



# SHOULD PRICE REGULATION CONTINUE?

## PORTS PRICE REVIEW: DISCUSSION PAPER NO. 1

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## **FOREWORD**

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The South Australian ports sector has experienced considerable change over recent years, culminating in the sale of seven government-owned ports to a private owner in 2001 and the simultaneous introduction of economic regulation of port services.

A significant part of that economic regulation is the price regulation of Essential Maritime Services under the *Maritime Services (Access) Act 2000*. This currently involves a system of price caps (or maximum prices) for a range of specific port services.

The price cap system is an initial arrangement, with the Act requiring a review of price regulation, to determine whether it should continue to apply and if so, in what form. Any changes may take effect from 31 October 2004.

The Essential Services Commission of South Australia is the economic regulator for ports, and is responsible for conducting the review. The Ports Price Review, as it is called, begins with this Discussion Paper.

The Ports Price Review must deal with a range of complex matters, looking at both whether price regulation should continue and, if necessary, what form it should take. The Commission seeks the involvement of all stakeholders in this review to ensure that a wide range of views and experiences can be considered. The success of a review of this kind depends on the contribution of stakeholders. The eagerness and willingness of stakeholders to be involved will also provide a signal to the Commission about the importance of regulated port prices to South Australian businesses.

I invite all people interested in the economic regulation of South Australian ports to engage with the Commission in this review.

Lewis W. Owens  
**CHAIRPERSON**



# TABLE OF CONTENTS

<b>Foreword</b>	<b>iii</b>
<b>Glossary</b>	<b>1</b>
<b>1. Introduction</b>	<b>3</b>
1.1. ESCOSA's approach	4
1.2. Structure of this Discussion Paper	4
<b>2. What the legislation says</b>	<b>7</b>
2.1. Scope	8
2.2. Legislative factors and considerations	8
2.3. Conduct	10
<b>3. What are Essential Maritime Services?</b>	<b>11</b>
3.1. Current situation	11
3.2. Beyond 2004	12
<b>4. Deciding whether price regulation should continue</b>	<b>15</b>
4.1. What is price regulation	15
4.2. General approach	15
4.3. Assessment criteria	21
4.4. Making the assessment	22
<b>5. Call for information</b>	<b>25</b>
5.1. Market structure	25
5.2. Monopoly or market power	26
5.3. Competitiveness	27
5.4. Feasibility and cost of price regulation	27
<b>6. Next steps</b>	<b>29</b>
6.1. Consultation	29
6.2. Submissions	30



## GLOSSARY

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<b>BHF ACT</b>	<i>South Australian Ports (Bulk Handling Facilities) Act 1996 (SA).</i>
<b>CPI</b>	Consumer Price Index (a measure of inflation).
<b>ESC ACT</b>	<i>Essential Services Commission Act 2002 (SA).</i>
<b>ESCOSA</b>	Essential Services Commission of South Australia, established under the ESC Act.
<b>ESC (Vic)</b>	The Victorian Essential Services Commission (an equivalent but separate organisation to ESCOSA, responsible for economic regulation in Victoria).
<b>ESSENTIAL MARITIME SERVICES</b>	Services defined under Section 4 of the MSA Act and subject to price regulation.
<b>EXCLUDED ASSETS</b>	Certain developments that Flinders Ports Pty Ltd is bound to make as part of its purchase agreement with the South Australian Government, covering: <ul style="list-style-type: none"><li>• Dredging and wharf upgrade at Port Giles to accommodate panamax vessels;</li><li>• Wharf upgrade at Wallaroo to allow partial loading of panamax vessels; and</li><li>• Dredging and new wharf construction at Outer Harbour, Port Adelaide, for panamax bulk grain vessels.</li></ul>
<b>FPD</b>	Minister for Government Enterprises' <i>First Pricing Determination</i> (under Section 6 of the MSA Act).
<b>FME</b>	Force Majeure Event.
<b>GT</b>	Gross Tonnage.
<b>H&amp;N ACT</b>	<i>Harbors and Navigation Act 1993 (SA).</i>
<b>MARITIME SERVICES</b>	The full suite of services subject to regulation or potential regulation by ESCOSA and defined under Section 4 of the MSA Act.
<b>MSA ACT</b>	<i>Maritime Services (Access) Act 2000 (SA).</i>
<b>PANAMAX</b>	The largest ships able to use the Panama Canal, typically ships up to 70,000 tonnes deadweight.
<b>POA</b>	Port Operating Agreement (under Section 28 of the H&N Act) between a Port Operator and the Minister for Transport.
<b>PORT OPERATOR</b>	The person authorised by a POA to operate a port.
<b>PORTS ACCESS REGIME</b>	The access regime contained in Part 3 of the MSA Act.
<b>REGULATED ASSET BASE</b>	All assets directly referable to the provision of Essential Maritime Services including any relevant channels, navigational aids, breakwaters, berths, wharves, jetties, land, buildings and site improvements, but not Excluded Assets.
<b>REGULATED OPERATOR</b>	A person subject to the ports access regime. The term is also used in the FPD to describe a person subject to ports price regulation.
<b>REGULATED SERVICES</b>	Services defined by proclamation under Section 4 of the MSA Act and subject to access regulation.
<b>SAIIR</b>	South Australian Independent Industry Regulator, subsumed by ESCOSA in September 2002.





## 1. INTRODUCTION

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Services in seven South Australian ports are subject to price regulation, administered by the Essential Services Commission of South Australia (ESCOSA). Price regulation can take many forms and the current system for South Australian ports involves price caps, which are maximum prices that a port operator can charge a port customer.

Price regulation for port services occurs under the *Maritime Services (Access) Act 2000* (the MSA Act). The current system of price caps occurs under the First Pricing Determination (FPD) and applies at least until 31 October 2004.<sup>1</sup>

Whether the current or any other form of price regulation continues beyond that time depends on the outcome of a review that ESCOSA must conduct under Section 7 of the MSA Act – the Ports Price Review. The review is to consider whether price regulation should continue and, if so, what form it should take.

This Discussion Paper marks the beginning of the Ports Price Review – by raising issues relating to whether or not price regulation is needed. This involves looking at the reasons that price regulation is used – what “problems” does it seek to fix? Do those problems exist, or continue to exist, in relation to ports? Can price regulation address these problems and, even if it can, is it justified? Will it cause other problems?

ESCOSA is not seeking to determine the form of price regulation until it has determined whether it should continue. However, the nature of the answer to the initial question may provide an indication as to what form might be most appropriate.

In raising these issues ESCOSA is seeking to inform people about what is relevant to the review and seek comment from them on those issues. The views of people involved in the ports industry are important to the review because practical experience is a good guide to determining which issues are significant and how significant they are.

ESCOSA also sets out the legal requirements for the review, including:

- ▲ what factors the relevant legislation requires ESCOSA to consider; and
- ▲ what port services are included in the scope of the review.

These are also important because ESCOSA cannot ignore or go beyond its legislative boundaries. Setting these things out first will enable stakeholders to avoid spending time addressing or responding to issues or factors that are not part of the review.

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<sup>1</sup> Further information can be found in the ESCOSA Information Paper “Regulation of South Australian Ports: Reissued October 2002”, available from the ESCOSA website: [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).



## **1.1. ESCOSA's approach**

ESCOSA's general approach to the Ports Price Review will follow the "ABC of Regulation", which applies to all its regulatory work:<sup>2</sup>

- ▲ A – to achieve the objectives of the Act(s);
- ▲ B – to balance the regulatory bargain; and
- ▲ C – within a climate of regulatory collaboration.

The first element recognises that ESCOSA must work within the legal framework. The Ports Price Review is mandated by legislation and ESCOSA must ensure that it meets the provisions, objectives and principles set out in the relevant legislation.

The second element involves ESCOSA balancing the interests of various port users and the interests of Regulated Operators.

The final element involves ESCOSA adopting a collaborative approach to regulation. This means inviting and encouraging input from stakeholders, and ESCOSA actively seeking to learn about port and related industries through contact with stakeholders. Details about how to make submissions and other aspects of ESCOSA's proposed consultation program can be found in Chapter 6.

## **1.2. Structure of this Discussion Paper**

The structure of this Discussion Paper is as follows.

Chapter 2 identifies the legislative requirements for the review, including the objectives that ESCOSA must consider in this review and directions for the conduct of the review.

Chapter 3 examines the services subject to price regulation and considers what are, or what should be, Essential Maritime Services.

Chapter 4 discusses the basis upon which ESCOSA should decide whether price regulation should continue, by examining the implications of ESCOSA's legislative objectives and setting out the type of assessment criteria that these require.

Chapter 5 then discusses the type of information that should be most relevant to this stage of the review.

Chapter 6 discusses the next steps in the review and includes information for those wishing to make submissions to ESCOSA.

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<sup>2</sup> Further detail about the ABC of Regulation can be found in the Publications/Speeches section of the ESCOSA website: [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

ESCOSA has placed questions throughout this paper to both prompt and encourage responses. Their purpose is to stimulate thought and consideration on those questions in submissions to the review. However, stakeholders are also free to raise in their submissions any other matters they consider relevant.



## **2. WHAT THE LEGISLATION SAYS**

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Price regulation of Essential Maritime Services arises in Section 6 of the MSA Act, which provides that:

- ▲ Essential Maritime Services are regulated under the ESC Act, hence making them subject to price regulation under the ESC Act;
- ▲ ESCOSA is to administer price regulation for the first 3 years (ending 30 October 2004) under the First Pricing Determination (FPD) as made by the Minister for Government Enterprises (not by ESCOSA); and
- ▲ ESCOSA cannot change the FPD in the first 3 years (except in the limited circumstances set out in the FPD).

The MSA Act also defines Essential Maritime Services. The definitions are discussed later in this paper.

ESCOSA can change the FPD, or issue a new determination to replace the FPD, after the first 3 years – from 31 October 2004 onwards. This need not occur immediately as the FPD has no particular expiry date and can continue until changed or replaced.

Section 7 of the MSA Act requires ESCOSA to undertake a review before changing/replacing the FPD. Section 7 requires that:

- ▲ ESCOSA must, before the end of the first 3 years, conduct a review of the industries subject to the FPD to determine whether Essential Maritime Services should continue to be subject to price regulation and, if so, the appropriate form of the regulation;
- ▲ in conducting the review, ESCOSA must comply with any provisions of the pricing determination that are relevant to the carrying out of the review;
- ▲ ESCOSA must give reasonable notice of the review in a newspaper circulating generally throughout the State, inviting written submissions on the matters under review within a reasonable time specified in the notice;
- ▲ ESCOSA must consider submissions made in response to the notice and other submissions made in the course of other forms of public consultation undertaken by ESCOSA in connection with the review; and
- ▲ on completing the review, ESCOSA must forward to the Minister (Assisting in Government Enterprises) a report on the review and the conclusions reached by ESCOSA as a result of the review.

The requirements of Section 7 relate to both the scope and conduct of the review.



## **2.1. Scope**

The key terms of reference for the Ports Price Review are contained in Section 7(1) of the MSA Act, being to determine:

- ▲ whether Essential Maritime Services should continue to be subject to price regulation; and, if so
- ▲ the appropriate form of the regulation.

The two parts explain ESCOSA's two-stage approach to the review; this first stage focussing on the whether price regulation should continue.

Only after ESCOSA has reached a conclusion on whether price regulation should continue will it consider the form (the HOW of price regulation). If ESCOSA determines that price regulation should not continue then the second stage will not be needed.

Section 7(1) also makes clear that ESCOSA must confine itself, in this review, to Essential Maritime Services<sup>3</sup>. These are defined in the MSA Act. Further discussion on the definitions and services covered is contained in Chapter 3.

## **2.2. Legislative factors and considerations**

ESCOSA must meet its legislative obligations in that it must carry out the review in a manner that:

- ▲ meets the objectives of the MSA Act (Section 3);
- ▲ meets the objectives of the ESC Act (Section 6); and
- ▲ complies with any provisions of the FPD that are relevant to the review.

Further, if ESCOSA determines that price regulation should continue and also issues a new price determination<sup>3</sup>, it must have regard to the additional factors laid out in Section 25(4) of the ESC Act.

### **2.2.1. MSA Act objectives**

Section 3 of the MSA Act provides four objectives for the whole Act, not just price regulation, being:

- ▲ to provide access to maritime services on fair commercial terms;
- ▲ to facilitate competitive markets in the provision of maritime services;

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<sup>3</sup> This review does not look at the Ports Access Regime, but note that some Essential Maritime Services are covered in that regime.

- ▲ to protect the interests of users of Essential Maritime Services by ensuring that regulated prices are fair and reasonable, having regard to the level of competition in, and efficiency of, the regulated industry; and
- ▲ to ensure that disputes about access are subject to an appropriate dispute resolution process.

The first and fourth objectives relate to the Ports Access Regime (the term “fair commercial terms” arising in that regime) rather than price regulation.

### **2.2.2. ESC Act objectives**

Section 6 of the ESC Act provides that ESCOSA must:

- ▲ have as its primary objective the protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and
- ▲ at the same time, have regard to the need to—
  - ▲ promote competitive and fair market conduct;
  - ▲ prevent misuse of monopoly or market power;
  - ▲ facilitate entry into relevant markets;
  - ▲ promote economic efficiency;
  - ▲ ensure consumers benefit from competition and efficiency;
  - ▲ facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and
  - ▲ promote consistency in regulation with other jurisdictions.

ESCOSA is to have regard to these additional objectives. This means that ESCOSA must consider each, although recognising that it may have to balance them against each other in order to achieve the primary objective.

The objectives impact on how ESCOSA should approach this review. This is discussed in further detail in Chapter 4.

### **2.2.3. FPD provisions**

The FPD does not set any specific objectives for this review. However, some of the elements of the FPD have carry-over implications if ESCOSA issues a new determination as a result of this review. Specifically:

- ▲ if price regulation continues, then any pass-through arrangements in place (force majeure or change in taxes) may need to be carried over; and



- ▲ if price regulation continues, then any asset augmentations approved under clause 2.6 of the FPD will need to be considered in accordance with clause 2.6.5 of the FPD.

The way these would carry forward will need to marry in with the form of price regulation chosen. However, the total value of the revenues being carried over would remain the same.

### **2.3. Conduct**

ESCOSA must conduct this review in accordance with the specific conduct requirements set out in Section 7 of the MSA Act. These require:

- ▲ ESCOSA to give reasonable notice of the review in a newspaper circulating generally throughout the State, inviting written submissions on the matters under review within a reasonable time, specified in the notice;
  - ▲ this has been achieved by advertising the review in The Advertiser and Lloyd's List DCN (Daily Commercial News);
  - ▲ the advertisements and this Discussion Paper invite submissions, and provide for submissions to be received by 6 March 2003, a period of over three months;
- ▲ ESCOSA must consider submissions made in response to the notice and other submissions made in the course of other forms of public consultation undertaken by ESCOSA in connection with the review;
  - ▲ as is explained further in Chapter 6, ESCOSA will release a Progress Report in May 2003 that will include its conclusion on whether price regulation should continue;
  - ▲ the timing of that report ensures that ESCOSA can consider all submissions made by the due date;
  - ▲ as is also explained in Chapter 6 ESCOSA is willing to meet stakeholders to explain the review process further and discuss issues if that would assist people in understanding the review and enable them to contribute to the review;
- ▲ on completing the review, ESCOSA must forward to the Minister (Assisting in Government Enterprises) a report on the review and the conclusions reached by ESCOSA;
  - ▲ ESCOSA will forward a copy of its final report to the Minister, as well as a copy of the Progress Report and any other papers or reports released (including this Discussion Paper);
  - ▲ If ESCOSA issues a new determination, then it will also need to comply with the additional conduct requirements contained in Section 26 of the ESC Act.

These requirements are consistent with ESCOSA's normal approach to the conduct of public reviews or inquiries that seeks to encourage stakeholder involvement through a collaborative approach.



### **3. WHAT ARE ESSENTIAL MARITIME SERVICES?**

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One of the first matters for ESCOSA to resolve is the coverage of price regulation – exactly which services are subject to regulation? Determining coverage can be difficult because it requires careful interpretation of words and terms defined in legislation.

However, coverage is important because ESCOSA must confine its assessment in this review to covered services only, and, if price regulation continues, then ESCOSA must ensure that only covered services are regulated.

This Chapter examines what is covered and seeks input from interested parties on their views of what services fall within the definitions. The starting point is the definition of Essential Maritime Services under Section 4 of the MSA Act, where an Essential Maritime Service is a Maritime Service consisting of:

- a) providing or allowing for access of vessels to a proclaimed port; or
- b) providing port facilities for loading or unloading vessels at a proclaimed port; or
- c) providing berths for vessels at a proclaimed port.

The seven proclaimed ports are:

- ▲ Port Adelaide;
- ▲ Port Giles;
- ▲ Wallaroo;
- ▲ Port Pirie;
- ▲ Port Lincoln;
- ▲ Thevenard; and
- ▲ Ardrossan.

Flinders Ports Pty Ltd operates the first six and AusBulk Ltd operates the port at Ardrossan.

#### **3.1. Current situation**

Until 31 October 2004, the three definitions above are taken to accord, collectively, with the three charges regulated under the FPD, being the:

- 1 Navigation Services Charge;
- 2 Cargo Services Charge; and
- 3 Harbour Services and Mooring Charge.



There is a general understanding of what services these charges cover, but not an explicit list of services. As an example, the South Australian Government still uses the three charge categories for Indentured ports (not subject to ESCOSA regulation). In a recent schedule<sup>4</sup>, the charges were described as being, respectively, to recover the costs of:

- ▲ providing navigational aids to commercial shipping using the [port];
- ▲ providing the basic port facilities; and
- ▲ servicing vessels in port and at berths.

More generally the three current charges might be thought of as covering the activities, infrastructure and services of, respectively:

- ▲ navigational aids, channels, harbour control;
- ▲ wharves, cargo loading/unloading areas; and
- ▲ berths, mooring structures, fenders, mooring and provisioning connections.

***What services do you understand each of the three current charges to cover?***

***What does the amount charged for each of the three services indicate about the services each covers?***

### **3.2. Beyond 2004**

After 31 October 2004 there need be no automatic assumption that the definitions of Essential Maritime Services will continue to equate to the current charges. This may be because the charges themselves change (either in name or structure), because some additional services are found to have been missed and need to be added, or because some of the services included in the charges should not be covered.

Fortunately, the scope for interpretation of an Essential Maritime Service is narrowed to some extent by the following elements of the MSA Act:

- ▲ for a service to be an Essential Maritime Service it must be a Maritime Service (defined in Section 4 of the MSA Act). The following services are excluded from being Maritime Services and are therefore not Essential Maritime Services:
  - ▲ towage;
  - ▲ bunkering;
  - ▲ provisioning; or
  - ▲ waste removal;

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<sup>4</sup> South Australian Government Gazette, 19 September 2002, page 3439.

- ▲ the following are also not Essential Maritime Services, because of their deliberate omission from the definition:
  - ▲ pilotage;
  - ▲ providing for the storage of goods; and
  - ▲ providing access to land in connection with other Maritime Services; and
- ▲ stevedoring plant and equipment (port facilities is defined in Section 4 of the MSA Act, with the result that the Essential Maritime Service of providing port facilities for loading or unloading vessels at a proclaimed port does not cover stevedoring plant and equipment).

Stevedoring itself is also not covered.

The legislation provides that the above items are not Essential Maritime Services. Therefore ESCOSA is not permitted to include them under price regulation or consider them in this review.

ESCOSA needs to determine which services are covered and seeks comment on this from those experienced in the delivery or use of ports and port services.

***What port services do you think fall under the definition of Essential Maritime Services – other than those excluded as above?***

ESCOSA also needs to determine whether any of the services currently “included” should not be covered. For example, the Harbour Services and Mooring Charge includes payment for the mooring service. Does the mooring service itself really fall under the definitions? That is, while “providing berths” would include mooring structures, should it also include mooring?

Similarly, at some berths the Cargo Services Charge may include the use of storage areas (covered or uncovered). However, the definitions presented above exclude providing for the storage of goods.

Where it is clear that a service is not included in the definition, ESCOSA will not consider continuing to subject that service to price regulation – unless it were:

- ▲ impractical to separate the service out; and
- ▲ very minor or insignificant.

***Which services, currently included in the three types of port charges, do you consider should not fall within the definition of Essential Maritime Services?***

***Should mooring be removed? Can mooring be removed?***



***Should storage be removed? Can storage be removed?***

***How significant are these services in terms of their value and strategic impact upon you as a customer?***

## **4. DECIDING WHETHER PRICE REGULATION SHOULD CONTINUE**

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The first part of the terms of reference for the Ports Price Review asks: should price regulation of Essential Maritime Services continue? ESCOSA can only decide that price regulation should continue if it is convinced that doing so would best achieve the legislative objectives laid out in Chapter 2 above and explained further below.

### ***4.1. What is price regulation***

For the purposes of this review, price regulation refers to the application of the price regulation powers contained in Part 3 of the ESC Act. These powers allow ESCOSA to apply a number of different forms of price regulation. Section 25 (3) provides that:

- ▲ a price determination may regulate prices, conditions relating to prices, or price-fixing factors in a regulated industry in any manner ESCOSA considers appropriate, including:
  - ▲ fixing a price or the rate of increase or decrease in a price;
  - ▲ fixing a maximum price or maximum rate of increase or minimum rate of decrease in a maximum price;
  - ▲ fixing an average price for specified goods or services or an average rate of increase or decrease in an average price;
  - ▲ specifying pricing policies or principles;
  - ▲ 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;
  - ▲ specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the supply of goods or services;
  - ▲ 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
  - ▲ monitoring the price levels of specified goods and services.

These provide a broad range in choice of the form of price regulation, from potentially more heavy-handed price fixing to very light-handed price monitoring. Each option will be available if price regulation of ports continues, with the eventual choice depending on what the regulation is trying to address.

### ***4.2. General approach***

In general, price regulation is usually designed to:



- ▲ resolve problems resulting from market power (competitive deficiencies); and/or
- ▲ provide consumer protection.

For this review, ESCOSA will consider price regulation in the context of the legislative objectives set for it. The following discussion examines the relevant legislative objectives (which were listed in Chapter 2) and discusses what they mean for price regulation of Essential Maritime Services.

ESCOSA encourages stakeholders to link their views or arguments to the objectives.

#### **4.2.1. MSA Act**

##### **Facilitate competitive markets in the provision of Maritime Services**

This objective applies to the MSA Act generally, of which the price regulation of Essential Maritime Services (which are also Maritime Services) is only one part.

One implication of this objective is that, at the very least, price regulation should not, by its action or existence, hinder the development of competitive markets.

For example, price regulation should not lock in a monopoly (albeit regulated) for services that could be otherwise contestable by requiring prices that are too low. Price regulation may facilitate competition in a contestable market serviced by a single provider by setting prices sufficiently high that competitors find entry attractive. However, if this approach is taken in markets where it is known that competition will not arise, it can result in users paying relatively high prices for no particular benefit. Price regulation may also facilitate competition in markets other than the market for the regulated service (see 4.2.2).

The main message from this objective, for this review, is to avoid “over regulation”, which stifles competitive markets.

##### **Protect the interests of users of Essential Maritime Services by ensuring that regulated prices are fair and reasonable, having regard to the level of competition in, and efficiency of, the regulated industry**

This objective is specific to price regulation of Essential Maritime Services and identifies the need for regulated prices to be “fair and reasonable”. It also identifies competition and efficiency as key considerations.

The meaning of “fair and reasonable” can generate significant debate given that what a buyer thinks is fair and reasonable may not seem so fair and reasonable to the seller. This is a common problem in economic regulation.

A number of concepts are used when thinking about “fair and reasonable”. These include that a regulated price should:

- ▲ be sufficient for the seller to generate a return on their associated investment;
- ▲ not cause a buyer to pay for poor investments, over-investments or investments that have nothing to do with the service in question;
- ▲ not cause a buyer to fund unnecessary operating costs;
- ▲ allow for some appropriate amount of future investment to maintain the service, if required; and possibly
- ▲ the regulated price should provide incentive for ongoing improvements in service standards if customers are willing to pay for them.

The degree to which each concept might be relevant depends on the situation being addressed. The need to have regard to the level of competition and efficiency says that regulated prices should address competition concerns and encourage efficiency<sup>5</sup>. For example, if port services were a monopoly then regulated prices may be set to avoid rewarding excessive or monopoly profits.

The implication is that price regulation should be considered where there are concerns about competition and efficiency in the delivery of port services. Hence ESCOSA will need to examine the level of competition in and efficiency of the delivery of Essential Maritime Services to determine whether there are such concerns and whether they are best addressed by price regulation.

#### **4.2.2. ESC Act**

The objectives in the ESC Act apply to ESCOSA’s role more generally, not just to price regulation. However, the following discussion focuses only on the implications of each objective for price regulation of Essential Maritime Services.

**ESCOSA must have as its primary objective the protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of Essential Maritime Services**

The primary objective of the ESC Act requires ESCOSA to look beyond the short-term interests of port customers (which might presumably be the lowest possible price) and consider instead how an ESCOSA decision might impact on price, quality

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<sup>5</sup> Addressing both ensures that one is not pursued at the expense of the other. For example, economies of scale and scope may mean that a single service provider may be the most efficient outcome – a natural monopoly. Regulating to force an increase in the number of service providers may reduce efficiency in this case.



and reliability of Essential Maritime Services<sup>6</sup> in the longer term (the next few years or even decades). This includes the need to ensure that they:

- ▲ continue to be available;
- ▲ are delivered efficiently;
- ▲ are delivered to appropriate standards; and
- ▲ keep up with changes in demand, technology and preferences over time.

Therefore ESCOSA will need to consider whether there are problems with the price, quality and reliability of Essential Maritime Services (and determine whether those problems can be solved by price regulation). In addition, this primary objective requires ESCOSA to ensure that price regulation will not have a negative impact on consumers in terms of price, quality and reliability in the long term.

The focus on long-term interests ensures that the consumer protection aspect of price regulation is not used to force short-term, but unsustainable, price reductions.

This objective also identifies the group “South Australian consumers”. This means, in the first instance, South Australian consumers of Essential Maritime Services. However, it also has a broader extension and includes the interests of indirect customers. For example, the price, quality and reliability of Essential Maritime Services impact on primary producers, even though they may not be the people first invoiced for the service. This requires ESCOSA to consider Essential Maritime Services in their broader context, including the effects on indirect consumers and final consumers.

### **ESCOSA must:**

#### **Have regard to the need to promote competitive and fair market conduct**

Promoting competitive and fair market conduct says that price regulation should seek to:

- ▲ encourage competitive conduct by avoiding excessive price outcomes (while leaving room for competition to evolve) or predatory pricing;
- ▲ encourage fair conduct by improving price transparency and having an informed market; and
- ▲ have regulated prices and conditions reflect those that would arise in a competitive market.

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<sup>6</sup> Note that the Act refers to essential services, as the objective applies to the full range of services regulated by ESCOSA, but in this instance it is Essential Maritime Services.



This requires that ESCOSA examine the level of competition and the type of conduct seen in the market for Essential Maritime Services to determine whether price regulation would promote these.

This objective also has broader connotations, in that price regulation should, if possible, seek to facilitate competitive markets in associated markets; for example, competition in the logistics and transport industries might be facilitated if port prices were reduced or standards raised.

### **Have regard to the need to prevent misuse of monopoly or market power**

This objective focuses on avoiding the downside or costs of monopoly, and is one of the most basic premises for price regulation. That is, that prices be regulated where effective competition cannot be achieved and monopoly or market power exists and is being exercised, or has the potential to be exercised.

This suggests that ESCOSA should investigate monopoly or market power in the market for Essential Maritime Services to determine whether there are problems that would warrant price regulation. The investigation would include looking at both:

- ▲ whether monopoly or market power exists; and
- ▲ whether it is being exercised or has the potential to be exercised (on a forward looking basis).

ESCOSA will also be mindful of the various other fair trading and trade practices laws to which the providers of Essential Maritime Services are subject.

### **Have regard to the need to facilitate entry into relevant markets**

Some of the objectives above have dealt with promoting competitive markets. One means of achieving this is to facilitate entry into relevant markets. This can work in two ways.

First, this can include facilitating entry into the market for Essential Maritime Services. The entry of additional providers of at least some services may help to place competitive pressures on those services, which can reduce prices and/or help to maintain or raise standards. If there are such possibilities, then ESCOSA needs to take care that price regulation does not stifle such entry.

Second, this can include entry into related markets. For example, price regulation of Essential Maritime Services may facilitate the emergence of new port users and therefore encourage growth in exporting and importing industries. ESCOSA will need to determine whether such entry might occur and whether it might be facilitated by price regulation.

### **Have regard to the need to promote economic efficiency**

Economic efficiency is a complex concept that looks at the broad dynamics of markets, economies, businesses and consumers, and the way economic resources are allocated. Efficiency means an economy using the right mix of resources, producing the right goods and services and keeping this up over time.

At a business or service level, economic efficiency means producing the right services (or goods) at the right time, using the right mix of inputs, such that the prices charged can be “efficient prices” based on “efficient costs”.

Economic efficiency, in its purest sense and ignoring externalities, is generally encouraged when competitive markets operate without unnecessary restrictions or interventions. This is because competition can discourage poor investments, over-investment, cost padding and poor service. Price regulation would be unnecessary in such situations and may introduce distorted decisions that reduce efficiency.

However, markets can sometimes fail to produce these efficient outcomes. One of the key causes of such “market failure” is the presence of monopoly or market power, which can result in costs and prices moving away from efficient levels. Price regulation may help to overcome this situation.

A loss of efficiency can be damaging to an economy, but the costs are not always easy to observe. ESCOSA therefore needs to be sure that price regulation would not unduly distort efficiency. This means being confident that price regulation will fix distortions, rather than create them, thereby mimicking a competitive market. This commonly means looking to incentive based regulation, which provides competitive-type signals to the regulated business to perform. It also means considering the cost of price regulation, because administering and complying with price regulation itself uses resources.

### **Have regard to the need to ensure consumers benefit from competition and efficiency**

This objective requires that the benefits of competitive and efficient markets flow through to customers and are not captured by service providers. This means that if price regulation is used, it should be designed to encourage the distribution and sharing of benefits.

There are a number of technical aspects of price regulation that can achieve this and ESCOSA will consider these if price regulation is to continue.

**Have regard to the need to facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment**

This factor imposes on ESCOSA a requirement to have regard to the cost of providing Essential Maritime Services, and to ensure that price regulation does not squeeze prices so far as to threaten their financial viability. Further, it recognises the need for an appropriate return on investment if the industry is to continue to invest in its operations and deliver services to customers over time.

One of the more difficult aspects of this objective is the decision on what costs should be allowed. ESCOSA cannot ignore market practicalities. For example, prices for Essential Maritime Services may be “too high” because the provider faces unduly high input costs. If these are the result of factors outside the control of the provider then price regulation cannot simply “wish” these costs lower. Equally, price regulation should not reward high cost structures that are the result of the provider’s own poor purchasing decisions or incompetence.

This objective is most relevant to the design of price regulation and hence will become an issue if price regulation continues.

**Have regard to the need to promote consistency in regulation with other jurisdictions**

This objective seeks to avoid the emergence of varying and disjointed regulatory systems across Australia (and beyond). It is not a call for foolish consistency, but rather seeks to streamline regulation where possible, appropriate and allowable in law. This can be important for the businesses involved in regulated industries as it can be confusing to comply with different systems in different states (and countries).

In Australia, only Victoria and Queensland other than South Australia apply economic regulation to ports. Queensland will begin its first exercise in ports regulation shortly. Therefore, ESCOSA will primarily examine the Victorian system of ports regulation to determine whether consistency with aspects of that system is applicable – if price regulation continues.

Ports regulation may also share some features of airports regulation and rail regulation. Therefore ESCOSA will also examine those areas.

As noted earlier, ESCOSA would also need to have regard to an additional set of factors in Section 25(4) of the ESC Act, if it were to issue a price determination. Whether that would need to occur depends upon whether price regulation continues.

### **4.3. Assessment criteria**

Based on the discussion above, the key issues for this stage of the review are:



- ▲ monopoly and market power;
- ▲ competitiveness; and
- ▲ whether these threaten:
  - ▲ the long term interests of South Australian consumers;
  - ▲ efficiency;
  - ▲ market entry; and
  - ▲ the viability and availability of Essential Maritime Services.

Based on these issues, ESCOSA expects the following criteria will be relevant to determining whether price regulation should continue. Stakeholders are invited to comment on these, providing their opinions, experience and preferably, data or analysis in support of their views. Alternatively, stakeholders may wish to propose other criteria.

Expected assessment criteria are:

- ▲ Does the structure of the market for Essential Maritime Services suggest market power could exist?
- ▲ Does monopoly or market power exist?
- ▲ Is market power being exercised or is the potential there for it to be exercised?
- ▲ Do customers have alternative routes for their goods (indirect competition)?
- ▲ Is competitive entry possible?
- ▲ Does the answer vary between proclaimed ports and between the goods being moved (for example is the situation in grain different to that for container traffic)?
- ▲ Are Essential Maritime Services of sufficient importance to the South Australian economy to warrant economic efficiency concerns? This could occur either because Essential Maritime Services themselves are a significant industry or because they have a significant impact on the economics of other industries.
- ▲ Can price regulation fix the above matters or will it impose excessive additional costs and risks?

***What other implications do the objectives have for the way in which ESCOSA should decide whether price regulation should continue?***

***What other criteria should ESCOSA apply in its analysis and how should they be applied?***

#### ***4.4. Making the assessment***

To reach its decision, ESCOSA will assess Essential Maritime Services against the above criteria (and other criteria adopted through consultation). The assessment and the

conclusions reached may vary for each of the different services or groups of services included in Essential Maritime Services. That is, ESCOSA may determine that price regulation should continue for some Essential Maritime Services but not others.

Only some of the criteria can provide clear cut or even numerical answers. Therefore ESCOSA's final decision will need to be based on regulatory judgement of the information gathered and the stakeholder views presented to it, against the legislative objectives set for it. However, ESCOSA's assessment will be based on the examination of actual and expected activity in the ports industry.



## 5. CALL FOR INFORMATION

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To make its assessment ESCOSA will need a range of information about Essential Maritime Services, the ports industry and ports users more generally. ESCOSA's analysis will tend to focus on the performance of port services over the last 1-2 years, and projections for the next few years. ESCOSA intends that its assessment will be based heavily upon actual market experience (both good and bad), not merely theoretical market descriptions. Therefore, stakeholders are urged to provide hard data and practical information in support of their submissions. Sensitive information can be presented on a confidential basis.

The following discussions outline some of the types of information that ESCOSA will seek. It is not expected that any individual stakeholder will be able to provide data in all areas and ESCOSA will also be undertaking its own data collection.

***What information can you provide in the areas listed below, or in other areas you consider relevant?***

### 5.1. Market structure

ESCOSA believes that it will need to understand the nature and structure of the markets in which Essential Maritime Services are provided, recognising that the situation for each port is different and the situation for each cargo is different.

The range of products imported and exported from South Australia's ports is vast, especially when container traffic is broken down into the variety of cargoes carried in containers. This means that a single port can form one part of hundreds or even thousands of separate supply chains at the same time.

ESCOSA anticipates preparing several summaries or mini-case studies of key cargo supply chains (since it will not be possible to do this for every cargo). These will be constructed to provide an indication of the variety of experiences between ports and cargoes. For example, the experience of those involved in exporting grain from the Eyre Peninsula will be different from those exporting vehicles from Port Adelaide. Similarly, Eyre Peninsula grain experiences may differ from Yorke Peninsula grain experiences, and Thevenard gypsum will differ from Thevenard grain.

This means that ESCOSA seeks some specific information on the:

- ▲ number of providers of Essential Maritime Services in each proclaimed port;
- ▲ scope for, or impediments to, having additional providers of Essential Maritime Services in each port;



- ▲ way Essential Maritime Services are packaged and delivered in each port; and
- ▲ importance of Essential Maritime Services in port operations.

It also means seeking information more broadly on the:

- ▲ various customers using Essential Maritime Services in each proclaimed port;
- ▲ type and value of cargoes moving through each proclaimed port (last 2-3 years and projections for the next 2-3 years);
- ▲ significance of those cargoes to South Australia:
  - ▲ import and export values;
  - ▲ value added;
  - ▲ employment; and
  - ▲ investment;
- ▲ nature of the supply chains that each cargo moves through and the position of Essential Maritime Services in those supply chains (road, rail, air, sea, interchange, storage, chain/product integrity);
- ▲ proportion of total transport cost for which Essential Maritime Services account;
- ▲ availability of alternative avenues for import or export, for example:
  - ▲ rail, or road, to and from Port Melbourne;
  - ▲ rail to and from Fremantle;
  - ▲ rail, or road, to and from Portland; or
  - ▲ prospectively rail to and from Darwin;
- ▲ availability and economics of new and alternative port development options:
  - ▲ availability of suitable sites for new ports;
  - ▲ expansion options at existing ports; and
  - ▲ cost of developing these options.

## **5.2. Monopoly or market power**

Monopoly or market power results in the ability of a service provider to raise prices, withdraw services, reduce service standards or otherwise act in a discriminatory manner. Monopoly or market power can have various causes, some of which may justify price regulation, although sometimes it may be preferable to remove the cause.

ESCOSA seeks the following information in respect of Essential Maritime Services:

- ▲ legal or physical barriers to entry, that is:
  - ▲ are there legal constraints that stop others from offering Essential Maritime Services in proclaimed ports; or



- ▲ are there no sites or space available to offer them;
- ▲ economic barriers to entry (are there large sunk costs required to offer Essential Maritime Services);
- ▲ direct and indirect competition (are there competitors, is there indirect competition from other ports, other forms of transport, other locations);
- ▲ economies of scope or scale in Essential Maritime Services (is it cheapest to have only one provider of Essential Maritime Services in each port);
- ▲ excess returns to or costs of the current providers of Essential Maritime Services:
  - ▲ have excessive profits been generated from Essential Maritime Services;
  - ▲ are the providers' costs excessive;
- ▲ whether customers have countervailing power, that is:
  - ▲ do port customers have sufficient weight to stop a port operator from using any market power they might have;
- ▲ The degree of pricing transparency, that is:
  - ▲ are port prices relatively well known and open, such that it would be difficult for a port operator to set different prices for different users without clear reason?

### **5.3. Competitiveness**

ESCOSA is interested in quantitative and qualitative indicators of port competitiveness. These can indicate whether a port operator is acting in a way that suggests monopoly or market power is being exercised.

ESCOSA seeks information on:

- ▲ the profitability of Essential Maritime Services in the proclaimed ports;
- ▲ comparisons with charges in comparable ports elsewhere (ESCOSA recognises that it is not always easy to benchmark like with like, but regards these comparisons as having value as long as the limitations are acknowledged);
- ▲ the responsiveness of Essential Maritime Services providers to customer needs (port customers are best placed to provide their experiences here);
- ▲ the responsiveness of Essential Maritime Services providers to changes in needs and new technologies; and
- ▲ the proactiveness of Essential Maritime Services providers in anticipating new demands and trends.

### **5.4. Feasibility and cost of price regulation**

The feasibility and cost of price regulation varies depending upon the form chosen. For example, a heavy-handed system of fixed prices can require considerable effort from both ESCOSA and the port business. Alternatively, a simple system of price notification (which



just requires that prices be posted publicly) would impose little cost. The ultimate choice depends upon the problem(s) that price regulation is there to fix.

However, stakeholders may have views on the feasibility and cost of price regulation, including their experiences in other jurisdictions. Therefore ESCOSA welcomes information or views on the:

- ▲ cost of complying with price regulation;
- ▲ ability of different forms of price regulation to achieve the desired outcomes; and
- ▲ costs (to businesses, customers and the South Australian economy generally) of price regulation “getting it wrong”.

## **6. NEXT STEPS**

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The release of this Discussion Paper denotes the beginning of the first stage of the Ports Price Review. The process to be adopted for the remainder of the Ports Price Review depends upon ESCOSA's conclusions from this first stage, particularly its conclusion on whether price regulation should continue.

ESCOSA intends to release a Progress Report in May 2003 that will explain its initial conclusions and set out a process for going forward. Two possible situations are that:

- ▲ ESCOSA concludes that price regulation of Essential Maritime Services should continue in some form. The Progress Report would state and explain this conclusion and set out a process going forward to develop HOW price regulation should occur; or
- ▲ ESCOSA concludes that price regulation of Essential Maritime Services should not continue. The Progress Report takes the status of a draft report, stating and explaining the conclusion and inviting stakeholders to comment on the conclusion and the reasoning underlying that conclusion. This allows stakeholders the opportunity to support or challenge the conclusion. If new information or reasoning were to become available that caused ESCOSA to change its conclusion, then a subsequent report would be released stating and explaining the new conclusion and setting out a process going forward to develop HOW price regulation should occur. Otherwise, ESCOSA would release a Final Report concluding that price regulation should not continue.

In either case, the Progress Report will not be final. ESCOSA's final conclusions will be contained in a Final Report. It is most likely that this will be completed and released publicly in 2004 and forwarded to the Minister (Assisting in Government Enterprises) in accordance with Section 7(5) of the MSA Act.

### **6.1. Consultation**

In addition to receiving submissions (as discussed below) ESCOSA will seek to discuss the Ports Price Review with stakeholders. This may include discussions with representatives of port operators, shippers, ship owners, importers, exporters, agents, brokers, manufacturers, growers, government (all levels) and associated industries. Any interested party wishing to discuss the Ports Price Review is welcome to contact ESCOSA on the numbers listed below.

ESCOSA also recognises the importance of rural and regional issues in this review, noting that six of the seven proclaimed ports are located outside Adelaide and that grain and minerals form the backbone of most of the ports. ESCOSA encourages regional input into this review and is available to meet regional industry and community representatives where that will assist with the conduct of the review.



## **6.2. Submissions**

ESCOSA invites written submissions from interested parties in relation to the issues raised in this paper. Written comments should be provided to ESCOSA by Thursday 6 March 2003. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is ESCOSA policy to make all submissions publicly available via its website ([www.escosa.sa.gov.au](http://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.

Responses should be directed to:

### **Ports Price Review: Should Price Regulation Continue?**

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