.pdf.

⁵⁴ Training and licensing costs can be considered fixed costs. Port-specific knowledge and training lies with pilots, so may be considered sunk costs.

⁵⁵ ACCC, *Application for authorisation lodged by Brisbane Marine Pilots Pty Ltd in respect of an exclusive pilotage services agreement at the Port of Brisbane*, 3 December 2010, pp. 4-6, available at <https://www.accc.gov.au/system/files/public-registers/documents/D10%2B3712649.pdf>.

4 Competitive analysis

This section sets out the Commission's analysis of competitive conditions across proclaimed ports in South Australia. Promoting the objects of the MS Act requires analysis of competition in regulated industries in relation to maritime services covered under the access regime and the price determination.⁵⁶

An operator of regulated and essential maritime services may have the potential to exercise market power. This can arise when there is an enduring lack of competition, which can be brought about if substitution opportunities are limited, if the cost of entry and switching is high, and if customers do not have sufficient countervailing bargaining power. A lack of competition can impose costs on the community when it allows an operator to limit competition in upstream and downstream markets and/or to set prices well above costs for regulated and essential maritime services. Also, there are risks that can arise if an operator is integrated into related markets (including from strategic behaviour to modify market structures and their competitors' conduct, to shape the competitive environment into one favourable to their own operations).

The analysis in this chapter considers proclaimed ports and focusses on two main areas: structural barriers to entry for new ports, and inter-port competition (for container freight, bulk mineral freight and bulk grain freight). The chapter sets out the Commission's analysis of whether or not a regulated operator may have an incentive and ability to exercise market power. The risk of integration with related entities is discussed separately in Chapter 5.

For the analysis in this chapter, the market has been defined as the supply of and demand for port services at ports within and outside South Australia. This approach has been adopted to account for actual patterns of trade and threats to incumbents from new suppliers. This aligns with the purpose and legislative questions of sections 43 and 6 of the MS Act.⁵⁷

4.1 Structural barriers to entry for new port infrastructure

As outlined in Chapter 3, regulated and essential maritime services have characteristics of a natural monopoly, and existing companies in the maritime supply chain have large asset-specific sunk investments at, or near, proclaimed ports. These features indicate a high cost to end customers of switching to a new port, along with high barriers to entry. Unless there is sufficiently high expected demand, new port entry is unlikely in most instances. Indeed, over the past decade there have been limited port entrants in South Australia for containerised freight and non-grain bulk freight.

There have, however, been several port entrants in the grain sector in recent years, such as T-Ports' operations at Lucky Bay and at Wallaroo (the former is operating, the latter is under construction). Submissions received claim the access regime has contributed to this entry.⁵⁸ Further, despite the apparent high cost of entry, several prospective new ports are reported by Flinders Ports as credible threats; these have been identified at Cape Hardy, Port Playford and Port Spencer and will service the grain and mineral sectors.⁵⁹ New port entrants can be underpinned by one large single trade (ie

⁵⁶ Section 3(b) and (c) of the MS Act.

⁵⁷ Market definition is an analytical tool to aid consideration of the competitive processes and the identification of the key variables of interest; it should not be determinative in and of itself. Further, market definition necessarily involves value judgements about the boundaries of overlapping geographic and product markets. See *Application by Chime Communications Pty Ltd (No 2) [2009] ACompT 2* at 29, and *ACCC v Liquorland (Australia) Pty Ltd [2006]* at 442.

⁵⁸ GPSA, pp. 1-2, and Viterra, p. 3. Some stakeholders have argued in previous reviews that the presence of the regulatory regime can provide favourable conditions for new port entrants (although this argument assumes that the new entrant does not expect to ever become part of the access regime).

⁵⁹ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 29-39, and Synergies, p. 24.

production from a new mine). Flinders Ports has argued that potential new entry provides the same economic constraints as existing operations for the purpose of competition law.⁶⁰

The potential for new entry should not, on its own, be conclusive.⁶¹ The credibility of any such threat depends on actual conditions (including commercial realities) that affect the ability of potential competitors to enter and constrain the behaviour of a regulated operator. High switching costs for customers and any new port projects' dependence on commodity market developments are reasons to caution against placing too much weight on the theoretical prospect of new entry alone.⁶²

Overall, while structural barriers to entry for new port infrastructure in South Australia can vary across geographic and product markets, there are sufficient reasons to conclude that they are high and, in some cases, likely to be insurmountably so. The implication is that – absent access regulation – regulated operators may have an ability to exercise market power for an anti-competitive purpose.

4.2 Competition conditions according to main cargo types

As mentioned earlier, a port may be constrained by three main dimensions of substitution: competition from existing ports, new ports and alternative transport options. This section sets out the Commission's analysis of the competitive processes and key variables of interest in respect of three main cargo types: container freight, bulk non-grain (mineral resources) freight and bulk grain freight.

4.2.1 Containerised freight

As noted in Chapter 3, most container freight passes through the Port of Adelaide. Research studies⁶³ and reports from stakeholders⁶⁴ indicate that the Port of Adelaide and the Port of Melbourne compete to some extent. One indicator of inter-port competition is the low number of imported containers per capita for the Port of Adelaide compared with the Port of Melbourne and the Australian average (Figure 4). Based on TEU measurements per capita, the Port of Adelaide appears to capture only 60 percent of containerised imports into South Australia, though it captures most (if not all) of its export potential.⁶⁵

⁶⁰ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 11.

⁶¹ Application by Chime Communications Pty Ltd (No 2) [2009] ACompT 2 at 46.

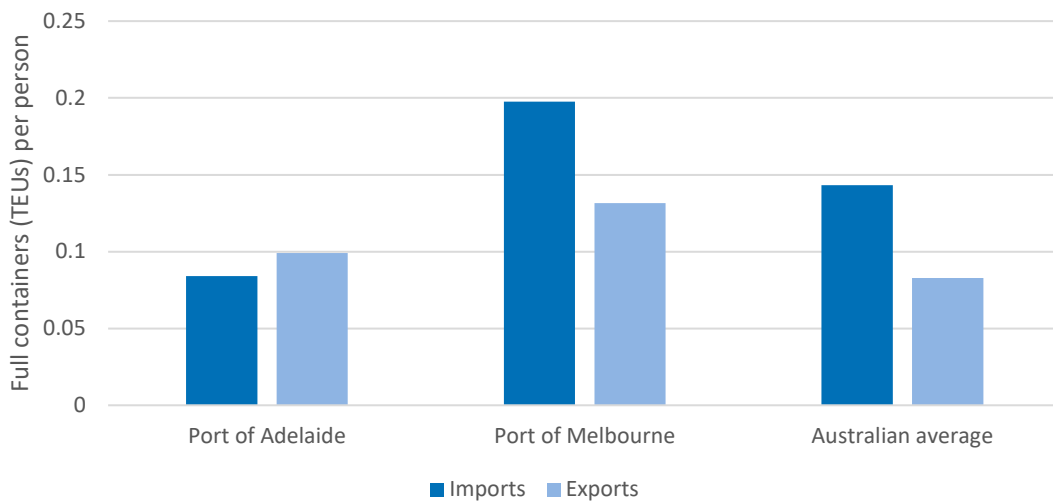
⁶² The latter is illustrated by the fact that some mineral and grain port developments can remain prospective for long periods. For example, a potential port at Port Spencer was flagged back in 2012 by Flinders Ports (involving both mineral and grain freight). However, a grain-only port at this location is now reportedly commencing construction (see Tauriello G, *Port Spencer deep-water grain export port secures funding, construction to start*, *The Advertiser*, 4 May 2022). A potential port at Cape Hardy to transport mineral resources was flagged by Flinders Ports in 2017, yet at this stage it has not commenced construction. Flinders Ports, *Submission to 2012 Ports Access and Pricing Review*, p. 3, available at https://www.escosa.sa.gov.au/ArticleDocuments/683/120328-2012_PortsPricing_AccessReviewIssuFlinders.pdf.aspx?Embed=Y, and Flinders Ports, *Submission to 2017 Ports Access and Pricing Review*, November 2016, p. 6, available at <https://www.escosa.sa.gov.au/ArticleDocuments/1023/20161220-2017PortsPricingAccessReviewSubmission-FlindersPorts.pdf.aspx?Embed=Y>.

⁶³ Port of Melbourne, pp. 14-15, and ACCC v NSW Ports Operations Hold Co Pty Ltd [2021] at 761 and 762.

⁶⁴ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 34-36, and Synergies, pp. 32-36.

⁶⁵ Consistent with competition between the two ports, there are reports that some wine exporters are now sending containers to the Port of Melbourne, rather than to Adelaide, in order to both avoid delays (caused by ships bypassing Adelaide in light of COVID-19 related disruptions) and to take advantage of discounted backhaul rates offered on interstate rail services. Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 36, and South Australian Wine Industry Association, *Submission to Australia's Maritime Logistics Inquiry*, 11 February 2022, pp. 5-7, available at: https://www.pc.gov.au/_data/assets/pdf_file/0009/336528/sub017-maritime-logistics.pdf.

Figure 4. Imported and exported containers per capita, 2019-20 (Sources: BITRE, ABS)



To complement the information above, a simple hypothetical case study was estimated to illustrate the cost from transporting goods to South Australia from Melbourne, by either sea freight or another mode of transport (road or rail). Melbourne was chosen as a point of comparison because of its potential for competition with the Port of Adelaide. It is important to note that the hypothetical example is a simplification, and the results are highly sensitive to the assumptions used.⁶⁶

The hypothetical case study illustrates that sea transport through the Port of Adelaide may be lower cost than landing in Melbourne and transporting container freight by road or rail to Adelaide (Figure 5). The result is consistent with the 60 percent share of imported containerised freight captured by the Port of Adelaide.

The case study also indicates which of the Port of Adelaide's hinterlands may be contestable or captive. In particular, the analysis suggested that, should the prices of certain ship- and cargo-based charges increase by, say, 10 percent, the share of imported freight to the Limestone Coast region of South Australia (estimated at approximately 4 percent of import demand based on its share of population) may shift to the Port of Melbourne.⁶⁷ Many other regions, however, were estimated to be unlikely (all things being equal) to see switching in response to a 10 percent increase in the prices of certain ship- and cargo-based charges.⁶⁸

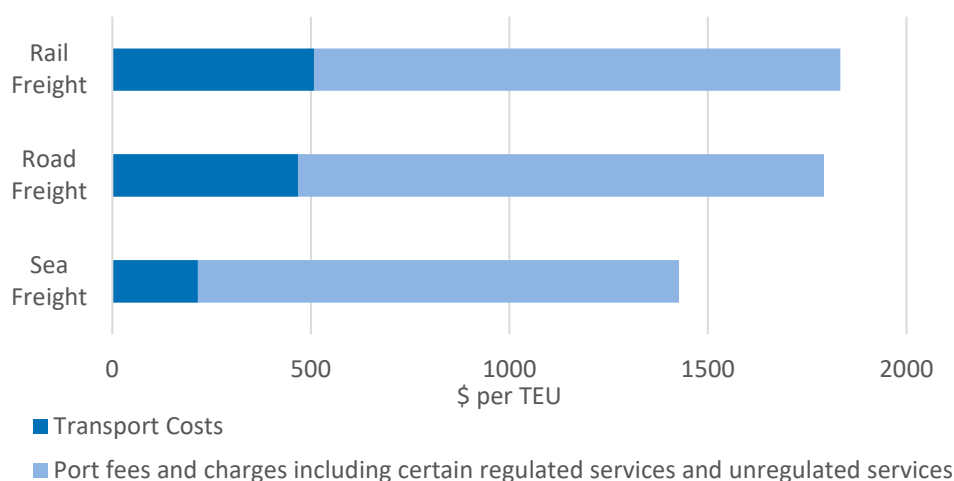
Overall, substitution between ports and other modes of transport for containerised freight appears evident: international shipping lines can choose to call at various ports across Australia, customers sometimes prefer the timeliness and flexibility of road and rail transport, and there are some customers in South Australia that are located in contestable hinterlands. The efficiency and timeliness of loading and unloading can also impact inter-port competition. Nevertheless, the presence of contestable hinterlands does not preclude the existence of some captive hinterlands.⁶⁹ For captive hinterlands there is a risk that market power could potentially be exercised.

⁶⁶ The hypothetical case study is a simplification. The demand for transport services will be influenced by costs as well as other factors from which customers derive value such as service quality and timeliness. It is known that a key advantage of road transport is its flexibility, timeliness and convenience for customers. This means that the results may overstate the cost advantage to sea freight in the hypothetical case study.

⁶⁷ Areas north of the Limestone Coast, such as those in the Sunraysia region, may also be at risk of switching. Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 35.

⁶⁸ Essential maritime services were proxied in the case study by certain ship- and cargo-based charges, as published by the BITRE in Waterline 67.

⁶⁹ The presence of a natural port gateway has been acknowledged by Flinders Ports; see FTA / APSA interview with Stewart Lammin, February 2018.

Figure 5. Estimated cost of transporting imported container freight, between Melbourne and Adelaide⁷⁰

4.2.2 Bulk non-grain (mineral resources) freight market

As noted in Chapter 3, many proclaimed ports have a single user or just a few large end customers. Those end customers tend to charter ship operators to pick up, carry and deliver goods on their behalf. The ship operators (ie customers) commercially negotiate with Flinders Ports to obtain access to regulated and essential maritime services.

There are factors that can limit Flinders Ports' incentive and ability to exercise market power in this situation. This includes Flinders Ports' desire to attract future investment, which can limit the incentive to exercise market power in the short term,⁷¹ and the fact that single and common user berths appear to be operating with spare capacity.⁷² Also, ship operators and customers in commodity markets are sophisticated global companies that may have countervailing bargaining power.⁷³

As an indication, Flinders Ports points to, among other things, the successful commercial negotiation of access contracts, with approximately 60 percent agreed at negotiated prices. It also highlights a lack of disputes with and complaints from customers accessing, and seeking access to, regulated and essential maritime services.⁷⁴ Flinders Ports' attraction of OZ Minerals mineral output, away from the

⁷⁰ There are a range of limits to the assumptions. The simple example calculates the key cost differential of services once a ship has reached the geographical point of Melbourne. It compares the cost of access, docking, unloading at Melbourne, and sending freight by road or rail transport to Adelaide, against the alternative of continuing (without docking at Melbourne) and instead docking at Adelaide and unloading there. It ignores the cost of any storage at container parks and distribution centres – this is because that particular cost is likely to be evident in both Melbourne and Adelaide.

⁷¹ For instance, pricing today by a regulated operator to maximise short-term returns (by expropriating from those that have already sunk costs in local operations or mines) may risk sending a signal to future investors in mines and manufacturing operations that Flinders Ports may act in this way in future.

⁷² Berth occupancy is measured based on the average hours a berth is utilised compared with the available hours of the berth, as reported in operational performance measure 2 under Guideline 1.

⁷³ Global shipping lines have seen rationalisation in recent years. The result is that the number of services were, in some local cases such as Adelaide, reduced and larger vessels have arrived. See Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 3, and Flinders Ports, *Submission to Productivity Commission*, p. 6.

⁷⁴ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 15-20.

Port of Darwin, is also cited by Flinders Ports as an example of competitive inter-port pressure⁷⁵ (although weather related risk factors may also have contributed⁷⁶).

In practice, however, there are barriers that in some cases counteract the factors outlined above.

Land transport is the key to inter-port substitution and many transport options face practical constraints. Constraints include a lack of access to integrated mine-rail-port infrastructure; the weight of the mineral resource product and size of the freight task (which means that rail, rather than road, transport is typically required); the long geographical distance to be travelled to some alternative ports; and/or the possibility of community opposition to the road transport of mineral products through urban areas (due to safety risks and congestion).

The lack of substitution opportunities is reinforced by the fact that some miners and manufacturers have related sunk investments and long-term lease agreements at ports (and/or for connection to bulk grain loading facilities).⁷⁷ These features increase the switching costs for customers. Furthermore, it is important to consider the commercial realities for some bulk non-grain products: while substitution might exist in theory, to the extent that switching by customers has failed to eventuate over a sustained period of time, then this can itself be indicative of commercial barriers that are not immediately evident.⁷⁸

There can also be factors that could incentivise exercise of market power by Flinders Ports. The cost of access tends to be small relative to expected total transport and mineral production costs. Accordingly, the access cost may not materially influence an investor's expected valuation of a new project and may not in and of itself deter a port's monopolistic pricing to existing users.

Overall, having considered the main variables of interest, it appears that for some ports there may exist competitive pressures limiting the ability and incentive to exercise market power, yet for other ports, this appears less likely. If alternative ports are not a close substitute, and customer switching costs are high, then end customers stand to lose the most from any failure to reach agreement on access. Absent access regulation, this could potentially lead to the exercise of market power, which may limit competition in upstream or downstream markets.

4.2.3 Bulk grain freight market

The Commission and the Australian Competition and Consumer Commission (ACCC) have undertaken recent assessments of competitive conditions relating to grain freight and the bulk grain export supply chain.⁷⁹ Bulk grain freight exhibits competitive pressures that appear more pronounced at some port locations than others. Competitive pressures (or otherwise) have implications for both Flinders Ports and Viterra.⁸⁰ Competition among ports for bulk grain freight stems largely from direct competition

⁷⁵ Another example is rail product being transported from South Australia to Bunbury in Western Australia. Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 11, 38.

⁷⁶ Coggan M, 'NT derailment poses environmental risk', ABC news, 29 December 2011, available at <https://www.abc.net.au/news/2011-12-29/northern-territory-flood-environmental-damage/3750572>.

⁷⁷ For example, GRA has existing conveyor facilities connected into bulk grain loading facilities at Thevenard, and Nyrstar operations have specific assets for unloading and loading operations at Port Pirie berths. GRA, pp. 1-5, and QUBE, pp. 59-63.

⁷⁸ Stephen P. King, 'Market Power and airports', *Report for the ACCC*, 25 January 2001, pp. 2-3, available at <https://www.accc.gov.au/system/files/Airports%20Report%20by%20Professor%20King%20-%20Market%20Power%20and%20Airports.pdf>.

⁷⁹ Commission, *Inquiry into the South Australian bulk grain export supply chain*, December 2018, pp. 1-175, available at <https://www.escosa.sa.gov.au/ArticleDocuments/1076/20190129-Inquiry-BulkGrainExportSupplyChainCosts-FinalReport.pdf.aspx?Embed=Y>, and ACCC, *Viterra wheat port exemption assessment*, documents available at <https://www.accc.gov.au/regulated-infrastructure/wheat-export/wheat-export-projects/viterra-wheat-port-exemption-assessment>.

⁸⁰ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 3, 13.

from other port operators – both new and existing – and competition from land transport options (such as road and rail transport). These competitive pressures can be impacted by domestic and external demand for grain, land transport costs, as well as storage options (at port and on-farm).

The most obvious source of competition with respect to bulk grain freight is from competing port operations. Some submissions pointed to new port entry as a sign of competitive pressure.⁸¹ Other submissions attributed recent entry of new grain ports to the effect of the current access regime.⁸² Other submissions pointed to the prospect of various new grain ports including Cape Hardy and Port Spencer.⁸³

According to the ACCC, South Australia can be typically thought to consist of two distinct grain markets – the Eyre Peninsula and eastern South Australia. The two regions would likely not be deemed substitutes due to their geography. In addition to facing local competition, the eastern South Australia market also faces a degree of interstate competition from facilities in Victoria.⁸⁴ The ACCC has reported that grain near the South Australia-Victoria border is exposed to both states' bulk export markets.⁸⁵

According to the ACCC, while the Eyre Peninsula market does not face this interstate threat, T-Port's Lucky Bay port facility does pose a credible competitive threat to facilities at Port Lincoln, and to a lesser extent, Thevenard. Despite the Lucky Bay port only beginning operations in March 2020, from its inception to 31 May 2021, its market share of total grain bulk shipments on the Eyre Peninsula was 13 percent.⁸⁶ This can indicate the presence of competitive pressures.⁸⁷ New entry at Port Spencer should also add competitive pressures. GPSA credits the current access regime with promoting this competition.⁸⁸

Grain can be exported via containers, as well as in bulk. Container transportation can be preferred when only small volumes of grain are demanded (such as niche grain products), or when destination ports are ill-equipped to receive bulk services. Given that containerised grain exports represent only 6 percent of South Australia's grain production, and that approximately 95 percent of containerised grain in South Australia is exported out of Port Adelaide, the ACCC has reported that competition from other ports represents limited competitive pressure.⁸⁹

Finally, land transport costs provide competition for bulk grain freight and these competitive pressures can be triggered when domestic demand on the east coast of Australia rises sufficiently to make it

⁸¹ Viterra, pp. 1-4.

⁸² GPSA, pp. 1-3.

⁸³ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 30-31, and Viterra, pp. 1-2.

⁸⁴ ACCC, *Viterra Operations Pty Ltd – Exemption assessments of port terminal services provided at the following port terminal facilities: Port Adelaide Inner Harbour; Port Adelaide Outer Harbour; Wallaroo; Port Giles*, 27 April 2021, p. 133, available at <https://www.accc.gov.au/system/files/Viterra%20Final%20Determinations%20-%20IHB%2C%20OHB%2C%20Wallaroo%2C%20Port%20Giles.pdf>.

⁸⁵ ACCC, – *Exemption assessments of port terminal services provided at the following port terminal facilities: Port Adelaide Inner Harbour; Port Adelaide Outer Harbour; Wallaroo; Port Giles*, p. 141.

⁸⁶ ACCC, *Viterra Operations Pty Ltd – Exemption assessments of port terminal services provided at the following port terminal facilities: Port Lincoln; Thevenard*, 20 July 2021, p40, available at <https://www.accc.gov.au/system/files/Viterra%20Final%20Determinations%20for%20Port%20Lincoln%20and%20Thevenard.pdf>.

⁸⁷ As evidence of increased competition, Viterra notes that since the last Pricing and Access Review in 2017 (when they were the only operator or grain export ports in SA), five new operators have entered the market. Viterra, pp 1-2.

⁸⁸ GPSA, p. 3.

⁸⁹ ACCC, *Viterra Operations Pty Ltd – Exemption assessments of port terminal services provided at the following port terminal facilities: Port Adelaide Inner Harbour; Port Adelaide Outer Harbour; Wallaroo; Port Giles*, p146

more feasible to send it by road or rail transport interstate. An example of this was in 2018-2019 and 2019-2020, when dry weather conditions limited local supply.⁹⁰

Overall, for some port facilities competitive pressures exist for bulk grain freight that are likely to provide constraints on the incentive and ability to exercise market power of Viterra and Flinders Ports; however, for some other port facilities this is less likely. Absent access regulation, this could potentially lead to the exercise of market power for anti-competitive purposes.

⁹⁰ ACCC, *Viterra Operations Pty Ltd – Exemption assessments of port terminal services provided at the following port terminal facilities: Port Adelaide Inner Harbour; Port Adelaide Outer Harbour; Wallaroo; Port Giles*, p. 150; Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 13; and One Rail, *Submission to 2020 SA Rail Access Regime Review – Draft Report*, p. 1, July 2020, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21516/20200730-Rail-SARailAccessRegimeReviewDraftReportSubmission-OneRail.pdf.aspx?Embed=Y>.

5 Risks from integration with related markets

This section documents stakeholder concerns regarding Flinders Ports having related entities operating in adjacent markets. It outlines a framework for considering the relevant risks and discusses observations on the risks. It suggests a proportionate increase in information collection and regulatory monitoring may be worthwhile (discussed further in Chapter 7) and notes that issues relating to ring-fencing will be considered in stage two of the review.⁹¹

5.1 Contextual considerations

As mentioned in Chapter 2, FPH is the head company of an integrated supply chain business, involving a range of diverse services. It owns and operates key ports and FACT. It also provides supply chain solutions through a warehouse and distribution service (Flinders Warehousing and Distribution, FWD)) and a logistics service (Flinders Logistics). Beyond ports and logistics, FPH offers a hydrographic survey service (HydroSurvey Australia). It is noted that, while some of FPH's services are vertically structured, others may be better described as horizontally structured (as they contribute to the same ultimate quayside service for end customers).

While the number and range of services being offered by FPH has increased over the past decade, and one stakeholder has claimed that FPH is now the '*... most diverse and vertically integrated operator of any privatised port in Australia*',⁹² the revenues derived from services unregulated by the MS Act (as a share of total revenues) has trended sideways over the past decade, fluctuating at between 65 and 75 percent.

The risks arising from FPH's integration across related markets has been raised by stakeholders over the past decade.⁹³ It has been noted and considered by the Commission at various times.⁹⁴

During the 2021 re-certification process for the access regime the issue arose again. Submissions from QUBE and LINX to the NCC review highlighted stakeholder concerns that the regime was failing to prevent FPH from using its monopoly position in Flinders Ports' regulated services to competitively favour the operations of FPH's entities in related markets (such as in stevedoring, distribution and logistics services).

In contrast, Flinders Ports argued in its submission to the NCC's draft recommendation that concerns about vertical integration were misplaced and, among other factors, it argued that it did not operate in the relevant market that is upstream and downstream, it did not have the ability and incentive to discriminate against downstream rivals and claimed there was evidence of ongoing investment and vigorous competition in markets in which its related entities operate.⁹⁵

The NCC's final recommendation responded to concerns and recommended that:

⁹¹ The analysis in the chapter focuses only on Flinders Ports. This because the Commission looked into Viterra's integration into related markets as part of the 2018-2019 grain export supply chain study. Commission, *Inquiry into the South Australian bulk grain export supply chain*, December 2018, pp. 1-5.

⁹² QUBE, p. 7. However, vertical integration in the maritime sector does not have to involve only the port. It can, for example, involve stevedores purchasing logistics operators and distribution centres, and shipping lines moving into land logistics. ACCC, *Container stevedoring monitoring report*, October 2021, pp. 34, available at <https://www.accc.gov.au/system/files/Container%20stevedoring%20monitoring%20report%202020-21.pdf>.

⁹³ QUBE, pp. 1-8, 40-78.

⁹⁴ Commission, *2017 Ports Access and Pricing Review*, p. 18, and Commission, *2012 Ports Access and Pricing Review*, pp. 33-46. More generally, the potential role for an access regime in permitting effective competition in other markets was noted in the second reading speech for the MS Act by the Hon. KT Griffin MLC on 9 November 2000.

⁹⁵ Also, Flinders Ports provided responses to claims made by QUBE. See Flinders Ports, *Response to Draft Recommendation of the National Competition Council*, 2 July 2021, pp. 4-21, available at https://ncc.gov.au/images/uploads/FPH_Submission_on_Draft_Rec.pdf.

*'... ESCOSA give careful consideration to whether the access regime and other associated government policies require amendment and improvement to better deal with Flinders Ports' increased vertical integration into dependent markets when it next conducts a review of it in 2022.'*⁹⁶

In its submission to this review QUBE has claimed that FPH's integration across related markets has raised the possibility of anti-competitive activities.⁹⁷ It pointed to the possibility of discriminatory activities, bundling and foreclosure conduct, and the use of confidential or competitively sensitive information obtained through its role as the regulated operator to benefit contestable businesses.⁹⁸

In contrast, Flinders Ports has argued that FPH does not compete in dependent upstream and downstream markets, and that the dependent markets in question are global and/or workably competitive. It has also argued that it has economic incentives to promote competition in dependent upstream and downstream markets in order to increase throughput at port.⁹⁹

5.2 Integration into related markets

While FPH operates an integrated business, with operations in multiple layers of the supply chain, including in competitive activities, Flinders Ports (the regulated operator) does not, for example, grant access to berths and channels to its related entities or rivals. As outlined earlier, a shipping line typically pays for regulated services, such as for access of vessels to the port and berths, and also pays for the stevedore to load and unload the ship. In contrast, firms (including stevedores) may access and/or lease land, berths and sheds from Flinders Ports or FPH (these are services unregulated under the MS Act).¹⁰⁰ Ultimately, the structure of the regime and Flinders Ports' linkage with related entities in adjacent markets has implications for the need and manner in which to consider the risks. Firms operating in adjacent competitive market segments do not have direct access to the regime's dispute mechanisms.

Given the structure of the access regime and the range of integrated services involved, the concern of leverage from regulated operator to an adjacent market segment can be viewed through a horizontal foreclosure framework (Figure 6).¹⁰¹ This framework is adopted because the cost of regulated and essential maritime services as well as the cost of related market services (such as for the loading and unloading of cargo) is typically paid by the ship operator to the port and also to the firm in the adjacent market.¹⁰²

The framework of horizontal foreclosure recognises that a monopoly facility can, in theory, deter entry (or induce) exit in the adjacent market, allow the monopoly facility to reinforce a dominant position, and alter rivals' incentives to invest and innovate in the adjacent market.¹⁰³ Strategic barriers to entry can manifest, for instance, if:

⁹⁶ NCC, p. 8.

⁹⁷ QUBE, pp. 1-13.

⁹⁸ QUBE, pp. 1-13, 85-87.

⁹⁹ Flinders Ports, p. 14.

¹⁰⁰ Licenses provided by Flinders Ports to stevedores allow stevedores the right to enter certain portions of land next to vessels that have berthed and allow the right to use those portions of land to undertake stevedoring operations. These licenses are not services regulated under the MS Act. The payment for the license is a nominal administration fee. For example, see Commission, *Negotiations between Qube Ports Pty Ltd and Flinders Ports Pty Ltd and the application of the Maritime Services (Access) Act 2000(SA)*, 9 September 2001, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21758/20210817-Ports-Proposed-MSAct-dispute-betweenQube-FlindersPorts-letter.pdf.aspx?Embed=Y>.

¹⁰¹ P Rey and J Tirole, 'A Primer on Foreclosure', *Handbook of Industrial Organisation III*, ed. Armstrong and Porter, January 30, 2006. Online access: <http://idei.fr/sites/default/files/medias/doc/by/tirole/primer.pdf>.

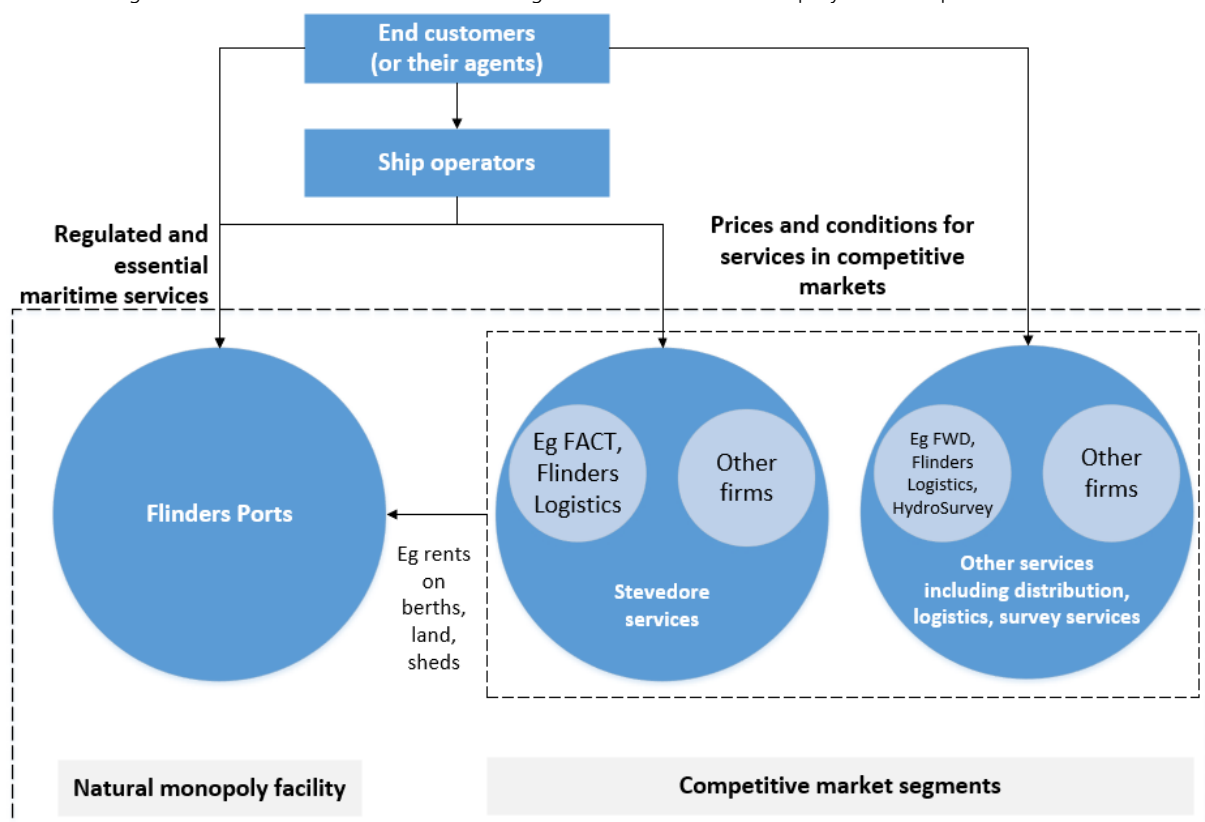
¹⁰² ACCC, *Container stevedoring monitoring report*, October 2021, p. 4, and ACCC v NSW Ports Operations Hold Co Pty Ltd [2021] FCA at 27.

¹⁰³ Rey and Tirole, pp. 49-65.

- ▶ access to regulated and essential maritime services is restricted only to the operations of Flinders Ports' related entities in related markets, via refusal of Flinders Ports to supply or by tying regulated and essential maritime services exclusively to services in related markets¹⁰⁴
- ▶ the price and conditions of regulated and essential maritime services are offered on favourable terms exclusively when they are sold as part of a bundle of services (that is, including services in related markets *and* regulated and essential maritime services), and/or¹⁰⁵
- ▶ discrimination and regulatory evasion take place through (insofar as possible) the sharing of sensitive information between FPHs' related entities regarding competitors, or in the way its subsidiary (Flinders Ports) negotiate and process access services for ship operators, and/or in the shifting of subsidiaries' costs between regulated and unregulated activities.

The OECD has previously highlighted the general proposition that the port sector is susceptible to tying and bundling, as it involves a range of services being provided by a port facility.¹⁰⁶

Figure 6. The horizontal and vertical integration of a natural monopoly into competitive markets



In addition, while the framework outlined above has been described in the context of horizontal foreclosure, there can be a risk of vertical foreclosure in certain circumstances. For instance, this could relate to the extent that Flinders Ports charges for the rent of sheds, land or equipment to firms in the market segment for land and storage, including charging to its own affiliated businesses. In this situation, vertical integration can raise the risk of transfer pricing and preferential treatment.¹⁰⁷

¹⁰⁴ Tying involves the situation in which a product or service is sold *conditional* on one or more services or products also being supplied.

¹⁰⁵ Bundling generally refers to the situation where two or more services or products are sold as a single package.

¹⁰⁶ OECD, 'Competition in Ports and Port Services', *OECD Policy Roundtables*, 2011, p. 51, available at <https://www.oecd.org/daf/competition/sectors/48837794.pdf>.

¹⁰⁷ QUBE noted the risk of leasing terms and conditions for warehouses; see QUBE, p. 33. The NCC noted, among other factors, the risks of preferential treatment and misuse of confidential information; see NCC, pp. 110.

To be clear, the above horizontal and vertical integration risks are stated for illustrative purposes only. In practice, the incentive and ability for a port facility to leverage market power into a related market depends on various factors. These include:

- ▶ The relationship between the services in question (are the services horizontally or vertically integrated, and is the supply and demand for these services positively or negatively correlated?).
- ▶ The nature and type of the bundled service involved (are the services bundled or tied and how transparent is the pricing to customers and competitors?).
- ▶ The characteristics of the markets (who is buying and how likely is it that those customers need, or prefer, to purchase a bundle of services).

5.3 Observations on risks

It is important to highlight that the motivations for integrating into related markets and for bundling services need not be anti-competitive.¹⁰⁸ Integration can generate efficiencies from scope and can provide greater service choice and convenience to ship operators, end customers and firms in competitive market segments (by reducing transaction and search costs).^{109,110} Furthermore, to the extent there were competitive concerns with bundling of regulated and unregulated services then there is a question as to how material this concern is. Over the past five years, the amount of regulated revenue collected by Flinders Ports from bundled services was reported at less than five percent of total regulated revenues.

Strategic barriers to entry (such as preferential treatment of price, terms and conditions) can lead to periods of intense competition in adjacent markets, thereby deterring entry and inducing exit, and reducing incentives of potential entrants to invest.¹¹¹ In theory, the risk from horizontal foreclosure and bundled services can exist and is likely to depend on whether or not the services are complements or independent of the demand for regulated and essential maritime services. Services in adjacent markets, which are positively correlated to regulated and essential maritime services, may, if bundled by a monopoly entity, raise the risk of creating strategic barriers to entry that can raise rivals' costs.¹¹² Those services in adjacent markets that are negatively correlated would, if bundled, be less likely to do so.¹¹³ Of course, the exact complementarity, or otherwise, is difficult to identify and evaluate.

In terms of vertical foreclosure, the risk can, in theory, exist and it could be associated with leases and rents. The fact that FPH is vertically integrated and offers landlord services is not in and of itself an issue. Furthermore, locational advantages of facilities, such as warehouses, can be expected to reflect the price paid for the asset.

¹⁰⁸ Jeffrey M. Perloff, *Microeconomics*, International edition, 2001, pp. 410-413.

¹⁰⁹ The general benefits of integration are also evident in the fact that nationally there has been increased reports of vertical integration occurring in various parts of transport supply chains. Furthermore, it is important to highlight that firms in competitive markets often bundle products and services in ways that are convenient for customers.

¹¹⁰ There may also be benefits through economies of scale (through lower per unit corporate costs).

¹¹¹ On the one hand, QUBE has reported 'fierce' competition in adjacent markets such as that for stevedoring (QUBE, Submission to NCC, February 2021, p. 6, available at https://ncc.gov.au/images/uploads/Non-confidential_-_Qube_Ports_submission_to_NCC_%2826.02.21%29_.pdf). It has also claimed that the focus of its investment in South Australia has now changed toward mobile capital equipment due to competitive conditions (QUBE, p.9). On the other hand, competition is an objective of the access regime, and many companies in competitive markets derive option value in purchasing capital equipment that is mobile rather than fixed.

¹¹² Rey and Tirole, pp. 45-68, and J Gans and S King, 'Potential Anticompetitive Effects of Bundling', *Australian Business Law Review*, July 2004, pp. 6-11.

¹¹³ Rey and Tirole, pp. 45-68, and Gans and King, pp. 6-11.

Overall, the current situation reveals that more information is required to understand the degree of risk that may be present. Without considering the structural and behavioural characteristics of the market and firms in adjacent and monopoly markets, along with how past conduct in the monopoly and adjacent markets has shaped the result and environment, it is difficult to draw strong conclusions about behaviour that is otherwise common in competitive markets.

The MS Act provides some degree of protection through information collection and regulatory reporting (including accounting separation), as does the Commission's price determination under the ESC Act. However, given the degree of integration present and stakeholder concerns, a proportionate increase in the monitoring of these risks appears worthwhile. This is discussed further in Chapter 7.

Issues relating to ring-fencing will be considered in stage two of the review. It is important to consider the nature of the access regime and the type of integration (horizontal and vertical) when considering the need and magnitude of any potential regulatory response to the risks from integration into related markets.

The issue of horizontal and vertical foreclosure can be an issue for the CCA. For instance, strategic barriers to entry, such as bundling and tying, are currently protected against through Part IV, sections 45 to 47, of the CCA. However, that anticompetitive conduct legislation can address issues of horizontal and vertical foreclosure does not preclude the Commission from seeking to understand and monitor (in a low-cost manner) any risks associated with integration into related markets.

6 Why the access regime should continue in operation

Draft recommendation: the Minister should extend the current access regime for five years from 31 October 2022. The industries subject to the access regime involve high barriers to entry and, in many instances, substitutability opportunities are limited. Accordingly, a form of protection for customers is appropriate and the access regime provides this at a relatively low cost. Most stakeholders supported the continuation of the access regime.

This section summarises information and evidence on whether the access regime should continue, or not. It is organised into four parts. First, it summarises the decision criteria to be followed. Second, it summarises findings from the competitive analysis to establish that there is a need for protection and then assesses the costs of the current access regime. Third, it summarises stakeholder positions. Finally, it sets out the Commission's position on why the access regime should continue in operation for a further prescribed period.

6.1 Decision criteria

The Commission's review under section 43 of the MS Act has two parts:

1. Taking the regime on an 'as is it stands' basis as set out in the MS Act, should it continue to apply to the industries (ie regulated maritime services) to which it currently applies (section 43(2))?
2. Given the Commission's findings in relation to that question, and subject to the costs of the current regime, should the access regime itself continue to apply for a further prescribed period (section 43(5))?

The interplay between the two elements of the review indicates that:

- ▶ If the Commission determines that the regime should continue to apply to at least one of the industries (regulated maritime services), then it would follow that the Commission should recommend to the Minister that the regime itself should continue for a further period.
- ▶ If the Commission determines that the regime should not continue to apply to at least one of the industries (regulated maritime services), then, absent other information or contextual factors in favour of maintaining the regime for a further five years, it follows that the Commission's recommendation to the Minister would be that the regime should not continue.

The access regime is taken on an as it stands basis reflecting that it is set out in the MS Act and the services covered are declared by Proclamation. However, the Commission can, under section 45 of the MS Act, make recommendations to the South Australian Government to vary proclamations.

Several stakeholders pointed to a potentially broader role for the Commission under the review. One stakeholder suggested that the continuation of the regime should be contingent on improvements being implemented,¹¹⁴ while another stakeholder suggested that the Commission's review should not just be a 'retain/remove decision'.¹¹⁵ However, as noted above, the Commission must answer the legislative question asked of it under section 43 of the MS Act. Broader issues, including potential improvements relating to ring fencing, information disclosure, provisions for confidential information, time frames for the provision of information and the scope of coverage, will be considered in stage two of the review.

¹¹⁴ QUBE, pp. 3-4, 30-31.

¹¹⁵ SAFC, p. 1.

6.2 Competition and costs

6.2.1 Competitive analysis

The findings on competitive conditions from sections 4.1 to 4.3 suggest that:

- ▶ The economic characteristics of proclaimed ports and services, including channels, berths and pilotage services, indicate that at least some of the regulated maritime services likely have natural monopoly characteristics. A natural monopoly position for a regulated maritime service can create high barriers to entry, making duplication economically unfeasible.
- ▶ There are reasons to expect that some degree of inter-port substitutability exists for certain proclaimed ports and berths in South Australia. However, the weight of evidence suggests that there is a natural hinterland for various proclaimed ports, and there are limits to inter-port substitutability due to, among other things, land transport costs and barriers to switching (reflecting end customers' sunk asset-specific investments). This suggests that – absent access regulation – there may be an ability and incentive for the regulated operator to exercise market power resulting in potential limitations to competition in upstream and downstream markets.

There is therefore likely to be some value in providing a form of protection to customers, as is the case with the current access regime.

6.2.2 Costs of the regime

Forms of regulation can impose indirect costs through the influence on private market behaviour as well as direct administrative costs.

There can, in theory, be indirect costs resulting from the existence of an access regime. Compulsory access can undermine incentives to resolve commercial disputes and weaken incentives for the regulated operator to invest in port infrastructure.¹¹⁶ This can result from:

- ▶ regulatory error in relation to prices and terms and conditions¹¹⁷ and the potential crowding out of alternative dispute resolution processes outside of the access regime, and/or
- ▶ regulatory settings that leave the regulated operator to bear a disproportionate share of downside demand risk (ie if regulation is expected to expropriate above-normal returns when demand from customers is high, but not compensate for below-normal returns when demand is low).¹¹⁸

As Flinders Ports has noted in their submission, many other Australian jurisdictions have not chosen to apply access regulation to port corporations.¹¹⁹ Nonetheless, nationally, there is limited evidence available to suggest that third party access regimes have had the effect of stifling the investment of regulated operators.¹²⁰ Importantly, Flinders Ports has itself reported \$450 million of investment since privatisation in 2001,¹²¹ and it has reported plans to invest approximately \$550 million over the next 20

¹¹⁶ Synergies, pp. 12-36.

¹¹⁷ Synergies notes the risk of scope creep (Synergies, pp. 17-18). This could be viewed as regulatory error.

¹¹⁸ Productivity Commission, 'National Access Regime', pp. 211, 228.

¹¹⁹ Synergies, p.4, 6.

¹²⁰ Daniels, 'Regulation of Natural Monopoly Infrastructure in Australia – An Empirical Analysis of The Effectiveness Of Part IIIA of the Competition and Consumer Act 2010 (Cth)', PhD Thesis submitted to Melbourne Law School, 2016, p. 254, available at: <http://hdl.handle.net/11343/192644>. The Productivity Commission has suggested that access regimes in general have the potential to stifle investment but found insufficient evidence to suggest that the national access regime was having that effect in practice; see Productivity Commission, 'National Access Regime', pp. 211, 228.

¹²¹ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, p. 3, 15, 17-18.

years.¹²² Therefore, there is limited evidence to suggest that compulsory access under the current regime has weakened investment.

The direct administrative costs imposed by the current (certified) regime – on operators, customers and the regulator – appear to be relatively low. The backstop nature of the regime is light-handed and the information requirements of a regulated operator, such as in the Commission’s Guidelines 1 and 2, which involve financial and operational performance reporting, and the sharing of price information with potential customers, do not appear too onerous. The SAFC described the regime as being low-cost in nature.¹²³

6.3 Summary of stakeholder views

The majority of submissions received by the Commission supported the continuation of the access and pricing regime, while one stakeholder recommended a major overhaul.

- ▶ GRA considered the current regime to be necessary, but argued for a range of potential improvements.¹²⁴
- ▶ Viterra argued that there is significant competition among grain ports in South Australia, and that it is incentivised to encourage access to regulated maritime services. It overall supported the retention of the access regime but argued that regulation should consist of the lowest level of oversight possible and should apply to all grain ports.¹²⁵
- ▶ GPSA supported retention of the access regime. It considered the regime important in promoting disclosure and transparency, enabling inter-port competition to emerge, and in mitigating the risk of monopolistic behaviour.¹²⁶
- ▶ SAFC supported the negotiate-arbitrate framework. It argued that the regime was a low-cost form of protection against the misuse of market power, and that the risks and costs (including decision timeframes) associated with alternative access frameworks (such as under the national access regime) meant that it would support continuation of the state-based regime. It supported the Commission exploring the NCC’s recommendations through the review process.¹²⁷
- ▶ Flinders Ports questioned whether an access regime was required. As evidence of competitive pressures, they pointed to potential and existing threats from ports elsewhere, to agreements having been negotiated at prices below published prices, to the lack of disputes with customers and to Flinders Ports’ investment in infrastructure. They did, however, note that should an access regime be deemed necessary that the current regime was appropriate without change.¹²⁸
- ▶ QUBE pointed to the possibility of discriminatory activities, bundling and foreclosure conduct, and the use of confidential or competitively sensitive information under the current access regime. It did not support continuation of the access regime unless continuation was conditional on improvements being implemented. It proposed a major overhaul of the regime.¹²⁹

¹²² Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, 17-18.

¹²³ SAFC, pp. 1-4.

¹²⁴ GRA, pp. 3-4.

¹²⁵ Viterra, pp. 2-3.

¹²⁶ GPSA, pp. 2-3.

¹²⁷ SAFC, pp. 3-6.

¹²⁸ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 3-4, 10.

¹²⁹ QUBE, pp. 3-4, 30-31.

6.4 The Commission's draft recommendation

The current access regime establishes a negotiate-arbitrate framework that helps to provide protection against the exercise of market power, which may limit competition in upstream and downstream markets. As noted earlier, the Commission considers that access to fair commercial terms would be consistent with commercial transactions between a customer and the regulated operator.

The Commission's draft recommendation is that the access regime should continue to apply to regulated maritime services, and, given that finding, and the low costs of the current regime, should continue in operation for a further five years from 31 October 2022. The draft recommendation is based on the following considerations and evidence.

- ▶ The decision criteria adopted, under section 43 of the access regime, has been that, if the Commission determines that the access regime should continue to apply to at least one of the regulated maritime service, then it would follow that the Commission should recommend that the access regime should continue for a further five years.
- ▶ Most regulated maritime service tend to exhibit natural monopoly characteristics (low variable costs, and high fixed and sunk costs). These features can create barriers to entry, suggesting the potential incentive and ability for market power to be exercised by a regulated operator resulting in potential limitations to competition, contrary to the objects of the MS Act. Certainly, some degree of inter-port competition exists, and this can provide a competitive constraint on the regulated operator. But, in some cases, land transport costs and switching costs, among other things, are sufficiently high such that inter-port substitution is unlikely to provide an effective overall constraint on the potential use of market power in regulated maritime services.
- ▶ Most stakeholders supported the regime's role in containing the capacity of regulated operator's to potentially exercise market power.
- ▶ It is unclear to the Commission whether meaningful conclusions can be drawn from any lack of pricing disputes or complaints in the presence of the current access regime. The fact that the arbitration mechanism has in fact been drawn on recently is a demonstration of its operation.
- ▶ The regime was generally perceived by stakeholders as being a low-cost form of regulatory backstop protection that is supportive of commercial negotiation.
- ▶ Without the current state-based regime, there may be uncertainty about the type, nature and timing of any protections available under the national access regime.¹³⁰ Delays in obtaining an alternative access pathway can increase uncertainty, and this can have an effect on the operation of, and investment in, the maritime sector supply chain.¹³¹
- ▶ While compulsory access can, in theory, weaken incentives for the regulated operator to invest in infrastructure, it is not evident that this has been the case. Flinders Ports has made a number of

¹³⁰ For example, it is unclear what maritime services would be of sufficient size to be considered nationally significant and therefore be suitable for declaration. Moreover, the NCC noted that the access protections under Part IIIA of the CCA were not significantly different from the MS Act. See NCC, p. 119.

¹³¹ The longer the declaration process, the higher the legal costs and the commercial costs of delay and uncertainty. The declaration of a service under the national access regime can be a lengthy process with the possibility of legal appeals from an initial decision (which can take further time). The Fortescue Metals cases, which were about the declaration of four railways in the Pilbara, took over eight years to reach a final determination and, even excluding those cases, the average time from application to conclusion over the last two decades (11 cases) was approximately 20 months. For example, see Commission, *2020 Rail Access Regime Review – Final Report*, August 2020, p. 24, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21535/20200828-Rail-AccessRegimeReview-FinalReport.pdf.aspx?Embed=Y>.

major investments in infrastructure since privatisation in 2001, and it has long-term plans to invest in infrastructure to maintain existing levels of trade at its ports.¹³²

It is noted that some stakeholders have suggested that certain changes to the regime could improve its operation (see Appendix A). These will be considered in **stage two** of the review.

¹³² Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 17-18.

7 The need for, and form of, a price determination under the ESC Act

Draft finding: The Commission’s proposed price determination will continue the use of a monitoring scheme for essential maritime services under the ESC Act, but expand its form to be a price and financial performance monitoring scheme. The proposed scheme will involve annual information collection (of detailed price and financial information including bundled regulated and unregulated services), annual publication of published prices (as currently occurs) and annual monitoring of trends in actual revenues, costs and profits. The proposed scheme is not expected to raise administrative costs and will allow for continued commercial negotiation of access under the MS Act.

The Commission currently has in place a price determination for essential maritime services under the ESC Act. Under the current 2017-2022 price determination, Flinders Ports must publish on its website a schedule of published prices, prior to the commencement of each financial year, and provide a copy of those published prices to the Commission and provide accompanying reasons for any increases. The Commission monitors those published prices and reports on them annually. However, with the current determination set to expire on 31 October 2022, this section of the stage one review establishes the need, proposes the form, and outlines the timing, of a new price determination to be made.

The primary purpose of the Commission’s price determination is to protect the long-term interests of port customers by ensuring that prices and terms for essential maritime services are fair and reasonable in order to promote competition in upstream and downstream markets. Regulating prices (or conditions relating to prices, pricing principles and price-fixing factors) can facilitate competition in markets and promote the economically efficient use and operation of, and investment in, maritime services.

7.1 Is there a need for a price determination?

As outlined in Chapter 4, the evidence on competitive conditions across proclaimed ports indicates that barriers to entry and switching costs are likely to be high for many essential maritime services. This can create the incentive and ability for the regulated operator to use market power for an anti-competitive purpose, and in the absence of any regulation, inter-port competition is unlikely to provide a sufficient competitive constraint. There are also risks from strategic barriers to entry (as outlined in Chapter 5) and some stakeholders have highlighted a general lack of information disclosure and transparency.¹³³ Taken as a whole, this suggests that some form of price determination under the ESC Act may provide protection to customers accessing essential maritime services and promote the economically efficient use and operation of, and investment in, maritime services.

7.2 What should the form of any price determination be?

7.2.1 Existing price-related regulation needs to be considered

As outlined in Chapter 2, essential and regulated maritime services have a degree of overlap, including services that provide for vessel access to berths and channels. On the basis that the access regime continues in operation (as recommended in Chapter 6), the form of any price determination needs to operate alongside the current access regime and other parts of the MS Act (such as the monitoring of pilotage charges under section 8 of the MS Act). The access regime includes price-related factors.¹³⁴

¹³³ QUBE, pp. 15-24.

¹³⁴ These include pricing principles for arbitration, information sharing requirements including information on prices as set out in Guideline 1, and financial and operating reporting requirements as set out in Guideline 2.

7.2.2 The Commission's current 2017-2022 determination sets out a price monitoring scheme

The Commission's current price determination is a price monitoring scheme. The scheme has been in operation since 2008-09.¹³⁵

Where markets may not be competitive, the scrutiny of prices and market performance can be aided through the publication of key information. This can assist customers in negotiations with an operator and can also allow stakeholders to gain a better understanding of competitive conditions.

Price monitoring can, in principle, enhance market transparency and assist the competitive process. It can be an instrument of regulation and compliance and/or a means of observing and understanding conditions in a market. There is a range of industries regulated under various price monitoring regimes adopted by state and national regulators.¹³⁶

The Commission has previously argued that the regulatory costs imposed under the current price monitoring regime are low, non-intrusive and not costly to administer and comply with, and the benefits of greater transparency can aid commercial negotiations. The Commission has previously pointed to the following evidence to support the scheme:¹³⁷

- ▶ A price monitoring scheme is a complement to the negotiate-arbitrate framework and the information sharing requirements associated with it.
- ▶ There is a risk of market power being exercised, and the fact that a material share (approximately 40 percent) of private contracts is agreed at published prices can indicate customers may have limited bargaining power. This reinforces the need for a published price schedule and the monitoring of prices. The published prices can act as a starting point for commercial negotiation. At the same time, the Commission has noted the fact that a sizeable share of agreements (approximately 60 percent) is signed at prices below those that are published. This can indicate that some customers may have countervailing bargaining power.
- ▶ There have been no concerns raised by users of essential maritime services in relation to engagement, service standards, pricing and/or (under/over) investment by Flinders Ports.
- ▶ The Commission has previously (for example in 2017) assessed Flinders Ports as not having earned excessive profits.
- ▶ The benchmarking of interstate ports previously suggested that increases in Flinders Ports' charges for essential maritime services were below those increases observed at other ports.
- ▶ A compliance assessment of regulatory accounts in 2013 provided assurance that accounting separation was being followed in line with the Commission's Guideline 2.

7.2.3 Summary of stakeholder views generally supported the current monitoring scheme

Of the six submissions received, only three expressed views on the Commission's current price determination for essential maritime services:

¹³⁵ Commission, *2012 Ports Access and Pricing Review*, p. 10.

¹³⁶ This includes retail gas and electricity, water, container deposit schemes, funeral services, stevedore services, taxi services, and some ports.

¹³⁷ Commission, *2017 Ports Access and Pricing Review*, pp. 29-41.

- ▶ SAFC argued that the current price monitoring approach was appropriate, given it was low cost and in line with industry views.¹³⁸
- ▶ Flinders Ports argued that there was no reason, or compelling evidence, to change the current price monitoring regime, and that it should continue for a further five years.¹³⁹
- ▶ QUBE argued that the price determination was ex-post in nature and did not prevent Flinders Ports from engaging in discriminatory behaviour.¹⁴⁰

In its submission, Flinders Ports pointed to many of the same points highlighted by the Commission. It argued that essential maritime services have been provided on fair commercial terms, given that contracts have been reached by way of commercial negotiation and there have been no disputes or complaints. Flinders Ports also claimed that the prices for essential maritime services have been fair and reasonable as evidenced by: the absence of disputes and complaints, the large share of commercial agreements struck below published prices, the fact that annual increases in published prices have been in line with CPI or actual cost increases, and the annual pricing reports provided to the Commission have been accepted.¹⁴¹

In its submission, QUBE pointed to general limitations of ex-post regulatory mechanisms in preventing anti-competitive behaviour. It argued there is limited transparency about access prices granted by Flinders Ports to its own related entities and there is not any express prohibition that would prevent Flinders Ports from favouring its own downstream entities when setting prices.

7.2.4 Limitations of the Commission's current price monitoring scheme

When considering the potential form of a price determination, it is important to acknowledge that price monitoring is not without its limitations. Its effectiveness depends, among other factors, on the nature of the monitoring scheme (ie its intent, measurement and reporting) and the strength of the regulatory threat (ie the willingness and capacity of the regulator to act, if appropriate).

The Commission's current price monitoring scheme has several limitations, some of which have been highlighted in previous reviews. The key limitations are outlined below.

- ▶ There is no annual publication of information on actual prices, revenues, costs and profits. Yet even if annual published price changes follow cost changes this does not necessarily mean that prices are efficient.¹⁴² Additionally, it is not that uncommon for regulators to publicly report on a monopoly's financial performance, including revenues, costs and profits, in order to improve market transparency.¹⁴³
- ▶ Insofar as certain essential maritime services are not backed by the negotiate-arbitrate regime, there is a risk that monitoring alone may not be sufficient to limit the use of market power and support fair and reasonable terms.¹⁴⁴

¹³⁸ SAFC, pp. 4-6. It also noted that there was '*... a legitimate question as to whether Terminal Access Charges (TACS – formerly known as 'Infrastructure Charges') should be added to the ongoing price monitoring undertaken by ESCOSA'*' (SAFC, p. 5).

¹³⁹ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 23-27, and Synergies, pp. 19-28.

¹⁴⁰ QUBE, pp. 21-22.

¹⁴¹ Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 23-27, and Synergies, pp. 19-28.

¹⁴² For instance, this ignores the starting point of prices (prices may not initially reflect efficient costs) and that increasing volumes over time could mean that average costs may actually decrease.

¹⁴³ For example, ACCC, *Container stevedoring monitoring report*, October 2021, pp. 35-43.

¹⁴⁴ The role of price monitoring without the presence of an access framework (ie recourse to arbitration) has attracted criticism and has been described by some as 'ill-conceived in theory and not working in practice'. See Sims R, *How did the light handed regulation of monopolies become no regulation?*, speech given at Gilbert + Tobin

- ▶ While the prevalence of bundled services appears limited (as explained in Chapter 5), the current monitoring approach does not explicitly address this risk.
- ▶ The monitored prices being reported annually are those that are published. Yet as mentioned earlier, there is a large share of actual prices negotiated at a discount to published prices.
- ▶ Annual increases in published prices are based on a weighting of generic costs (inflated by macroeconomic price indices) and idiosyncratic costs (that relate to the particular circumstances in which Flinders Ports operates and are inflated by costs actually incurred).¹⁴⁵ However, this approach does not transparently outline how, and to what extent, expectations of efficiency are accounted for in Flinders Ports' setting of annual published prices. After all, some degree of efficiency is expected over time as the result of capital investments and labour productivity.
- ▶ Price monitoring schemes can impact whether any published prices could potentially decline (however likely, or not, a price decrease might be). For instance, reducing published prices, even if it were warranted, could create perception problems later on if an increase of a large magnitude were needed. Flinders Ports may therefore choose to post published prices higher than otherwise and rely on the use of discounts to manage pricing flexibility.
- ▶ The Commission's current monitoring scheme allows for it to state publicly its views regarding whether annual price movements of essential maritime services by Flinders Ports have been satisfactory (or not). However, the scheme has operated as a form of observing and understanding performance and of providing information to the public. This reflects the diverse range of services covered, which can exhibit varying rates of growth in costs. In this respect the current monitoring scheme has operated more akin to an instrument of market transparency rather than incentive-based regulation.

7.2.5 Any regulatory option adopted should generate the greatest net benefit

Chapter 7.1 outlines the need for a price determination in order to provide protection to customers accessing essential maritime services, in order to promote the economically efficient use and operation of, and investment in, maritime services, and to promote competition in upstream and downstream markets. However, there are a range of regulatory options available for consideration. The current monitoring scheme has costs and benefits, as does the introduction of alternative forms of regulation. Table C1 in the Appendix provides a simple summary of some available regulatory options.

Overall, while there is a range of options available, the costs of prescriptive approaches (such as revenue and price controls) are large and therefore the hurdle to introduce them (and generate expected net benefits) is high. At this point in time there is not sufficient evidence to justify such prescriptive approaches. Consistent with this, the majority of stakeholder submissions did not propose a heavier-handed price/revenue control.

7.3 Proposed price determination to include price and financial performance monitoring

Having considered stakeholder views and having had regard to the relevant factors in the MS Act and ESC Act, including sections 24 and 25 of the ESC Act, it is proposed that the Commission's price determination should expand to include both price and financial performance monitoring. Stakeholder submissions supported the need for at least the current form of price monitoring. The proposal expands on the current price monitoring scheme, enabling more information collection, public reporting and a greater level of transparency, thereby helping to facilitate competitive markets, promote

Regulated Infrastructure Policy Workshop, Melbourne, 29 October 2015, available at

<https://www.accc.gov.au/speech/how-did-the-light-handed-regulation-of-monopolies-become-no-regulation>.

¹⁴⁵ Synergies, pp. 29-31, and Flinders Ports, *Submission to 2022 Ports Pricing and Access Review*, pp. 23-27.

efficiency and protecting the long-term interests of users of maritime services. The proposed scheme is not expected to raise administration costs or weaken investment incentives. (Box 3 outlines the intended methodology and the information requirements. Table C2 in Appendix C explains the alignment between the Commission's proposal and the relevant objectives in the MS Act and the ESC Act.)

On the basis that the access regime continues in operation, an expanded form of monitoring can deliver benefits in excess of costs, given that the presence of the access regime provides protections to customers seeking access and there are likely to be large costs associated with introducing a more prescriptive alternative price determination. The proposed scheme meets some basic underlying principles for the design of price monitoring schemes relating to transparency, flexibility, timeframe, non-intrusiveness and cost (see Table 3).¹⁴⁶

Table 3. Basic underlying principles for the design of price monitoring schemes

Principle	Yes / No	Comment
Transparency – the method should be known, and conclusions or further action should be based on observations and results of monitoring activities, and should be published	✓	Monitoring of price and financial performance information is currently done by several regulators
Flexibility – the scheme should be sufficiently flexible to allow the monitoring body to report on areas of concern over time	✓	The financial performance monitoring approach will allow flexibility to the regulator to consider any issues as they arise
Timeframe – the scheme should not be indefinite	✓	The scheme will be reviewed at the end of the prescribed period. This will allow an assessment of the costs and benefits.
Non-intrusive – monitoring should not be intended as a form of de facto price control or entail unwarranted intrusion in commercial operations	✓	The scheme is consistent with the operation of the access regime (which allows commercial negotiation for access)
Not costly to administer or comply with – reporting requirements should not be overly onerous	✓	Data collected will be based on information that is available to the operator

While there are limitations to monitoring schemes, the Commission's proposed price and monitoring scheme addresses several of them. While the annual publication of revenues, costs and profits will be a step further in market transparency than the Commission has taken in the past, it is not uncommon for these types of financial indicators to be included within monitoring schemes (for example, the ACCC's container stevedore monitoring report includes various financial return metrics).¹⁴⁷ Further, trends in actual revenues, costs and profits are relevant for assessing competition issues and the potential use

¹⁴⁶ NERA, *Assessment of Price Monitoring in Australia – A briefing note for the AEMC*, 14 December 2007, pp. 9-10, available at <https://www.aemc.gov.au/sites/default/files/content/ae7a4c09-8393-4405-87e4-7ad8f0a44897/Price-Monitoring-in-Aust-NERA.pdf>, and Productivity Commission, 'Review of the Prices Surveillance Act 1983: Inquiry Report', *Inquiry Report No 14*, 14 August 2001, pp. 105-115, available at <https://www.pc.gov.au/inquiries/completed/prices-surveillance-act/report/psa.pdf>.

¹⁴⁷ It is also not uncommon for these types of financial indicators to be reviewed and published for regulated operators in third party access regimes. For example, the Commission undertakes periodic public reviews of the revenues earned from third party access to rail infrastructure services for the Tarcoola to Darwin railway.

of market power. The purpose of the proposed level of information collection will allow the Commission to be informed on the risks arising from Flinders Ports having related entities operating in related markets (including from strategic barriers to entry and bundling).

The proposed price determination is for a five-year period. At the end of the period the Commission will review the effectiveness of the price and financial performance monitoring scheme.

Box 3. Proposed price determination to include a price and financial performance monitoring scheme

The proposed price and financial performance monitoring scheme will involve: (1) the publication of an annual price monitoring report (as is currently the case), and (2) the publication of an annual financial performance report. The proposed scheme will overcome some of the shortcomings of the current scheme. It will complement the access regime and it is not expected to raise administration costs or weaken investment incentives.

Monitoring of published prices (a continuation of the current scheme)

Stakeholders have supported the current scheme involving the publishing of prices for essential maritime services. Under the Commission's proposed 2022-2027 price determination, Flinders Ports must publish on its website a schedule of published prices, prior to the commencement of each financial year. Flinders Ports must provide a copy of those published prices to the Commission and provide accompanying reasons for any increases. As part of providing published prices, the Commission will request that Flinders Ports transparently report to it on what, if any, efficiency expectation for the year ahead is included in the setting of its published prices. The Commission will, as it does currently, monitor the published prices and report on them annually.

Monitoring of financial performance (actual revenues, costs and profits)

The Commission proposes to report annually (say, within six months or so after the end of each financial year) on Flinders Ports' actual revenues, costs and profits. The report is to be public and will express findings and observations including with respect to revenue and cost categories, aggregate profit margins (ie earnings before interest and tax) and aggregate financial returns (return on assets). Financial information on bundled services will be collected and, if relevant (and subject to confidentiality), be reported on. The Commission will focus its public reporting on trends in the financial results of Flinders Ports' regulated business.

Customer-specific information will be excluded from these annual reports (to the extent possible). The data will be reviewed only in aggregate. Insofar as the information collected warrants it, the report may also set out qualitative discussion of trends and developments in financial performance. In this respect, the exact content of the reports may vary from year to year.

8 Draft findings and recommendations

In accordance with sections 43 and 6 of the MS Act, the Commission's draft recommendation is that the access regime should continue in operation for a further five years (ie the prescribed period), and its draft finding is that a price and financial performance monitoring scheme be introduced as part of a price determination under the ESC Act.

Many regulated and essential maritime services have, to varying degrees, high barriers to entry and their customers face high switching costs. Together these features can create the incentive and ability for a regulated operator to exercise market power, which may limit competition of maritime services and limit competition in upstream and downstream markets. In the absence of regulation, inter-port competition and the countervailing bargaining power of customers is, overall, unlikely to provide a sufficient competitive constraint on the potential exercise of market power.

Most stakeholders supported the continuation of the regime: it was perceived as a low-cost form of regulatory backstop protection, and stakeholders supported the regime's focus on commercial negotiation.

The Commission's proposed price determination is to include price and financial performance monitoring. The proposal expands on the current price monitoring scheme, enabling more information collection, public reporting and a greater level of transparency, thereby helping to facilitate competitive markets, promote efficiency and protect the long-term interests of users of maritime services. Given there are risks from Flinders Ports' integration with related markets, a proportionate increase in the monitoring of these risks will be included in the scheme.

8.1 Next steps

The Commission seeks stakeholder views on this draft report on **stage one** of the review by 8 July 2022. The Commission is aiming to publish its final decision on the access regime and the price determination (stage one) in October 2022.

Stakeholders will have the opportunity to make separate submissions on **stage two** of the review.

Appendix A: Stakeholder suggestions for improvements to the access and pricing regime

Table A1. Summary list of stakeholder suggestions for improvements. These are paraphrased below.

Stakeholder	Summary of key stakeholder suggestions
NCC	<ul style="list-style-type: none"> ▶ consider the range of regulated services covered by the access regime ▶ introduce ring-fencing provisions and safeguards around the handling of confidential information ▶ prescribe a timeframe in which preliminary information should be provided to customers seeking access ▶ provide a mechanism for review of any charge imposed by the operator for the supply of such information, and ▶ consider introducing a process for stakeholders to apply for new services to be subject to the access regime.
Viterra	Recommended the inclusion of all grain ports (including new ones) within the regime
SAFC	<p>Supports a review of issues raised by the NCC, such as the scope of services and port coverage, ring-fencing and confidential information, and time frames for sharing information.</p> <p>Supports a review of which grain infrastructure and grain ports should be covered.</p> <p>Suggests Terminal Access Charges should be added to the price monitoring regime.</p>
GRA	Supports increased information disclosure by regulated operators, clearer negotiation process rules and timeframes, increased powers for ESCOSA, and more guidance around price methodologies and minimum service levels.
QUBE	<p>Proposes that a major overhaul of regime is needed. Issues include the scope of services and port coverage, ring fencing and confidential information (including protection against potential vertical foreclosure through the bundling of services), public reporting of information and improved service standard reporting.</p> <p>Suggests that the focus of the regime should be to prevent anti-competitive behaviour rather than ex-post detection.</p>

Appendix B: Proclamation of regulated services

Proclamation of regulated maritime services

Regulated services are those defined as regulated maritime services under the proclamation, as follows:¹⁴⁸

- (a) *providing, or allowing for, access of vessels to the port;*
- (b) *pilotage services facilitating access to the port;*
- (c) *providing berths for vessels at the following common user berths –*
 - (i) *Port Adelaide Outer Harbour berths numbers 1 to 4 (inclusive), 16 to 20 (inclusive), and 29;*
 - (ii) *Wallaroo berths numbers 1 South and 2 South;*
 - (iii) *Port Pirie berths numbers 5 and 7;*
 - (iv) *Port Lincoln berths numbers 6 and 7;*
 - (v) *berths adjacent to the loading and unloading facilities referred to in paragraph (d);*
- (ca) *providing port facilities for loading or unloading vessels at berths adjacent to the loading and unloading facilities referred to in paragraph (d);*
- (d) *loading or unloading vessels by means of port facilities that –*
 - (i) *are bulk handling facilities as defined in the South Australian Ports (Bulk Handling Facilities) Act 1996 (SA); and*
 - (ii) *involve the use of conveyor belts;*
- (da) *loading or unloading vessels by means of port facilities that are bulk handling facilities situated at Port Adelaide Outer Harbor berth number 8; and*
- (e) *providing access to land in connection with the provision of the above maritime services.*

¹⁴⁸ South Australia, *The South Australian Government Gazette*, No 141, 25 October 2001, 4686; South Australia, *The South Australian Government Gazette*, No 77, 26 August 2004, 3405; and South Australia, *The South Australian Government Gazette*, No 75, 29 October 2009, 4985.

Summary of ports and berths

The table below documents key cargos shipped through proclaimed ports in South Australia. Berth information has also been included.

Table B1: Summary of cargo and berth information at proclaimed ports

Proclaimed ports	Cargos (berth number in brackets)	Berth information	
		Berth numbers	Berth access covered under Proclamation (regulated maritime service)
Port Adelaide			
<i>Outer harbour</i>	General cargo (1), passenger terminal and motor vehicles (2), motor vehicles (3), petroleum products and motor vehicles (4), containers (6 and 7) (FACT), grain and seeds (8)	1-8	1-4, 8
<i>Inner harbour</i>	Fertilisers, scrap metal, steel, textiles, acids, soda ash (16-20), stores (25), grains and seeds (27), mineral sands, livestock, sulphur, fertilisers and scrap metal (29), cement, cement clinker and limestone (H and K) (Adelaide Brighton), petroleum and bulk liquid (M and N).	18-20, 25, 27, 29, H, K, M and N	16-20, 29
<i>Osborne</i>	Acid, break bulk, general cargoes, grain, cement (1 and 4)	1 and 4	N/A
Port Pirie	General cargoes and containers (5 and 7), tug berth (4), and grain, ores, mineral concentrates, bulk imports (6, 8,9 and 10)	2-10	5, 7
Wallaroo	Grain, seeds and fertiliser (2N and 1S)	2N and 1S	1S and 2S
Port Lincoln	Grain and seeds (4 and 5), fertilisers (6), fishing boats (7, 8 and 10), roll-on and roll-off (9) and petroleum (11)	4-10, 11	4, 5, 6, 7
Thevenard	Grain, mineral sands	Jetty	All
Port Giles	Grain and seeds	Single berth	N/A

Appendix C: Further information relating to the price determination

Table C1 is a summary of costs and benefits of certain regulatory options available under a price determination.

Table C1. Simplified view of the benefits and costs of regulatory options

Regulatory option	Benefits and costs
Maximum prices and maximum revenues, or an indicative reference price	<p>These options could, for example, involve the setting of maximum prices, maximum revenues or a reference tariff. The options can provide for a relatively strict mitigation against the likelihood of the use of market power and the risk of integration with related markets. It can also set out the terms of regulated prices that are considered by the Commission to be fair and reasonable. However, under these options the administrative costs to the regulator would be large (ie in conducting price or revenue reviews). They would also be large for the operator (in complying and engaging with the determination). These approaches may also limit the operator's flexibility in price setting and in making commercial decisions including regarding investment. No stakeholder submissions have called for a price determination of this nature.</p>
Price notifications	<p>This option could involve the restriction of annual price increases to be conditional on the regulator's acceptance/assessment of the operator's proposal. For example, the regulated operator could submit price notifications to the Commission, who would then assess, and accept or reject any proposal. The key benefit relates to the regulatory threat of the price change not being accepted. This regulatory instrument would require directions from the Commission regarding expectations for the pricing of essential maritime services. The costs to the regulator and the operator may be large under this type of regulatory option (although potentially less costly than the maximum price and revenue control). No stakeholder submissions have called for a price determination of this nature.</p>
Pricing principles	<p>This regulatory option could provide guidance to the operator 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 should be consistent with, and if needed, could be an improvement on, those pricing principles that exist in section 32 of the MS Act (ie the arbitration pricing principles). The administrative costs to the regulator of imposing pricing principles are likely to be relatively small. The magnitude of the administrative costs to the operator will depend on the type of pricing principles introduced. Any impact on the operator's investment incentives would depend on the nature and type of pricing principles. No stakeholder submissions have called for a price determination of this nature.</p>
Price monitoring	<p>As mentioned in Chapter 7, this type of regulatory option can be used as an instrument of regulation and compliance, and/or as a means of observing and understanding the performance of a firm, industry or market. The indicators to be monitored can vary from service levels through to prices, cost and profits. The costs to the operator and the regulator tend to be relatively contained. The monitoring approach can help to identify competition concerns and the threat of further regulation can provide an incentive to the operator. Stakeholders have supported the continuation of the Commission's current price monitoring scheme, noting its low-cost nature.</p>

The table below documents how the Commission's proposed form of price and financial performance monitoring accords with the Commission's objectives under the MS Act and the ESC Act.

Table C2: Alignment of objectives with the proposed price determination

Objective	Alignment
Facilitate competitive markets in the provision of maritime services (MS Act)	The proposed price determination is light-handed and has a low risk of reducing competition, because it allows operators and their customers to seek out their own preferred arrangements for the supply of essential maritime services. At the same time, the presence of annual published prices can assist negotiations, and the regular monitoring of financial performance can help to raise market transparency. This can act as a deterrent to the use of market power.
Protect the interests of users of Essential Maritime Services by ensuring that regulated prices are fair and reasonable, having regard to the level of competition in, and efficiency of, the regulated industry (MS Act)	The proposed price determination raises transparency and increases information collection, and therefore may discourage operators from setting prices above costs and/or preventing access in downstream or upstream markets. This can facilitate competition and promote efficient use and operation of, and investment in, maritime services. At the same time, the proposed price determination does not impose significant costs (direct and indirect) on the operator.
Commission must have as its primary objective the protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services (ESC Act)	Price and financial performance monitoring supports the long-term delivery of essential maritime services, as it provides incentives for the operator to continue to invest in and provide maritime services. However, improved transparency and the threat of further regulation can limit the delivery of inefficient or excessively priced services.
Have regard to the need to promote competitive and fair market conduct (ESC Act)	The Commission examined levels of competition and conduct in the market for essential maritime services and assessed that there is competitive behaviour in some areas, but less so in others. The purpose of price and financial performance monitoring is to raise transparency and increase information collection. It can also discourage operators from setting prices above costs and/or preventing access in downstream markets.
Have regard to the need to prevent misuse of monopoly or market power	The Commission has concluded that there are some areas in which there is an incentive and ability to exercise market power. Price and financial performance monitoring is designed to increase transparency and therefore increase the threat of further regulation in future, if, for instance, operators set prices above costs and/or prevent access in downstream and upstream markets.
Have regard to the need to facilitate entry into relevant markets	By improving market transparency and increasing information collection in relation to risks from integration in related markets, such as downstream markets, the price and financial monitoring scheme can facilitate competition in markets.
Have regard to the need to promote economic efficiency	Economic efficiency, most notably allocative efficiency, will be promoted through improved competition in upstream and downstream markets, and through reduced duplication of natural monopoly services (such as berths and channels).
Have regard to the need to ensure consumers benefit from competition and efficiency	The price and financial performance monitoring aims to promote transparency and information collection, and allow information to assist customers negotiate access arrangements. Through greater information collection the

Objective	Alignment
	proposed determination accounts for the risks that may arise in downstream markets (which could limit the benefits from competitive processes accruing to end consumers).
Have regard to the need to facilitate maintenance of the financial viability of regulated industries and the incentive for long-term investment	The proposed price determination is relatively low cost and focusses only on transparency and information collection. It does not, for instance, limit the financial returns that can be earned. The proposed determination should not threaten the financial viability of the operator.
Have regard to the need to promote consistency in regulation with other jurisdictions	Port access regimes differ across and within states in Australia. The Commission's proposed price and financial performance monitoring scheme is complemented by the negotiate-arbitrate access regime. The latter is consistent with interstate access regimes, as reflected in its certification. In this respect, the access regime, combined with a monitoring scheme, is different to some other states.



The Essential Services Commission
Level 1, 151 Pirie Street Adelaide SA 5000
GPO Box 2605 Adelaide SA 5001
T 08 8463 4444

E escosa@escosa.sa.gov.au | W www.escosa.sa.gov.au