AusBulk

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Mr. Lew Owens
Chairperson
Essential Services Commission of South Australia
GPO Box 2605
Adelaide SA 5001

4th March 2003

Dear Mr. Owens,

RE: PORTS PRICE REVIEW

In November 2002 the ESCOSA released Ports Price Review: Discussion Paper #1. The discussion paper called for submission about whether Port Operators should continue to be subject to continued price regulation for Essential Maritime Services ("EMS").

AusBulk has considered the issues raised in the discussion paper and provides the following submission for your consideration.

Introduction

AusBulk believes the fundamental issue for consideration is whether in the absence of continued pricing regulation, will EMS prices be fair and reasonable, reflective of what could be expected to be provided in a competitive market, and absent of any rent seeking or other monopoly behaviour.

AusBulk as a stakeholder

AusBulk is a major stakeholder in the ports that are subject to the *Maritime Services (Access) Act 2000* ("MSA Act"), and its interest in price regulation takes three forms, namely:

- as the Regulated Operator for the Port of Ardrossan;
- as an owner and operator of country and terminal infrastructure and as a provider of maritime services at other ports, the demands for which may be materially affected by the pricing regimes adopted for EMS by Regulated Operators; and,
- as a user of EMS, associated with the bulk export sale of non-wheat and non-barley grains, the container export of processed grains, the bulk and container export of malt, and the intrastate movement of grain by marine freight.

For the purposes of this discussion, AusBulk will group the second and third interest areas together under the category of EMS user.

In the capacity of Regulated Operator of the Port of Ardrossan, AusBulk's interest in pricing regulation of EMS hinges around:

- whether or not regulation allows efficient operations;
- its impact on returns for new investment; and,
- the extent of administrative burden of compliance

As a user, AusBulk is affected by the provision and pricing of EMS directly and indirectly.

AusBulk is a price taker in the international markets in which it sells grains and grain products. Accordingly EMS prices have a direct impact on the prices offered to growers for grain, and to the extent there is price elasticity in the supply of grain, EMS prices impact on total grain throughput at AusBulk assets and hence profitability of all of AusBulk's country and terminal operations.

Relative pricing is important to AusBulk as changes to port charges have an influence on the total supply chain cost and may impact on the transport route and mode used from country silos to the ports. This in turn could have an unwanted effect on asset utilization and efficiency at AusBulk sites, if the prices are not reflecting commercial values required to deliver such services.

It is clear that AusBulk wears two hats with respect to EMS pricing, which can be perceived to have opposing objectives.

AusBulk believes that with respect to this review, ESCOSA should foremost aim to enshrine the continued protection of long term interest of port users, even if this places a continued regulatory burden on AusBulk as a provider of EMS.

Ardrossan

In 2001 AusBulk acquired from One Steel the jetties and bulk loading plant at the Port of Ardrossan. In addition it completed a Port Operating Agreement and executed leases of subjacent land with the State of South Australia.

Ardrossan has traditionally been a dolomite and grain export port. Over the last 3 years the port has reverted to exclusively dolomite use, due to loading constraints in the Port for grain vessels. The Port of Ardrossan is subject to a current pricing order but the pricing for EMS provided by AusBulk has been reached by negotiation between AusBulk and One Steel.

AusBulk aims to operate the Port of Ardrossan in an efficient manner, and is actively considering investment in the port to allow handling of larger vessels and renewed loading of grain. In approaching this prospective investment, it is the aim of AusBulk to negotiate with port users new charges that are fair and reasonable, given the benefits and costs associated with the port upgrade where those benefits are enjoyed by port users. In the event AusBulk cannot reach such agreement, AusBulk will look to periodically publish Price Information Guidelines for Regulated Services with prices set in accordance with the port asset values, the cost of capital and the commercial risks associated with port operations.

The merit of continued pricing regulation

1. Market structure factors

At each port in South Australia, there is only one provider of EMS, as the State has appointed exclusive port operating responsibility, lease of port lands and subjacent lands, and control of port waters to a single operator: AusBulk at Ardrossan and Flinders Ports at other Regulated Ports.

The extent of interstate and intrastate competition faced between each Regulated Operator varies with commodity type and region, for example:

- Eyre Peninsula regional ports face no medium term competition and/or threat of competition from another port operator;
- Competition in dry bulk commodities is limited to grains in the Victorian border region;
- high value container cargoes from eastern South Australia face significant competition from the Port of Melbourne; and,
- petroleum imports face competition from Port Stanvac.

AusBulk believes that there is potential for transfer of profit margin, from contestable arenas of operation to captive cargoes and ports, to compensate for loss of margins in areas where there is substantial competition and hence a need to lower prices to remain competitive.

AusBulk believes continued price regulation is required to protect the interest of port users with limited/no alternative EMS given the concentration of ownership of ports control in South Australia.

2. The impact of Excluded Assets upgrades

Over the next two years Flinders Ports will complete the upgrades at Port Adelaide, Wallaroo and Port Giles described as Excluded Assets in the discussion paper. In the case of Port Adelaide this will be supported by a new grain terminal development at Outer Harbor.

Grain exported from each of these ports currently is price penalised by ABB Grains Ltd and AWB Limited due to additional market costs associated with having use sub panamax vessels due to port constraints: these penalties will be removed after the ports upgrade to full/partial panamax status.

The benefits of removing marketers penalties at draft-restricted ports should flow through to S.A. growers in higher farm gate prices. It is also likely that the recalibration of Port Adelaide prices set by ABB Grain Ltd and AWB Limited will increase the competitiveness of Port Adelaide as a load port for grain compared to Victorian ports. This will see an extension of the practical drawing arc of Port Adelaide (and therefore tonnage) for export of Victorian grains through Port Adelaide. This drawing arc will extend yet further into Victoria following the completion of standardisation of the Pinnaroo to Ouyen rail line.

In disposing of South Australian Ports Corporation (SAPC), the State structured the sale to receive part of the consideration in the form of completed Excluded Assets upgrades, rather than cash. It was the intention of the State that having paid for these works, the grain industry should get the full benefit from the upgrade. The MSA Act in part demonstrated this by excluding the value of this upgrade from the regulated asset value of future regulatory price determinations. Nevertheless, the Act was silent about the volumetric (and therefore revenue) benefits for Port Adelaide that will flow from this upgrade. Arguably it was the intent of the S.A. Government that the port users should be the financial beneficiaries of this upgrade and accordingly the volume impacts of this upgrade should be tracked by the ESCOSA and benefits passed to users of these facilities.

AusBulk believes continued price regulation is required to ensure that the all of the benefits of the Excluded Assets upgrade are passed to the users of these facilities.

3. **Future investment**

The excluded assets upgrade at Port Adelaide will deliver a 12-metre channel and berth for grain vessels at Outer Harbor and will with tidal assistance allow full loading of panamax grain vessels.

Trends in container ship technology have seen the introduction of panamax container ships into Australia. It appears to AusBulk that container shipping lines do not seem willing to commit to Port Adelaide calls because of channel restrictions. Some container vessels would have a draft that would preclude them from entering Outer Harbor without a deeper channel and others may need to wait for tidal assistance to call into or leave port. Waiting for tidal assistance has a minimal impact on bulk commodity vessels, but a major impediment for container shipping lines that sail to fixed time schedules.

It is known that Flinders Ports is actively considering the additional investment associated with dredging the Port Adelaide outer channel to 14 metres, which may have an additional cost of $60 million. AusBulk believes that the investment associated with 14 metres dredging is essential for the container terminal to remain competitive.

The risk for grain and other users is that the 14-metre channel investment may be sought to be recouped widely across all port users. Increased fees may be applied to vessels for whom the additional depth is of no utility, or whom may get only a margin savings of eliminated waiting time to sail which has limited commercial value.

If this upgrade is conducted it will be possible to at least part-load post-panamax grain vessels. However, given the wide range of commodities grown in Port Adelaide zone and the high number of quality types segregated, the number of post panamax vessels that will be loaded in Port Adelaide is projected to be small (see South Australian Deep Sea Ports Report - January 1999).

AusBulk contends that should Port Adelaide outer channel be upgraded to 14 metres, recovery of this investment should be applied only to container ships and any other bulk commodity ships that are actually taking advantage of the deeper channel.

AusBulk believes continued price regulation is required to protect against substantial cross subsidisation of new port development costs by port users who receive no or limited benefit from that investment, or to prevent incremental charges for new infrastructure exceeding the value of customer benefits.

4. First Pricing Determination

The FPD under which Flinders Ports and AusBulk currently operates was determined by the Minister under the MSA Act, set at rates prevailing under SAPC prior to divestment. The FPD rates have not been set through any empirical analysis, and therefore it is not clear whether the EMS rates represent a competitive market return compared to the value of regulated assets used to deliver the EMS. Accordingly it is not transparent to users whether EMS prices are fair and reasonable.

AusBulk believes continued price regulation is required to demonstrate EMS prices are fair and reasonable.

Regulatory intensity

AusBulk believes that at this time there is a need for continued pricing regulation, although the need is somewhat case specific, while the need for continued regulation will evolve and should be reviewed periodically.

It is possible for the ESCOSA to rely on one of three disciplines for preventing rent seeking behaviour, comprising:

- market discipline of the threat of competition; or,
- behavioural undertaking by Regulated Operators; or,
- the structural solution of continued price regulation.

AusBulk believes that removal of a price regulation framework is inappropriate at this point given:

- the concentration of ownership of the Regulated Ports;
- limited prospect of competition for some ports and/or cargoes;
- the potential for cross subsidies between users; and,
- given the limited track record of the current Regulated Operators under the existing regime.

AusBulk believes that behavioural approaches to regulation are likely to be difficult to monitor and involve uncertain regulatory burden on Regulated Operators.

Accordingly it is the view of AusBulk that the structural approach of continued pricing regulation is likely to be the most effective and transparent discipline on Regulated Operators.

In making a recommendation for continued price regulation of EMS, AusBulk accepts that it will remain subject to that regulation in its operations at the Port of Ardrossan.

AusBulk looks forward to progressing and concluding these issues with the ESCOSA.

Yours sincerely,

MICHAEL NICOLAI
DEPUTY CHIEF EXECUTIVE