



3 November 2003

FINAL REPORT

Summary

The Essential Services Commission of South Australia (ESCOSA) has drawn its final conclusions in its review of price regulation of Essential Maritime Services in Proclaimed Ports, as is required under the *Maritime Services (Access) Act 2000* (MSA Act).

The two-stage review began with the release of the Discussion Paper “Should Price Regulation Continue?” in November 2002. Seven submissions were received in response. In May 2003, ESCOSA released a Progress Report and six submissions were received in response. In August 2003 ESCOSA released a Draft Report and eight submissions were received in response.

[Those earlier reports, and the Final Report, are available on the ESCOSA website at: www.escosa.sa.gov.au.]

The Essential Maritime Services to which price regulation applies at Proclaimed Ports are (mostly) the basic infrastructure services a ship operator or cargo importer/exporter (consignee / shipper) needs when using a port, such as channels, navigational aids, berths and wharves, but they exclude pilotage, towage and stevedoring. They are defined in the MSA Act as:

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

The first and third definitions relate to shipping services charged to the ship operator; the second relates to cargo services charged to the shipper.

There are seven Proclaimed Ports, as listed below.

? Port Adelaide	? Port Lincoln
? Port Giles	? Thevenard
? Wallaroo	? Ardrossan
? Port Pirie	

Flinders Ports Pty Ltd operates the first six ports. AusBulk Ltd operates the port at Ardrossan. These two companies are the “regulated operators” for the purposes of ports regulation. Price regulation began on 31 October 2001, following privatisation of the first six ports¹, which were formerly owned by the SA Ports Corporation.

The first stage of the review process looked at whether price regulation should continue. Based on criteria derived directly from the legislative objectives, ESCOSA concluded that there are sufficient grounds to continue price regulation of Essential Maritime Services, but noted that the grounds vary between services, cargoes and even customers. ESCOSA’s key concerns surround bulk grain cargoes, as these tend to have fewer or no viable alternatives.

While ESCOSA has identified the potential for regulated operators to misuse market power in a way that deprives port customers of sharing in the benefits of efficiencies in port operations, ESCOSA has also recognised that Essential Maritime Services generally form only a small proportion of costs in the context of supply chains and cargo values. Accordingly, while Essential Maritime Services may present a potential opportunity for the exercise of market power, ESCOSA has formed the view that the effects on economic efficiency of any misuse in this area would be limited. ESCOSA has also recognised that many port customers have reached commercial agreements for port use with the regulated operators, involving a variety of price and service combinations. ESCOSA would not wish to hinder such activity.

The second stage of the review process looked at which form of price regulation should apply. An appropriate form is one that addresses the concerns identified in the first stage.

ESCOSA has concluded that a more light-handed form of price regulation would be most appropriate for Essential Maritime Services. This will focus on removing the incentive for regulated operators to earn excess profits from that subset of customers over whom they may be able to exercise market power without applying undue regulation in other areas, and without unduly hindering the striking of commercial agreements between the parties.

¹ An additional port, Klein Point, was also sold but it is not a Proclaimed Port.

A New Form of Ports Price Regulation

The new form of price regulation for Essential Maritime Services will involve 2 parts:

1. price monitoring of Essential Maritime Services for a three year period; and
2. negotiate/arbitrate arrangements in relation to grain berths² – achieved by extending the existing Ports Access Regime to cover cargo services at these berths.

Price monitoring allows regulated operators and their customers the freedom to negotiate commercial agreements, while the threat of re-regulation³ provides an ongoing deterrent against the misuse of market power by regulated operators.

The extension of the negotiate/arbitrate model of the Ports Access Regime will provide ongoing regulatory support to commercial negotiations in the areas subject to ESCOSA's greatest market power concerns (note that a negotiate/arbitrate model serves to facilitate access on fair commercial terms – it does not exist to hand out access).

ESCOSA will establish price monitoring on the basis of a three-year review cycle, aligning it with the Ports Access Regime cycle. Note that this new form of price regulation is dependent upon the Ports Access Regime continuing for a further three years beyond 31 October 2004. Whether the Ports Access Regime should continue is subject to a separate review by ESCOSA beginning in November 2003 and due for completion in March 2004. Should it happen that the Ports Access Regime does not continue following its review⁴, then ESCOSA would instead adopt an alternative price monitoring regime, which is outlined in the Final Report.

Implementation

Assuming the Ports Access Regime continues, and only after that is known, ESCOSA will recommend to the South Australian Minister for Infrastructure that the government extend that regime to cover the (cargo) service of “providing port facilities for loading or unloading vessels” at the grain berths identified in that regime. (The relationship between price regulation and the access regime is explained further in the Final Report). Note that the South Australian Government has indicated a general agreement with this approach (the South Australian Government submission is reproduced in Attachment 1 to Appendix A of the Final Report).

² Actually berths *adjacent* to certain bulk loaders – some of which are used for more than grain.

³ That is, the subsequent introduction of tighter, more intrusive regulation.

⁴ The review of the Ports Access Regime involves some issues that have not been addressed here.

ESCOSA will then make a price determination under Part 3 of the Essential Services Commission Act 2002, replacing the First Pricing Determination (FPD). This would set out a price monitoring regime across the full suite of Essential Maritime Services:

- ? allowing regulated operators to set their own prices for Essential Maritime Services from 31 October 2004 to 30 October 2007;
- ? obliging regulated operators to post a comprehensive (in coverage, not necessarily in size) price list (of their own design) for Essential Maritime Services throughout that period;
- ? allowing regulated operators and their customers to enter commercial arrangements involving price/service levels and structures that differ from the posted price list if both parties agree, or, for example, if the service demanded requires additional investment;
- ? obliging regulated operators to inform ESCOSA of the posted prices, any changes as may occur to them from time to time, and (on a confidential basis) in summary form, any other prices at which Essential Maritime Services are provided;
- ? allowing ESCOSA to monitor and report on Essential Maritime Services prices and associated performance through that period, including benchmarking against other relevant ports as appropriate; and
- ? having ESCOSA conduct a subsequent review to determine whether price regulation is warranted beyond 31 October 2007, and if so, in what form (the review would begin in 2006).

If the subsequent review found that the regulated operators had been, for example, misusing market power, then ESCOSA would be able to introduce new price regulation of any form from 31 October 2007. This provides a strong incentive for regulated operators to steer clear of misusing market power, as ESCOSA may, for example, choose to include clawback provisions in any future form of price regulation. The broad criteria for any decision to introduce new price regulation following the subsequent review are discussed below.

In accordance with the requirements of the FPD, the new price determination will also state that a regulated operator cannot implement a price increase in connection with an Excluded Asset (being the Port Giles, Wallaroo and Outer Harbour assets established or extended as per the ports sale). A breach of this obligation would be a contravention of the price determination.

ESCOSA will continue to collect financial and operational performance data from the regulated operators throughout the period stated above under the two existing Ports Industry Guidelines, which may be amended to reflect the new form of price regulation.

ESCOSA may publish summary performance reports periodically to inform port customers and the community about the performance of the regulated operators. ESCOSA expects to develop and include benchmark measures in these reports that would allow some comparison with ports elsewhere, and will work in collaboration with the regulated operators, port customers, and others, in developing these reports.

Subsequent Review

Under the new form of price regulation, ESCOSA will conduct a subsequent review of price regulation of Essential Maritime Services. In that review ESCOSA will determine whether price regulation should continue from 31 October 2007, and if so, in what form. ESCOSA expects that the review will begin in late 2006.

ESCOSA expects that key criteria for that review will involve observations of the actual behaviour of the regulated operators under the price monitoring regime. In particular:

- ? the timing and frequency of changes to the posted price list;
- ? the degree of transparency displayed;
- ? the incidence and outcome of disputes under the Ports Access Regime;
- ? successful negotiations;
- ? trends in service quality;
- ? price changes – in absolute terms and relative to other ports (noting, for example, that ESCOSA does not necessarily accept CPI as an appropriate basis for ongoing price rises);
- ? revenue / volume growth;
- ? levels of, and changes in, financial performance; and
- ? pricing patterns at regional ports – noting that some regional port users face ongoing cost and service pressures. ESCOSA will review the price and service performance at regional ports closely as this will have a major bearing on the conclusions of the subsequent review.

While the review will look at (then) past behaviour, ESCOSA expects that it will also consider whether other structural changes affect the outlook and hence, for example, the ongoing potential for misuse of market power. Upgrades at Ardrossan and other ports, rail infrastructure improvements that increase effective Victorian port competition, new port developments, etc are examples of the type of structural developments that ESCOSA expects it will consider.

These comments are provided for guidance. However, ESCOSA will not limit its future self in terms of what specific issues the subsequent review may cover.

Transitional arrangements

ESCOSA is aware that some port customers have contracts involving discounts or rebates linked directly to the prices established under the First Pricing Determination. ESCOSA will require each regulated operator to write to each of these contracted customers by the end of November 2003, to alert them to this change. This will ensure that those customers have had advance notice of the change in regulation (almost one year), and hence an opportunity to renegotiate/restructure their contracts.