2012 PORTS PRICING AND ACCESS REVIEW

DRAFT REPORT

June 2012

The Essential Services Commission of South Australia
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REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (the Commission) invites written submissions from interested parties in relation to the issues raised in this paper. Written comments should be provided by **20 July 2012**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is Commission 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 exhibit any submission based on their 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:

2012 Ports Pricing and Access Review

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Information about the role and activities of the Commission, including copies of latest reports and submissions, can be found on the ESCOSA website at www.escosa.sa.gov.au.

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GLOSSARY OF TERMS

2007 REVIEW	2007 Ports Pricing and Access Review
ACCC	Australian Competition and Consumer Commission
ASCIANO	Asciano Limited
CCA	*Competition and Consumer Act 2010*
CIRA	Competition and Infrastructure Reform Agreement
COMMISSION	Essential Services Commission of South Australia
CPI	Consumer Price Index
ESC ACT	*Essential Services Commission Act 2002*
ESSENTIAL MARITIME SERVICES	Services defined under section 4 of the MSA Act and subject to price regulation
FLINDERS PORTS	Flinders Ports Pty Ltd
GHD	GHD Pty Ltd
GPSA	Grain Producers South Australia
GUIDELINE NO. 1	The Commission's *Ports Industry Guideline No. 1 "Access Price Information"*
GUIDELINE NO. 2	The Commission's *Ports Industry Guideline No. 2 "Regulatory Accounts"*
MEYRICK AND ASSOCIATES	Meyrick Consulting Group Pty Ltd
MSA ACT	*Maritime Services (Access) Act 2002*
REGULATED SERVICES	Services defined by proclamation under section 4 of the MSA Act and subject to access regulation
REVIEW	2012 Ports Pricing and Access Review
ROA ACT	*Railways (Operations and Access) Act 1997*
RS ACT	*Rail Safety Act 2007*
SAL	Shipping Australia Limited
TEU	Twenty-foot Equivalent
VITERRA	Viterra Operations Limited

EXECUTIVE SUMMARY

The Essential Services Commission of South Australia (**Commission**), established under the *Essential Services Commission Act 2002* (**ESC Act**), is the economic regulator of proclaimed ports in South Australia. Under the ports pricing and access regimes established under the *Maritime Services (Access) Act 2000* (**MSA Act**), the Commission regulates certain maritime services.

The MSA Act requires the Commission to review the pricing and access regimes within a year prior to 30 October 2012, to examine whether or not continued regulation is necessary. The Commission's 2012 Ports Pricing and Access Review (**Review**) is being conducted to meet this requirement. As part of this Review, the Commission is also conducting an inquiry, pursuant to section 34 of the ESC Act, into areas where the ports pricing and access regimes can be generally improved.

This Review is therefore considering the following questions:

- Should price regulation for Essential Maritime Services continue for a further five-year period from 31 October 2012? If it is to continue, what form of price regulation should be adopted?; and
- Should the ports access regime continue for a further five-year period from 31 October 2012? If it is to continue, the Commission will also examine, pursuant to section 34 of the ESC Act, how its effectiveness could be improved?

The Commission invites comments on the conclusions reached in this Draft Report. Submissions to the Draft Report are to be provided by 20 July 2012. The Commission intends to release a Final Report in September 2012.

The Commission's draft findings are set out below.

Ports Price Review

The Commission's draft finding is that within the pricing regime there exists the potential for market power to be exercised by ports operators. However, there is no evidence to suggest that such power is being exercised. The Commission has reached this conclusion after having regard to the following:

- the regulatory accounts of Flinders Ports Pty Ltd (**Flinders Ports**) and Viterra Limited (**Viterra**), which indicate they have not been earning excessive profits;
- the ports price benchmarking study conducted by GHD Pty Ltd (**GHD**), which shows the rate of increase in ports charges during the current regulatory period not been any greater than at other ports. Whilst South Australian ports charges continue to be higher relative to other large capital city ports, there has been a substantial narrowing between ports charges at South Australian ports relative to

other Australian ports (from 17% higher than average non-SA port prices in 2006 to 1% higher in 2012);

- price movements of maritime services subject to price regulation over the current regulatory period have generally reflected Consumer Price Index (**CPI**)[1] increases except where special circumstances exist; and

- commercial information provided by Flinders Ports and the absence of any disputes. The former indicates that negotiations over ports charges have been occurring over the current regulatory period and that ports users have been successful in achieving pricing outcomes that are below the listed price schedule.

In light of the above, the Commission's draft finding is that the current form of price regulation (price monitoring) is appropriate and should be maintained for a further five-year regulatory period on the basis that it produces the greatest net benefit compared with all other price regulation options. This will continue to allow ports operators to set their own ports charges constrained by the threat of re-regulation.

Ports Access Review

Similarly, the Commission's draft finding in respect to the access review is that access regulation should continue for a further five-year regulatory period. Since many of the services subject to price regulation are also subject to the access regime, the Commission's draft finding is the same.

In relation to those services that fall within the access regime but are not price regulated (the provision of pilotage, bulk loading facilities and land), the Commission has also concluded that access regulation should continue.

With respect to areas where the effectiveness of the access regime could be improved, the Commission has made the following draft findings:

- While submissions to the review have suggested that the access regime should be extended to cover certain other services, such as non-grain at-ports storage and intermodal services, the Commission has not yet seen sufficient evidence to conclude that additional access regulation is warranted;

- The negotiation and information framework set out in Part 3 of the MSA Act and the Ports Industry Guideline 1: Access Price Information (**Guideline No. 1**) are adequate for facilitating access. Further, should commercial negotiations fail, the conciliation/arbitration process set out in Part 3 is sufficient for resolving access disputes; and

[1] Under the present ports price monitoring regime, the Commission does not collect any data on actual ports charges that have been negotiated between ports users and Flinders Ports. These commercially negotiated charges may be different to those published in the pricing schedule.

- There are no persuasive arguments for the introduction of a more intrusive form of ring-fencing arrangement going forward.

Given the above, the Commission's draft finding is that the access regulation (negotiate-arbitrate) should continue for a further five-year regulatory period in its current form. Also, in light of the fact that no access disputes have been raised with the Commission and stakeholder submissions to the Commission's Issues Paper generally supported the continuation of the regime in its current form, it seems reasonable to continue the access regime in its current form. The continuation of the negotiate-arbitrate framework allows third parties to engage in commercial negotiations with ports operators whilst also providing them with a safety net of the arbitration process outlined in the MSA Act should commercial negotiations fail.

1 INTRODUCTION

The Commission is undertaking a review into the pricing and access regimes that apply to proclaimed ports in South Australia. The Commission is reviewing whether the ports pricing and access regimes specified in the MSA Act should continue beyond 30 October 2012 for a further five-year period.

Under the MSA Act, the Commission is responsible for the regulation of pricing and access at proclaimed ports. The Pricing and Access Regime covers the six commercial ports in South Australia which are currently operated by Flinders Ports, namely:

- Port Adelaide;
- Port Giles;
- Wallaroo;
- Port Pirie;
- Port Lincoln; and
- Thevenard.[2]

Whilst all of these ports are operated by Flinders Ports, some regulated services (i.e. bulk loader services) are provided by Viterra.

The MSA Act requires the Commission to review the pricing and access regimes within a year prior to 30 October 2012, to examine whether or not continued regulation is necessary. The Commission's 2012 Ports Pricing and Access Review is being conducted to meet this requirement. In particular, the Review will consider the following questions:

- Should the ports access regime continue for a further five-year period from 31 October 2012? If it is to continue, the Commission will examine, pursuant to section 34 of the ESC Act, how its effectiveness could be improved; and
- Should price regulation for Essential Maritime Services continue for a further five-year period from 31 October 2012? If it is to continue, what form of price regulation should be adopted?

[2] The Port of Ardrossan, previously also a proclaimed port, was removed from the coverage of the ports access regime in 2010 following a recommendation made by the Commission in the 2007 Ports Pricing and Access Review. Regulation of Ardrossan could be reinstated by proclamation under regulation in accordance with section 5 of the MSA Act.

1.1 Services subject to price regulation

There are currently two sets of ports maritime services subjected to price regulation; Essential Maritime Services and Pilotage Services.

1.1.1 Essential Maritime Services

Pursuant to section 4 of the MSA Act, Essential Maritime Services are defined as maritime services providing:

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

There are varying terms applying to Essential Maritime Services in ports around Australia. For the purposes of clarity, the range of port services covered by Essential Maritime Services as defined in the MSA Act include maritime services relating to the provision of: navigation aids, harbour control (but not pilotage or towage), channels, berths, wharves, cargo loading and unloading (marshaling) areas (but not loading and unloading itself), jetties, berth pockets, fenders, mooring structures, mooring and unmooring and provisioning connections (but not provisioning).

There are three charges that presently cover the provision of essential maritime services:

- Navigation Services charge;
- Harbour Services and Mooring charge; and
- Cargo Services charge.

These ports charges, in aggregate, cover the suite of Essential Maritime Services. They also correspond relatively well, though not exactly, with the three-part definition of Essential Maritime Services. There is no particular requirement for each charge to correspond to each part of the definition.

Pilotage Services

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

The price regulation regime requires the operator of a proclaimed port to maintain a schedule of Pilotage Service charges and provide the Commission with a current schedule and notice of any proposed changes to these charges.

1.1.2 Regulated Services

Pursuant to section 10 of the MSA Act, maritime services falling within the scope of the port access regime, termed Regulated Services, are the provision of:

- channels;
- common user berths;
- bulk handling facilities as defined in the *South Australian Ports (Bulk Handling Facilities) Act 1996* (operated by Viterra) but only in relation to conveyor belts (i.e. storage areas are not included);
- berths adjacent to bulk handling facilities;
- land providing access to maritime services; and
- the Outer Harbor bulk loader at Port Adelaide (operated by Viterra).

The Governor may, by proclamation, declare a maritime service to be a Regulated Service and be subject to the ports access regime.

1.2 Criteria for determining the continuation of access and price regulation

There are a number of objectives and factors that the Commission must or may have regard to in determining whether or not continued price and access regulation is necessary. The Commission has established the following assessment criteria, based on a distillation of those objectives and factors pursuant to which it will undertake this Review.

The assessment criteria are:

1. Market power

Market power is said to exist when the provision of a certain service is supplied by a firm with the ability to raise prices above competitive levels. Misuse of market power can lead to economically inefficient outcomes and be detrimental to the long-term interests of consumers and the South Australian economic wellbeing.

Economic regulation of ports services has therefore been justified on the grounds that ports exhibit natural monopoly characteristics since it will not be economically feasible to duplicate ports infrastructure facilities to meet market demand. It is seen as an important tool in protecting the interests of parties seeking access to the services provided by these essential facilities by facilitating the development of a more competitive market, or by constraining the ability of a port operator to misuse market power, in order to achieve outcomes that are more consistent with the operation of a competitive market.

Where there is evidence that a port operator has misused market power (e.g. extracting monopoly rents), regulation is necessary where it will constrain the misuse of market power and promote greater economic efficiency.

Similarly, regulation may be necessary to provide an ongoing deterrent against misuse of market power in situations where market power exists and there is a potential for it to be misused by ports operators.

2. Is there a net benefit to regulation

In a regulatory context, regulation should only be imposed where it can be shown that it is able to achieve outcomes more efficiently than would be achieved by alternatives (including no regulation), bringing the greatest net benefit to the community.

In undertaking this Review, the Commission will need to determine whether the costs associated with any market failure (e.g. misuse of market power) that might arise in the absence of regulation would exceed the regulatory costs that would be imposed on regulated entities as a result of continued regulation.

3. Other factors

The Commission would need to understand the impacts of any recent changes in the market or possible changes in the near future that may impact on the Commission's review of the need for continued regulation.

1.3 Review Process

The Commission's review of the ports pricing and access regimes commenced in February 2012 with the release of an Issues Paper for consultation.[3] The Issues Paper sets out the Commission's key questions in relation to the need for continued price and access regulation, and key issues identified by the Commission that may be of relevance to the Review for stakeholders comment. It was intended that submissions in response to the Issues Paper would guide and inform the Commission in preparing this Draft Report.

Eleven[4] submissions to the Issues Paper were received from the following parties[5]:

- Asciano Limited;
- Flinders Ports Pty Ltd;
- Grain Producers SA;

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3 The Commission's 2012 Ports Pricing and Access Review – Issues Paper is available at the Commission's website at: http://www.escosa.sa.gov.au/Publications/DownloadPublication.aspx?id=2117&versionId=2207.

4 This total includes three supplementary submissions received from Flinders Ports, Asciano and Viterra. The supplementary submissions provided comments on submissions made by other parties.

5 Submissions received in response to the 2012 Ports Pricing and Access Review – Issues Paper are available at the Commission's website at: http://www.escosa.sa.gov.au/projects/172/2012-ports-pricing-and-access-review.aspx#stage-list=1.

- Professor Malcolm Tull (Dean, Murdoch Business School) and Mr. Joel Meehan;
- Select Committee on the Grain Handling Industry;
- Shipping Australia Limited;
- The South Australian Government; and
- Viterra Limited.

The Commission's approach to the Review relies substantially on the expectations and experiences of stakeholders with the current ports pricing and access regimes. Submissions were therefore considered to be particularly important to the Review.

The Commission appreciates the contributions made by stakeholders making submissions to the Issues Paper and acknowledges the valuable input that the submissions have provided into the preparation of this Draft Report.

Many of the Commission's decisions in this Draft Report involve consideration of both confidential and non-confidential information provided by stakeholders. In order to maintain the confidentiality of particular information, this Draft Report does not contain any confidential information. Nevertheless, the Commission has attempted to provide an appropriately detailed summary of the relevant issues and its analysis of such issues.

2 REGULATION OF PORTS: 2007-2012

In 2007, as required under the MSA Act, the Commission conducted a similar review into the South Australian ports pricing and access regimes, to determine whether or not continued regulation was necessary.[6] As part of the 2007 Ports Pricing and Access Review (**2007 Review**), the Commission also undertook an Inquiry into whether or not the access regime was consistent with certain principles agreed upon by the Council of Australian Government under the Competition Infrastructure Reform Agreement (**CIRA**).[7]

The Commission's conclusions in the 2007 Review are summarised below.

2.1 2007 Ports Access Review

The Commission recommended that the ports access regime should continue for a further regulatory period on the basis that there was the potential for the exercise of market power in the provision of Regulated Services and that it was appropriate to retain the safety net provided by access regulation. Following this recommendation, a regulation was made under the MSA Act to enable the regime to continue.

In recommending that the access regime should continue, the Commission assessed the regime against the following assessment criteria:

- Is there the potential for the port operator to exercise market power?;
- Is there any evidence of misuse of market power by the port operator?; and
- Will regulation produce a net benefit?

Determining the extent to which a port operator can misuse market power was central to the question of whether or not to regulate. The Commission found that services subject to the access regime generally displayed natural monopoly characteristics. Despite the fact that market power existed, the Commission found no evidence of misuse of market power in the provision of Regulated Services.

The Commission's review of the access regime also focused on two potential issues that the Commission considered might have an impact on the regime in the near future. First, whilst the Commission recognised that there was uncertainty surrounding the impact that grain exports might have on the access regime, following deregulation of barley exporting and potential changes to wheat exporting, the Commission formed

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6 Documents relating to the 2007 Ports Pricing and Access Review are available at the Commission's website at: http://www.escosa.sa.gov.au/projects/24/2007-ports-pricing-and-access-review.aspx.

7 The CIRA is available at the Council of Australian Government's website at: http://www.coag.gov.au/coag_meeting_outcomes/2006-02-10/index.cfm. This agreement aims to establish a simpler and consistent national approach to the economic regulation of significant infrastructure, thereby promoting efficient investment in and use of these infrastructure.

the view that those changes were more likely to support the argument for the continuation of the access regime than for its expiry. Second, the Commission also formed the view that significant potential expansion of the minerals sector provided sufficient justification for continuing the access regime, noting that the negotiate-arbitrate framework underpinning the regime provided the necessary incentives for commercial negotiations to meet the specific infrastructure requirements of the minerals expansion.

The above findings led the Commission to the conclusion that it was appropriate for the access regime to continue, but that only light-handed regulation would be necessary to deter the misuse of market power by ports operators. The negotiate-arbitrate framework underpinning the access regime was considered to be appropriate for the provision of Regulated Services. The Commission also recommended that the coverage of the regime should be extended to the new bulk loader at Port Adelaide (Outer Harbor) and be removed from the Port of Ardrossan. The former was recommended to ensure greater consistency in the regulation of bulk loaders. The latter was recommended on the basis that there was only one main user at the port, with established long-term arrangements in place, and little potential for additional port access in the near future.

As part of the Commission's review of the access regime, a separate Inquiry into the consistency between the access regime and clause 2 of CIRA was also conducted. The Inquiry concluded that whilst the regime was generally consistent with the relevant CIRA principles, there were some improvements that could be made to enhance the overall effectiveness of the regime.

Amendments to the MSA Act were subsequently enacted by the South Australian Parliament to implement all but one of the Commission's recommendations. The only recommendation not adopted by the South Australian Government was for the introduction of an "advice and directions" provision into the MSA Act.

The Commission also concluded in its review that there was a prima facie case for regulating access to at-ports grain storage and bulk handling facilities given the existence of market power, but that it was appropriate for any regulatory scheme to be considered in a broader context by the South Australian Government, having regard to the whole of the grain supply chain. The ports access regime is limited to at-ports services and many of the services envisaged here extend well beyond the port boundary.

It is noted that no such review has been undertaken by the South Australian Government.

2.2 2007 Ports Price Review

The Commission's 2007 Ports Price Review concluded that the ports price regulation regime should continue for a further regulatory period on the basis that there was scope for the misuse of market power in the provision of Essential Maritime Services. The assessment criteria used by the Commission in reaching this conclusion were consistent with those used for assessing whether or not the access regime should continue.

The Commission found that, despite ports operators having the potential to exercise market power, there was no clear evidence that they had misused market power. The Commission's conclusion was reached after having regard to:

- regulatory accounts submitted by Flinders Ports, which indicated that they had not been earning excessive profits;
- information provided by Flinders Ports, which indicated that ports users had been successfully negotiating contracts below the published ports charges;
- increases of Essential Maritime Services charges throughout the regulatory period, which indicated that port charges had generally moved in line with changes in CPI; and
- benchmarking of ports charges conducted by Meyrick Consulting Group Pty Ltd (**Meyrick and Associates**)[8] on behalf of the Commission, which showed that although ports charges in South Australia are generally more expensive compared to other Australian ports, greater economies of scale in other ports were considered to be a major factor explaining this difference, rather than the misuse of market power by South Australian ports operators.

Similar to the conclusions reached in the access review, the Commission's major area of concern was in relation to grain exports, where Flinders Ports faced no direct competition in the provision of ports services used in the export of grain produced on the Eyre Peninsula.

The Commission concluded that the price monitoring regime should continue to provide flexibility for ports operators and users to negotiate commercial arrangements, but indicated that it would examine alternative approaches to reporting ports charges in the subsequent regulatory period.

A new Ports Price Determination was subsequently made in October 2007 to give effect to the new ports price regulation regime. A subsequent Ports (Variation) Price Determination was made in September 2010 to reflect amendments made to the MSA Act.

[8] Meyrick and Associates was acquired by GHD in 2008.

2.3 The Commission's Observations

The ports pricing and access regimes are ultimately underpinned by a negotiate-arbitrate framework, where ports users are encouraged to engage in commercial negotiations with ports operators over charges and service standards. To encourage commercial outcomes, there is the requirement for negotiations to be conducted in good faith, with open and transparent information exchange between parties.

This section sets out the Commission's current thinking on the effectiveness of the existing regulatory regimes during the current regulatory period.

2.3.1 Ports Price Regime

Commencing with the 2008/09 regulatory year, the Commission implemented a new ports price monitoring approach whereby it would monitor trends in the Essential Maritime Services charges. Where price monitoring reveals that an Essential Maritime Services charge has increased by more than the change in CPI, the Commission requests the ports operator to provide the Commission with justification for such a change. The Commission's considerations of any real price increase, and the justifications provided, are discussed in annual ports price monitoring reports released by the Commission.

As a general observation, cumulative increases in Essential Maritime Services charges have exceeded the cumulative increase in CPI by 1.8% during the first four years of the current regulatory period. The largest real increase was experienced in 2008/09, where average Essential Maritime Services charges rose by around 1.3% in real terms. That increase was primarily driven by a 10% increase in Cargo Services charges, which was applied to enable Flinders Ports to recover the capital expenditure associated with the extension and strengthening of its container berth at Port Adelaide.[9] Aside from 2008/09, the Commission notes that port charges for Essential Maritime Services have generally moved in line with CPI.

Table 2-1 shows the average real increase in Essential Maritime Services charges during the first four years of the current regulatory period. A more detailed table showing movements in all published port charges from 2008/09 to 2011/12 is set out in Appendix 2: Published Charges for Ports Services 2008/09 – 2011/12.

[9] ESCOSA, *2008 Ports Price Monitoring Review*, October 2008, p. 10 (refer http://www.escosa.sa.gov.au/library/081007-PortPriceMonitoring_2008-Report.pdf).

Table 2-1: Average increase in Essential Maritime Services charges

Financial Year	Above CPI Increase
2008/09	1.3%
2009/10	0.4%
2010/11	0.1%
2011/12	0%
Overall increase above CPI	1.8%

Source: The Commission's Annual Ports Price Monitoring Reports[10]

The Commission observes that cumulative increases in Pilotage Services have exceeded the cumulative increase in CPI by 8.7% over the same period. In 2008/09 and 2011/12 there were notable real increases in Pilotage Services charges, primarily as a result of enterprise bargaining agreements covering both marine pilots and boat crews. Those agreements led to significant increases in pilotage wages. Costs associated with the salary and wages of pilots and boat crews generally make up a high proportion of the costs associated with the provision of Pilotage Services.

Table 2-2 shows the average real increase in Pilotage Services charges during the first four years of the current regulatory period.

Table 2-2: Average increase in Pilotage Services charges

Financial Year	Above CPI Increase
2008/09	5.5%
2009/10	0%
2010/11	0.9%
2011/12	2.3%
Overall increase above CPI	8.7%

Source: The Commission's Annual Ports Price Monitoring Reports

[10] Refer http://www.escosa.sa.gov.au/ports-overview/pricing-access/ports-price-monitoring.aspx.

The Commission's examination of information put forward by Flinders Ports to justify any real price increase is central to the effectiveness of the current ports price monitoring regime. Ports users rely on the Commission to scrutinise the information provided to ensure ports charges are cost-reflective and that any real price increases are not as a result of market power being misused.

In general, the Commission's assessments of the information provided by Flinders Ports to justify the real increases in both Essential Maritime Services and Pilotage Services charges during the current regulatory period have found no particular areas of concern. Price movements have generally reflected CPI increases except where special circumstances exist.

In those circumstances, the Commission's assessments of information provided by Flinders Ports suggest that that the magnitudes of those real increases were reflective of the cost increases that would be incurred by Flinders Ports. The Commission notes that no concerns over increases in ports charges and pricing disputes had been raised with the Commission during the current regulatory period.

2.3.2 Ports Access Regime

As a general observation, the Commission has found no evidence of misuse of market power in the provision of Regulated Services during the current regulatory period. The Commission has neither been required to activate the formal dispute resolution process provided for under the MSA Act nor has it been provided with any positive evidence that would suggest that market power has been misused in the provision of Regulated Services.

Whilst a request for conciliation was referred to the Commission during the current regulatory period, the Commission's role was limited to gathering information from parties to better understand the nature of the disagreement and directing the exchange of information to facilitate commercial negotiations. The formal dispute resolution provisions provided for under the MSA Act were not activated as both parties ultimately reached commercial agreement.

The Commission believes that the best possible commercial outcomes are reached when negotiations are conducted in good faith, with open and transparent information exchange between parties. The abovementioned example demonstrates the merit of an informal "advice and directions" role for the Commission to facilitate commercial negotiations by directing the exchange of relevant information. The Commission believes that this would encourage the resolution of disputes at an informal level in the first instance and would make low cost dispute resolution more accessible for negotiation matters.

3 SHOULD PRICE REGULATION CONTINUE?

The South Australian ports pricing regime works on a five-yearly cycle. The MSA Act requires the Commission to review the regime a year prior to its expiry, to examine if there is an ongoing need for price regulation of certain ports services or should the regime expire on 31 October 2012. If price regulation is to continue, what form of price regulation should be adopted?

In order for the Commission to determine whether or not continued price regulation is necessary, the current ports price regime has been assessed against the criteria set out in Chapter 2, namely:

- Is there the potential for ports operators to exercise market power?;
- Is there any evidence of misuse of market power by ports operators?; and
- Is there a net benefit to price regulation?

The Commission's approach to this Review is to only consider departing from the current form of price regulation (price monitoring) where there is evidence to suggest that an alternate approach to price regulation is warranted based on the experiences of stakeholders, or if the market or regulatory environment is likely to change such that the current approach may no longer be appropriate for the next five-year regulatory period.

This Chapter sets out the Commission's draft conclusion on whether or not continued price regulation is necessary, and if so, in what form. The Commission invites stakeholders' comments on the draft conclusions reached, and will take any comments into account before publishing its Final Report in September 2012.

3.1 Operation of the ports price regime

The 2007 Ports Price Determination establishes a system of price monitoring for Essential Maritime Services, which is separate to, but complements the negotiate-arbitrate access framework. It allows a regulated port operator to adjust charges for maritime services subject to price regulation as it sees fit, subject to the requirement that it publish a pricing schedule and inform the Commission of changes to that schedule within 10 days of any changes to those ports charges. The emphasis of this approach is on achieving a basic level of price transparency.

Whilst a regulated port operator can reach agreement with ports users for the provision of Essential Maritime Services at a price that is different to the published price, the port operator must inform, and give relevant details to, the Commission of any such agreements within 3 months after the end of that financial year in which the 2007 Ports Price Determination has effect.

Under the present price monitoring regime, the Commission also publishes annual ports price monitoring reports to provide information on ports charges, and commentary on factors underpinning price movements. The key focus for the Commission in the monitoring of ports charges is determining whether or not any above CPI price increase is adequately justified and is not as a consequence of market power being misused by ports operators.

Whilst the current regime can be considered as relatively light-handed, the Commission is not prevented from introducing a more heavy-handed form of price regulation should it believe that information provided by ports operators does not adequately justify the real price increases or if there is any other reason to conclude that a heavier-handed form of price regulation is more appropriate.

The Commission notes that it undertakes a detailed ports price benchmarking study as part of its five-yearly ports pricing and access review to inform itself of how prices have moved over the regulatory period and between different regulatory periods.

3.2 Legal requirements for the review

Under section 25(2) of the ESC Act, the Commission may only make a price determination if authorised to do so by a relevant industry regulation Act or by regulation under the ESC Act. Pursuant to regulation 3 of the *Essential Services Commission Regulations 2004*, the Commission is authorised to make a price determination in respect of essential maritime industries, within the meaning of the MSA Act.[11] Part 3 of the ESC Act sets out the Commission's price regulation powers.

Part 2 of the MSA Act (regulation of maritime industries) details the Commission's price regulation function in respect of Essential Maritime Services, which are regulated industries for the purposes of the ESC Act. Section 9 of the MSA Act specifies that the Commission must keep maritime industries under review with a view to determining whether regulation (or further regulation) is necessary. It is within this context that the Commission must determine whether or not price regulation should continue beyond the expiry of the current price regime (being 30 October 2012).

In the event that the Commission determines that the ports price regulation regime should continue, a new price determination will be made. In making such a determination, the Commission must comply with its statutory objectives as set out in the ESC Act.

[11] Regulation 3 of the Essential Services Commission Regulations 2004.

3.2.1 Application of the ESC Act

Section 6 of the ESC Act states that the Commission must:

(a) Have as its primary objective protection of the long term interests of South Australian consumers with respect to the price quality and reliability of essential services; and

(b) At the same time, have regard to the need to:

(i) Promote competitive and fair market conduct;

(ii) Prevent misuse of monopoly or market power;

(iii) Facilitate entry into relevant markets;

(iv) Promote economic efficiency;

(v) Ensure consumers benefit from competition and efficiency;

(vi) Facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and

(vii) Promote consistency in regulation with other jurisdictions.

In addition to having regard to the abovementioned statutory objectives in carrying out the Review, the Commission must also have regard to the factors set out in section 25(4) of the ESC Act when making a price determination, namely:

(a) The particular circumstances of the regulated industry and the goods and services for which the determination is being made;

(b) The costs of making, producing or supplying the goods or services;

(c) The costs of complying with laws or regulatory requirements;

(d) The return on assets in the regulated industry;

(e) Any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries;

(f) The financial implications of the determination;

(g) Any factors specified by a relevant industry Act or by regulation under this Act; and

(h) Any other factors that the Commission considers relevant.

Furthermore, under section 25(5) of the ESC Act, the Commission must also ensure that in making a price determination:

(a) Wherever possible the costs of regulation do not exceed the benefits; and

(b) The decision takes into account and clearly articulates any trade-off between costs and service standards.

At section 25(3), the ESC Act also specifies the range of regulatory approaches that the Commission can choose from in the making of a price determination, ranging from those that are not determinative in nature (e.g. price monitoring), to those that are considered more prescriptive (e.g. price setting).

Section 25(3) of the ESC Act provides that:

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

(a) Fixing a price or the rate of increase or decrease in a price;

(b) Fixing a maximum price or maximum rate of increase or minimum rate of decrease in a maximum price;

(c) Fixing an average price for specified goods or services or an average rate of increase or decrease in an average price;

(d) Specifying pricing policies or principles;

(e) Specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed or any other specified factor;

(f) Specifying an amount determined by reference to quantity, location period or other specified factor relevant to the supply of goods or services;

(g) Fixing a maximum average revenue, or maximum rate of increase or minimum rate of decrease in maximum average revenue, in relation to specified goods or services; and

(h) Monitoring the price levels of specified goods or services.

3.2.2 MSA Act Objects Clause

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

- *To provide access to maritime services on fair commercial terms; and*
- *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; and*

- *To promote 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 objects provision in the MSA Act is essentially a statement of intent as to how the legislation should operate and not, per se, a list of factors that the Commission must have regard to when exercising its functions (e.g. making a price determination).

The objects clause works to indicate to the Commission the intended purpose of the legislation and is therefore used by the Commission as an aid to interpreting the legislative provisions of the MSA Act.

3.3 Assessment against criteria

Given the number of objectives and factors that the Commission must or may have regard to under both the ESC Act and MSA Act, the Commission has applied the following assessment criteria to examine whether or not continued price regulation is necessary.

3.3.1 Is there the potential for ports operators to exercise market power?

Market power is said to exist when the provision of a certain service is supplied by a firm with the ability to raise prices above competitive levels. Misuse of market power can lead to economically inefficient outcomes and be detrimental to the long-term interests of consumers.

The assessment of market power was a central theme to the 2007 Review, and continues to be fundamental to the question as to whether or not continued price regulation is required.

To better understand the impact of recent developments, or likely future developments, that may have an impact on the influence on the market power of ports operators going forward, the Commission sought stakeholders' comment on the following matters in the Issues Paper.

Container Trade

Port Adelaide is South Australia's largest ports facility and is the only port capable of handling significant volumes of containers. The Commission observes that there is an increasing number of commodities (e.g. grain) being handled in containers that were previously shipped in bulk.

There is presently no intra-port and intra-terminal competition within the port for container facilities. However, for many ports users it is feasible to transport containers by other transport modes (e.g. rail and roads) to and from interstate ports such as Port of Melbourne.

In the Issues Paper, the Commission sought stakeholders' comment on the following:

- How has competition between ports for container volumes developed?; and
- To what extent does Flinders Ports hold market power in providing container facilities?

The Flinders Ports submission commented:

> *"[It] competes not only with other Australian ports like Melbourne and Fremantle for those shipping services that operate within this trade sector, but with other ports within the region and around the globe."*[12]

Flinders Ports went on to comment that:

> *"container importers and exporters therefore have viable and existing alternatives and this market pressure continues to ensure that [it] cannot and does not have market power in providing container port facilities."*[13]

Flinders Ports estimated that the extent of the South Australian container trade being "transshipped" through Port of Melbourne remains significant, albeit lower than the 70-80,000 containers (TEU) (or 35% of the South Australian market) estimated as part of the economic justification for the deepening of the Port Adelaide outer channel.

The South Australian Government submission expressed a similar view in that the Adelaide Container Terminal shares a contestable cargo hinterland with the Port of Melbourne, commenting that:

> *"The Draft South Australian Containerised Origin Energy/Destination Study notes that in 2008, 125,000 international import/export containers destined for/originating in South Australia were shipped via the Port of Melbourne."*[14]

Whilst the Commission notes that there remain significant barriers to competitive entry to the South Australian container trade market in the foreseeable future, it shares the views of Flinders Ports and the South Australian Government that interstate ports and other transport modes

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12 Flinders Ports, *Flinders Ports' Response to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 9.

13 Ibid, p. 9.

14 South Australian Government, *South Australian Government's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, April 2012, p. 2.

continue to provide competition to Port Adelaide for the provision of container services going forward. The Commission considers that where a user has credible alternatives to using the container services, the ability of a ports operator to extract monopoly rents is reduced.

The Commission's draft finding is that there is little potential for the misuse of market power for containerised cargoes.

Mining Developments

Whilst there are several South Australian ports with infrastructure that is capable of loading minerals for export, forecasts of strong growth in exploration and mining developments would continue to place increased demand on ports infrastructure. It is therefore likely that substantial capital expenditure would be required in the near future to address longer-term infrastructure requirements.[15]

The South Australian Government submission shared this view, commenting that:

> *"The growth in the minerals and resources sector, combined with the natural growth expected in other bulk cargoes, suggests that port capacity will need to increase substantially."*[16]

This was supported by the Flinders Ports submission, which commented that:

> *"… additional investment on specific infrastructure (storage, loading and integrated logistics services) will be required to support the specific requirements of and the anticipated growth in this industry sector."*[17]

To ensure that the development of the required infrastructure not only meets the specific needs of the South Australian mining industry but are also economically viable, Flinders Ports' submission went on to argue that:

> *"… the port operator and its customer are in the best position to resolve the issue of the port services/pricing package moving forward."*[18]

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15 Uncertainty relating to access and capacity of existing, new and proposed ports infrastructure in South Australia was identified by survey respondents as an area of major concern in the 2011 Infrastructure Demand Study commissioned by the South Australian Government's advisory body the Resources and Energy Sector Infrastructure Council.

16 South Australian Government, *South Australian Government's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, April 2012, p. 3.

17 Flinders Ports, *Flinders Ports' Response to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 10.

18 Ibid, p. 11.

The Commission observes that direct negotiations between the ports operator and ports users was an important input into the development of an ambitious Master Plan developed by Flinders Ports to build a "best-practice" bulk commodities precinct to cater for the specific future needs of the South Australian resources industry, as well as other bulk commodity sectors.[19]

The Commission therefore agrees with Flinders Ports that direct negotiation model between the ports operator and ports users is most appropriate to address mining developments going forward. The Commission considers Flinders Ports is best able to account for the specific infrastructure requirements and circumstances of the resources industry.

However, it is mindful that developments in both the resources industry and ports infrastructure may give rise to market power concerns going forward. To the extent that investment in port infrastructure to increase service standards and capacity will affect the unit cost of providing the port service, this may place upward pressure on ports charges as ports operators seek to recover the associated expenditure from ports users in the form of higher charges. This may also give rise to concerns over the extent to which the magnitude of price increases are reflective of the actual level of expenditure incurred.

Whilst the Commission's assessment of the port industry over the current regulatory period reveals that it has yet to have any major impact on the level of or potential for market power in relation to ports, it is of the view that any uplift in mining development could give rise to concerns over market power going forward. The Commission will therefore continue to monitor these issues.

Grain

The 2007 Review concluded that market power concerns were likely to be greatest in relation to grain produced on the Eyre Peninsula, given that there is no significant domestic market for grain and because grain exporters have little or no choice but to use Port Lincoln (or Thevenard), both of which are owned by Flinders Ports. This situation remains unchanged.

Competitive entry

Flinders Ports, the relevant ports operator, holds an exclusive Port Operating Agreement with the Minister of Transport. This agreement gives Flinders Ports the exclusive right to provide, or manage the provision of, Essential Maritime Services across proclaimed ports in South Australia. This also means that competitive entry is not possible within proclaimed ports.

[19] The $50 million bulk precinct redevelopment will include, amongst other things, new material handling systems, upgraded or improved ancillary facilities, and a $5 million private rail link and interface with the national rail network.

Therefore, the only alternative for a new entrant to enter the market is to build a new port, providing a suitable site can be found and regulatory approval obtained. The Commission understands that the proposed new ports at Spencer Gulf and Eyre Peninsula (Port Bonython and Port Spencer) have both been granted major development status by the South Australian Government.

In the absence of competitive entry, the Commission's draft finding is that there is the potential for ports operators to exercise market power in the provision of Essential Maritime Services going forward.

Draft Report Conclusion

The structure for the market for Essential Maritime Service suggests that there is the potential for market power to exist.

3.3.2 Is there any evidence of misuse of market power by ports operators?

Having determined that there is the potential for market power to exist in the provision of Essential Maritime Services, the Commission is interested in any evidence that would suggest that such market power has been misused by ports operators over the current regulatory period. The misuse of market power could be evidenced by the behaviour of ports operators in a number of ways.

In considering this issue, the Commission has examined the following indicators:

Number of Disputes

An indicator of the effectiveness of the current form of regulation could be in the form of either an absence or low number of pricing or service quality related dispute between a ports operator and ports users.

The Commission has not been presented with any specific evidence from ports users that ports operators have exercised market power in a malicious way in respect to both ports charges and service quality over the current regulatory period.

Annual Profitability

Under the current regulatory regimes, Flinders Ports and Viterra (being regulated operators) are required to report certain operational and financial information to the Commission on a periodic basis.[20] This information is to be

[20] Section 42 of the MSA Act requires the regulated operator to separate accounts and records for Regulated Services, and to separate these by port.

prepared and reported to the Commission in accordance with the *Ports Industry Guideline No. 2: Regulatory Accounts* (**Guideline No. 2**).[21]

Operational information collected under Guideline No. 2 consists of information on the capacity, utilisation and availability of Regulated Services. Financial information consists of profit and loss statements in respect to the same set of services. This information is collected not only for the purposes of providing relevant information to an arbitrator in the event of an access dispute, but also to allow the Commission to gain an insight into the following:

- market profile;
- market structure;
- market power; and
- competition in the market.

Accordingly, the Commission has examined this information for the purposes of this Review.

The Commission's assessment of financial information reported pursuant to Guideline No. 2 has found no clear evidence that ports operators are earning excessive profits. Whilst there were fluctuations in the level of profitability over the current regulatory period, these were explained by the substantial increase in the volume of grain exported (from around 3.5 million tonnes in 2009/10 to around 7.6 million tonnes in 2010/11) due to favorable harvest conditions. On the basis of the assessment of financial and operational information provided by ports operators, the Commission's draft finding is that there is no evidence to suggest ports operators are earning excessive profits.

The information used by the Commission in its assessment is confidential and cannot be reported in this Draft Report. The Commission will continue to collect and monitor this information in the next regulatory period.

Draft Report Conclusion

There is no evidence to suggest that ports operators are earning excessive profits.

[21] The Ports Industry Guideline No. 2: Regulatory Accounts is available on the Commission's website at: http://www.escosa.sa.gov.au/library/100415-PortsGuidelineNo2-RegulatoryAccounts.pdf.

3.3.3 Are ports charges indicative of market power being exercised?

Under the ports price regime, a ports operator is allowed to adjust Essential Maritime Services charges as it sees fit, subject to the requirement that it publish a pricing schedule and inform the Commission of changes to that schedule. The availability of such information can provide an insight into the level of ports charges relative to other ports and overall price movements, and may indicate whether or not market power has been misused.

Despite the potential for market power to exist, the Commission's monitoring of Essential Maritime Services charges over the current regulatory period has found no particular areas of concern. Annual ports price monitoring reports published by the Commission have concluded that price movements have generally reflected CPI increases except where special circumstance exists. An example of such a special circumstance is the 10% increase applied to Cargo Service charges in 2008/09 to allow Flinders Ports to recover the capital expenditure associated with the extension and strengthening of its container berth at Port Adelaide.

Where special circumstances exist, the Commission's assessment of information provided by Flinders Ports suggests that the magnitudes of those price increases were reflective of the cost increases that would be in incurred by Flinders Ports.

3.3.4 Benchmarking of ports charges in Australia

As part of this Review, GHD was engaged by the Commission to undertake a benchmarking study of ports charges in Australia. The rationale for undertaking such a benchmarking study is to enable the Commission to:

- consider the reasonableness of ports charges in South Australia relative to other Australian ports;
- examine the key factors that are likely to explain the differences in ports charges between South Australian ports and other Australian ports; and
- examine how South Australian ports charges have moved between the current and previous regulatory periods.

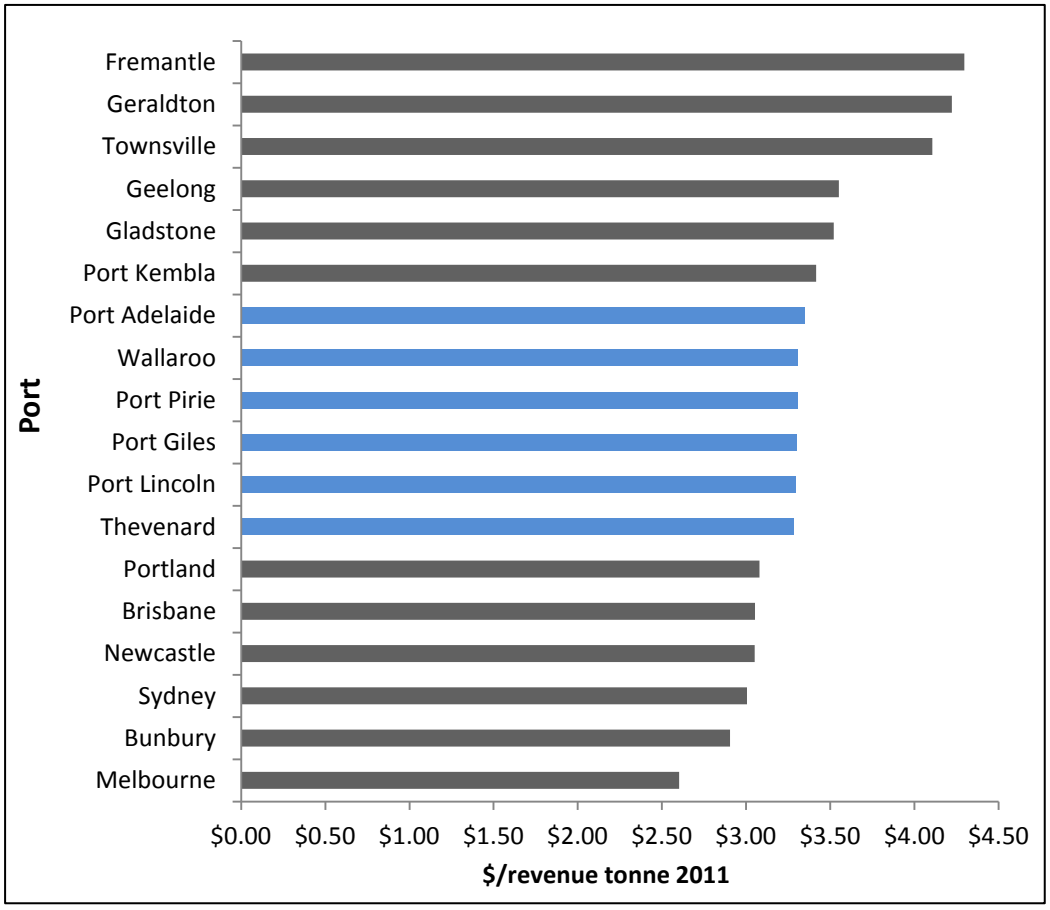
In undertaking this benchmarking study, GHD utilised a methodology similar to that used by Meyrick and Associates in the 2007 ports price benchmarking study.[22] This is to both ensure consistency and enable a direct comparison between the previous and current regulatory periods.

[22] A more detailed description of the methodology can be found in GHD's Final Report which is available on the Commission's website at: http://www.escosa.sa.gov.au/projects/172/2012-ports-pricing-and-access-review.aspx#stage-list=3.

The GHD Final Report made two key findings. First, Essential Maritime Services charges at South Australian ports are slightly higher than other Australian ports. Secondly, there has been a substantial narrowing of those charges between South Australian ports and other Australian ports between the previous and current regulatory periods.

Figure 3-1 below depicts the 2011 Essential Maritime Services charges at individual ports across Australia. It shows that ports charges across all South Australian ports are very similar, and were slightly above the middle of the comparator range.[23] On an individual port-by-port basis, South Australian ports charges are ranked in the middle of the sample.

Figure 3-1: Comparison of weighted average charges for individual ports ($/revenue tonne, 2011)



Source: GHD, *Port Price Benchmarking Final Report for the Essential Services Commission of South Australia*, April 2012, p. 37.

[23] Port Adelaide's port charges continue to be the highest among all South Australian ports due to the channel levy imposed on ships entering that port.

The GHD Final Report noted that there are a number of factors that are likely to explain why South Australian ports charges are higher than some of the other Australian ports, particular the large capital ports of Melbourne and Sydney. These factors include but are not limited to:

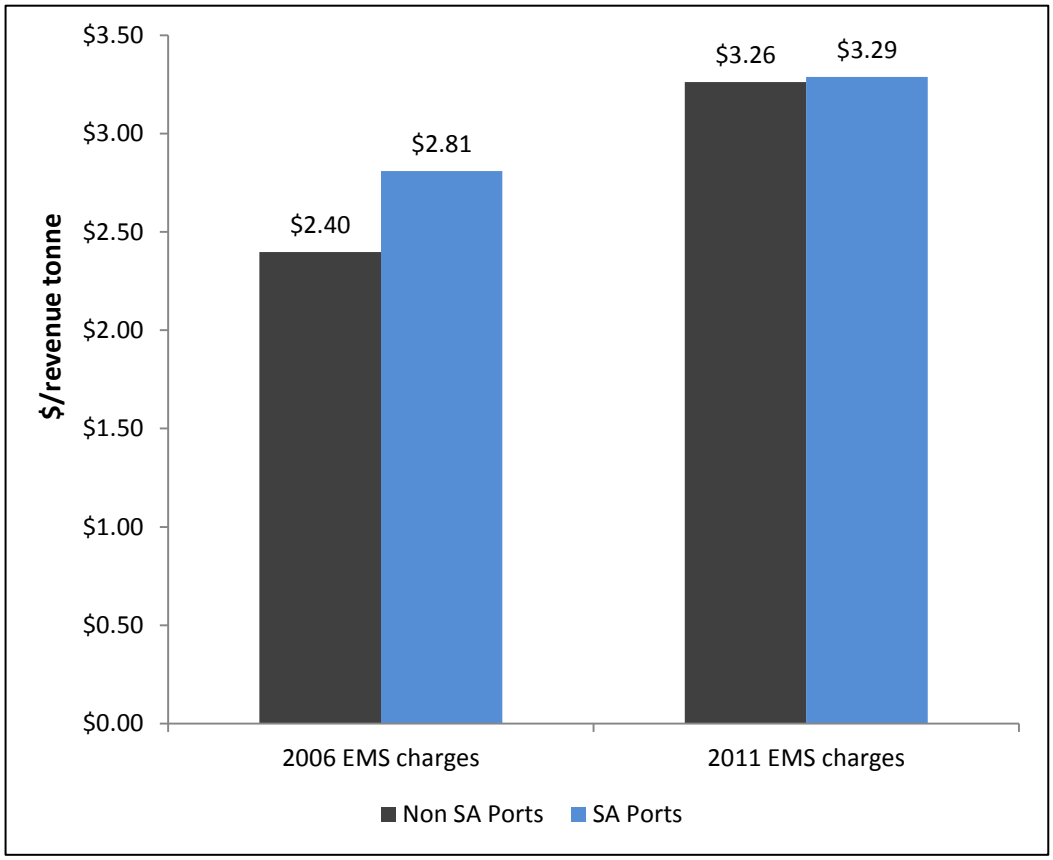
- ***Economies of scale*** – South Australian ports on average are small relative to these large capital ports, and are therefore unable to take advantage of the benefits that come from economies of scale;

- ***Geographical disadvantage*** – Flinders Ports' operations are spread over a number of ports including remote ports which can suffer from under utilisation given the narrow and cyclical nature of the customer base. This can present some pricing challenges given a substantial proportion of the costs associated with ports infrastructure operations are fixed; and

- ***Ownership*** – government-owned ports such as the Port of Fremantle suffer from a degree of underpricing and do not earn a commercial rate of return. In contrast, Flinders Ports, a privately owned company, is required by its shareholders to earn a commercial rate of return. All else being equal, this will result in higher charges at non-Government owned ports relative to privately owned ports.

Figure 3-2 below illustrates the average Essential Maritime Services charges at South Australian ports relative to non-South Australian ports between the previous and current regulatory periods. It can be observed that, although South Australian ports charges continue to be higher, there has been a substantial narrowing of those charges (from 17% higher in 2006 to 1% in 2012). During the current regulatory period, average Essential Maritime Services charges at South Australian ports have increased by 17% compared to the 36% observed across other Australian ports.

Figure 3-2: Level of EMS charges at SA and non-SA ports in 2006 and 2011 (average $/revenue tonne[24])



Source: GHD, *Port Price Benchmarking Final Report for the Essential Services Commission of South Australia*, April 2012, p. 39.

The GHD Final Report stated that this is likely due to the fact that some non-South Australian ports had experienced a strong growth in trade volumes relative to those in South Australian ports. Those developments have led to subsequent investment in ports infrastructure and rises in ports charges to recover the associated capital expenditure.

Given the complex factors that could impact ports charges, care should be taken when drawing conclusions from the benchmarking study. This concern was expressed in the Flinders Ports submission; it commented that each port around Australia is very different (cargo mix, size and location) and therefore comparing ports charges across various ports can be problematic.[25]

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24 Revenue tonne is a shipping term describing the measurement on which the shipping is freighted. Cargo can be rated as weight (metric tonnes) or measure (cubic meters/kilolitres), and a revenue tonne is based on the greater of the two measures.

25 Flinders Ports, *Flinders Ports' Response to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 13.

Notwithstanding this, the result of the benchmarking study suggests that even though there is the potential for Flinders Ports to exercise market power, there is no evidence to suggest that it has been exercised. This may indicate that the current price regulation regime has been effective and that a more intrusive form of price regulation is not necessary.

Draft Report Conclusion

There is no evidence to suggest that Essential Maritime Services charges over the current regulatory period are indicative of market power being exercised.

3.3.5 Are ports users actively negotiating ports charges?

The current ports price regime allows a ports operator to adjust Essential Maritime Services charges as it sees fit, subject to the requirement that it publish a pricing schedule and inform the Commission of changes to that schedule. However, ports operators and ports users are encouraged to engage in commercial negotiations to negotiate their individual contract terms and conditions.

The requirement for a ports operator to publicly publish a pricing schedule plays an important role in that it provides a starting point for ports users to negotiate individual contracts. Based on submissions in response to the Issues Paper, this appears to be occurring. The Flinders Ports submission commented that:

> *"Throughout this period [it] has negotiated a number of key trading outcomes with a range of port users which has not only supported the growth achieved but underpinned a significant investment in port and port related infrastructure."*[26]

The Commission's assessment of information provided by Flinders Ports regarding its negotiated contracts with ports users reveals that negotiations over ports charges have been occurring over the current regulatory period and that ports users have been successful in achieving pricing outcomes that are below the listed price schedule.[27] Further, the Commission has not been made aware of, or provided with any evidence, that would suggest that Flinders Ports has not been negotiating in good faith over Essential Maritime Services during the current regulatory period.

The Commission's draft finding is therefore that ports operators and ports users have been active in negotiating commercial arrangements.

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26 Ibid, p. 14.

27 These pricing outcomes incorporate both up-front discounts and volume rebates.

Draft Report Conclusion

Ports operators and ports users have been active in negotiating commercial arrangements over the current regulatory period.

3.3.6 Will price regulation produce a net benefit?

The Commission's draft finding that there is the potential for ports operators to exercise market power in the provision of Essential Maritime Services going forward suggests that ongoing price regulation is necessary.

The Commission believes it is appropriate to continue with price monitoring as there is no evidence to suggest that a more intrusive form of regulation is required. The Commission believes that price monitoring produces the greatest net benefit compared with all other available options on the basis that it imposes minimal compliance costs and provides the desired level of transparency through the publication of a price list. Price transparency helps to avoid the potential exercise of market power and limits the scope for price discrimination as all ports users are able to readily access ports prices across all vessels and products.

The majority of submissions received in response to the Issues Paper supported ongoing price regulation, and a continuation of the price monitoring approach.

The Flinders Ports submission commented that:

> *"… if pricing regulation is to continue then the only form of regulation that should be adopted is a light handed one."*[28]

The Viterra[29] and South Australian Government[30] submissions both commented that the present form of price regulation (price monitoring) has struck an appropriate balance between providing a credible deterrent to the misuse of market power and minimising compliance costs on ports operators.

The Commission's draft finding is therefore to continue price monitoring as the form of regulation for the next regulatory period. The Commission believes it produces benefits that outweigh the costs, given the potential for misuse of market power.

This will involve the requirement for ports operators to publicly make available a pricing schedule and inform the Commission of any changes to ports charges.

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28 Flinders Ports, *Flinders Ports' Response to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 20.

29 Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 6.

30 South Australian Government, *South Australian Government's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, April 2012, p. 4.

It will also allow the Commission to publish annual ports price monitoring reports.

Draft Report Conclusion

Price monitoring should continue for the next regulatory period on the basis that it produces the greatest net benefit compared with all other price regulation options.

3.4 Areas for general improvement of the price regulation regime

3.4.1 Is an alternative form of price regulation necessary?

Whilst section 25(3) of the ESC Act specifies a range of regulatory approaches that the Commission can utilise in a price determination, they differ significantly in terms of the extent of information required by the regulator, the costs involved in complying with the regime and the degree to which prices are determined by the regulator. In a regulatory context, a more intrusive form of price regulation should only be imposed where there is the potential for significant inefficiencies to arise from the misuse of market power.

In a heavy-handed approach (i.e. direct control being imposed on prices and related terms and conditions of service supply), the regulator plays a more intrusive role in the price-setting process and will require more information from the regulated operator. Price regulation of this form therefore imposes a greater level of compliance costs on the regulated operator, which is ultimately passed on to ports users in the form of higher prices.

A light-handed approach (i.e. price monitoring) does not require the regulator to control prices directly but emphasises commercial negotiation or information transparency with recourse to a dispute resolution process (e.g. arbitration). Further, it relies on the threat of re-regulation to act as an ongoing deterrent against the misuse of market power. Price regulation of this form imposes less compliance costs on the regulated operator as less information is required by the regulator.

The key factors that underpin the choice of price regulation are that it should reflect the specific characteristics of the ports industry and, more importantly, should be commensurate with the degree of market power that is involved. The chosen form of price regulation should be one which, in achieving its goal, produces the greatest net benefit compared with all other available options.

The submission from Professor Malcolm Tull and Mr. Joel Meehan argued that a more intrusive form of price regulation be imposed for the next regulatory period, commenting that:

> *"CPI-x regulation, whilst admittedly being more burdensome to comply with, could potentially promote economic efficiency and put downward pressure on process."*[31]

To support its argument, the submission from Professor Malcolm Tull and Mr. Joel Meehan asserted that there is evidence to suggest that Flinders Ports has exploited its market power to some degree during the current regulatory period. The submission did not provide any detailed information to substantiate its argument, but made a number of general observations.[32]

The Commission does not intend to respond in detail to each observations made in the submission from Professor Malcolm Tull and Mr. Joel Meehan, but would make the following general comments.

First, ports charges should not be considered in isolation as there are a number of factors that could have an impact on the level of charges, such as the level of trading volume and economies of scale. Higher port charges alone are therefore not necessarily indicative of market power being exercised.[33] For example, undertaking investment in port infrastructure to meet requirements of ports users may put upward pressure on ports charges as ports operators seek to recover the associated expenditure from ports users in the form of higher charges. This may result in deterioration in price competitiveness in the short-medium term. It is therefore important to consider these factors so as to give context to comparison of ports charges between different ports.

Secondly, the fact that a regulated entity is consistently profitable is not necessarily indicative of the exercise of market power to earn monopoly rents. Indeed, a financially viable regulated industry that has incentives for long-term investment is consistent with the long-term interests of consumers.[34] As noted, the Commission's analysis of Flinders Ports' regulatory accounts has found no clear evidence to suggest it has earned excessive returns or any abnormal trends that are of concern to the Commission.

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31 Professor Malcolm Tull and Mr. Joel Meehan, *Professor Malcolm Tull and Mr. Joel Meehan submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 16 March 2012, p. 2 of unnumbered document.

32 Ibid, p. 2.

33 The GHD 2012 Ports Price Benchmarking Study highlighted that there are a number of factors that drive different pricing outcomes, with many of these factors being difficult to quantify and unrelated to questions of market power.

34 Section 6(b)(vi) of the ESC Act requires the Commission to have regard to facilitating maintenance of the financially viable regulated industries that have incentives for long-term investment.

Thirdly, using a measure such as return on assets to compare the financial performances of ports operators is only useful to the extent that there are consistencies in the asset profiles (e.g. asset lives and depreciation schedule), and methodologies[35] used to derive the respective asset base. Due to these differences, significantly different return on asset ratio values may result.

Lastly, the Commission notes that the imposition of a more intrusive form of price regulation (i.e. CPI-x) without positive evidence to justify such an imposition will impose significant costs for the Commission, ports operators and interested parties without any net benefit. There are also some inherent difficulties with choosing the appropriate productivity offset rate (x) as there is no guarantee that productivity gains made in the past will continue to be relevant in the future.

In the absence of any disputes around Essential Maritime Services charges over the current regulatory period and matters considered by the Commission as part of this review (refer section 3.3), the Commission's draft finding is that there is no evidence to suggest that a more intrusive form of price regulation (e.g. CPI-x) is required.

Draft Report Conclusion

There is no evidence to suggest that a more intrusive form of price regulation is required.

3.4.2 Alternative approaches to monitoring ports charges

The current approach of monitoring ports charges against changes in CPI was adopted following the 2007 Review on the basis that price trend analysis is a standard practice used among port operators and regulators.

Nevertheless, the Commission recognises that there may be some limitations to the current approach. For example, whilst CPI is a broad-based index encompassing the cost of living for metropolitan households in Australia, it may not adequately reflect the rate of increase in cost inputs that the ports operator would face (e.g. wage costs).

However, the Commission recognises that there are many complex factors affecting the level of comparative port charges, not all which will fall within the control of either the Commission or the port operators (i.e. economies of scale, location and cargo mix).[36]

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35 In practice, a variety of asset valuation approaches are used (e.g. Depreciated Optimised Replacement Cost or Depreciated Actual Costs) for different reasons and in differing circumstances.

36 It is inherently difficult to quantify these factors irrespective of the price monitoring methodology used.

As part of this Review, the Commission is interested in exploring alternative approaches to monitoring ports charges over the next regulatory period. Whilst the Commission has identified two options below for comment, stakeholders are encouraged to put forward any views on the precise form of the price monitoring approach that should apply for the next regulatory period. The two options are:

- ***Using an alternative index*** – this option would involve the Commission monitoring ports charges against another index (e.g. producers price index). To the extent that ports charges do increase beyond changes in the index, the Commission will similarly request that the ports operator provide information to justify these price changes; or
- ***Monitoring port charges without reference to an index*** – this option would involve the Commission monitoring ports charges without any reference to an index. It relies purely on ports operators informing the Commission of any changes to ports charges and submitting information to explain those changes.

Should stakeholders believe that an alternative price monitoring approach is preferable, the Commission requests stakeholders to provide information to substantiate their positions.

Draft Report Conclusion

The Commission invites stakeholders to comment on the appropriateness of continuing with the current approach of monitoring ports charges against movements in CPI.

Should stakeholders believe that an alternative price monitoring approach is preferable, the Commission invites stakeholders to provide information to substantiate their positions.

4 SHOULD ACCESS REGULATION CONTINUE?

The South Australian ports access regime similarly works on a five-yearly cycle. The MSA Act requires the Commission to review the regime a year prior to its expiry, to examine if there is an ongoing need for access regulation or should the regime expire on 31 October 2012.

Consistent with the approach taken for the review of the price regulation regime, the Commission has assessed the current access regime against the criteria set out in Chapter 2. The Commission will consider making significant changes to the access regime where there is evidence that such changes are warranted based on experiences of stakeholders, or if the market or regulatory environment is likely to change such that the current approach may no longer be appropriate going forward.

This Chapter sets out the Commission's draft conclusion on whether or not continued access regulation is necessary. The Commission invites stakeholders' comments on the draft conclusions reached, and will take any comments into account before publishing its Final Report in September 2012.

4.1 Operation of the ports access regime

The framework for South Australian ports access is set out in Part 3 of the MSA Act and is summarised in Appendix 1 of this paper. The access regime provides for the negotiation of access to particular port services, defined in the MSA Act as Regulated Services, and provides for conciliation and arbitration to occur where an access dispute arises which cannot be otherwise resolved between the parties.

The access regime prescribed by the MSA Act applies to persons (regulated operators) who carry on a business of providing maritime services at a proclaimed port that are declared by proclamation to be regulated services.

The access regime has been certified as an effective state-based access regime pursuant to Part IIIA of the *Competition and Consumer Act 2010 (*Cth*)* (**CCA**)[37] for a period of ten years. A consequence of this certification is that maritime services provided for under the ports access regime cannot be declared under the provisions of the national access regime or be made subject to an access undertaking to the Australian Competition and Consumer Commission (**ACCC**).

Any party wishing to gain access to one of these Regulated Services must submit its interest direct to the regulated operator (Flinders Ports or Viterra) who will manage the access request in accordance with the MSA Act.

[37] The *Trade Practices Amendment (Australian Consumer Law) Act (no 2. 2) 2010* (Cth) renamed the *Trade Practices Act 1974* (Cth) (TPA) the *Competition and Consumer Act 2010* (Cth) with effect from 1 January 2011.

4.2 Legal requirements for the review

Section 43 of the MSA Act specifies that the Commission must, within the last year of each regulatory period, conduct a review of the industries which are presently subject to the access regime to determine if the regime should continue to apply to those industries. This element of the review does not extend to a consideration of other industries which ought, in the Commission's view, to be subject to that access regime.

The Commission must make a recommendation to the South Australian Government on the ongoing applicability of the access regime. If it is determined that the access regime should continue, a regulation must be made extending the period of its operation accordingly.

If, however, the Commission recommends that ongoing access regulation is not necessary, and a regulation is not made, then the access regime will expire.

4.3 Assessment against criteria

In determining whether or not the access regime should continue, the Commission has used the same assessment criteria as applied to the price regulation question. It is appropriate to use the same criteria as the Commission must have regard to the same ESC Act objectives in both cases and the factors that are important in considering the need for ongoing regulation, whether price or access regulation, are generally the same.

However, it is important to highlight the differences between the services that are covered by the access regime (Regulated Services) and those that are subject to price regulation (Essential Maritime Services), as it is possible for different conclusions to be drawn in relation to different services.

Whilst the services that are subject to the access regime are largely the same as those that are subject to price regulation, there are some important differences:

- Only common user berths at proclaimed ports are covered by the access regime whereas all berths are subject to price regulation;
- The provision of Pilotage Services at a proclaimed port is subject to the access regime but is not an Essential Maritime Service and is therefore not price regulated. However, section 8 of the MSA Act does require a provider of Pilotage Services at a proclaimed port to notify the public of its current pilotage charges and notify the Commission before changing any Pilotage Services charges. Effectively, section 8 provides for a form of price monitoring for Pilotage Services which is similar to the price regulatory regime developed by the Commission for Essential Maritime Services;

- Only the Viterra operated bulk loaders at Port Adelaide, Outer Harbor, Port Giles, Wallaroo, Port Pirie, Port Lincoln and Thevenard are covered by the access regime[38]; and
- The provision of land in connection with the provision of Regulated Services is itself covered by the access regime, but is not defined as an Essential Maritime Service.

In this Review, the Commission must consider whether or not it is appropriate to remove this safety net and rely purely on price monitoring for those Essential Maritime Services that are also Regulated Services.

In respect of those services that are both Regulated Services and Essential Maritime Services, the Commission's consideration of the continuation of access and price regulation produces the same conclusions, given that it is based on the same assessment criteria. That is, the Commission has concluded that there is the potential for the exercise of market power in the provision of Essential Maritime Services, but that there is no evidence of misuse of market power, suggesting that a light-handed form of regulation is appropriate.

However, the Commission continues to have concerns over the potential for misuse of market power in relation to grain services and mining developments going forward. In that regard, the ports access regime plays a very important role in addressing concern over market power being misused, by providing ports users with an additional safety net in the form of a formal dispute resolution process.

The Commission would also note that submissions received in response to the Issues Paper generally supported ongoing access regulation. The Viterra submission commented that:

> *"In seeking to achieve competitive outcomes and prevent monopoly pricing, there is a fine line between the benefits and costs of the current approach. [It] considers that maintaining the current framework, which is operating efficiently, is the best outcome in the circumstances."*[39]

The Viterra submission went on to comment that:

> *"The balance between constraining the potential use of market power and the direct costs it imposes on regulated business has been appropriately struck and no changes to the regulatory regime are required."*[40]

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38 Pursuant to a Proclamation gazetted on 25 October 2001, the provisions of the ports access regime apply to bulk handling facilities that are designed principally for handling grain.

39 Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 6.

40 Ibid, p. 6.

The South Australian Government submission also supported ongoing access regulation, commenting that:

> *"With respect to access, coverage of a facility under the provisions of the MSA Act results in greater certainty of access arrangements for access seekers and providers than would be the case under the Commonwealth's access provisions."*[41]

In principle, the Commission considers that economic efficiency is enhanced where third-party access to bottleneck infrastructure can be achieved on commercial terms. The Commission notes that Part IIIA of the CCA establishes the National Third Party Access Regime for services provided by significant monopoly infrastructure. Under Part IIIA, there are three pathways to access: declaration, voluntary access undertakings and certification as an effective state-based access regime.[42]

The ports access regime has been certified as an effective state-based access regime for a period of ten years. A consequence of this certification is that maritime services provided for under the ports access regime cannot be declared under the provisions of the national access regime or be made subject to an access undertaking to the ACCC.

It is the Commission's view that a certified State-based access regime route provides several significant advantages over the other options for third-party access. In particular:

- A certified access regime provides the greatest level of regulatory certainty to the access provider and access seekers over how third-party access will be regulated. This assists in promoting new investment in ports infrastructure and investment in both upstream and downstream markets. In the absence of a certified regime, the potential for declaration provides significant uncertainty to an access provider to undertake such investments;
- The criteria for declaration or acceptance of an access undertaking do not incorporate some of the important aspects of CIRA such as promoting commercial outcomes in the first instance[43]; and
- The declaration process can be extremely costly to any access provider and access seeker that are in dispute over whether or not access should be granted.

Having considered this matter, the Commission's draft finding is that access regulation should continue to apply to those Regulated Services that are also Essential Maritime Services. The Commission considers that the benefits to be derived from ongoing access regulation outweigh the costs given the potential for misuse of market power.

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41 South Australian Government, *South Australian Government's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, April 2012, p. 5.

42 The National Competition Council's Access to Monopoly Infrastructure in Australia – Introduction is available at the NCC's website at: http://www.ncc.gov.au/images/uploads/Access_to_Monopoly_Infrastructure_in_Australia.pdf.

43 Clause 2.2 of CIRA.

Given this draft finding, the Commission's focus in the remainder of this chapter will be on maritime services that are subject to access regulation but not price regulated. These maritime services are:

- Pilotage;
- Bulk loaders at Port Adelaide, Outer Harbor, Port Giles, Wallaroo, Port Pirie, Port Lincoln and Thevenard; and
- Land.

> ***Draft Report Conclusion***
>
> ***Access regulation should continue to apply for those Regulated Services that are also Essential Maritime Services.***

4.3.1 Is there the potential for ports operators to exercise market power?

Having concluded that there continues to be the potential for misuse of market power by ports operators, the Commission has to determine whether or not ongoing access regulation is necessary for those Regulated Services that are not Essential Maritime Services.

The Commission's assessments are discussed below.

Pilotage

Pilotage involves the provision of an experienced and specifically qualified seafarer (a marine pilot) on board a vessel to direct a vessel through the waterways that lead to a port – for reasons relating to both the protection of ports infrastructure and ensuring safety of the ships.

For most vessels pilotage is a mandatory service – the vessel cannot use the port without using the pilotage service – and hence displays bottleneck characteristics. Flinders Ports is currently the sole provider of Pilotage Services at each of the proclaimed ports.[44]

Whilst the Commission notes that ports users could elect to appoint an alternative pilotage provider, no such provider currently exists. This could be because no individual port is serviced solely by separate and dedicated pilots and associated infrastructure as vessel numbers and trade volumes do not yet warrant such arrangements. Rather, Flinders Ports' resources in respect to pilotage infrastructure are spread geographically to service all of the ports

[44] The Port Operating Agreements (between Flinders Ports and the Minister for Transport) under which Flinders Ports operate their ports provide that they must allow for the training of new pilots, even where they are not their own employees.

collectively.[45] It is therefore difficult for a new entrant to compete effectively with Flinders Ports to provide Pilotage Services without gaining a spread of new businesses across other geographical regions.

Given the limited scope for competitive entry going forward, the Commission's draft finding is that there is the potential for ports operators to exercise market power in the provision of Pilotage Services.

Bulk loaders

Bulk loaders form an important element in ports logistics as they are vital for loading dry bulk cargoes. In the case of grain, bulk loaders tend to be co-located with grain storage and handling facilities, or with storage or open-air stockpiling facilities for other commodities.

At present, there are seven bulk loaders operating at proclaimed ports in South Australia that are subject to access regulation, all of which are owned and operated by Viterra. These bulk loaders therefore display bottleneck characteristics as exporters of dry bulk commodities are likely to have only one feasible service provider available to them in South Australia.

In addition to being the predominant provider of at-ports grain storage and handling facilities in South Australia, Viterra is also a grain marketer and exporter in its own right. This means that Viterra may be competing with some users of its bulk loader service in the grain export market.

Given this sole integrated provider structure, the Commission's draft finding is that there is the potential and incentive for market power to be exercised in the provision of bulk loading services.

Land

Access regulation of land is provided in order to give practical effect to the rights of access to other Regulated Services. For example, access to a bulk loading facility can only be achieved if access is also granted to land that must be crossed in order to deliver dry bulk cargo to the facility.

As access to land is clearly limited to land necessary to enable meaningful access to other Regulated Services, the same conclusions on questions of market power must apply to land as they do to the other Regulated Services.

[45] A targeted pilotage resource sharing system with backup provided by pilot resources in each region appears to be the most effective arrangement at this time.

Draft Report Conclusion

The structures for the markets for Regulated Services that are not Essential Maritime Services suggest that there is the potential for market power to exist.

4.3.2 Is there any evidence of misuse of market power by ports operators?

In general, submissions to the Issues Paper also expressed the view that there is no evidence that would suggest market power has been misused by ports operators over the current regulatory period, and that the negotiate-arbitrate framework was generally working well.

In particular, the Viterra submission commented that:

> *"There are sufficient protections for access seekers under the access regime such that they can obtain access in a timely and cost efficient manner without discrimination."*[46]

The Commission's examination of whether market power in the provision of Regulated Services that are not Essential Maritime Services had been misused over the current regulatory period is discussed below.

Pilotage

Whilst there has been a substantial real cumulative increase in Pilotage Services charges between 2008/09 and 2011/12 (8.7%), the Commission's assessments of the information submitted by Flinders Ports to justify those real increases have found no particular areas of concern. The assessments revealed that the majority of the increases in those charges were primarily as a result of enterprise bargaining agreements covering both marine pilots and boat crews.[47]

Further, the GHD 2012 Ports Price Benchmarking Study revealed that South Australia's Pilotage Services charges continue to be in line with changes at comparable interstate ports.

In light of the above, and in the absence of any disputes around Pilotage Services charges over the current regulatory period, the Commission's draft finding is that there is no evidence of misuse of market power in the provision of Pilotage Services.

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46 Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 5.

47 Costs associated with the salary and wages of pilots and boat crews generally make up a high proportion of the costs associated with the provision of Pilotage Services.

Bulk loaders

Whilst a request for conciliation was referred to the Commission during the current regulatory period in relation to one of Viterra's regulated bulk loading facilities, the formal dispute resolution provisions provided for under the MSA Act were not activated as both parties ultimately reached commercial agreement. In that particular case, the Commission's involvement was limited to facilitating the exchange of information to facilitate commercial negotiation.

Further, the Commission's analysis of the financial and operational performance reported by Viterra pursuant to Guideline No. 2 during the current regulatory period does not suggest there has been any misuse of market power.

Therefore, while there is the potential for misuse of market power in relation to bulk loading services, there is no evidence to suggest such market power has been misused.

Land

There have been no access disputes in relation to gaining access to land in connection with the provision of other Regulated Services nor has the Commission been presented with any specific suggestions from ports users that market power was being exercised in a malicious way.

The Commission would expect any evidence of misuse of market power in the provision of access to land to be linked to evidence of misuse for these other services. However, the Commission is not aware of any such evidence.

The Commission's draft finding is that there is no evidence of misuse of market power gaining access to land in connection with the provision of other Regulated Services.

4.3.3 Will access regulation produce a net benefit?

With respect to Regulated Services that are not Essential Maritime Services, the Commission's draft conclusion is that whilst there is the potential for the misuse of market power. In this context, the Commission believes that there is an ongoing need for access regulation.

Whilst the Flinders Ports submission acknowledged that the access regime provided a safety net to users and potential users, it however questioned whether there is a real benefit with retaining access regulation given the regulatory costs that it imposes on regulated operators through, for example, annual regulatory accounts and quarterly reporting obligations.[48]

[48] Flinders Ports, *Flinders Ports' Response to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 15.

The Commission acknowledges that the access regime does impose some regulatory costs. However, it does not share the view that those costs are substantial. Based on discussions with Flinders Ports and Viterra, the Commission understands that the costs of regulatory compliance are a relatively minor component of the overall costs associated with the provision of Regulated Services. The Commission therefore believes that there is a strong net benefit to ongoing access regulation.

Ongoing access regulation not only provides a safety net to ports users in relation to gaining third-party access to services provided by bottleneck infrastructure on fair and reasonable commercial terms, it also provides the greatest level of regulatory certainty to all stakeholders over how access will be regulated. In the absence of access regulation, there is an ongoing risk that Regulated Services that are also Essential Maritime Services could be subject to a declaration under Part IIIA of the CCA. This view was supported by the South Australian Government submission, which commented that:

> *"With respect to access, coverage of a facility under the access provisions of the MSA Act results in greater certainty of access arrangements for access seekers and providers than would be the case under the Commonwealth's access provisions."*[49]

The Commission would note that submissions made in response to the Issues Paper also generally supported the continuation of the access regime. The Viterra submission commented that:

> *"[It] considers that maintaining the current [access regulatory] framework, which is operating efficiently, is the best outcome in the circumstances."*[50]

In light of the above, the Commission's draft finding is that the access regime provided for under Part 3 of the MSA Act should continue.

Draft Report Conclusion

The access regime provided for under Part 3 of the MSA Act should continue.

[49] South Australian Government, *South Australian Government's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, April 2012, p. 5.

[50] Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 6.

5 AREAS FOR GENERAL IMPROVEMENTS OF THE PORTS ACCESS REGIME

Assuming that access regulation continues, an important issue for the Commission to consider is how the effectiveness of the access regime could be improved. As part of the access regime review, the Commission is also considering areas where the regime can be generally improved.

In the conduct of this inquiry, the Commission believes it is important to receive input from stakeholders who have had experience with the regime, or are expecting to utilise the regime at a future date. The practical application of the access regime in facilitating commercial negotiation of access to Regulated Services is a key area of concern for the Commission.

This Chapter sets out the Commission's draft recommendations on general areas for improvement of the regime, having regard to comments raised in submissions to the Issues Paper and the Commission's experiences with the regime. The Commission invites stakeholders' comments on the draft recommendations, and will take comments into account before publishing its Final Report in September 2012.

5.1 Legal requirements for the inquiry

Section 34 of the ESC Act allows the Commission to conduct an inquiry into matters which properly fall within the scope of the MSA Act already, if it believes such an inquiry is necessary for the Commission to carry out its regulatory functions. Such an inquiry, however, must be preceded by consultation with the Treasurer.

Accordingly, the Commission consulted the Treasurer by way of a letter, informing him that the Commission intends to conduct an inquiry, pursuant to section 34 of the ESC Act, into areas where the ports access regime can be generally improved. The Commission noted that such an inquiry is being undertaken on the basis that it is critical for ensuring the ongoing effectiveness of South Australian ports access regime, and that the public consultation processes conducted as part of the 2012 Review provide an opportune time for stakeholders to provide comment on how the regime could be improved based on their actual experience with the current regime.

The Commission notes that the result of any such inquiry will not per se result in the industries being brought within the access regime – that will depend on adoption of any such recommendation by the South Australian Government and subsequent legislative amendment.

5.2 Coverage

Ensuring that an access regime has sufficient coverage over the supply chain to include all areas where competition is currently not effective is an important aspect to supporting competition. As discussed, the ports access regime only applies to the provision of Regulated Services at proclaimed ports in South Australia. The coverage of the regime, however, can be varied by the Governor though proclamation to either include or remove certain ports or maritime services.[51]

The Commission is mindful that effective competition cannot occur if access seekers are unable to gain access to certain maritime services, or can only do so subject to monopoly prices. In this respect, the Commission's principal view is that coverage should be extended to ports and ports infrastructure where it is necessary for meaningful access to occur and where it would be uneconomic to develop alternative facilities to provide the same services.

Whilst certain ports services such as at-ports facilities for storage, loading and unloading are not defined as a Regulated Services, they are captured within the definition of Maritime Services and could therefore be brought within the scope of the access regime by proclamation. The appropriateness of such action would depend on the potential for, or actual misuse of, market power by the service provider and the costs and benefits of imposing access regulation.

In the Issues Paper, the Commission sought stakeholders' comments on whether there any ports or at-ports services to which coverage of the access regime should be extended or revoked. Aside from the submission from Professor Malcolm Tull and Mr. Joel Meehan, all of the submissions received commented on the coverage of the ports access regime.

The Commission's draft findings on the issues raised by stakeholders are discussed below.

5.2.1 Grain supply chain

In addition to being the predominant provider of at-ports grain storage and handling facilities in South Australia, Viterra also has a significant presence in both upstream[52] and downstream[53] markets. Given this sole integrated provider structure, it can be argued that Viterra has significant market power, and inefficient economic outcomes could result should that power be exploited.

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51 Following recommendations made by the Commission in the 2007 Review, the coverage of the regime was varied to remove the Port of Ardrossan and include the bulk loader at Outer Harbor at Port Adelaide.

52 Viterra owns and operates up-country storage and handling facilities (i.e. grain silos).

53 Viterra is a grain marketer and exporter in its own right in respect to grain exports. This means that Viterra competes with other grain marketers who use its bulk loader service in the grain export market.

Concerns over market power in relation to the South Australian grain handling industry is an issue that has been raised repeatedly by various stakeholders during recent transport reviews carried out by the Commission.[54] Such concerns remain as evidenced by submissions made in response to the Issues Paper. For example, the Grain Producers SA (**GPSA**) submission commented that:

> *"[It] recommends that the [South Australian Government] not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations…"*[55]

The submission went on to comment that:

> *"[It] recommends that the [South Australian Government] increase the powers of ESCOSA to enable oversight of the entire [grain] supply chain to enable arbitration for grain growers around pricing, terms and conditions offered by a dominant vertically integrated access provider."*[56]

The Commission notes the concerns expressed over the potential misuse of market power and the absence of regulatory oversight in the upstream and downstream markets of the grain industry. Such concerns were similarly expressed by the ACCC in a hearing before the Senate in which it commented on the lack of alternatives to using Viterra's ports facilities in South Australia.[57] However, the Commission observes that this issue is outside the scope of this Review.

Nevertheless, in light of these concerns, the Commission reiterates that it continues to see merit in considering access issues as part of a broader review of the entire grain supply chain on the basis that it would allow for the specific circumstances of the grain industry (e.g. interface between the different modes of transport and regulatory regimes, and adequacy of logistics resources) to be appropriately considered and scrutinised. The Commission previously recommended that the South Australian Government undertake such a review in both the 2007 Review and the 2009 Rail Access Regime Inquiry.[58]

Prior to the commencement of this Review, the Commission wrote to both the Minister for Transport and Infrastructure and Minister of Agriculture, Food and Fisheries to advise them of the scope of the current Review, and reiterate the merits of undertaking a broad review of the grain supply chain. The Commission also emphasised in the correspondences that such a review to examine issues in

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54 Concerns over third-party access to up-country grain storage and handling facilities were raised in both the 2007 Review and the 2009 Rail Access Regime Inquiry.

55 Grain Producers SA, *Grain Producers SA's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 22 March 2012, p. 4 of unnumbered document.

56 Ibid, p. 4 of unnumbered document.

57 Australian Federal Parliament, *Senate Committee Rural Affairs and Transport References Committee – Operational Issues in Export Grain Networks*, 16 November 2011, p. 7.

58 Documents relating to the 2009 Rail Access Regime Inquiry are available at the Commission's website at: http://www.escosa.sa.gov.au/projects/42/2009-south-australian-rail-access-regime-inquiry.aspx.

relation to up-country grain storage and handling facilities and aspects of the grain supply chain can only be referred to the Commission by the Treasurer, pursuant to section 35(1) of the ESC Act.[59]

The Commission understands that the South Australian Government has no intention for such a review to be carried out at this stage. In the absence of such a referral from the Treasurer, the Commission cannot consider such matters as part of this Review.

Draft Report Conclusion

The Commission recommends that the South Australian Government to consider undertaking a broader review of the South Australian grain supply chain.

5.2.2 Rail facilities

As part of the development of Port Adelaide, a rail siding was constructed to connect Inner Harbour Berth 29 with the standard gauge rail network running into Port Adelaide.[60] This rail infrastructure is an important component of Flinders Ports' intermodal rail facility.

The Asciano Limited (**Asciano**) submission expressed three particular concerns with this intermodal rail facility. The first concern relates to whether or not the rail siding is subject to any form of access regulation. The second concern relates to the lack of price transparency in the offers provided by the ports operator. The last concern relates to the potential for Flinders Ports to exercise market power in the provision of loading and unloading services at this facility in the absence of viable commercial alternatives.

These concerns are discussed in further detail below.

Rail siding

Pursuant to a Proclamation gazetted on 7 May 1998[61], the provisions of the Access Regime under the *Railway (Operations and Access) Act 1997* (**ROA Act**) do not apply to, amongst other things, "private sidings".

Under the *Rail Safety Act 2007* (**RS Act**), a private siding is defined as a siding that is managed, owned or controlled by a person, other than a person who manages the rail infrastructure with which the siding connects or to which it has access, but does not include a:

59 The Treasurer is the only Minister with the power to refer an Inquiry into broader matters to the Commission.

60 Whilst the rail siding is owned by Flinders Ports, it is operated by Genesee & Wyoming Australia Pty Ltd.

61 p. 2115.

- marshalling yard;
- crossing loop;
- passenger terminal;
- freight terminal; or
- siding, or a siding of a class, prescribed by the regulations not to be a private siding.

Furthermore, pursuant to the *Rail Safety (General) Regulations 2008*, the following are also not private sidings:

- a siding under the control and management of an accredited rail infrastructure manager; and
- a balloon loop used for the purpose of loading or unloading trains.

Based on previous discussions on the intent of these provisions with the South Australian Government, the Commission understands that private sidings are meant to capture privately-owned sidings where the railway infrastructure is for the sole use of the owner (e.g. for manufacturing processes) and is not meant for access purposes.

Based on the discussions held with the South Australian Government and the Commission's interpretation of the legislation, the Commission considers that the rail siding at Berth 29 is not a private siding for the following reasons:

- the siding is controlled and managed by Flinders Ports, which is an accredited rail infrastructure manager;
- Flinders Ports does not own the rail infrastructure to which the rail siding connects[62]; and
- the siding is not considered to be one of exclusions listed in the RS Act or the *Rail Safety Regulations 2008*.

In light of the above, the Commission's draft finding is that the rail siding at Inner Harbour Berth 29 is subject to access regulation under the South Australian rail access regime, set out under Parts 3 to 8 of the ROA Act.

[62] The rail infrastructure to which the siding connects is owned and operated by Genesee & Wyoming Australia Pty Ltd.

Price transparency

The Commission also noted that a framework which promotes successful commercial negotiation of access must ensure that sufficient information on prices is provided to an access seeker, to enable it to make an informed decision.

Based on further discussions held with Asciano, the Commission understands that its concern relates to the lack of price transparency in the bundled offers provided by Flinders Ports. In the absence of any price transparency, Asciano claims it is being prevented from assessing the reasonableness of the offer due to its inability to differentiate the individual components of the access offer (e.g. rail intermodal and logistic services).

The Commission notes that access regulation imposes certain regulatory obligations on regulated operators. Under section 28(1) of the ROA Act, access providers of railway infrastructure services are required to provide an Information Brochure which must contain, amongst other things, unbundled access charges and information on the level of service quality that is to be provided at that particular charge. Given this requirement, the Commission believes that there should be no impediments to Asciano gaining access to the cost component (separate above and below-rail charges) that relates to the rail siding access.

Whilst the issue of price transparency in relation to non-Regulated Services (e.g. loading and unloading of trains at Berth 29 rail siding) is outside the scope of this Review, the Commission believes that there are no impediments to ports users being provided with a breakdown of the individual cost components. Based on further discussions, Flinders Ports has commented to the Commission that such information will be provided if requested.

Based on the Commission's review of confidential information provided by Flinders Ports, the Commission understands that commercial negotiations between Flinders Ports and Asciano are still at a preliminary stage. In this context, the Commission encourages both parties continue to negotiate in good faith and accommodate each parties' information request insofar as is reasonable and practicable to do so.

Loading and unloading services

Access and price regulation is often considered for infrastructure or services that possess natural monopoly characteristics. That is, where it would be uneconomic to duplicate infrastructure or where market power associated with the service or infrastructure may be misused. The Commission would apply the assessment criteria set out in Chapter 2 in examining whether or not a particular infrastructure or service should be subject to regulation.

In this context, the potential for any form of regulation depends on the potential for, or actual misuse of, market power by the provider of loading and unloading services and the costs and benefits of imposing regulation on such services.

The Commission notes that, while the provision of loading and unloading services at the rail siding is undertaken by one operator, the rail siding does not operate in isolation. Therefore, the potential for market power to be exercised by the entity which loads and unloads cargoes from the rail siding[63] is constrained by the potential for third parties to utilise alternative rail facilities and options such as containers.

Based on further discussions held with Flinders Ports and Asciano, the Commission understands that there are currently loading and unloading services provided by other operators at various rail facilities at Port Adelaide. These alternatives include a rail facility owned by Kerry Logistics outside of Berth 29, a rail terminal operated by Mackenzie Hillibrand at Outer Harbor and also a rail facility operated by Viterra at Berth 27. It is also worth noting that the provision of loading and unloading cargoes at these rail sidings is conducted by a single operator and not by multiple operators. This is consistent with the Berth 29 intermodal facility developed by Flinders Ports.

Market power is further constrained by other alternatives such as the use of containers that can be transported into the port by trucks and also competition from interstate ports. In light of the availability of alternatives, the Commission considers that the intermodal rail facility operator has a significant incentive to provide a competitive service to attract customers to provide a return on the investment made into the infrastructure, and to prevent that infrastructure asset from being stranded.

The Commission therefore does not consider that the provision of loading and unloading services at the intermodal rail facility at Berth 29 should be subject to access regulation.

5.2.3 Storage and handling facilities

Whilst the provision of non-grain at-ports storage facilities is not defined as a Regulated Service, it is captured within the definition of Maritime Services under the MSA Act and could therefore be brought within the scope of the access regime by proclamation.[64] The appropriateness of such action depends on the potential for, or actual misuse of, market power by the provider of storage services and the costs and benefits of imposing regulation on storage.

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63 Loading and unloading services at the Berth 29 rail intermodal facility are provided by Flinders Logistics Pty Ltd – a wholly owned subsidiary of Flinders Ports.

64 Section 4(1) of the MSA Act.

Although non-grain at-ports storage facilities are not covered by the access regime, it is worth noting that access to land is. Therefore, it is possible for third parties to seek access to land within the port boundary from Flinders Ports, on fair commercial terms, and develop their own storage facilities should the need arise. In addition to land available inside Berth 29, there are a number of land parcels outside Berth 29 that could be leased by third parties from the South Australian Government.

Further, the Commission notes that not all cargoes are stored using non-grain at-ports facilities due to alternatives from non-ports storage facilities. For example, there are a number of fertiliser importers which utilise storage facilities located outside of Port Adelaide. These cargoes are stored for a period of time and later transported into the port for shipment. This suggests that there is a degree of competition between at-ports and non-port storage facilities.

Based on further discussions with Flinders Ports, the Commission also understands that there are several ports users currently leasing both land and at-ports storage facilities from Flinders Ports at Berth 29. The Commission has requested information from Flinders Ports which shows that active lease agreements with third parties have been negotiated during the current regulatory period.[65]

In the absence of any disputes over third-party access to land or attaining a lease agreement with Flinders Ports to utilise its at-ports storage services, the Commission does not consider that the provision of non-grain at-ports storage facilities should be subject to access regulation.

5.2.4 Towage

The Productivity Commission defines towage as services provided by tugs to assist vessels to manoeuvre in navigation channels and to both enter and leave berths at ports.[66] The Commission understands that Flinders Ports is currently the sole provider of towage services across all South Australian ports.

Under section 4(1)(g) of the MSA Act, towage services are explicitly excluded from the definition of maritime services and are therefore not captured by the current scope of the pricing or access regime.

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[65] This information is confidential and cannot be disclosed, but was an important input to the Commission forming the view that there is no evidence to suggest that there are impediments to gaining third-party access to both land and non-grain at-ports storage facilities during the current regulatory period.

[66] Productivity Commission, *Economic Regulation of Harbour Towage and Related Services – Inquiry Report No. 24*, 20 August 2002, p. xxi.

The Shipping Australia Limited (**SAL**) submission argued that the coverage of the access regime should be extended to cover towage services on the basis that towage charges have increased beyond industry standards over recent years, and also due to the lack of alternative towage providers.[67]

The Commission notes SAL's argument for the expansion of the access regime to cover towage services, but observes that it is outside the scope of this Review to consider maritime services that are explicitly excluded from the definitions of the MSA Act. Any consideration of this issue is entirely a separate matter for the South Australian Government.

5.2.5 New ports

There are several new ports developments occurring in South Australia as a result of developments in the resources industry that may have an impact on the access regime. For example, the Commission understands that the proposed new ports at Spencer Gulf and Eyre Peninsula (Port Bonython and Port Spencer) have both recently been granted major development status by the South Australian Government.

In its submission to the Issues Paper, the Select Committee queried whether the Commission would have any role in regulating access and pricing at new ports.[68]

In a separate submission, the South Australian Government noted that:

> *"…an extension of the [access regime] can be made at any time. Consideration would be given to altering the coverage of the [access regime], including the proclamation of new multi-user ports (and existing single-user ports which may seek to become multi-user ports) under the MSA Act, should circumstances require. This will be determined on a case by case basis."*[69]

The Commission notes the Select Committee's query on the application of price and access regulation to new ports, but observes that it is outside the scope of this Review. The scope of the regimes under the MSA Act is limited to ports that have been proclaimed by the Governor.

For regulation to occur at a new port, it will require proclamation by the Governor. As noted in the South Australian Government submission, any consideration to alter the coverage of the access regime, including the proclamation of new ports is a separate matter that would be dealt with on a case-by-case basis by the South Australian Government.

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67 Shipping Australia, *Shipping Australia's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 16 March 2012, p. 1 of unnumbered document.

68 Select Committee on the Grain Handling Industry, *Select Committee's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 15 March 2012, p. 3 of unnumbered document.

69 South Australian Government, *South Australian Government's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, April 2012, p. 5.

The Commission, however, notes that there would be an ongoing risk for new ports to be subject to a declaration under the provisions of the National Access Regime in the absence of access regulation under the South Australian regulatory framework.

Draft Report Conclusion

The rail siding at Inner Harbour Berth 29 is subject to access regulation under the South Australian rail access regime, set out under Parts 3 to 8 of the ROA Act.

The Commission considers that there should be no impediments to ports users accessing information in respect to individual cost components of a bundled service.

There are no persuasive arguments to suggest that the provision of loading and unloading services at the intermodal rail facility at Berth 29 should be subject to access regulation.

There are no persuasive arguments to suggest that the provision of non-grain at-ports storage facilities should be subject to access regulation.

Any consideration to expand the access regime to cover towage services is a separate matter for the South Australian Government.

Any consideration to expand the access regime to cover new ports is a separate matter that will be dealt with on a case-by-case basis by the South Australian Government.

5.3 Negotiation

Part 3 of the MSA Act provides a framework for the negotiation of access between an access provider and access seeker. The intention behind establishing such a framework is to allow sufficient flexibility such that parties can tailor the terms and conditions of an access contract to cover both the price and non-price arrangements for the use of Regulated Services.

In the Issues Paper, the Commission sought stakeholders' comments on the adequacy of the negotiate framework provided for under Part 3 of the MSA Act and, if necessary, areas where it could be improved.

The Commission's draft findings are discussed below.

5.3.1 Basis of access

Division 2 requires a regulated operator to use all reasonable endeavours to accommodate the requirements of an access seeker with a view to reaching agreement on whether the requirements could be reasonably met and, if so, how the terms and conditions of the access contract should reflect this. The requirement for parties to negotiate in good faith is an important principle underpinning the framework.

Submissions from Flinders Ports[70] and Viterra[71] both expressed the view that the provisions provided for under Part 3 of the MSA Act are sufficiently adequate to facilitate commercial outcomes. In particular, the Viterra submission commented that:

> *"[It] is of the view that the process set out in Part 3 is appropriate as evidence by the lack reference to conciliation and arbitration."*[72]

Given no submissions were received from ports users commenting on encountering difficulties in negotiating with ports operators over access to ports infrastructure and in the absence of any access disputes over the current regulatory period, the Commission's draft finding is that Part 3 of the MSA Act is sufficient for negotiating access to port infrastructure.

5.3.2 Negotiation of access

Division 3 requires that a regulated operator must provide an access seeker with information reasonably requested about technical requirements, access rules and capacity utilisation, to assist the access seeker in preparing an access proposal, and any other information required to be provided under guidelines issued by the Commission.

Section 12(1)(b) of the MSA Act requires a regulated operator to provide information about the price of Regulated Services in accordance with guidelines issued by the Commission. Guideline No. 1 sets out the Commission's requirements for the price information that a regulated operator must provide.

The proponent requirements may also be expressed through a written proposal detailing the proposed terms and conditions (including modification of ports facilities and establishment of additional port facilities) for the provision of maritime services to be carried out by the regulated operator. Further, if required by the operator, the proponent must provide additional information regarding the proposal that the operator reasonably requires.

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70 Flinders Ports, *Flinders Ports' Response to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 18.

71 Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 8.

72 Ibid, p. 8.

In the Issues Paper, the Commission sought stakeholders' comments on the adequacy of the information requirements set out under Part 3 of the MSA Act and Guideline No. 1 and if additional information is required for parties to make informed decisions regarding access to ports infrastructure.

Viterra submitted that the information requirements were adequate, and also commented that:

> *"… the Guideline does not restrict [it] from providing additional information sought by an access seeker if that information will assist the parties in negotiating an access arrangement."*[73]

In the absence of submissions from ports users commenting on this issue, the Commission's draft finding is that the information requirements set out under Part 3 of the MSA Act and Guideline No. 1 are sufficient.

Draft Report Conclusion

There are no impediments to negotiating access to ports infrastructure, due to the current regulatory framework.

The negotiate process set out in Part 3 of the MSA Act is adequate for facilitating commercial negotiation of access.

The information requirements set out under Part 3 of the MSA Act and Guideline No. 1 are adequate for facilitating the negotiation of access.

5.4 Dispute Resolution

A transparent and effective dispute resolution process is important to the overall effectiveness of the access regime as it provides a safety net to access seekers and access providers should commercial negotiations fail.

Part 3 of the MSA Act establishes a framework for the conciliation or arbitration of access disputes. In the event that commercial negotiations between an access provider, the proponent or any interested third party cannot be negotiated, a dispute exists.[74] A party to the dispute may then refer the dispute to the Commission for resolution.

The Commission, in the first instance, would attempt to resolve the dispute by conciliation. If, however, the Commission failed to resolve the dispute by conciliation after making reasonable attempts to do so, the Commission must then, if warranted, appoint an arbitrator and refer the dispute to arbitration.

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[73] Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 8.

[74] Under the MSA Act a dispute is defined as a 30 day period where the operator, proponent and any interested third party cannot agree on the terms for the provision of the proposed service.

In the Issues Paper, the Commission sought stakeholders' comments on the adequacy of the current conciliation/arbitration process set out in Part 3 of the MSA Act and areas in which the process could be improved. Further, the Commission sought stakeholders' comment on whether or not there is a benefit to introducing an informal dispute resolution provision into the MSA Act.

Submission from Flinders Ports[75] and Viterra[76] both expressed support for retaining the dispute resolution framework in its current form on the basis that it is adequate in resolving disputes. The Viterra submission specifically drew on its experience of a dispute which was resolved, evidencing the success of the framework.

With respect to the benefit of introducing an informal dispute resolution provision into the MSA Act, the Viterra submission commented that, while it may be useful, there is currently no need for such a provision.

Given submissions in response to the Issues Paper uniformly agree that the dispute resolution process set out under Part 4 of the MSA Act is sufficient, the Commission's draft finding is that the dispute resolution process should be maintained in its current form.

Draft Report Conclusion

The conciliation/arbitration process set out in Part 3 of the MSA Act is adequate for resolving access disputes.

5.5 Others

The Commission received one submission from Asciano in response to its request for comments from stakeholders on whether or not there are any future issues that need to be considered as part of the access regime review.

The Asciano submission commented that the issue of ring-fencing and vertical separation should be considered to ensure non-related third parties are not disadvantaged by discriminatory operational treatment.

The Commission's assessment of this issue is discussed in further detail below.

5.5.1 Ring-fencing

The objectives of ring-fencing are to facilitate competition in markets where services are provided by a vertically integrated operator. This lessens the opportunity for the operator to use its market power and favour related businesses to the detriment of participants.

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75 Flinders Ports, *Flinders Ports' Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, March 2012, p. 18.

76 Viterra, *Viterra's Submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 28 March 2012, p. 8.

Regulators generally provide controls that seek to:

- Avoid the anti-competitive effects of cross-subsidies or other discriminatory interactions between the contestable and non-contestable activities;
- Protect the commercially sensitive information acquired by a non-contestable activity, for the benefit of contestable activity;
- Services are being provided on terms and conditions that are no more or less favourable than those available to related entities; and
- Provide the regulator with sufficiently detailed and accurate information to undertake reviews.

There are a number of options in which a ring-fencing arrangement can be implemented. Table 5-1 sets out some ring-fencing options.

Table 5-1: Ring-fencing options

Options	Description
Legal separation	This form of ring-fencing requires the vertically integrated operator's contestable and non-contestable businesses to be separately incorporated in legal entities under the Corporations Law. However, this still allows both the contestable and non-contestable businesses to be owned by the same parent entity. In practice, legal separation requires the legal entities to enter into more formal contractual and reporting arrangements. This is to create clear boundaries between the legal entities, and reinforce the accounting separation of the contestable and non-contestable businesses.

Accounting separation	This form of ring-fencing requires the vertically integrated operator to keep accounts and records relating to the provision of non-contestable businesses separately from those related to other aspects of the business carried on by the regulated operator. In practice, the regulator would prescribe the manner in which accounting/financing information is to be prepared and reported.
Structural separation	The form of ring-fencing requires the physical separation of the contestable and non-contestable businesses within the vertically integrated operator. In practice, resources such as staff and infrastructure associated with undertaking the contestable and non-contestable businesses would be physically separated.

The ports access regime currently imposes an accounting ring-fencing arrangement on a regulated operator. Section 42 of the MSA Act requires accounts and records relating to the provision of Regulated Services to be kept separately. Section 42 states that:

> *(1) A regulated operator must keep accounts and records relating to the provision of Regulated Services separately from accounts and records related to other aspects of the business or businesses carried on by the operator.*
>
> *(2) If Regulated Services are provided at different ports, separate accounts must be kept for each port.*
>
> *(3) The accounts and records must be prepared and maintained in accordance with guidelines issued by the Commission.*
>
> *(4) A regulated operator must, at the request of the Commission, make the accounts and records available for inspection by the Commission.*

The Commission's Guideline No. 2 sets out how the obligations and requirements of regulated operators under section 42 will be met. In particular, Guideline No. 2 sets out the manner in which costs are to be allocated and disclosure requirements for all third-party transactions.[77] This is intended, amongst other things, to prevent practices such as cost-shifting between the contestable and non-contestable businesses.

[77] In terms of compliance with the accounting ring-fencing arrangement, the Commission's Guideline No. 2 requires a director's responsibility statement to be attached to the financial information submitted by the regulated operator, and a copy of a regulatory audit report. The appointment of an auditor shall be subject to the approval of the Commission.

The Asciano submission noted that Flinders Ports (a vertically integrated regulated operator) is currently supplying non-contestable services to companies such as Patrick, while at the same time competing with Patrick in contestable markets (i.e. stevedoring). Based on its experience, the submission alleged that:

> *"Flinders Ports are using operating processes and procedures, such as environmental controls, licensing and government approval issues, to disadvantage unrelated third parties using Flinders Ports' facilities as competitors or potential competitors to Flinders Ports."*[78]

The Asciano submission went on to express concern over the adequacy of the current accounting ring-fencing arrangement to deal with anti-competitive behaviour, commenting that:

> *"… a strong ring fencing regime should be established such that Flinders Ports or its related parties are not advantaged by discriminatory access, discriminatory pricing, discriminatory information provision or discriminatory operational treatment."*[79]

As a matter of principle, the Commission believes that it is important to ensure that a regulated operator does not leverage its market power in the provision of non-contestable services, or collude with associated entities, to give it or its associated entities an unfair competitive advantage over their competitors in contestable markets.

To investigate this matter further, the Commission has had further discussions with both Asciano and Flinders Ports to discuss the allegation made in the Asciano submission.

Based on those discussions and comments made in Asciano's confidential supplementary submission[80], the Commission understands that Asciano is not alleging that Flinders Ports' market power has necessarily been misused. Rather, the comment was made in the context that the vertically integrated nature of Flinders Ports provides substantial scope for the potential misuse of market power. Asciano was therefore of the view that a prescriptive form of ring-fencing arrangement is required to deter such power being leveraged from the non-contestable markets to other contestable markets.

In a confidential supplementary submission made to the Commission, Flinders Ports rejects Asciano's allegation that it had sought to deter competition through operational processes and procedures by virtue of it being the ports operator. Flinders Ports submitted that all ports users (including affiliated

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78 Asciano, *Asciano's submission to the 2012 Ports Pricing and Access Review – Issues Paper*, 23 March 2012, p. 3.

79 Ibid, p. 3.

80 Asciano, *Confidential Correspondence: Further Information to ESCOSA regarding the 2012 Ports Pricing and Access Review*, 3 April 2012, p. 3.

parties) are required to comply with the same port access protocols (i.e. occupational safety and health and environmental requirements).[81]

To substantiate its claims that it does not treat any party any differently in relation to compliance with strict operational procedures, Flinders Ports has provided confidential extracts documents relating, amongst other things, to lease agreements which it has entered into with different ports users. Whilst this documentary evidence is confidential and cannot be disclosed, it was an important input to the Commission forming the view that there is no evidence to suggest that Flinders Ports is disadvantaging competition through the use of operational processes and procedures.

With respect to concerns over the adequacy of the current accounting ring-fencing arrangement, the Commission has not been presented with any positive evidence to substantiate the argument for a more intrusive form of ring-fencing arrangement to be introduced. The Commission notes that any recommendation for the imposition of a more intrusive form of ring-fencing arrangement (i.e. legal separation) will ultimately still depend on the adoption of such recommendation by the South Australian Government and subsequent legislative amendment.

In the absence of any positive evidence (i.e. actual misuse of market power) and based on its experience under the current access regime where there has not been any concerns raised in respect to the issue of ring-fencing, the Commission's draft finding is that there are no persuasive arguments for the introduction of a more intrusive form of ring-fencing arrangement going forward.

Draft Report Conclusion

There is no evidence to suggest that Flinders Ports is disadvantaging competition through the use of operational processes and procedures.

There is no evidence to suggest that a more intrusive form of ring-fencing arrangement is required.

[81] Flinders Ports, *2012 Ports Pricing and Access Review – Supplementary Submission*, 24 April 2012, p. 6.

6 NEXT STEPS

The Commission invites comments on the conclusions reached in this Draft Report. Details on how to submit can be found on the opening page of this report. Submissions to the Draft Report are to be provided by 20 July 2012.

Following consultation of the Draft Report, the Commission intends to release a Final Report in September 2012. If the Final Report concludes that price regulation of Essential Maritime Services should continue, the Commission will issue a Draft Price Determination for targeted stakeholder consultation at the same time as releasing the Final Report. A Final Price Determination, if required, is expected to be made in October 2012.

APPENDIX 1: OPERATION OF THE PORTS ACCESS REGIME

The access regime set out in Part 3 of the MSA Act operates under a negotiate-arbitrate framework. The regime is summarised as follows:

Basis of access (Division 2)

Access is to occur on fair commercial terms, which covers both the price and non-price arrangements for the use of Regulated Services. This means that a regulated operator (port operator) is to provide Regulated Services on terms:

- agreed to between the regulated operator and the customer; or
- as determined by arbitration.

Where the price of a Regulated Service is already regulated under an ESC Act price determination, then that price is to be regarded as a fair commercial term. This covers those Regulated Services that are also Essential Maritime Services. However, under price monitoring of Essential Maritime Services, this link does not have any effect as the Commission is not regulating those charges (under price monitoring the Commission will only be regulating conditions relating to charges).

Negotiation of access (Division 3)

Division 3 sets out the information that a regulated operator must provide to a person that is considering seeking an access request.

It also requires an access seeker to make a written proposal to the regulated operator setting out its proposed terms and conditions for the provision of the maritime service.

Once the proposal (or amended proposal) is lodged, the regulated operator has one month to:

- give written notice of the proposal to the Commission;
- give written notice to any other person whose rights would be affected by the proposal (an affected third party);
- advise the proponent of the name and address of any affected third party; and
- advise the proponent of its preliminary response to the proposal, including whether:
  - it would be prepared to provide the services, and on what terms and conditions; and

- any facilities changes required and the acceptability and terms and conditions of those changes.

If an affected third party indicates its interest in the negotiations, it becomes an interested third party. At this stage, the preference is for the parties to use the information available to reach a commercial agreement. The parties must negotiate in good faith on the basis that the proponent's reasonable requirements are to be accommodated as far as practicable. However, if no agreement is reached within 30 days of the proposal being lodged, then a Dispute exists, and thereafter any party may refer the Dispute to the Commission.

Conciliation (Division 4)

Conciliation is the first stage of direct intervention. When a Dispute is referred to the Commission, it must first seek to resolve it by conciliation, unless, in the Commission's view:

- the subject matter is trivial, misconceived or lacking in substance; or
- the parties have not negotiated in good faith.

The Commission may choose to call voluntary or compulsory conferences.

Reference of Dispute to Arbitration (Division 5)

If conciliation fails, or if the Commission decides it is unlikely to succeed, or, in any event if the dispute is not resolved within 6 months after the referral of the dispute to the Commission under Division 4, the Commission may refer the Dispute to arbitration, unless, in the Commission's view:

- the subject matter is trivial, misconceived or lacking in substance;
- the parties have not negotiated in good faith; or
- there are other good reasons why it should not.

The Commission will select the arbitrator after consultation with the various parties. The Commission may elect to act as the arbitrator. The *Commercial Arbitration Act 1986* applies to a ports access arbitration, to the extent that it may operate consistently with the MSA Act.

Parties to Arbitration (Division 6)

The parties to an arbitration are the proponent, the regulated operator and any interested third parties. The arbitrator may also join additional parties whose interests are materially affected. Parties may elect to be represented by a lawyer, or another representative if the arbitrator so permits. The Commission may also participate in an arbitration, calling evidence and making representations on the matters in the arbitration.

Conduct of Arbitration (Division 7)

The arbitrator is obliged to act expeditiously, meaning that the process should be as quick as possible given the need to conduct the arbitration properly. The MSA Act provides a range of powers for the arbitrator to make the collection of evidence quick and relevant, leaving out or altering some procedural strictures that are unnecessary for an access arbitration. For example:

- the power to obtain information in writing, by telephone, video link or measures other than oral evidence;
- the power to sit at any time or place; and
- the power to refer a matter to an expert for report, and accept the expert's report in evidence.

The arbitrator may also conduct two or more arbitrations on related matters together. This might arise where the access proposal involves services from more than one regulated operator.

The arbitrator has various powers to obtain information relevant to the arbitration from any party to the arbitration or from other people. Any information collected can be kept confidential in whole or in part. Confidentiality must be requested and will be determined by the arbitrator.

Proceedings must be conducted in private unless all parties agree to public proceedings. To ensure the maintenance of commercial confidentiality, the arbitrator is entitled to determine who should attend any private hearing.

While the proceedings may be private, the arbitrator may publish the outcome of an arbitration if they consider it to be in the public interest. The arbitrator may engage a lawyer for advice on conduct and drafting an award. A proponent may elect to terminate an arbitration at any time before an outcome – terminating the Dispute and withdrawing the proposal. An early withdrawal does not preclude the proponent from pursuing a similar proposal at another time.

The arbitrator may also elect to terminate an arbitration if, in the arbitrator's view:

- the subject matter is trivial, misconceived or lacking in substance;
- the proponent has not engaged in negotiation in good faith; or
- an existing contract or award should apply.

The Commission can make representations on a termination.

Awards (Division 8)

The outcome of an arbitration is known as an Award, which must be made within the period of 6 months from the date on which the dispute is referred to arbitration. An Award contains the terms and conditions upon which access may occur. It should take into account:

- the regulated operator's legitimate business interest and investment in the port or port facilities;
- the costs to the operator of providing the service (including the costs of any necessary modification to, or extension of, a port facility) but not costs associated with losses arising from increased competition in upstream or downstream markets;
- the economic value to the operator of any additional investment that the proponent or the operator has agreed to undertake;
- the interests of all parties holding contracts for use of any relevant port facility;
- firm and binding contractual obligations of the operator or other persons (or both) already using any relevant port facility;
- the operational and technical requirements necessary for the safe and reliable provision of the service;
- the economically efficient operation of any relevant port facility; and
- the benefit to the public from having competitive markets.

An Award must:

- be in writing;
- set out its reasoning; and
- specify the period for which it remains in force.

Once an Award is made, the arbitrator must give a copy to each party and the Commission. An Award may affect the existing legal rights of other port facility customers. This is allowable so long as those customers' needs can continue to be met or they are compensated. The parties to an Award may change it by agreement between all the parties to the Award. A variation could include terms and conditions, or may extend its duration.

A proponent may choose to withdraw from an Award up to seven days after its making (or longer if the Commission so permits), by notice in writing to the Commission. In this case the Commission must notify the regulated operator and other parties within seven days. However, if a proponent chooses this

course, then they are precluded from making a similar proposal for two years from the date of notice – unless the regulated operator or the Commission agrees.

Enforcement of Awards (Division 9)

An Award is binding on the parties to it in the same way as a contract. As a result, the parties to an Award may seek injunctive remedies and compensation through the Supreme Court.

Appeals and Costs (Division 10)

There is provision for appeal to the Supreme Court in respect of an Award (or a decision to not make an Award) on questions of law only. The Supreme Court may:

- vary the Award or decision;
- revoke the Award or decision;
- make an Award or decision that should have been made;
- remit the matter to the arbitrator for further or re-consideration; and
- make incidental and ancillary orders.

The costs of an arbitration are to be borne by the parties either:

- in proportions decided by the arbitrator (for example if one party had not negotiated in good faith, the arbitrator may award costs against that party); or in the absence of that
- in equal proportions.

If a proponent terminates an arbitration or withdraws from an Award, they are liable for all costs. The arbitrator will decide how to define costs – it could include a party's internal costs.

APPENDIX 2: PUBLISHED CHARGES FOR PORTS SERVICES 2008/09 – 2011/12

Cargo Services Charges (Ex GST)	2011/12		2010/11		2009/10		2008/09	
	(CPI 3.63%)		(CPI 2.6%)		(CPI 2.3%)		(CPI 4.48%)	
		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.
Bulk Cargo								
Salt ($/tonne)	$ 1.54	3.36%	$ 1.49	2.76%	$ 1.45	3.57%	$ 1.40	4.48%
Gypsum ($/tonne)	$ 1.54	3.36%	$ 1.49	2.76%	$ 1.45	3.57%	$ 1.40	4.48%
Limestone ($/tonne)	$ 1.54	3.36%	$ 1.49	2.76%	$ 1.45	3.57%	$ 1.40	4.48%
Dolomite ($/tonne)	-	-	-	-	-	-	$ 1.40	4.48%
Grain ($/tonne)	$ 1.90	3.83%	$ 1.83	2.81%	$ 1.78	3.49%	$ 1.72	4.24%
Flour ($/tonne)	$ 2.01	3.61%	$ 1.94	2.65%	$ 1.89	3.28%	$ 1.83	4.57%
Liquids ($/Kilolitre)	$ 5.19	3.59%	$ 5.01	2.66%	$ 4.88	3.39%	$ 4.72	4.42%
All other products ($/tonne)	$ 3.74	3.60%	$ 3.61	2.56%	$ 3.52	3.23%	$ 3.41	4.60%
Other Non-Containerised Cargo								
Live sheep ($/head)	$ 0.2915	3.59%	$ 0.2814	2.59%	$ 0.2743	3.31%	$ 0.2655	4.49%
Live goats ($/head)	$ 0.2915	3.59%	$ 0.2814	2.59%	$ 0.2743	3.31%	$ 0.2655	4.49%
Live Cattle ($/head)	$ 2.03	3.57%	$ 1.96	2.62%	$ 1.91	3.24%	$ 1.85	4.52%
Bagged Grain/Flour ($/tonne)	$ 2.01	3.61%	$ 1.94	2.65%	$ 1.89	3.28%	$ 1.83	4.57%
All other products ($/tonne or cubic metre, whichever is the greater)	$ 3.74	3.60%	$ 3.61	2.56%	$ 3.52	3.23%	$ 3.41	4.60%
Motor Vehicles Completely Built								
Volume <10m3 ($/unit)	$ 23.97	3.59%	$ 23.14	2.62%	$ 22.55	3.30%	$ 21.83	4.50%
Volume 10m3 < 15m3 ($/unit)	$ 34.61	3.59%	$ 33.41	2.61%	$ 32.56	3.30%	$ 31.52	4.51%
Volume > 15m3 ($/unit)	$ 55.90	3.60%	$ 53.96	2.61%	$ 52.59	3.30%	$ 50.91	4.50%
Containerised Cargo								
20' Container ($/unit)	$ 70.70	3.51%	$ 68.30	2.55%	$ 66.60	3.32%	$ 64.46	10.26%
40' Container ($/unit)	$ 129.80	3.59%	$ 125.30	2.62%	$ 122.10	3.28%	$ 118.22	11.30%
Channel Levy (Ex GST)								
Levies apply to Port Adelaide only								
Grain Levy Port Adelaide ($/tonne)	$ 0.4043	2.59%	$ 0.3941	2.50%	$ 0.3845	4.20%	$ 0.3690	2.50%
Grain Levy Port Adelaide (applicable from 1 January)	$ 0.4189	3.61%	$ 0.4043	2.59%	$ 0.3941	2.50%	$ 0.3845	-
20' Container Levy ($/unit)	$ 5.80	3.57%	$ 5.60	1.82%	$ 5.50	3.09%	$ 5.34	6.70%
40' Container Levy ($/unit)	$ 11.60	3.57%	$ 11.20	1.82%	$ 11.00	3.09%	$ 10.67	6.70%

Harbour Service Charges (Ex GST)	2011/12		2010/11		2009/10		2008/09	
	(CPI 3.63%)		(CPI 2.6%)		(CPI 2.3%)		(CPI 4.48%)	
		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.
Port Adelaide (includes mooring)								
Base charge ($ per ship visit)	$ 3,427.33	3.60%	$ 3,308.23	2.60%	$ 3,224.40	2.30%	$ 3,151.91	4.50%
Variable charge ($ per gross registered tonne ("GRT") per hour)	$ 0.0056	3.70%	$ 0.0054	1.89%	$ 0.0053	1.92%	$ 0.0052	4.00%
Other Ports (includes mooring)								
Base charge ($ per ship visit)	$ 2,946.19	3.60%	$ 2,843.81	2.60%	$ 2,771.74	2.30%	$ 2,709.42	4.50%
Variable charge ($ per GRT per hour)	$ 0.0054	3.85%	$ 0.0052	1.96%	$ 0.0051	2.00%	$ 0.0050	4.17%
State Trader (all Proclaimed Ports)								
>40 GRT and <50 GRT	$ 101.77	3.60%	$ 98.23	2.60%	$ 95.74	2.30%	$ 93.59	4.50%
>50 GRT and <100 GRT	$ 160.95	3.60%	$ 155.36	2.60%	$ 151.42	2.30%	$ 148.02	4.50%
>100 GRT and <200 GRT	$ 245.77	3.60%	$ 237.23	2.60%	$ 231.22	2.30%	$ 226.02	4.50%
>200 GRT and <500 GRT (Base charge)	$ 245.77	3.60%	$ 237.23	2.16%	$ 232.22	2.74%	$ 226.02	4.50%
Variable charge ($ per GRT)	$ 0.7085	3.60%	$ 0.6839	2.60%	$ 0.6666	2.30%	$ 0.6516	4.51%
>500 GRT and <1000 GRT (Base charge)	$ 465.21	3.60%	$ 449.04	2.60%	$ 437.66	2.30%	$ 427.82	4.50%
Variable charge ($ per GRT)	$ 3.7100	3.63%	$ 3.5800	2.58%	$ 3.4900	2.35%	$ 3.4100	4.60%
>1000 GRT ($ per GRT)	$ 7.00	3.55%	$ 6.76	2.58%	$ 6.59	2.33%	$ 6.44	4.55%
Fishing Vessels								
<40 GRT	$ 135.20	-	-	-		-	-	-
>40 GRT and <50 GRT	$ 152.37	3.60%	$ 147.08	2.60%	$ 143.35	2.30%	$ 140.13	4.50%
>50 GRT and <100 GRT	$ 240.85	3.60%	$ 232.48	2.60%	$ 226.59	2.30%	$ 221.50	4.50%
>100 GRT and <200 GRT	$ 367.90	3.60%	$ 355.12	2.60%	$ 346.12	2.30%	$ 338.34	4.50%
>200 GRT and <500 GRT (Base charge)	$ 367.90	3.60%	$ 355.12	2.60%	$ 346.12	2.30%	$ 338.34	4.50%
Variable charge ($ per GRT)	$ 1.0600	3.92%	$ 1.0200	2.48%	$ 0.9953	2.30%	$ 0.9729	4.50%
>500 GRT and <1000 GRT (Base charge)	$ 696.41	3.60%	$ 672.21	2.60%	$ 655.18	2.30%	$ 640.45	4.50%
Variable charge ($ per GRT)	$ 5.4100	3.64%	$ 5.2200	2.55%	$ 5.0900	2.21%	$ 4.9800	4.40%
>1000 GRT ($ per GRT)	$ 10.45	3.57%	$ 10.09	2.64%	$ 9.83	2.29%	$ 9.61	4.46%
Port Lincoln Fishing Industry Facilities (Levies apply to Port Lincoln only)								
<50 GRT (quarterly charge)	$ 410.04	2.80%	$ 398.87	1.30%	$ 393.75	5.00%	$ 375.00	-
>50 GRT and <100 GRT (quarterly charge)	$ 546.72	2.80%	$ 531.83	1.30%	$ 525.00	5.00%	$ 500.00	-
>100 GRT and <200 GRT (quarterly charge)	$ 820.08	2.80%	$ 797.74	1.30%	$ 787.50	5.00%	$ 750.00	-
>200 GRT and <500 GRT (quarterly charge)	$ 1,093.43	2.80%	$ 1,063.65	1.30%	$ 1,050.00	5.00%	$ 1,000.00	-
>500 GRT and <1000 GRT (quarterly charge)	$ 1,366.79	2.80%	$ 1,329.56	1.30%	$ 1,312.50	5.00%	$ 1,250.00	-
>1000 GRT (quarterly charge)	$ 2,733.59	2.80%	$ 2,659.13	1.30%	$ 2,625.00	5.00%	$ 2,500.00	-

Navigation Service Charges (Ex GST)	2011/12		2010/11		2009/10		2008/09	
	(CPI 3.63%)		(CPI 2.6%)		(CPI 2.3%)		(CPI 4.48%)	
		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.
1st Visit (All Proclaimed Ports)								
Base charge ($ per ship visit)	$ 1,094.12	3.60%	$ 1,056.10	2.60%	$ 1,029.34	2.30%	$ 1,006.20	4.50%
Variable charge ($ per GRT per visit)	$ 0.1208	3.60%	$ 0.1166	2.64%	$ 0.1136	2.34%	$ 0.1110	4.52%
2nd Visit (All Proclaimed Ports)								
Base charge ($ per ship visit)	$ 820.59	3.60%	$ 792.08	2.60%	$ 772.01	2.30%	$ 754.65	4.50%
Variable charge ($ per GRT per visit)	$ 0.0906	3.54%	$ 0.0875	2.70%	$ 0.0852	2.28%	$ 0.0833	4.52%
3rd Visit (All Proclaimed Ports)								
Base charge ($ per ship visit)	$ 547.06	3.60%	$ 528.05	2.60%	$ 514.67	2.30%	$ 503.10	4.50%
Variable charge ($ per GRT per visit)	$ 0.0604	3.60%	$ 0.0583	2.64%	$ 0.0568	2.34%	$ 0.0555	4.52%
4th Visit (All Proclaimed Ports)								
Base charge ($ per ship visit)	$ 273.53	3.60%	$ 264.03	2.60%	$ 257.34	2.30%	$ 251.55	4.50%
Variable charge ($ per GRT per visit)	$ 0.0302	3.42%	$ 0.0292	2.82%	$ 0.0284	2.16%	$ 0.0278	4.51%
Frequent Caller								
Base charge	$ 2,516.45	3.60%	$ 2,429.01	2.60%	$ 2,367.46	2.30%	$ 2,314.23	4.50%
Variable charge ($ per GRT per visit)	$ 0.2774	3.58%	$ 0.2678	2.61%	$ 0.2610	2.31%	$ 0.2551	4.51%
State Trader								
Charge ($ per GRT per visit)	$ 0.4012	3.59%	$ 0.3873	2.60%	$ 0.3775	2.30%	$ 0.3690	4.50%

Pilotage Charges (Ex GST)	2011/12		2010/11		2009/10		2008/09	
	(CPI 3.63%)		(CPI 2.6%)		(CPI 2.3%)		(CPI 4.48%)	
		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.		% change from prev. yr.
All Ports								
A	$ 2,511.21	5.90%	$ 2,371.30	3.50%	$ 2,291.11	2.30%	$ 2,239.60	10.00%
B	$ 1,619.73	5.90%	$ 1,529.49	3.50%	$ 1,477.77	2.30%	$ 1,444.54	10.00%
C	$ 1,349.77	5.90%	$ 1,274.57	3.50%	$ 1,231.47	2.30%	$ 1,203.79	10.00%

Pilotage Charges Movement details:

A - Boarding Station or Anchorage to or from Berth

B - Boarding Station to or from Anchorage

C - Removal from one Berth to another in a harbor and warping by Pilot