

REVIEW OF VICTORIAN PORTS REGULATION

Draft Report

May 2014



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GLOSSARY

Berth utilisation	The proportion of time that a berth is in use. That is, a ship being moored or secured at a berth for loading or discharging cargo.
Berths	The waterfront edge of a wharf in which a vessel is secured to load or discharge cargo.
Break bulk	Loose, non-containerised cargo stowed directly into a ship's hold. Typically steel and timber products but also items too large to fit into a shipping container.
Buoys	An anchored float serving as a navigation aid for ships.
Cargo throughput	The volume of cargo loaded or unloaded through a port.
Channel	The part of the body of water within the port waters of Melbourne of sufficient depth to be used by commercial vessels for navigation that is either marked with navigation aids or as marked on the appropriate nautical chart.
Channel Deepening Project	Completed in late 2009, this project delivered a new draught depth of 14 metres at the Port of Melbourne.
Channel fees	The charge for the provision of channels for use by specified commercial vessels.

Container	A steel or aluminum frame forming a box in which cargo can be stowed, meeting International Standard Organization (ISO)-specified measurements, fitted with special castings on the corners for securing to lifting equipment, vessels, chassis, rail cars, or stacking on other containers. Containers are measured in TEU.
Dolphin	A bollard, or pile, that is not fixed to the berth and is used for mooring ships.
Draught	The depth of a ship while in the water. Measured as the vertical distance between the waterline and the lowest edge of the keel.
Draught constrained	A ship with an actual draught that exceeds the maximum draught of the shipping channel, and therefore requires tidal assistance to navigate the shipping channels or cannot enter the channel in its fully loaded condition. This definition is based on actual draught and not summer draught, which is the maximum height taking into account the worst-case scenario of weather conditions.
Dry bulk	Loose, mostly uniform cargo, such as bulk agricultural products, coal, fertilizer, and ores that are transported in bulk carriers.
Gross Tonnage (GT)	A unit-less index related to a ship's overall internal volume. Is often used as a measure to deterring the cost of port, pilotage and towage fees
Liquid bulk	Cargo that must be contained in its liquid form. This includes petroleum, LNG, gasoline, chemicals and liquid edibles.
Liner shipping	Liner shipping is the service of transporting goods by means of high-capacity, ocean-going ships that transit regular routes on fixed schedules.

Mass tonnes	A measure of weight, used to measure cargo volumes.
Non-containerised	Bulk cargoes that are loaded and unloaded directly to and from a ship and are not transported in containers. See Breakbulk.
Non-liner shipping service	A ship that has no fixed routing or itinerary or schedule and is available at short notice for charter by a user to transport cargo from port to port.
On - window	the scheduled arrival of vessel
Off - window	the unscheduled arrival of vessel
Pilotage	The act of assisting the Master of a vessel in navigation when entering or leaving a port.
Port Capacity Project	Landside development in the Port of Melbourne which includes the redevelopment of Webb Dock and infrastructure upgrades at Swanson Dock to meet forecast container and automotive trade growth.
Port customers	Those parties who directly operate in the port and conduct: <ul style="list-style-type: none"> • Vessel operations, ie. shipping lines; • Vessel handling services, ie. pilotage, towage, line handling services; • Cargo marshalling and storage activities, ie. container stevedores, bulk products terminals (liquid or dry), break bulk stevedores.
Port users	Those who transact business through the port and typically are freight forwarders, land transport providers or vertically integrated logistic service providers and cargo owners.

Pre-delivery inspection	A standard procedure carried out where imported motor vehicles are fitted with compliance plates and custom options in preparation for their delivery to dealerships.
Prescribed services	The services specified in section 49(c) of the Port Management Act 1995.
Price Monitoring Determination 2010	The Price Monitoring Determination for the Victorian Ports made by the Essential Services Commission on 4 May 2010 for the regulatory period 2010-15.
Revenue tonnes	One revenue tonne equals the weight in tonnes or the volume in cubic metres, whichever is higher in terms of freight revenue.
Ship turnaround time	The time taken for a ship to berth, unload, load and depart the berth. The average ship turnaround time is calculated as the total hours that berths are utilized divided by the number of ships visiting the port.
Shipping activity	Ship visits to each port, including the number of visits and the gross tonnage of vessels.
Shipping line	Refers to a business that operates or charters ships that it may or may not own.
TEU	Twenty-Foot Equivalent Unit, the standard shipping container unit of measurement.
Vessel Traffic System	A marine traffic monitoring system that manages port traffic, coordinates port services and disseminates relevant information. VTS operators use a range of equipment to monitor ship movements including radar tracking, automatic identification systems, and other radio communications, closed circuit television and mobile and conventional telephones.

Wharfage fees

The charge per unit of quantity, volume or weight of cargo that an owner of a facility (terminal or port) charges for the movement of cargo through that facility.

2009 Review

The Commission's review of prescribed services at the Victorian ports undertaken in 2009.

ACRONYMS

AAT	Australian Amalgamated Terminals Pty Ltd
ABA	Australian Bulk Alliance
ACCC	Australian Competition and Consumer Commission
BCA	Business Council of Australia
BITRE	Bureau of Infrastructure, Transport and Regional Economics
CCA	Competition and Consumer Act 2010
CDP	Channel Deepening Project
CIRA	Competition and Infrastructure Reform Agreement
COAG	Council of Australian Governments
CPI	Consumer Price Index
EBIT	Earnings before interest and tax
ESC Act	<i>Essential Services Commission Act 2001</i>
ESCOSA	Essential Services Commission of South Australia
EOI	Expression of Interest
GFC	Global Financial Crisis
MPT	Melbourne Port Terminal
NAR	National Access Regime

NPV	Net present value
PCC	Pure Car Carrier
PDI	Pre-delivery inspection
PHDA	Port Hastings Development Authority
PIC Index	Port Interface Cost Index
PLF	Port Licence Fee
PMA	<i>Port Management Act 1995</i>
PMD	Price Monitoring Determination
PoMC	Port of Melbourne Corporation
PPS	Pricing Policy Statement
PPSP	Port Phillip Sea Pilots
ROA	Return on assets
RORO	Roll-on Roll-off
TDIER	Tasmanian Department of Infrastructure, Energy and Resources
TEU	Twenty-foot equivalent units
VCAR	Victorian Channel Access Regime
VRCA	Victorian Regional Channel Authority
VTS	Vessel Traffic Services

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EXECUTIVE SUMMARY

INTRODUCTION

The Essential Services Commission (the Commission) is responsible for the economic regulation of the Victorian ports sector under the *Port Management Act 1995* (the PMA). The PMA identifies which port services are prescribed for regulation by the Commission.

The prescribed services currently subject to economic regulation by the Commission are:

- shipping channels in Port of Melbourne waters, including the shared channels used by ships bound either for the Port of Melbourne or the Port of Geelong
- berths, buoys or dolphins for the berthing of vessels carrying container or motor vehicle cargoes in the Port of Melbourne and
- short-term storage or cargo marshalling facilities for the loading or unloading of vessels carrying container or motor vehicle cargoes in the Port of Melbourne.

Under the *Essential Services Commission Act 2001* (the ESC Act), the Commission has price regulation powers in respect of the prices charged for the provision of, or in connection with, prescribed services. The current form of price regulation in place for prescribed services is a price monitoring regime.

Under the PMA, every five years, the Commission must conduct a review and make a recommendation to the Minister administering the ESC Act (the Minister for Finance) whether the prescribed services should continue to be subject to price regulation and if so, the form of that price regulation. The Commission must also consider (in its final report) any transitional matters if it recommends a change to the form of regulation.

CURRENT REGULATORY REGIME

The current regulatory regime is a price monitoring regime which is given effect through the Price Monitoring Determination for Victorian Ports 2010 (the 2010 PMD).¹ The 2010 PMD sets out the obligations on the Port of Melbourne Corporation (PoMC) regarding the pricing and reporting of its prescribed services.

Price monitoring is a light-handed form of regulation whereby the Commission monitors prices for the prescribed services at the Port of Melbourne. Under the current regulatory regime, the Commission has no power to set prices or direct the PoMC to charge prices. Box 1 summarises the current regime.

BOX 1 CURRENT REGULATORY REGIME

The 2010 PMD requires the Port of Melbourne Corporation (PoMC) to:

- prepare a pricing policy statement (PPS) setting out its pricing approach, including how it will calculate its reference tariffs (prices) and how it applies pricing principles and other economic principles or commercial considerations (clause 6)
- publish a reference tariff schedule setting out its prices for prescribed services (clause 2.1)
- submit certain business and financial information to the Commission for monitoring purposes (clause 3).

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¹ Available on the Commission's website: <http://www.esc.vic.gov.au/Ports/Implementation-of-the-new-ports-price-monitoring-r/publications>

BOX 1 (CONTINUED)

Under the PMD 2010 the Commission's role is to:

- issue an Information Notice to PoMC setting out the business and financial information it must submit to the Commission for monitoring purposes (section 3.5 of the PMD)
- publish a ports monitoring report on an ad hoc basis (there is no requirement to publish a report annually) (section 4.1) and
- administer the PMD.

THE COMMISSION'S APPROACH TO THIS REVIEW

The Commission's overall approach to determining whether arrangements currently in place for the economic regulation of prescribed services at the Port of Melbourne continue to be appropriate has involved the following approach.

Firstly, determining the extent of market power held by PoMC (chapter 3) and then assessing the available evidence to ascertain whether PoMC has exercised that market power (chapter 4).

Secondly, having formed a view on PoMC's market power, we determine what (if any) form of economic regulation should apply. To assist our assessment as to the appropriate form of regulation to apply, we assess the existing regulatory framework (chapter 5) as set out in the 2010 PMD — we do this against the criteria of transparency, effectiveness, proportionality and accountability. In undertaking this assessment, we also consider changes that have occurred in the market since the Commission's last review in 2009.

Finally, based on these assessments, we propose a new monitoring framework (chapter 6) and make recommendations regarding the regulation of prescribed services and the form of regulation to apply (chapter 7).

Our assessments of these matters are further explained below.

MARKET POWER ASSESSMENT

An assessment of the extent of market power held by PoMC in the provision of the prescribed services at the port is the first step in determining if economic regulation of these services continues to be necessary.

The Commission's market power assessment (see chapter 3) entails analysis of the potential for competition in the provision of the prescribed services within defined markets for channel services, container and motor vehicle services. This analysis takes into account the following factors:

- the existence of barriers to entry to the market — barriers to entry are obstacles to new market entry by alternative providers and may include physical, economic or regulatory barriers
- competition between ports — this is the potential for rivalry between ports in providing port services to customers, including whether there are any other services which could be used in place of the prescribed services by PoMC
- countervailing market power — countervailing market power exists when a monopoly service provider's customer(s) also hold some degree of market power, strengthening the customer's bargaining position with the PoMC. For example, this may occur if the customer is a large firm or the sole user of port facilities. It may also occur if the customer has the ability and/or incentive to use alternative port services or influence its own customers to do so.

Where there are physical, economic, or regulatory barriers to entry, little or no scope for competition or viable alternatives for the service and a lack of effective countervailing power among customers, it is likely a service provider will have potential market power.

The Commission's findings regarding PoMC's market power in relation to the existing prescribed services are set out in Box 2.

BOX 2 DRAFT FINDINGS ON MARKET POWER

Channels

PoMC has substantial market power in relation to the channels it manages at the Port of Melbourne due to physical, operational and regulatory barriers to entry for an alternative channel service provider. It would not be economically feasible to duplicate these channels. The potential for port customers and users to utilise other Victorian or Australian ports is possible. However, it is unlikely due to the cost of land transport for moving cargoes between capital city ports.

The exercise of any countervailing power by port customers is significantly constrained by the fact that omitting a call at the Port of Melbourne may not be a commercially realistic option for most major liner shipping services to and from Australia.

In relation to the shared channels, while PoMC has the capacity to discriminate in favour of its customers in providing access to the shared channels, in practice, the actual competition between the ports (Geelong and Melbourne) is limited as they are not competing in the same markets for the majority of their cargoes.

Port services to container trades

PoMC holds significant market power in the provision of prescribed port services to containerised trade because of the lack of viable substitutes for its services and the lack of countervailing market power held by its customers sufficient to constrain PoMC's market power.

There are also high barriers to entry to the market for port services to container trades — there are significant costs associated with the construction of a container terminal of sufficient scale to compete with PoMC. In the short to medium term, and certainly in the five year period covered by the next regulatory period, the Port of Hastings will not be a new entrant into the market for port services provided to containerised trade.

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BOX 2 (CONTINUED)

Port services to motor vehicle trades

PoMC holds substantial market power in the provision of prescribed port services to the motor vehicle trade given limited scope for competition from other ports and locational advantage of the Port of Melbourne as a point of entry into the broader Melbourne market for motor vehicles.

While there are lower barriers to entry to the infrastructure services required for the motor vehicle trades, new market entry is unlikely in the short to medium term due to the proposed increase in capacity at the Port of Melbourne (the Webb Dock development).

PRESCRIBED SERVICES

In light of the Commission's assessment of PoMC's market power in relation to prescribed port services, the Commission is proposing that the current prescribed services continue to be subject to economic regulation. The Commission's draft recommendation on prescribed services is set out in Box 3.

BOX 3 DRAFT RECOMMENDATION ON PRESCRIBED SERVICES

The Commission's draft recommendation is that the current prescribed services continue to be subject to economic regulation and include:

- shipping channels in Port of Melbourne waters, including the shared channels used by ships bound either for the Port of Melbourne or the Port of Geelong
- berths, buoys or dolphins for the berthing of vessels carrying container or motor vehicle cargoes in the Port of Melbourne and
- short-term storage or cargo marshalling facilities for the loading or unloading of vessels carrying container or motor vehicle cargoes in the Port of Melbourne.

ASSESSMENT OF POMC'S PERFORMANCE AND THE CURRENT MONITORING FRAMEWORK

The Commission has found that PoMC holds substantial market power in relation to the current prescribed services. The nature of the regulatory problem in relation to PoMC can best be characterised as the potential for PoMC to misuse its substantial market power with associated adverse consequences for economic efficiency. As a result, there is a case for economic regulation.

However, the choice of the form of economic regulation (light-handed or heavy-handed) to apply needs to be tempered by the extent to which PoMC has actually exercised its substantial market power. The Commission has assessed the available evidence regarding movements in the prices, service quality and profitability of PoMC's prescribed services to ascertain whether there has been any misuse of PoMC's market power in relation to the provision of prescribed services. It is within this context that the Commission makes recommendations regarding the form of regulation to apply.

The available evidence indicates that price movements have been in excess of CPI growth but not substantially so, with the exception of the impact due to the introduction of the Port Licence Fee. Reported service quality outcomes have been stable or improved and reported profitability does not appear to have been excessive.

The Commission's finding regarding the exercise of PoMC's market power is in Box 4.

BOX 4 DRAFT FINDING — ASSESSMENT OF THE EXERCISE OF MARKET POWER BY POMC

The Commission considers that the observed movements in PoMCs prices, service quality and profitability in relation to its prescribed services over the current regulatory period indicate that PoMC is not misusing its market power.

To assist in determining the appropriate form of regulation to apply, the Commission has also assessed the the existing regulatory framework (chapter 5) based on the following assessment criteria:

- Transparency — is the objective and operation of the price monitoring framework clear?
- Effectiveness — is the framework appropriately addressing the regulatory problem?
- Proportionality — are the elements of the framework proportional to the nature of the regulatory problem, including the obligations currently placed on PoMC under the framework?
- Accountability — does the framework provide robust governance arrangements, which ensure the integrity of operation of the regime?

This assessment considered how effective the current regulatory framework has been in constraining PoMC's exercise of its market power in providing the current prescribed services. The Commission's findings regarding the assessment of the current monitoring regime are in box 5.

BOX 5 DRAFT FINDINGS — ASSESSMENT OF THE CURRENT REGIME

The Commission's draft findings regarding the operation of the existing price monitoring framework are as follows:

- Transparency – the Commission considers that the transparency of the price monitoring framework could be improved by providing greater clarity regarding the objectives and operation of the framework and by focussing more on a self-reporting regime

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BOX 5 (CONTINUED)

- Effectiveness – the price monitoring framework is likely to have contributed to the Commission’s findings based on the available evidence that PoMC has not misused its substantial market power in the current regulatory period. There is no evidence to warrant a more heavy-handed form of regulation being applied to PoMC at this time
- Proportionality – the Commission considers that there is scope for a reduction in the regulatory burden imposed on PoMC through the removal of the requirement for PoMC to submit business and financial information as well as prepare annual regulatory accounts for the Commission, while still maintaining the effectiveness of the price monitoring form of regulation
- Accountability – the Commission considers that a modified approach involving self-reporting of output-focussed key performance indicators would enhance PoMC’s accountability in relation to the pricing, service quality and profitability of its prescribed services

FORM OF REGULATION TO APPLY

Based on its assessment of market power, the available evidence of movements in the prices, service quality and profitability of PoMC’s prescribed services, and an assessment of the current regime, the Commission considers that the continuation of a light-handed form of economic regulation, namely price monitoring, is appropriate at this time. There is no evidence to warrant a more heavy-handed form of regulation being applied to PoMC at this time

A light-handed approach is consistent with the nature of market power issues identified in relation to PoMC’s provision of prescribed services.

Accordingly, the Commission’s draft recommendation (Box 6) is that the form of regulation to apply to the prescribed services is a price monitoring framework.

BOX 6 DRAFT RECOMMENDATION ON FORM OF REGULATION

The Commission recommends that a light handed form of economic regulation (namely price monitoring) apply to prescribed services.

PROPOSED NEW MONITORING FRAMEWORK

Based on an assessment of the current regime against the above criteria, the Commission considers that further refinements can be made to improve the price monitoring framework.

As part of the assessment of the price monitoring to apply, the Commission has considered the nature of the reporting requirements imposed on PoMC under the 2010 PMD, including the requirements in relation to Reference Tariff Schedules and Business and Financial Information.

The Commission has proposed some refinements to the existing price monitoring framework established in the 2010 PMD, which it considers promotes greater transparency and reflects a better balance in the costs and benefits of regulation.

These proposed changes are designed to ensure the price monitoring framework is effective while minimising the regulatory burden on PoMC. The proposals will also have the effect of reducing PoMC's regulatory administrative and compliance costs by removing the requirement on PoMC to submit annual regulatory accounts to the Commission and instead self-report on price, service quality and profitability indicators.

The Commission's draft recommendations for the new price monitoring framework are summarised in Box 7 below.

BOX 7 DRAFT RECOMMENDATIONS – NEW MONITORING FRAMEWORK

OBJECTIVES OF PRICE MONITORING FRAMEWORK

- The Commission proposes that the Ports Monitoring Determination (PMD) include a statement of the objectives of the regime, namely:
 - to prevent the exercise of substantial market power by PoMC, including engaging in monopoly pricing in relation to its prescribed services, through price monitoring
 - to enable the Commission, port users and customers and other stakeholders to be informed about the prices and performance associated with the provision of prescribed services.

POMC'S PRICING OBLIGATIONS

The Commission proposes that:

- PoMC prepare and seek the Commission's approval of a new Pricing Policy Statement (PPS) at the commencement of the next regulatory period and place the approved PPS on its website
- PoMC continue to place its annual Reference Tariff Schedule on its website
- PoMC prepare and place the weighted average annual changes in each of its wharfage and channel fees applied to prescribed services on its website

In relation to these pricing obligations, the Commission proposes that PoMC:

- clearly distinguish between its prescribed and non-prescribed service wharfage and channel fees in the Reference Tariff Schedule
- bring the existing overarching, general pricing and shared channel pricing principles in the PPS into one set of pricing principles applicable to the development of wharfage and channel fees for prescribed services
- provide a full explanation of the underlying basis of prescribed service wharfage and channel fees, including the cost allocation methodology adopted in the PPS

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BOX 7 (CONTINUED)

- explain the basis of the recovery of the Port Licence Fee across all trades and
- clearly identify and explain the underlying pricing methodology for any other charges applied to the provision of prescribed services.

SERVICE QUALITY

- The Commission proposes that PoMC publish the following service quality indicators on its website
 - % vessels delayed (berth not available)
 - % of port users reporting satisfaction in customer surveys.

PROFITABILITY

- The Commission proposes that PoMC publish the Rate of Return earned on each of its prescribed services on its website.

CONSULTATION WITH PORT USERS

- The Commission proposes that PoMC provide to the Commission an annual summary of stakeholder views and outcomes of all of its consultation processes in relation to its prescribed services, including all Reference Tariff Schedule consultations. The Commission would provide relevant commentary in its annual report.

REGULATORY REPORTING

The Commission proposes that:

- PoMC will no longer prepare and report annual regulatory financial accounts in relation to its prescribed services to the Commission
- a self-reporting regime will be introduced, whereby PoMC will publish the price, service quality and profitability information identified above on its website and in its annual report on an annual basis. The publication of this information should be sufficient to enable the objectives of the regime to be achieved.

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BOX 7 (CONTINUED)

COMPLAINT NOTIFICATION REQUIREMENT

The Commission sees merit in the introduction of a complaints notification requirement.

The Commission envisages that this notification requirement will include the following elements:

- When a port user or customer (or potential user or customer), or industry association, notifies PoMC of a complaint in writing, PoMC must notify the Commission of this occurrence as soon as reasonably practicable
- PoMC must advise the Commission of its response to the complaint and any steps taken to address the issue raised
- The port user or customer may also notify the Commission in writing of any concerns
- The Commission would keep a record of and provide any relevant commentary in its Annual Report

The complaints notification requirement would not give the Commission any role in complaints investigation or dispute resolution. Rather, it would ultimately assist the Commission to stay informed about emerging issues of concern at the port and form a view about the appropriate nature of economic regulation, if any, that is required in the future.

The Commission welcomes feedback from stakeholders on the merits of this complaint notification requirement, including any proposed amendments or alternatives.

1 PURPOSE & INVITATION FOR SUBMISSIONS

1.1 PURPOSE OF THIS REVIEW

Under section 53 of the Port Management Act 1995 (PMA), the Commission is required to conduct and complete an inquiry (referred to as a review) into the regulation of prescribed port services every five (5) years. The Commission's previous review was in 2009.

The purpose of this review is to make a recommendation to the Minister administering the *Essential Services Commission Act 2001* (ESC Act) (the Minister for Finance) whether the prescribed services should continue to be subject to price regulation and, if so, the form of that price regulation.

The review will determine whether the arrangements currently in place for the regulation of prescribed services continue to be appropriate and, if not, how they might best be amended to meet the objectives of the ESC Act and the PMA.

Specifically, under section 53 of the PMA, the review must address the following matters:

- whether or not prescribed services should be subject to price regulation and the form of that regulation and
- any transitional matters if the ESC recommends changes to the form of regulation.

This review is conducted in the context of existing legislative, regulatory and ownership arrangements. It is beyond the scope of this review to consider possible future arrangements.

1.2 REVIEW PROCESS AND TIMETABLE

The Commission published a Notice of Inquiry on 6 February 2014 setting out the purpose and scope of the review and requesting submissions from interested stakeholders by 14 March 2014. Some stakeholders requested an extension of time to make a submission.

The Commission has sought and received submissions from interested stakeholders, and these submissions have been taken into account in the preparation of this Draft Report.

The Commission received two public submissions in response to its Notice of Inquiry:

- The Port of Melbourne Corporation (PoMC) and
- The Tasmanian Department of Infrastructure, Energy and Resources (TDIER).

In undertaking this review, the Commission has also consulted with various interested parties including:

- The Victorian Department of Transport, Planning and Local Infrastructure
- Victorian Regional Channels Authority
- Port of Melbourne Corporation
- Patrick Ports
- Shipping Australia
- Asiaworld Shipping Services
- Mitsui OSK Lines
- Mediterranean Shipping Company (Aust)
- DP World and
- The Federal Chamber of Automotive Industries.

1.3 INVITATION FOR SUBMISSIONS TO THIS DRAFT REPORT

The Commission is now seeking stakeholder submissions on this Draft Report. **Submissions are due on 6 June 2014.** Submissions may be sent to: portsreview2014@esc.vic.gov.au

All submissions will be published on the Commission's website as per the Commission's charter of consultation and regulatory practice policy.

A public hearing will be held at the Commission's offices on Monday 2 June 2014 (details available on the Commission's website). The public hearing is an opportunity for stakeholders to raise any matters relevant to the review.¹ At this hearing, a presentation will be made by representatives of the Commission and by key stakeholders.

Following public consultation on this Draft Report, a Final Report with the Commission's final recommendations will be provided to the Minister for Finance on 30 June 2014.

Questions about this 2014 ports review may be directed to Dominic L'Huillier Senior Regulatory Manager of the Commission's transport branch on 03 9032 1365.

1.4 STRUCTURE OF THIS REPORT

The structure of this report is as follows:

- Chapter 2 provides a brief overview of the Port of Melbourne Corporation (PoMC), including its trade activity at the port, throughput and recent capacity expansion initiatives at the port.
- Chapter 3 assesses the extent of PoMC's market power in the provision of prescribed services. It does not consider other services provided by the port that

¹ The *Port Management Act 1995* requires the review to be conducted in accordance with Part 5 of the ESC Act, although the sections relating to Ministerial referrals do not apply. Section 43(4) (a) of the ESC Act requires a public hearing be held.

are not currently subject to economic regulation. Market power is assessed with reference to the following criteria: the existence of barriers to entry to the market; competition between ports; and the extent of any countervailing power held by port customers and users.

- Chapter 4 analyses trends in the prices, service quality and profitability of PoMC's prescribed services over the current regulatory period.
- Chapter 5 assesses the current monitoring regime (the Ports Monitoring Determination (2010 PMD)) with reference to the criteria of: transparency, effectiveness, proportionality and accountability
- Chapter 6 sets out the proposed new monitoring regime recommended to apply for the next regulatory period having regard to the Commission's findings regarding market power and PoMC's performance
- Chapter 7 summarises the Commission's draft recommendations.

Appendices

- Appendix A provides an overview of the facilities and users at the Port of Melbourne
- Appendix B summarises the main elements of the current regulatory regime, that is the price monitoring framework as provided by the 2010 PMD
- Appendix C identifies the legislative objectives of the *Essential Services Commission Act 2001* (ESC Act) and *Port Management Act 1995* (PMA)
- Appendix D provides an overview of the relevant principles of the Competition and Infrastructure Reform Agreement (CIRA)
- Appendix E provides a summary of economic regulation in other major Australian ports
- Appendix F provides a summary of the main forms of economic regulation.

2 THE PORT OF MELBOURNE

This chapter provides a brief overview of the Port of Melbourne Corporation (PoMC), including its trade activity at the port, throughput and recent capacity expansion initiatives at the port.

2.1 THE PORT OF MELBOURNE

PoMC is a Government-owned statutory corporation, operating as the developer and strategic manager of the port.¹

PoMC provides shipping-related services which include:

- vessel access through the provision of shipping channels
- vessel anchorages
- Vessel Traffic Services (VTS)²
- oversight, through the Harbourmaster, of the ship handling services such as pilotage, towage and line handling/mooring.³

¹ PoMC operates as a 'landlord' port authority with private operators managing cargo handling operations under lease agreements with PoMC.

² VTS is a marine traffic monitoring system that manages port traffic, coordinates port services and disseminates relevant information. VTS operators use a range of equipment to monitor ship movements including radar tracking, automatic identification systems, and other radio communications, closed circuit television and mobile and conventional telephones.

³ Pilotage is the act of assisting the Master of a vessel in navigation when entering or leaving a port. Towage is the service of towing ships or vessels using tugs. Line handling/mooring involves handling vessels' mooring lines.

Cargo handling and marshalling services include berthing of ship loading and unloading of cargo. Cargo handling at the port is generally undertaken by private operators under lease arrangements with PoMC.

Pilotage, towage and line handling services are not provided by PoMC directly, but are delivered by private operators at the port under an agreement with PoMC. Port Phillip Sea Pilots (PPSP) is the sole provider of pilotage services to the Victorian ports of Melbourne, Geelong and Port of Hastings. While PoMC does not provide pilotage services, these operations are controlled by the actions of PoMC's harbour control system and its priorities for vessel movement.

There are two commercial towage operators in the Port of Melbourne — Svitzer Australasia and PB Towage. There are three companies that provide mooring services at the port: 1-Port, Ausport Marine and Skilled Maritime Services.

Appendix A provides a more detailed overview of port facilities and users at the Port of Melbourne.

2.2 PORT OF MELBOURNE TRADE ACTIVITY

The Port of Melbourne is a major maritime hub, handling a broad range of import and export cargoes. It handles around 2.5 million containers (TEU, twenty-foot equivalent units) annually, which is approximately 37 per cent of Australia's container trade, making the Port of Melbourne the largest container and general cargo port in Australia. Other major trades handled at the port include motor vehicles, liquid bulk, dry bulk and break bulk (see Table 2.1).

The port has around 3200 commercial ship visits annually. Total trade is in excess of 85 million revenue tonnes (35 million mass tonnes),⁴ with a value of around \$84 billion.⁵

⁴ Mass tonnes refer to the actual weight (in kilograms) of the commodity whereas revenue tonnes (the billing unit in the shipping industry) relate to the volume of the cargo (cubic metres or kilolitres) or weight of cargo, whichever is the greater.

⁵ <http://www.portofmelbourne.com/about-the-port/quick-facts> [Accessed: 24 March 2014].

All Tasmanian domestic and international container trade moves through the Port of Melbourne using shipping services.

TABLE 2.1 PORT OF MELBOURNE TRADE 2012-13

Cargo type	Throughput/Volume
Total trade	85.6 million revenue tonnes
Containers	2.51 million TEU
New motor vehicles	4.8 million revenue tonnes (370 527 units)
Liquid bulk	6.5 million revenue tonnes
<ul style="list-style-type: none"> • crude oil (imports) • petroleum product (export) 	
Dry bulk	4.4 million revenue tonnes
<ul style="list-style-type: none"> • cement, gypsum, sugar (imports) • wheat, canola and barley (exports) 	
Break bulk	4.7 million revenue tonnes

Source: Port of Melbourne.

2.3 USE OF SHIPPING CHANNELS

Table 2.2 presents data on the number and type of ship visits to the Port of Melbourne since 2008-09.

TABLE 2.2 NUMBER OF CONTAINER AND CAR CARRIER SHIP VISITS

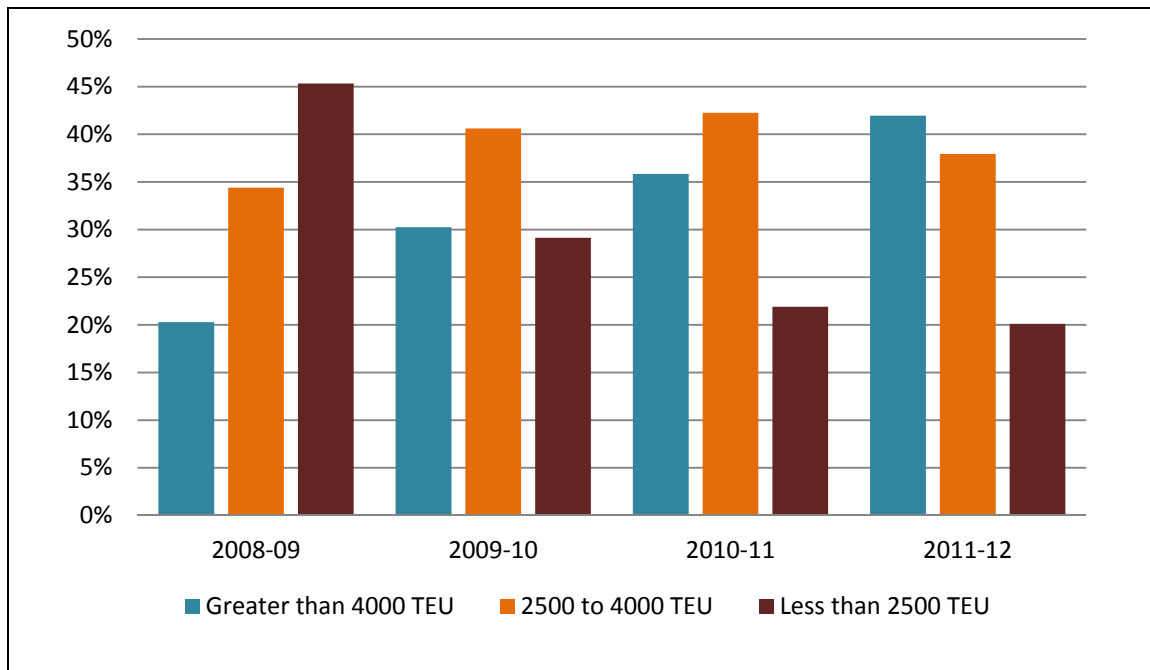
Year ending June	2009	2010	2011	2012	2013	Compound annual growth (four years) (%)
International containers	1220	1079	1234	1258	1145	-1.57
Pure car carriers	280	322	324	345	365	6.85
Other cargoes	1924	1756	1818	1776	1704	-2.99
Total (all ships)	3424	3157	3376	3379	3214	-1.57

Source: Essential Services Commission.

The total number of ship visits and international container ship visits was lower in 2012-13 than in 2008-09. The impact of the global financial crisis (GFC) and slowing in economic activity in Victoria could explain some of the fall in international container ship visits in 2009-10 (which fell by around 12 per cent). International container ship visits subsequently recovered, but again fell by around 9 per cent in 2012-13, potentially due to the imposition of the Port Licence Fee (PLF). Consequently, both international container and total ship visits at the port recorded an annual decline of 1.57 per cent over the 2008-09 to 2012-13 period.

Increasing ship sizes is another factor impacting the number of ship visits. Figure 2.1 indicates that container ship size at the Port of Melbourne has increased sharply between 2008-09 and 2012-13, which has been facilitated by the completion of the Channel Deepening Project (CDP) in 2009-10. The use of larger ships improves the efficiency of each ship visit, hence total trade demand can be met with fewer ship visits. This trend to larger ship size is an international one and can be expected to continue over the next regulatory period.

FIGURE 2.1 AVERAGE SIZE OF CONTAINER SHIPS AT PORT OF MELBOURNE



Source: Ports Australia web site

In contrast, pure car carrier ship visits appear to have been unaffected by these factors, increasing at an annual growth rate of 6.85 per cent between 2008-09 and 2012-13. This trend reflects strong sustained domestic demand for motor vehicles in Victoria (and Australia more broadly) since early 2009, with the impact of the GFC appearing to have had a limited effect on that demand.

2.4 USE OF BERTH SERVICES – CARGO THROUGHPUT

Table 2.3 presents data on the growth in cargo throughput at the Port of Melbourne.

TABLE 2.3 CARGO THROUGHPUT ('000 MASS TONNES)

Year ending June	2009	2010	2011	2012	2013	Compound annual growth (four years) (%)
International containers	38 053	35 950	41 228	44 068	42 816	2.99
Pure car carriers	14 022	17 105	17 167	19 284	20 616	10.12
Other cargoes	39 155	36 941	38 250	38 745	39 165	0.01
Total (all ships)	91 230	89 996	96 645	102 097	102 597	2.98

Source: Essential Services Commission.

Notwithstanding the decline in container ship visits at the port, PoMC's container trade throughput increased at an annual growth rate of 2.99 per cent between 2008-09 and 2012-13, due to the trend to larger container vessels at the port.

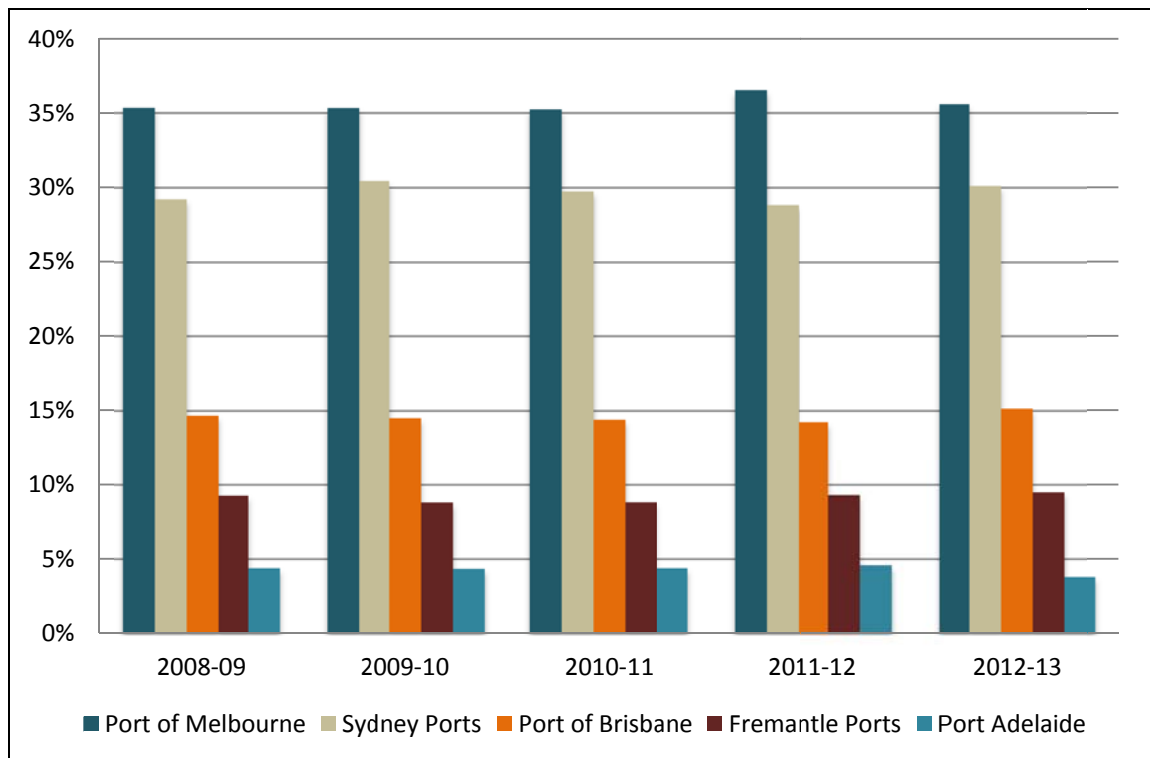
Similarly, the stronger annual compound growth for motor vehicle throughput (10.12 per cent) than for the number of Pure Car Carriers (PCC) ship visits at the port (6.85 per cent) indicates a trend to larger ship size.

2.5 CONTAINER THROUGHPUT AT PORT OF MELBOURNE

The Port of Melbourne is Australia's largest container port. It is also the only port in Victoria that handles large volumes of containers.

Figure 2.2 indicates that between 2008-09 and 2011-12, port shares of the Australian container trade have fluctuated slightly, with the Port of Melbourne retaining the largest share.

FIGURE 2.2 CONTAINER MARKET SHARES



Source: Ports Australia website

There does not appear to have been any material changes in PoMC's market share across the five-year period. Indeed, the respective container market shares of Australia's major ports have been relatively stable over this period. This stability suggests that the proportion of the container trade at each major port that is potentially contestable with other ports is relatively small.

The issue of potentially contestable container trade at the Port of Melbourne is discussed further in chapter 3 of this Draft Report in the context of the Commission's market power assessment.

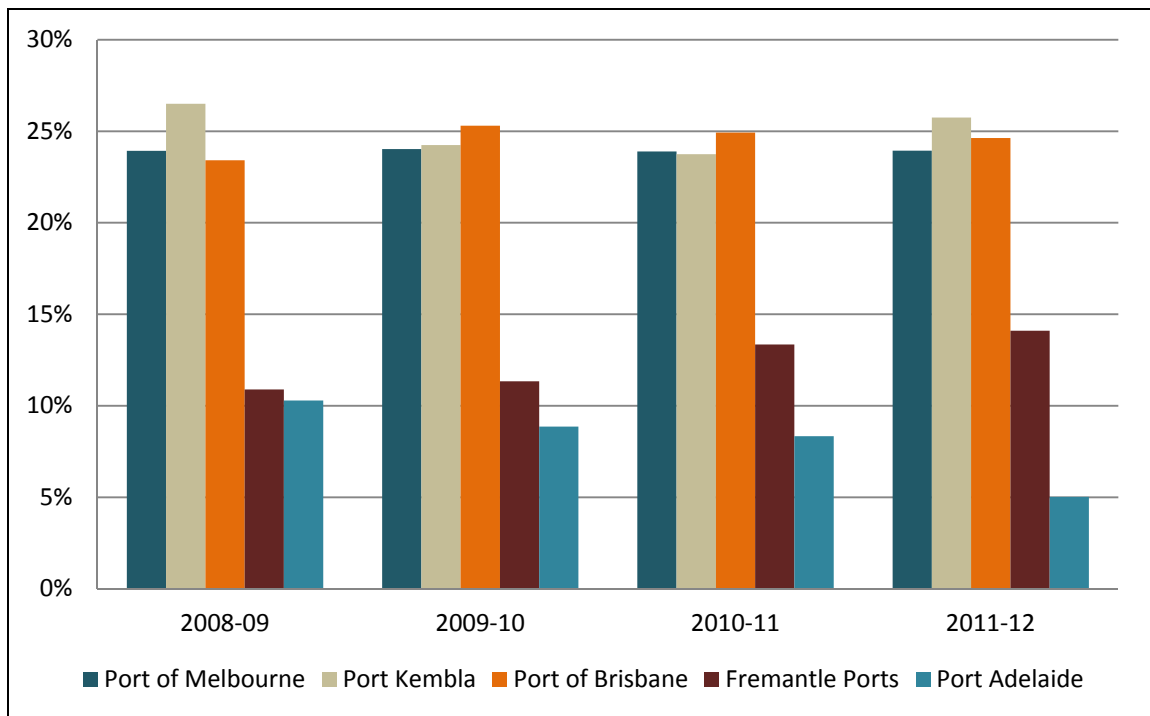
2.6 MOTOR VEHICLE CARGOES

The Australian motor vehicle trade at Australian ports is primarily an import trade, with exports of Australian-made vehicles declining between 2008-09 and 2012-13. The recent announcements by Holden, Ford and Toyota regarding the cessation of car manufacturing in Australia in coming years will reinforce the import nature of this trade.

Figure 2.3 sets out the port share of total Australian Pure Car Carrier (PCC) vessel ship visits. This is an imprecise measure of the motor vehicle throughput at the ports, because it reveals no information about the volume of motor vehicles carried by each ship. However, it is the only data available to the Commission and gives some indication as to the market share of the motor vehicle trade at each port. Figure 2.3 suggests that the majority of cars in Australia are being imported through three ports: the Port of Melbourne, Port Kembla and the Port of Brisbane.⁶ There have not been any major shifts in the share of PCC ship visits since 2008-09.

⁶ From 2009-10, Port Kembla handled all motor vehicle trade in NSW. In 2008-09, Port Botany accounted for 8.15 per cent of the NSW market share, which has been added to Port Kembla's share to present a whole of NSW perspective.

FIGURE 2.3 SHARE OF PURE CAR CARRIER (PCC) VESSEL SHIP VISITS



Source: Ports Australia website.

2.7 PORT EXPANSION PLANS

Victorian Government policy and PoMC’s announced expansion plans will have implications for the future state of competition in port services at the Port of Melbourne. A brief overview of relevant Government policy initiatives and future capacity expansion plans by PoMC is given below.

2.7.1 PORT OF MELBOURNE CAPACITY PROJECT

The Victorian Government announced a major expansion of the Port of Melbourne in April 2012. The Port of Melbourne Capacity Project comprises the construction of a

new international container terminal at Webb Dock and upgrades at Swanson Dock to increase capacity of the port's existing container terminals.

A new automotive hub, comprising an automotive terminal and pre-delivery inspection (PDI) hub, is also to be developed at Webb Dock West.

The new container terminal (T3) at Webb Dock is to be developed on the existing Webb Dock East 4/5 berth site (see Appendix A figure A3). Following a competitive process in which Expressions of Interest were sought, the Victorian Government has appointed Victoria International Container Terminal Limited (wholly owned by International Container Terminals Limited Inc and Anglo Ports) to develop and operate Port of Melbourne's third container terminal.⁷

Upgrades to the existing container hub at Swanson Dock are aimed at enhancing capacity expansion through a range of works, including reconfiguring internal road linkages. These upgrades will be made by both PoMC and the terminal operators.⁸

In June 2012, the Victorian Government announced that PoMC would develop an expanded automotive terminal and adjacent pre-delivery inspection (PDI) hub at Webb Dock West. This is to be constructed on the site of the existing AAT terminal (see Appendix A figure A3). This project will consolidate all automotive trade activity for the Port of Melbourne into one precinct and is expected to accommodate demand until 2040. It is proposed that the Terminal Operations Agreement between PoMC and the terminal operator will commit the operator to deliver an open access regime and specified operational performance standards, to be addressed in bidder proposals.⁹

Following an EOI process, the two operators for the PDI hub were announced in December 2013 – Patrick AutoCare and Prix Car. These are the two existing PDI operators which account for almost 80 per cent of the State's total PDI market. Patrick

⁷ <http://portcapacity.portofmelbourne.com/pages/bidding-information.asp> [Accessed 5 May 2014]

⁸ <http://portcapacity.portofmelbourne.com/pages/project-details.asp> [Accessed 25 March 2014]

⁹ Port of Melbourne Corporation 2012, *Invitation for Expression of Interest, Development and Provision of Services for an Automotive Terminal Webb Dock West*, Melbourne, October 2012.

AutoCare will develop a 12 hectare site and Prix Car will build a new 4 hectare facility, both of which are expected to be operational by mid-2015.¹⁰

The shortlisted bidders for operating the automotive terminal were announced in April 2013. Successful shortlisted bidders are:

- AAT
- Hutchison Port Holdings and
- Wallenius Wilhelmsen Logistics AS.

These bidders have accepted an invitation to compete in the Request for Proposals stage.¹¹

2.7.2 VICTORIA — THE FREIGHT STATE

The Victorian Government's 2013 *Transport and Freight Logistics Plan: Victoria – The Freight State*, outlines the long term strategy to improve freight efficiency, growing productivity and better connecting Victorian businesses with their markets.

The plan includes a number of key directions for Victorian ports, including:¹²

- implementation of the 'Port Capacity Project' at the Port of Melbourne to provide sufficient capacity until the mid-2020s
- accelerate planning and development for the Port of Hastings to supplement the capacity of the Port of Melbourne from the mid-2020s
- work with the private ports of Portland and Geelong to support their role in servicing existing and emerging regional commodity exports and key import trades
- work with port managers and industry to respond to the trend towards greater importation of refined petroleum product; and

¹⁰ The Hon David Hodgett MP, Media Release: Operators announced for Port of Melbourne's new automotive Pre-Delivery Inspection (PDI) hub, 17 December 2013.

¹¹ <http://portcapacity.portofmelbourne.com/pages/bidding-information.asp> [Accessed 26 March 2014].

¹² Victorian Government 2013, *Victoria – The Freight State, Victorian Freight and Logistics Plan*, August.

- work with industry and port managers to facilitate the provision of bulk port capacity for the export of brown coal products from Gippsland in the event that commercial export opportunities are developed.

The development of the Port of Hastings is intended to supplement Port of Melbourne capacity to meet projected growth in demand for container handling capacity to 2050 and beyond. To this end, the Government has commenced work on development of the Port of Hastings as the next container port in Victoria. It is anticipated that Hastings will handle growth in trade volumes up to and beyond 2050, once Port of Melbourne capacity — augmented by the Port Capacity Project — is exhausted. Development of Port of Hastings is occurring under the auspices of the Port Hastings Development Authority (PHDA) and the Victorian Government expects that the port will become an operating container terminal in the early to mid-2020s.¹³ The PHDA indicates that construction of the terminal will occur over the period 2018-2025.¹⁴

2.7.3 PRIVATISATION

The Victorian Government announced in March 2014 that it is investigating strategic and commercial options for the future of Victorian state-owned ports.¹⁵

This review is conducted in the context of the existing legislative, regulatory and ownership arrangements. It is beyond the scope of this review to consider possible future arrangements.

¹³ The Hon Dr Denis Napthine MP 2011, Media Release *New Board Appointed for Port of Hastings Development*, 23 December. Available at: <http://www.transport.vic.gov.au/freight/ports/port-of-hastings-development> [Accessed 25 March 2014].

¹⁴ <http://www.portofhastings.com/planning.html> [Accessed 25 March 2014].

¹⁵ The Hon Michael O'Brien MP 2014, *Media Release, Coalition Government to assess future of Victoria's ports*, 5 March.

3 ASSESSMENT OF MARKET POWER

KEY MESSAGES — MARKET POWER

Channels

The Commission considers that PoMC has a substantial degree of market power in relation to the channels it manages at the Port of Melbourne because of the very high barriers to entry and lack of viable substitutes for its channel services. In relation to the shared channels, while PoMC has the capacity to discriminate in providing access to Port of Geelong users, it does not have a strong incentive to do so.

Port services to container trades

The Commission considers that PoMC holds a substantial degree of market power in the provision of prescribed port services to containerised trade because of the high barriers to entry and the lack of viable substitutes for its services (with the exception of substitution possibilities at the boundaries of the south eastern Australian container market). The importer/exporter customer base is fragmented with each customer representing only a small proportion of total trade through the port, as a result, there is a lack of countervailing market power held by customers sufficient to constrain PoMC's market power.

Continued next page

KEY MESSAGES (CONTINUED)

Port services to motor vehicle trades

The Commission considers that PoMC holds substantial market power in the provision of prescribed port services for the motor vehicle trade as a result of the limited scope for competition from other ports. In addition, new market entry in Victoria is unlikely in the short to medium term due to the planned substantial increase in capacity at the Port of Melbourne.

3.1 INTRODUCTION

The scope of this review is to assess whether the currently prescribed services should continue to be subject to price regulation and, if so, the form of that price regulation.

The services currently prescribed under the *Port Management Act 1995* are:

- provision of channels for use by shipping in Port of Melbourne waters, including shared channels used by ships bound either for the port of Melbourne or for the port of Geelong
- provision of berths, buoys or dolphins in connection with the berthing of vessels carrying container or motor vehicle cargoes in the port of Melbourne and
- the provision of short-term storage or cargo marshalling facilities in connection with the loading or unloading of vessels carrying container or motor vehicle cargoes in the port of Melbourne.

In deciding whether PoMC's prescribed port services should continue to be regulated, the Commission has assessed the extent of market power held by PoMC in the provision of prescribed services.¹⁸ The Commission has done this by having regard to:

- whether there is competition between PoMC and other major Australian ports
- the existence of barriers to entry to the relevant defined markets and
- whether countervailing power exists in relation to port users.

Where there exists no scope for competition or viable alternatives for the service, physical, economic or regulatory barriers to entry, and a lack of effective countervailing power amongst users, it is likely that PoMC has the potential to exercise substantial market power.

However, before assessing the extent of PoMC's market power, the markets for assessment must first be defined.

3.2 MARKET DEFINITION

The purpose of market definition in the current context is to assess the degree of market power possessed by PoMC in the supply of its prescribed services.

Market definition is typically undertaken by assessing the extent of demand and supply-side substitutability for the services in question. Where there is a high degree of substitutability between two services, they are considered to be in the same market.

In addition to the extent of substitutability, there are also geographical dimensions, which must be considered when defining the relevant markets. In its 2009 review, the Commission considered that south-eastern Australia was the relevant geographical boundary of the market for the then prescribed services.

In addition, the Commission defined the relevant markets in terms of identified distinct sub-markets comprising the main cargo 'pack types' namely, the container market and

¹⁸ This chapter assesses the extent of PoMC's market power in the provision of prescribed services. It does not consider other services provided by the port that are not currently subject to economic regulation.

motor vehicle transport market. These cargoes are each transported by different types of ships. The land-side port infrastructure also tends to be specialised for these different cargo types.

The Commission also identified channel services as a separate market, with the focus of its market power assessment being the shared channels controlled by PoMC at the entrance to Port Phillip Bay.

The Commission is not aware of any significant market developments over the current regulatory period that invalidates the approach to market definition adopted in its 2009 review. For this reason, the Commission has retained a south-eastern Australia geographic market for the following distinct service markets:

- channel services
- container trade services and
- motor vehicle trade services.

The Commission's market power assessment for each of these markets is set out in the following sections.

3.3 ASSESSMENT OF MARKET POWER FOR CHANNEL SERVICES

In relation to channels, the prescribed service is the provision of channels for use by shipping in the Port of Melbourne, including shared channels used by ships bound either for the Port of Melbourne or for the Port of Geelong.

PoMC is responsible for the operation and maintenance of the following shipping channels in Port Phillip Bay:

- Heads and South shipping channels, used by all vessels entering and leaving Port Phillip Bay, including those accessing both the Port of Melbourne and Port of Geelong (the shared channels)
- Port of Melbourne Channel, Williamstown Channel and the Yarra River Channels, used by all vessels entering and leaving the Port of Melbourne.

The location of PoMC's channels means that any ship visiting either the Port of Melbourne or the Port of Geelong must pass through the shared channels and then may use one or both of two separate channels dedicated to serving the ports of Melbourne and Geelong.

3.3.1 COMMISSION'S 2009 REVIEW

In its 2009 review, the Commission concluded that Victorian shipping channels can be considered to be natural monopolies and, where there is 'vertical control' of shipping channels required to access competing ports, there is the potential for the exercise of substantial market power by the channel operator. The Commission also concluded that PoMC had market power in the provision of shared channel services, with there being the potential for this market power to impede competition in upstream or downstream markets.

The Commission recommended that price monitoring should apply to channels, including shared channels, in addition to the ongoing application of the Victorian Channel's Access Regime (VCAR). The Victorian Government supported price monitoring. However, it did not support a third party access regime applying to channels. As a result, a price monitoring framework alone has applied to channel services provided by PoMC through the 2010 Ports Monitoring Determination. The Victorian Government repealed the VCAR in December 2011.

To determine the extent of market power, if any, currently held by PoMC in relation to prescribed channels, the Commission has assessed the market circumstances that currently apply. In particular, this assessment considered whether there have been any changes since the 2009 review that would affect the extent of market power held by PoMC in relation to prescribed channels. The relevant factors in this assessment are outlined below.

3.3.2 COMPETITION BETWEEN PORTS FOR CHANNEL SERVICES

The only possible substitutes for users of the port's channel services are to potentially utilise other Victorian or Australian ports and 'land bridge' — that is, an importer of goods could, in principle, land their goods at another port and have those goods

transported to Melbourne via road or rail transport. Whether this is practical or economically feasible will depend on the cost of land transportation.

In practice, this form of competition is negligible. For example, the cost of land transport between the capital city ports is above \$1,000 per TEU by road on the East Coast, which significantly exceeds the non-road transport related differentials in port interface costs at major Australian capital city ports.¹⁹ In addition, interstate rail transport is not optimised for international containers. There is no direct rail transport service from Port Botany to Melbourne and the current configuration of the Port of Melbourne and the Dynon interstate rail terminal requires additional trucking costs and provides no advantage in terms of a faster delivery time. In the case of motor vehicle trades, land bridging is also unlikely to be economically feasible.

It may be the case that, given channel access charges are a relatively minor component of total supply chain costs, a customer would be unlikely to adopt an alternative supply chain strategy as a result of an increase in channel access charges at the Port of Melbourne.

Competition between ports also needs to be considered in the case of channel services provided by PoMC. Vessel access to shared channels controlled by PoMC is necessary for users of the Port of Geelong to access that port.

In some cases, these port users compete in the same markets as users of the Port of Melbourne. PoMC provides port infrastructure services for a range of liquid bulk, dry bulk and general cargo facilities in the Port of Melbourne, which compete (or potentially compete) with similar facilities provided by GeelongPort (the owner and operator) at the Port of Geelong. In terms of port users, GrainCorp, which operates a grain storage and handling facility at the Port of Geelong, competes with Emerald Grain, which operates the MPT facility at the Port of Melbourne. Similarly, the Shell petroleum products refinery at Geelong competes with the Mobil refinery in Altona (which uses the Port of Melbourne), as well as against imported refined products.

¹⁹ Bureau of Infrastructure, Transport and Regional Economics, Waterline, January 2014, pp 55-70 and Indec Consulting.

While PoMC has substantial market power given it controls the shared channels, the Commission does not consider that PoMC has a strong incentive to misuse this market power by discriminating in favour of its customers in providing access to the shared channels. While it is possible that the Port of Melbourne and Port of Geelong could compete for a range of trades, in practice, actual competition between the ports is quite limited as they are not competing in the same markets for the majority of their tonnages. PoMC's major trades are containers, cars and liquid bulk. The Port of Geelong does not currently operate in these markets. The two trades where the ports have users in the same market are bulk fuels and grain. For bulk fuels, the port choice is determined by which refinery the customer is going to or coming from, with Shell using Geelong and Mobil using Melbourne. While grain is another potential area of competition, the fact that it accounts for a relatively small proportion of PoMC's total revenue suggests that PoMC would not have any strong incentives to engage in discriminatory conduct.

Discriminatory pricing to channels would be very unlikely in any event to have any meaningful impact on inter-port competition given that channel charges form such a low proportion of total logistics costs for cargoes (although the proportion will vary for each cargo). For example, tonnage charges for a mid-sized container ship at the Port of Melbourne in 2013 were \$10 per TEU compared to total port-related logistics costs (including land transport to the port) of \$994 per TEU for containers. The difference in charges levied on vessels visiting each of the ports would need to be very large to have any meaningful impact on inter-port competition.

While PoMC has the capacity to use pricing of access to the shared channels to distort competition between the Ports of Melbourne and Geelong, the Commission does not consider that, in practice, it has a strong incentive to do so given that the ports are not competing in the same markets for the majority of their tonnages and that channel charges form only a small proportion of total logistics costs for cargoes. The latter factor means that discriminatory charging unrelated to usage in relation to shared channel services is unlikely to be an effective means of influencing the choice of port.

3.3.3 BARRIERS TO ENTRY TO CHANNEL SERVICES

A natural monopoly exists when it is cheaper for a single facility to provide a service to the market than it is for two or more facilities to do so. In the case of the channels managed by PoMC, it would not be economically feasible to duplicate these facilities given the high fixed costs of constructing a channel, as well as the fact that the existing PoMC channels have considerable spare capacity following completion of the Channel Deepening Project (CDP) in 2009.

The CDP at Port of Melbourne involved deepening the shared channels and the Melbourne channels to enable the draught of ships able to access Port Phillip Bay to be increased from 11.6 metres to 14 metres. As the CDP was designed to match the expected shipping fleet calling at the Port of Melbourne over an extended forecast period (to at least 2025), shipping channels are not likely to be capacity constrained in the medium to longer term (i.e. up to 2050 according to the Victorian Freight and Logistics Plan). In other words, the Port of Melbourne will be able to meet foreseeable demand for channel capacity from trades using the Port of Melbourne until at least 2025 and it is likely to be able to do so at a lower cost than any other alternative facility.

While channel capacity can be expanded – for example, through further channel deepening and widening to increase the maximum size of vessel able to access the port – it is highly unlikely that an alternative channel could feasibly be constructed within Port Phillip Bay to access the Port of Melbourne to provide channel access services in competition to PoMC for users of the Port. This is because of the likely physical, operational and regulatory constraints on new channel construction, including environmental approvals. Therefore, there are high barriers to entry in the market for channel services at the Port of Melbourne.

3.3.4 COUNTERVAILING MARKET POWER FOR CHANNEL SERVICES

Countervailing market power occurs when consumers of a particular service are able to counteract any market power held by the producer of that service. This typically arises when there are a small number of buyers who are in a strong negotiating position with the seller. Where PoMC's customers have some degree of countervailing market power, they are in a relatively stronger negotiating position with PoMC than would otherwise be the case.

The customer for channel services is the ship operator. In the container trade, the major operators are large global companies with extensive experience in negotiating with port authorities. Additionally, cooperation between shipping lines is the norm. At a global level, global alliances and a handful of major independent lines increasingly dominate the liner shipping trade:

- The CHKYE alliance, consisting of COSCO, K Line, Yangmin and Hanjin, joined in early 2014 by former independent mega-line Evergreen
- The G6 alliance, formed in 2011 by the merger of two former global alliances (the New World Alliance and the Grand Alliance) and consisting of NYK, Hapag Lloyd, OOCL, MOL, APL (NOL) and Hyundai
- three major independents (Maersk Line and its affiliated subsidiaries; CGM-CMA; Mediterranean Shipping Corporation), who are currently at an advanced stage of seeking regulatory approval for a new alliance, the P3 alliance.

Once the formation of the P3 alliance is completed, these three alliances will control approximately 75 per cent of global container shipping capacity.

Collaboration between lines, in the form of consortia agreements, is also a feature of container shipping to and from Australia. A consortium allows a shipping line to offer services to a wide range of ports by using a range of vessels shared with other shipping lines. These consortiums often reflect the global arrangements between shipping lines.

PoMC have noted that increased concentration in shipping alliances in recent years has increased countervailing market power.

Although these alliances trade on the East-West routes, there is potential for the impact of these alliances to cascade down to the North-South trade routes, of which Australia is a part. A greater concentration of shipping lines intensifies their countervailing power over deciding on which ports they call, the number of services they schedule and the frequencies at which they visit.

While there is a degree of concentration in the market for shipping lines and this has increased in recent years, other factors constrain the exercise of any countervailing market power by port customers. Most notably, as Australia's largest container handling port, the Port of Melbourne is very attractive as a port of call for shipping lines.

The Port of Melbourne is a major cargo destination for imports from Asia and from Europe and for exports to South Asia. Melbourne has the largest exchange of container cargo (imports and exports) of all Australian ports and is therefore an important stop for all major shipping lines. By-passing the Port of Melbourne is therefore not a realistic option for major liner shipping services to Australia.

Container shipping companies may nevertheless be able to impose some commercial pressure on the port without necessarily ceasing to call at that port. For instance, a shipping company may threaten to include or exclude a call at another port, such as Adelaide, which would have an impact on the volumes lifted through the Port of Melbourne. They could also change the order in which they call at Australian ports, which might influence the decision of shippers in marginal areas, such as the Riverina region in NSW, to ship via Sydney rather than Melbourne.

Container shipping companies are often involved in organising door-to-door logistics arrangements and tend to have deeper commercial relationships with importers and exporters than does the port. They therefore have some ability to mobilise both commercial pressure (through working with end customers at the margin to develop alternative supply chains — for example, Western Victorian exporters to switch to Adelaide) and more generally to mobilise lobbying activity to resist price increases that they see as unreasonable. One means of doing this is by imposing surcharges for calls at a particular port in response to price increases that they view as unreasonable.

The Commission considers that while there appears to be some capacity by PoMC's customers to exert commercial pressure on the port, this is at the margin. This is particularly the case for liner shipping services, which are dominated by well informed and commercially powerful consortia. However, this does not extend to being able to exert any material pressure to constrain increases in PoMC's prices. Moreover, the exercise of any countervailing power will be constrained by the fact that omitting a call at the Port of Melbourne is not a commercially realistic option for most major shipping lines to and from Australia.

In the non-liner trades (a ship that has no fixed routing or schedule), the extent of countervailing power will vary depending on the commercial reach and character of the party chartering the vessel. Some, such as major petroleum refiners and major motor vehicle manufacturers, are likely to have some degree of countervailing power in terms of being able to exert commercial pressure in their dealings with the port. Again, it is

unlikely that this countervailing power extends to exerting strong pricing pressure on PoMC. Those involved in minor trades are likely to have even less influence.

In relation to the shared channels, vessels bound for the Port of Geelong are likely to be in a particularly weak position and the PoMC does not have extensive commercial relationships with the main participants in these trades. It also has no stake in their continued prosperity other than the relatively small revenue that it earns from the shared channel charges. Consequently, countervailing power of the users of the shared channel is likely to be weak.

3.3.5 CONCLUSIONS – CHANNELS

The Commission is of the view that PoMC continues to hold a substantial degree of market power in relation to the channels it manages at the Port of Melbourne. This is on the basis that it is not feasible for an alternative channel service provider to enter the market and provide channel access in competition to PoMC.

While there is likely to be some countervailing power existing in relation to the international shipping lines that are involved in the largest trade (containers) at the port, the exercise of this countervailing power will be constrained by the lack of realistic substitutes to a call at the Port of Melbourne for most major shipping lines to and from Australia.

In relation to the shared channels, while PoMC has the capacity to discriminate in providing access to Port of Geelong users the Commission considers PoMC does not have a strong incentive to do so due to:

- the comparatively narrow scope of the trade that is actively contested by the two ports;
- limited scope for competition in the commodities served by both ports given the dedicated nature of the infrastructure used to service these trades at each port; and
- the knowledge that, because shared channel charges comprise a very small proportion of total logistics costs for any potentially competing trades, discriminatory charging for the shared channels unrelated to usage is unlikely to be an effective means of influencing the choice of port.

Whether PoMC has exercised this substantial market power in the channel services market is considered in the next chapter.

3.4 ASSESSMENT OF MARKET POWER FOR CONTAINER PORT SERVICES

Certain port services provided to container cargoes are also currently subject to economic regulation. The following port services provided to container trades are currently regulated:

- the provision of berths, buoys or dolphins in connection with the berthing of vessels carrying container cargoes in the Port of Melbourne; and
- the provision of short-term storage or cargo marshalling facilities in connection with the loading or unloading of vessels carrying container cargoes

The Port of Melbourne is the only port in Victoria to handle container trade and it is the largest container handling port in Australia. There are presently two international container terminals operating at Swanson Dock, with a third terminal expected to commence operations at a new facility at Webb Dock by 2016.

3.4.1 COMMISSION'S 2009 REVIEW

In its 2009 review, the Commission concluded that PoMC has the potential to exercise substantial market power with respect to the provision of port services for containerised trades. This was on the basis that there is:

- limited scope for existing ports to be redeveloped, or new ports to be developed, in order to provide direct competition to PoMC, because of the large capital expenditure required and the existence of substantial economies of scale and
- an absence of a credible competitive constraint either through countervailing market power or the port's statutory obligations as a Government owned port.

While concluding that PoMC retained the potential to exercise substantial market power, the Commission found no evidence to support a conclusion that PoMC had actually misused this market power.

In its 2009 Final Report, the Commission noted that ‘berth services’ included the provision of berths and other moorings (i.e. buoys and dolphins) and short-term storage and cargo marshalling areas directly behind the berths. The Commission concluded that these services are closely related because short-term storage and cargo marshalling areas are essential to the efficient functioning of the berths, and are essentially an extension of the berths themselves. However, ‘berth services’ were not considered to include warehousing and longer term distribution centres within the precinct of the port as they potentially compete with similar facilities at other locations.

3.4.2 COMPETITION BETWEEN PORTS FOR CONTAINER PORT SERVICES

The scope for competition between existing ports for the provision of port services for containerised trade is an important factor to assess when considering market power. As discussed above, the Port of Melbourne is the sole significant container port in Victoria (and is the largest container port in Australia), with additional capacity expected to be available by 2016. No other Victorian port has the facilities to compete effectively for this trade, or the capacity to develop them within the 5-year regulatory period.

However, other Australian container ports are potential competitors to the Port of Melbourne in this market. For example, Port Adelaide, Port Botany and Port of Brisbane all provide container handling terminals, with Port Botany and Port of Brisbane being the next largest after PoMC in Australia. Whether they do in fact provide competitive restraint on PoMC will depend on how the total cost (including the cost of transport to or from the port) of exporting or importing containers through Melbourne compares with the cost of exporting or importing through these other ports.

A key factor in determining the scope for competition between ports for container trades is the source of container trade that presently uses the Port of Melbourne. Shipping containers through the Port of Melbourne will be relatively more cost competitive than land bridging to or from another Victorian or Australian port where the source or destination of container cargoes is in close proximity to the port. A high proportion of containers exported and imported through the Port of Melbourne have their origin or destination either within Melbourne or within a broader catchment extending as far as parts of the Victorian borders with South Australia and southern

New South Wales. In this regard, PoMC has indicated that 91 per cent of road only imports travel less than 50 kilometres from the port, 66 per cent of road only exports originate less than 50 kilometres from the port and 75 per cent of all containers travel less than 20 kilometres from the CBD.²⁰

This indicates that the majority of containers passed through the port were close to the point of production or consumption. PoMC, therefore only faces significant competition from other container ports at the margin – that is, for containers originating in or destined for certain regions along the boundary of the port's 'catchment' in southern New South Wales and South Australia. It is reasonable to conclude from the available data that the contestable international containers from these regions account for a relatively small part of the container movements at the Port of Melbourne.

The Commission also concluded in its 2009 review that other major capital city container ports in the eastern States do not provide a material competitive constraint on PoMC given the costs of land bridging from Sydney and Brisbane. The Commission is not aware of any significant changes in the land transport market that would have changed this situation since 2009.

The likelihood of substitution for PoMC's services by alternative ports is limited by the fact that port charges form a relatively minor share of the total transport costs of a container shipped through the port. This means that, should PoMC significantly increase its charges for port infrastructure, it is unlikely to result in substitution to other ports through alternative supply chains (or the consumption of domestic rather than imported goods) due to the fact that port infrastructure charges are a small proportion of total transport costs.

It is too early to assess the impact of the increase in PoMC's charges on trade volumes and substitution possibilities following the introduction of the Port Licence Fee (PLF) in 2012-13. Despite the significant increase in channel and wharfage fees, neither ship numbers nor trade through the ports of Melbourne or Geelong have been significantly reduced since the PLF was introduced.

²⁰ <http://portcapacity.portofmelbourne.com/downloads/130924-Fact-Sheet-Statistics.pdf> [Accessed 15 May 2014].

3.4.3 BARRIERS TO ENTRY FOR CONTAINER PORT SERVICES

Barriers to entry include physical, regulatory and economic factors that would prevent a new operator from entering the market and providing prescribed port services in competition with PoMC.

Given the physical requirements for channel access, berth and wharf facilities, transport infrastructure and landside areas necessary to provide port services to the container stevedoring industry, it is not feasible to develop new container handling facilities outside of the existing ports in south-eastern Australia without close involvement by the relevant State Government.

An important constraint in the development of new port facilities is the availability of suitable developable sites. This physical constraint encompasses both the availability of suitable land and the ability or right to develop a facility. Regulatory constraints such as obtaining environmental approvals for new port developments are also likely to pose a significant barrier to entry. As a rule of thumb it takes approximately 10 years for a major port infrastructure development project to move from an approved concept to commencing operations.

In addition, the significant cost of related transport supply chain infrastructure, such as rail and road infrastructure, creates a further and significant obstacle to the development of 'greenfield' ports. These factors tend to constrain 'greenfield' port developments at potential sites located away from existing port precincts. This means that, in practice, there are significant physical and regulatory barriers to entry to the market for port services (berths, wharves, storage facilities and marshalling areas) for container trades. As such, scope for new container terminals in Victoria, and more broadly in south-eastern Australia, will be limited to expansion of capacity for those services within existing port precincts, which are already owned by port authorities and dedicated to port uses, often with existing infrastructure in place.

There are also economic barriers to entry to the market for port services to container trades. There are significant costs associated with the construction of a container terminal of sufficient scale to be able to compete with existing terminals. If substantial investment is required to develop a new facility to provide access to a service, substitution may only be feasible over the longer term.

There are significant scale economies arising from the provision of port services for containerised trade due to the high fixed cost nature of the facilities required. As a consequence, there is limited scope for other Victorian ports (or more broadly, ports in south-eastern Australia) to enter the market for the provision of port services to containerised trade in south-eastern Australia. In this regard, the Commission notes that its 2009 review found that there are high barriers to entry and important locational disadvantages in relation to development of a new container terminal at one of the two private ports, Geelong and Portland.

The barriers to entry in the Tasmanian container trade are also significant. In 2006, the Australian Competition & Consumer Commission (ACCC) found that barriers to entry into Bass Strait shipping were high, one reason being there is very little opportunity for a new entrant to gain access to berths, or develop additional berths within the Port of Melbourne.²¹

Another factor mitigating against new market entry is that the liner shipping companies tend to focus on ports where cargo volumes are greatest. As Australia's largest container port, this gives the Port of Melbourne a significant competitive advantage compared to other Victorian ports and also the Port of Adelaide. For this reason, the Port of Melbourne is relatively attractive as a destination in Australia for the international liner shipping companies, compared to any possible alternatives serving the south-eastern Australian container market.

As an established port, the Port of Hastings is a potential new market entrant to the port services market, including for services to container stevedoring. However, the timing of its entry into this market and its ownership structure – to be determined by the Victorian Government — will determine whether it will provide competition for the Port of Melbourne. The Port Capacity Project will increase container handling capacity at the Port of Melbourne, allowing market demand to be met by PoMC up until at least the mid to late 2020s (although this could be as late as 2030-35). Given this capacity at the Port of Melbourne, there is no realistic scope for the Port of Hastings (or any other

²¹ ACCC (2006) Public Competition Assessment, 5 May 2006, Toll Holdings Limited's proposed acquisition of Patrick Corporation Limited.

Victorian port) to compete with PoMC over the short to medium term while there is spare capacity at the port.

Since the Commission's 2009 review, there is greater clarity around future plans for the development of Hastings as a container port, with preliminary project scoping underway and plans in place for construction to be completed by 2025. Therefore, in the short to medium term and certainly in the five year period covered by the next regulatory period, the Port of Hastings will not be a new entrant into the market for port services related to container stevedoring.

The Commission concludes that there are significant economic, physical and regulatory barriers to entry to the market for port services for container stevedoring in the next regulatory period.

3.4.4 COUNTERVAILING MARKET POWER FOR CONTAINER PORT SERVICES

In the context of the prescribed services provided by PoMC to container cargoes, the customers are the importers and exporters of the containerised goods who pay the port charges for prescribed services (although in practice the shipping line typically acts as the collection agent for the port).

The importer and exporter customer base is compared to shipping lines, highly fragmented, with each customer representing only a small proportion of total trade through the port. This diverse customer base has limited scope to influence or constrain port behavior. As a result, importers and exporters have little or no countervailing market power

While there have been competitive developments in the container stevedore terminal market at the Port of Melbourne, notably the proposed introduction of a third operator, this is not relevant to an assessment of countervailing market power for prescribed services provided by PoMC to container cargoes. PoMC and the container terminal operators have a commercial relationship in their lease arrangements for occupied port land. However, this is not a prescribed service and so falls outside of the scope of the Commission's assessment.

3.4.5 CONCLUSIONS – CONTAINER PORT SERVICES

The Commission's view is that PoMC retains the potential to exert a substantial degree of market power in the provision of prescribed port services for containerised trade. This is because of the lack of viable substitutes for its services (with the exception of substitution possibilities at the boundaries of the south eastern Australia container market) and the lack of countervailing market power held by its customers sufficient to constrain PoMC's market power.

Whether PoMC has exercised its substantial market power in the container services market is considered in the next chapter.

3.5 ASSESSMENT OF MARKET POWER FOR MOTOR VEHICLE PORT SERVICES

The prescribed services in relation to motor vehicle cargoes at the Port of Melbourne are the provision of berths, buoys and dolphins and short-term cargo storage and marshalling facilities.

At present, motor vehicle imports and exports in Victoria occur only at the Port of Melbourne.

3.5.1 THE COMMISSION'S 2009 REVIEW

In its 2009 review, the Commission concluded that PoMC is likely to have substantial market power in the provision of port services for motor vehicles, at least in the short to medium term. This was on the basis that:

- there is limited scope for new entry or competition from existing ports to provide actual or a threat of competition if there are space constraints and/or technical challenges at the Port of Geelong
- GeelongPort is managed by Asciano, which is a participant in the motor vehicle facilities at the Port of Melbourne and
- vehicle shippers have relatively weak countervailing market power.

The Commission concluded that PoMC is likely to retain its monopoly on port services for motor vehicles in the short to medium term. However, the Commission noted that, should this prove over time to be incorrect, and land constraints or technical challenges at the Port of Geelong successfully resolved, then prices oversight of motor vehicle trades at the Port of Melbourne could be removed.

As noted above in relation to container services, in its 2009 Final Report the Commission concluded that prescribed 'berth services' included providing berths and other moorings (i.e. buoys and dolphins) and short-term storage and cargo marshalling areas directly behind the berths.

3.5.2 COMPETITION BETWEEN PORTS

This section considers the extent, if any, of competition between PoMC and interstate ports for this market. In this regard, the most likely commercially feasible possibilities are Port Kembla and Port Adelaide.

While the transport by land of motor vehicle cargoes through interstate ports is possible, whether it occurs will depend on the costs of land transport compared to the cost of shipping through the Port of Melbourne. The majority of motor vehicles shipped through the Port of Melbourne are either sourced locally in the case of exports (which will be negligible once large scale local car production ceases) or are distributed to local and regional car dealerships in Victoria in the case of imports (which will increase). This gives the Port of Melbourne a considerable locational advantage as a point of entry to the broader Melbourne and Victorian region motor vehicle market. This suggests that it is unlikely to be economically feasible at a high volume scale for 'land bridging' of motor vehicles through alternative ports. For example, an importation strategy of shipping motor vehicles to Victoria via the Port of Brisbane and the use of dedicated high capacity rail freight systems to Melbourne ceased in 2010.

The Commission understands that for motor vehicle trades, Australian 'capital city to capital city' transfers are also not likely to be a viable option because of the established motor vehicle supply chains for major local and imported car manufacturers concentrated in capital cities.

The Commission considers that there is limited scope for competition between PoMC and other Victorian ports for port services to motor vehicle cargoes in the short to medium term. Similarly, the concentration of origins/destinations around the capital and the costs of land transport make shipment through the closest interstate ports (such as Adelaide or Port Kembla) highly unlikely.

3.5.3 BARRIERS TO ENTRY

The port infrastructure facilities required to support motor vehicle shipping cargoes are less complex than is required for cargoes such as containers. The key requirement is for sufficient land for unloading and short-term storage of motor vehicles. As such, there is a relatively low cost of entry to the market for port infrastructure for motor vehicle shipping as, provided there is sufficient suitable port land available, it would be relatively easy to establish operations.

It was recognised in the Commission's 2009 review that there was some potential for the Port of Geelong to develop a motor vehicle terminal. In 2012, the Department of Transport, Planning and Local Infrastructure undertook an extensive feasibility study into relocating the export and import of cars to the Port of Geelong. The Feasibility Study cited a series of technical, infrastructure and industry constraints of relocation to Geelong and produced a Benefit Cost Analysis (BCA) comparing the operations at the Port of Melbourne with relocation to Geelong generating an overall negative Net Present Value (NPV) of -\$48.03 million. No further detail about the BCA, or the discount rate that was used in its calculation, is publicly available.

The Minister for Ports announced in 2013 that Victoria's roll-on, roll-off import and export car trade will be consolidated at a new location at Webb Dock.

PoMC has begun the redevelopment of Webb Dock and associated pre-delivery and inspection (PDI) hub, which will provide sufficient capacity to meet expected demand until 2040. The 2013 Port of Geelong Development strategy does not envisage new motor vehicle trade, highlighting that trade development through the Port of Geelong will continue to be focused on bulk commodities.

It remains technically feasible that port infrastructure services could be established at Geelong at some future point, given the relatively low barriers to entry and Geelong's

proximity to Melbourne. This could potentially occur if PoMC were to misuse its market power to such an extent that its motor vehicle cargo customers were dissatisfied. In this event it is possible that, over the medium to longer term, motor vehicle trades could seek alternative facilities at the Port of Geelong.

The Port of Hastings also has the potential to be developed to support motor vehicle trade. As with the Port of Geelong, given the capacity development at the Port of Melbourne, this is unlikely to occur in the short to medium term.

The Commission is of the view that the barriers to entry to prescribed port infrastructure services to the motor vehicle trades are relatively low given the nature of the infrastructure required. In light of the market developments in Victoria, including the creation of substantial new capacity for motor vehicle cargoes at the Port of Melbourne, it is unlikely that new market entry will occur, at least in the short to medium term.

3.5.4 COUNTERVAILING MARKET POWER

PoMC's customers for prescribed port services provided to the motor vehicle trade are the cargo owner. The cargo owner charters the vessel and ultimately pays port charges for the vehicles loaded and unloaded at the port. The cargo owner is therefore the relevant counter-party for an assessment of countervailing market power.

In the case of the motor vehicle trade, the cargo owners are the major motor vehicle manufacturers and importers. These are large organisations that are capable of developing highly sophisticated commercial relationships (such as supporting development of value added services in the port precinct in return for pricing assurances). As a result, PoMC's customers for prescribed services to motor vehicle trades may be able to exert some degree of countervailing market power in their dealings with PoMC.

This does not necessarily mean that they would readily by-pass the Port of Melbourne, unless there was an economically acceptable alternative supply chain (which is not presently the case). This factor will constrain the exercise of any countervailing market power.

3.5.5 CONCLUSION – MOTOR VEHICLES

PoMC holds market power in the provision of port infrastructure services for motor vehicle cargoes as a result of the limited scope for competition from other ports and given that new market entry is unlikely in the short to medium term due to the substantial increase in capacity at the Port of Melbourne.

However, the existence of some countervailing power combined with low barriers to entry could be expected to provide a reasonable constraint on the exercise of this substantial market power by PoMC.

Whether PoMC has exercised its market power in the motor vehicle services market is considered in the next chapter.

3.6 SUMMARY

To determine whether PoMC has substantial market power, the Commission has had regard to the scope for competition and viable alternatives for the service, barriers to entry, and the presence of effective countervailing power from users. The Commission has found that PoMC does hold substantial market power in relation to the existing prescribed services. As a result, there is a case for economic regulation.

However, the choice of the form of regulation to apply needs to be tempered by the extent to which PoMC has actually exercised its market power. In the next chapter, the Commission assesses the available evidence as to whether PoMC has consistently exercised its market power in the current regulatory period. It is within this context that the Commission makes recommendations regarding the form of regulation to apply in later chapters.

4 PORT OF MELBOURNE'S PERFORMANCE IN THE PROVISION OF PRESCRIBED SERVICES

This chapter assesses the available evidence regarding movements in the prices, service quality and profitability of PoMC's prescribed services to ascertain whether there has been any exercise of PoMC's market power in relation to the provision of prescribed services.

4.1 PRICE AND REVENUE MOVEMENTS — PRESCRIBED SERVICES

Under the current price monitoring regime, PoMC reports annually to the Commission on the charges and fees for its prescribed services.

The most significant pricing events at the Port of Melbourne over the 2008-09 to 2012-13 period were:

- the recovery of costs associated with the Channel Deepening Project (CDP), recovered as a separately identified component of the wharfage fee applied to the full international and Bass Strait container trade

- the introduction of the Port Licence Fee in 2012-13, which increased the prices of all charges and fees at the port.²²

The majority of PoMC's prescribed revenues are recovered through wharfage fees with channel fees a somewhat less important source of revenue.

CHANNEL DEEPENING PROJECT (CDP)

The Channel Deepening Project is PoMC's largest ever marine infrastructure development project comprising dredging works, landside improvements, and protection of underwater utilities, enhanced navigational aids for ships, and environmental monitoring and management. It was publicly announced as completed on 25 November 2009.

The costs of the Channel Deepening Project are being recovered through a separate wharfage-based Infrastructure Fee that applies only in relation to PoMC's container trade (given it was this trade that created the need for the channel deepening, due to the increasing size of container ships).

In 2012-13, the Channel Deepening Project assets were valued at \$632.7 million, accounting for around 40 per cent of PoMC's prescribed services asset base.

PORT LICENCE FEE (PLF)

The *Port Management Amendment (Port of Melbourne Corporation Licence Fee) Act 2012* (Vic) provides for the introduction of a Port Licence Fee on PoMC, commencing at \$75 million in 2012-13. The fee is to be remitted to the Victorian Government in quarterly instalments and it will be escalated each year in accordance with a CPI based adjustment factor.

The Port Licence Fee amount of \$75 million accounted for around 27 per cent of PoMC's prescribed revenues in 2012-13. It was recovered through an increase (of approximately 50 per cent) in all charges and fees at the port. PoMC has reported that the increase in charges effectively recovered \$73 million of the required amount

²² Excluding the Infrastructure Fee, which itself is a cost recovery fee for the CDP.

(representing a slight under-recovery). The notified Port Licence Fee for 2013-14 is \$76.4 million.

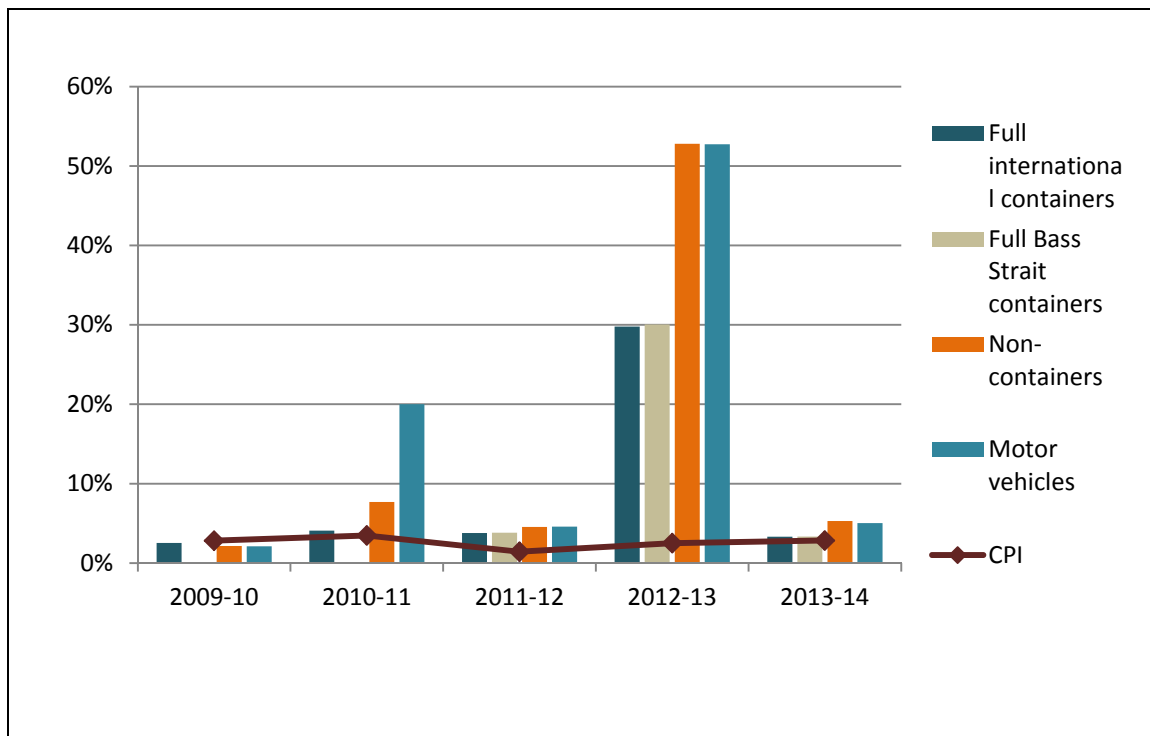
4.1.1 ANNUAL PRICE MOVEMENTS

Over the current regulatory period (2009-10 to 2013-14), PoMC's prices across all trades have generally increased by more than CPI growth²³. However, there has been much variability in price movements, which makes interpretation of price trends difficult. This is due, for example, to the significant investments that PoMC has made in new infrastructure, such as the Channel Deepening Project, as well as the introduction of the Port Licence Fee.

Nonetheless, figure 4.1 illustrates that annual increases in wharfage fees over the period from 2009-10 to 2013-14 have generally been around 5 per cent, with the exception of 2012-13 when the Port Licence Fee was introduced without a transition period. It is unclear what caused the atypically large increase of around 20 per cent in motor vehicle wharfage fees in 2010-11.

²³ CPI Melbourne.

FIGURE 4.1 WHARFAGE FEES



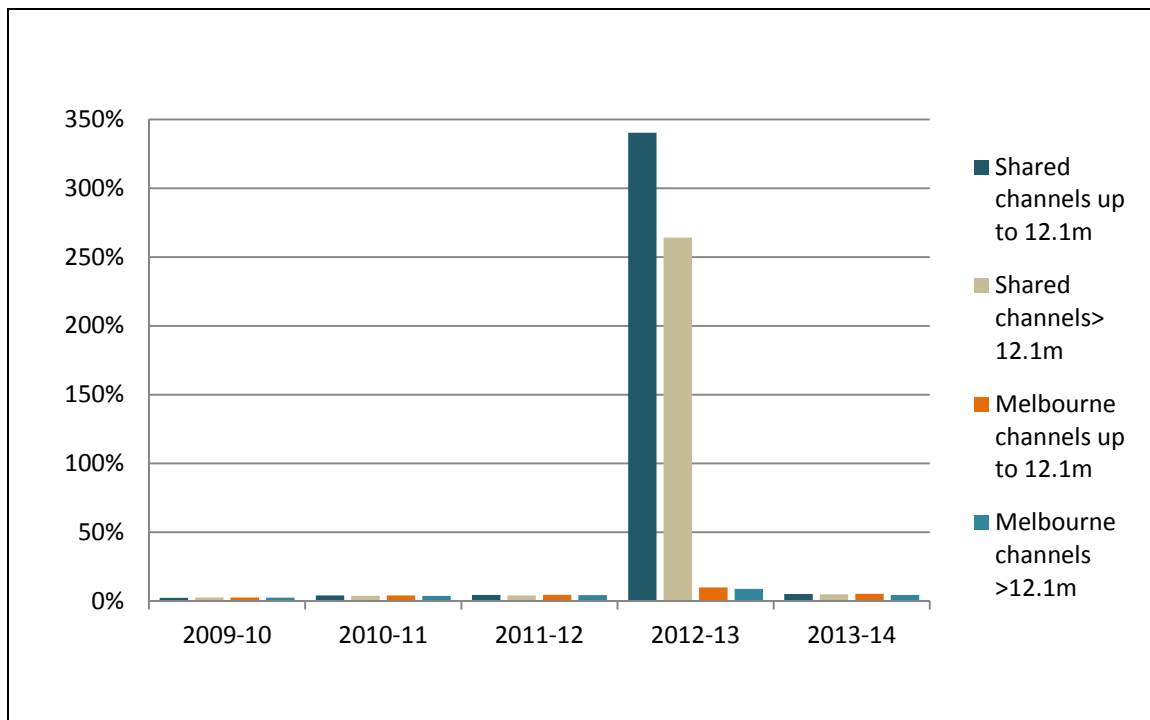
Source: Essential Services Commission.

Figure 4.1 shows a relatively smaller increase in full container wharfage than for the motor vehicle and non-containerised trades in 2013-13. This is because the Port Licence Fee is not being recovered through the Infrastructure Fee (which paid only by the full container trades).²⁴ The Commission notes that removing the Infrastructure Fee from the total wharfage fees paid by the full container trades results in residual wharfage fees increases in line with those faced by the motor vehicle and non-container trades.

Figure 4.2 indicates the charges for the shared channels were increased by 340 per cent and 264 per cent for vessels below and exceeding a summer draught of 12.10 metres respectively in 2012-13. The corresponding charges for the Melbourne channels were increased by only 10 per cent and 9 per cent.

²⁴ The Infrastructure Fee is a cost recovery fee for the Channel Deepening Project.

FIGURE 4.2 PRICING OF CHANNEL SERVICES



Source: Essential Service Commission

This potentially raises the issue of PoMC exercising its substantial market power in relation to the shared channels to disadvantage trades accessing the Port of Geelong.

PoMC explained in a letter to the Commission accompanying its 2012-13 reference tariff schedule that it undertook a review of its pricing structures and sought to realign and address existing anomalies. PoMC identified that under the previous pricing structure, the channels in aggregate achieved a modest positive return, however, on a stand-alone basis, the shared channels did not. PoMC realigned the relative prices for the shared and Melbourne channels to ensure a suitable rate of return on both assets, resulting in the large increases in channel fees for the shared channels.

Given the increases noted above in the shared channel fees, the Commission has analysed the breakdown of channel services revenue reported by PoMC prior to and after this realignment of shared channel and Melbourne channel fees to better understand its purpose. The Commission has found that in 2011-12, the proportion of shared channel service revenues was around 1.5 per cent of PoMC's total prescribed service revenues. Following the realignment in 2012-13, this proportion increased to

around 4.4 per cent. In contrast, the proportion of Melbourne channel service revenue of total prescribed service revenue fell from around 9.2 per cent to 7.4 per cent. In aggregate, the share of total channel fee revenues increased from around 10.7 per cent in 2011-12 to 11.8 per cent of total prescribed service revenue in 2012-13.

In light of the available evidence, the Commission considers that the revenue recovered from the shared channels is now better aligned with usage of these channels than was the case at the start of the current regulatory period. The realignment also means that the Port of Geelong users are making a larger, but more proportionate contribution to the recovery of the costs of the shared channels. In addition, and reflecting the international trend to increasing average ship size, around two-thirds of channel service revenues are now being recovered from vessels with a summer draught exceeding 12.1 metres.

4.1.2 RECOVERY OF PORT LICENCE FEE COSTS

PoMC indicated that recovery of the Port Licence Fee was based on the principles of equity and fairness and was spread across all of the port's trade sectors.²⁵ The Commission supports this approach to the recovery task although it notes the difficulty in applying equity judgments in determining prices.

The Commission has found through its stakeholder consultations that many port users have struggled to understand how the Port Licence Fee costs are being recovered through the wharfage and channel fees. Using information provided by PoMC in its regulatory accounts, the Commission has attempted to understand the basis of the licence fee recovery.

From an economic efficiency perspective it would be reasonable for PoMC to base its recovery approach on the demand elasticity of each of the trades using the port. In other words, by taking into account the sensitivity of users' respective demands to an

²⁵ PoMC 2013, Port Licence Fee, Information paper, August 2013.

increase in price. This would be an efficient form of price discrimination that is consistent with the pricing principles incorporated in PoMC's Pricing Policy Statement.

In addition, recovering a larger proportion of the Port Licence Fee from those trades with the largest volumes of traffic would be efficient due to a lower unit cost of recovery. The largest volume trades at the port are containers, motor vehicles and other non-container general breakbulk trades.

Under these economic efficiency and equity considerations, it would be reasonable to expect the container trades to make the largest contribution to recovery of the PLF.

Based on analysis undertaken by the Commission using PoMC's regulatory accounts, it appears that in 2012-13 around two-thirds of the PLF was recovered from the container trades. This is broadly in line with the container trade's share of total prescribed revenues at the port. The motor vehicle and non-container general breakbulk trades collectively accounted for around 20 per cent of the recovery, again, broadly in line with their respective shares of prescribed revenue. The residual recovery of PLF costs was spread across all other trades.

Notwithstanding the large increases in PoMC's wharfage and channel fees since 2008-09, the most significant increases can be attributed to the Channel Deepening Project and Port Licence Fee. Consequently, it is difficult to definitively conclude from these price movements that PoMC has exercised a substantial degree of market power in providing its prescribed services in the current regulatory period.

The potential exercise of market power is assessed further in the context of PoMC's reported rate of return on its provision of prescribed services in section 4.4 below.

4.1.3 SOURCES OF REVENUE

Table 4.1 indicates that the mix of port charges has remained relatively stable at the Port of Melbourne since 2008-09.

Ship-based charges primarily reflect PoMC's channel fees, levied on a per ship visit basis (on the gross tonnes of the vessel) for use of the shared and Melbourne channels. In contrast, wharfage fees are charged on a per unit basis for each major

trade, including transshipments. There are no longer any prescribed services that are charged on a time-of-use basis.

TABLE 4.1 SOURCES OF PRESCRIBED REVENUES

Year ending June	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)
Ship-based charges	15.25	14.38	14.90	15.24	17.09
Cargo-based charges	81.81	83.08	85.10	84.76	82.91
Time-of-use charges	1.63	1.53	n/a	n/a	n/a
Other charges	1.31	1.01	na	na	na

Source: PoMC regulatory accounts.

A majority of PoMC's prescribed revenues are recovered through cargo-based charges in the form of wharfage fees. However, as discussed in section 4.2, a large increase and re-balancing of channel fees associated with the introduction of the PLF in 2012-13 resulted in an increased proportion of PoMC's revenue being recovered through ship-based charges.²⁶

4.2 PORT PRICING BENCHMARKS

The Bureau of Infrastructure Transport and Regional Economics (BITRE) publication, *Waterline*, reports a Port Interface Cost Index (the PIC Index) for the five major Australian container ports. The most recent *Waterline* was released in January 2014.

According to the BITRE, the PIC Index provides a measure of shore-based shipping charges, which approximate the costs of moving imported and exported containers

²⁶ As the increase in fees and charges to recover the PLF was not applied to the Infrastructure Fee (a cargo-based charge) the relative share of cargo-based charges was reduced.

through Australia's major capital city ports.²⁷ The PIC Index is based on those charges typically charged by service providers rather than an average of all charges.

The PIC Index estimates changes in five major charging elements by port for exports and import container trade. The five components covered are: (a) ship-based charges; (b) cargo-based charges; (c) stevedoring charges; (d) customs brokers' fees; and (e) road transport costs.

In benchmarking PoMC's container charges, of most relevance are cargo-based charges because PoMC directly imposes them on port users. Cargo-based charges are defined to include wharfage charges and harbour dues (such as channel infrastructure fees) that are levied on each container by the port authorities.

The cargo-based charge proportion of the total fees and charges across Australian major ports is important because of its potential impact on the demand elasticity of PoMC's prescribed services. If cargo-based charges are a relatively small proportion of the total fees and charges associated with the port interface, then relatively large changes in these charges may have little impact on the demand for the prescribed services, i.e. demand is inelastic.

In contrast, the other charges in the PIC Index are, to varying degrees, the responsibility of other entities within the port. However, the Commission recognises that PoMC can have a material influence on these other charges as the landlord of the port, including through its leasing arrangements.

The PIC Index is estimated for three different ship sizes:

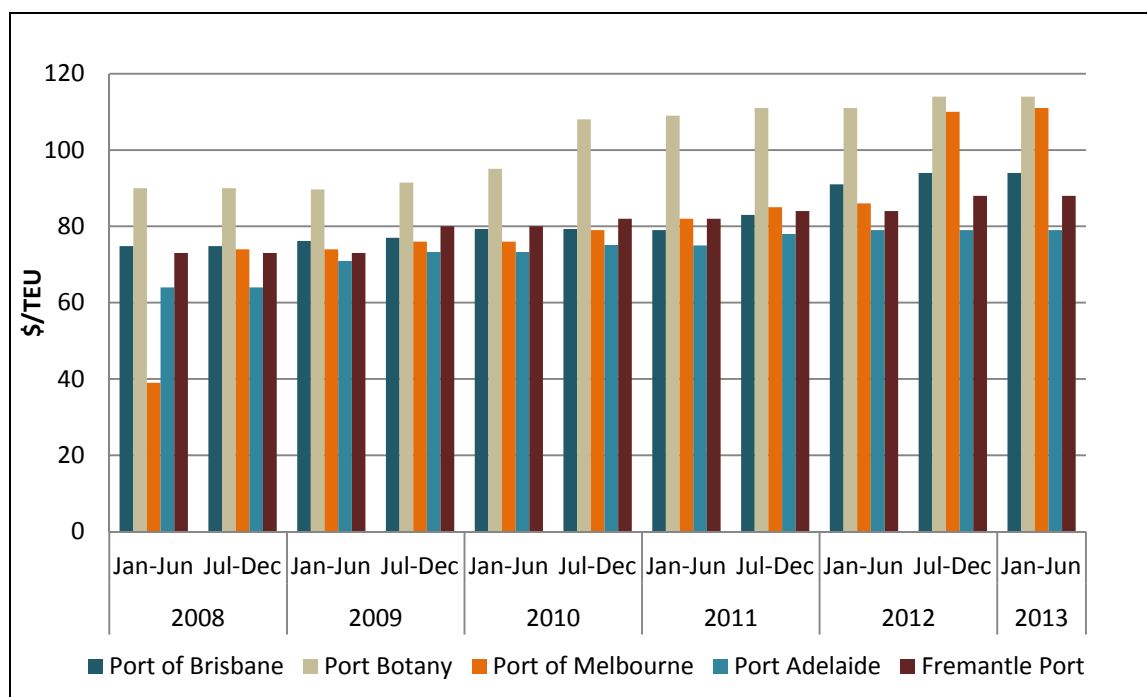
- small size ships (5 000 to 20 000 GT)
- medium size ships (35 000 to 40 000 GT)
- large size ships (50 000 to 55 000 GT).

²⁷ The distinction made between charges on imported and exported containers reflects the differential pricing exercised by port owners.

The majority of container ship visits at the Port of Melbourne are medium and large ships so the Commission has used cargo-based charges for these ships for benchmarking purposes.

In terms of the container price benchmarking outcomes, figure 4.3 indicates that PoMC’s cargo-based charges for imported containers have been consistent with those imposed by the other major Australian capital city ports since 2008-09, with Port Botany consistently the most expensive port. However, the imposition of the PLF in 2012-13 has closed the gap between PoMC and Port Botany.

FIGURE 4.3 IMPORTED CONTAINERS CARGO-BASED CHARGES



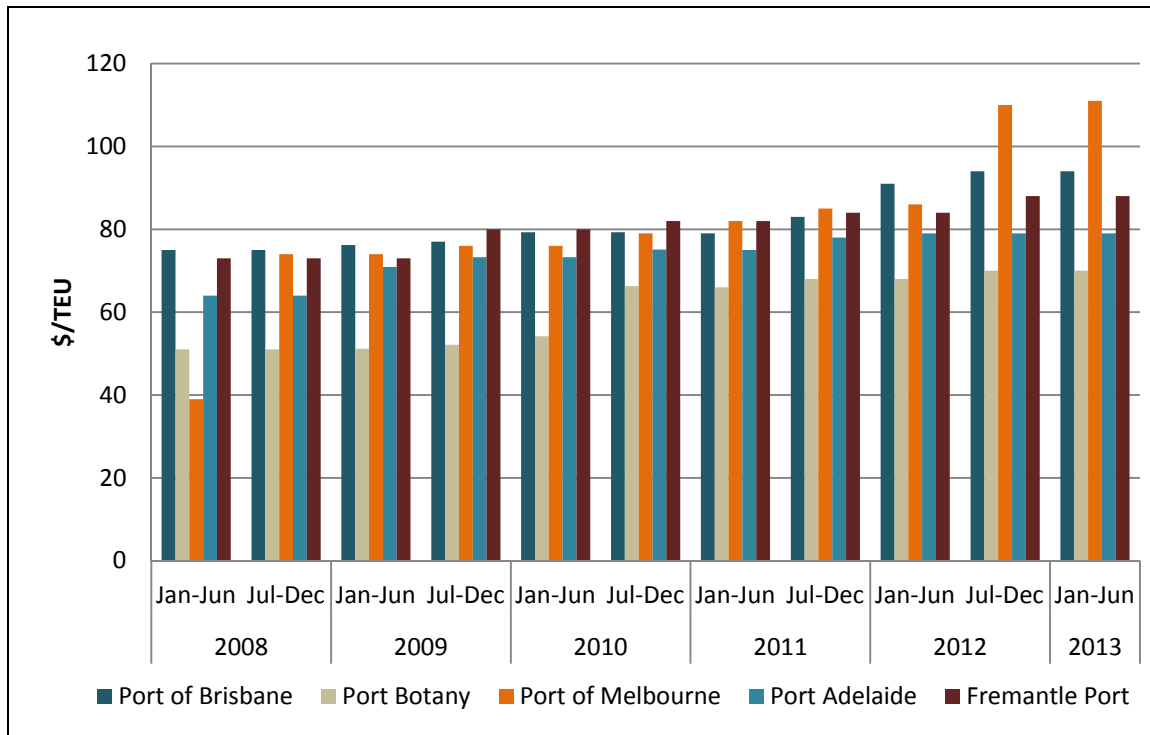
Source: Bureau of Infrastructure Transport and Regional Economics, Waterline.

Conversely, figure 4.4 indicates that PoMC’s cargo-based charges for exported containers have historically been relatively high compared to the other major ports, with the gap impacted by the introduction of the Port Licence Fee.

The relatively high charges for export containers at the Port of Melbourne potentially raises an efficiency issue given exporters are more likely than importers to face elastic

demand for their products (that is, they are likely to be price takers in the international market). The significance of this port transport competitiveness concern will ultimately depend on the total port interface costs faced by the various export trades using the port.

FIGURE 4.4 EXPORTED CONTAINERS CARGO-BASED CHARGES



Source: Bureau of Infrastructure Transport and Regional Economics, Waterline.

4.3 POMC'S SERVICE QUALITY

Indicators of the quality of services are important to the Commission's price monitoring regime because of the potential for PoMC to exercise its market power by reducing service quality.

Service quality indicators reported to the Commission are not reported consistently across major capital city ports (in contrast to the price benchmark data presented by

the BITRE). Therefore, the Commission has not sought to benchmark the service quality of PoMC with other ports but rather to assess movements in PoMC's own service quality against price movements.

The Commission also notes that the only service quality indicators of relevance to PoMC are those that it has full control over, rather than those indicators heavily influenced by the actions of terminal operators leasing land and facilities at the port.

The service performance indicators that are most influenced by PoMC are:

- the proportion of vessels that are draught constrained, which is a function of channel construction and deepening activities) and
- the proportion of vessels delayed from the scheduled berthing time or advised arrival time, which is influenced by the construction of wharves and berths to meet shipping demand.

Table 4.2 provides data on the above indicators between 2008-09 and 2012-13.

TABLE 4.2 QUALITY OF SERVICE INFORMATION

Year ending June	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)
Proportion of container vessels visiting the port that are draught constrained	57	20.8 ^a	0.0	0.0	0.0
Container ships delayed (berth not available) – off window	n/a	n/a	7.1	9.5	5.6
Container ships delayed (berth not available) – on window	n/a	n/a	2.2	1.5	1.4

^a The proportion of container vessels draught constrained in the final quarter of 2009-10 was 0.0 per cent following completion of the Channel Deepening Project, with the 12 month moving average being 20.8 per cent.

Source: Essential Services Commission

The most significant development in the period is the impact of the CDP, which resulted in the proportion of draught constrained container ships falling to 0 per cent following its completion in late 2009-10.

While the data series is short, there are no obvious adverse movements in the container ship delay indicators. In fact, the available evidence suggests an improvement in the container ship delay indicators. Consequently, there is evidence to suggest that PoMC is not exercising any market power to reduce service quality at the port.

Further to the above service quality indicators, PoMC reports customer satisfaction information to the Commission. Table 4.3 indicates a consistently high level of customer satisfaction with PoMC's overall performance. The Commission considers this to be an important indicator in capturing the dimensions of PoMC's service performance that are not practicably measurable using individual performance indicators.

TABLE 4.3 POMC'S CUSTOMER SATISFACTION DATA

Year ending June	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)
Overall Performance	69	66	69	70	70

Source: Essential Services Commission.

4.4 PoMC'S OBSERVED RATE OF RETURN

A key element of the Commission's assessment of whether PoMC has exercised a substantial degree of market power in the provision of its prescribed services is the reported profitability (often referred to as the rate of return) of these services.

Of most concern in a price monitoring context is whether a service provider is earning above normal profits for a sustained period of time, which would be indicative of the exercise of some degree of market power.

Choosing an appropriate measure of rate of return

The Productivity Commission has noted the importance of developing robust measures of the rate of return of government enterprises, such as PoMC.²⁸

Reliable measures of the rate of return on assets provide valuable information about the performance of GTEs [Government Trading Enterprises]. This can indicate whether the cost of capital is covered and shareholder value is maintained. It is particularly relevant for GTEs because other measures are unavailable (such as a share price) or difficult to estimate (such as productivity).

In simple terms, return on assets can be measured from an accounting or economic perspective.

The accounting rate of return on assets (RoA) is the ratio of earnings to the average value of assets used over the measurement period. There are a number of different forms of earnings measures that can be used including, Earnings Before Interest and Tax (EBIT), which removes the impact of discretionary decisions by a business regarding its capital structure and hence the treatment of interest and tax. Alternatively, the measure, Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) removes the impact of discretionary decisions by a business regarding the way in which it is writing down its fixed assets.

The RoA is a widely used and understood measure of the rate of return because it is derived from data readily available in published annual reports. In the current regulatory period, PoMC has reported an annual measure of RoA to the Commission.²⁹ The RoA calculation is as follows:

$$\frac{EBIT}{avg (opening \& closing) non - current assets}$$

²⁸ Productivity Commission (2007), Financial Performance of Government Trading Enterprises 2004-05 to 2005-06, Productivity Commission Research Paper, p 50.

²⁹ PoMC reports to the Commission a estimated return on capital for its whole business and for its prescribed services.

This measure provides information about how well capital is being managed, but it has a number of limitations as a measure of profitability.

Most importantly, the accounting concept of earnings used does not capture the other component of economic income, capital gains. It may also include assets valued at their historical cost (the acquisition cost, less accumulated depreciation) rather than at current market values. By not accurately capturing changes in economic or market values, an accounting rate of return can be an incomplete indicator of total returns.

A conceptually superior measure is the economic rate of return (ERR). The ERR measures the rate of return on assets in a period based on the ratio of economic income earned (earnings plus the change in the fair value of assets) to the fair value of all assets employed over the relevant period. This captures all sources of returns to shareholders and is consistent with analysis commonly used to assess investments in the private sector. However, there are difficulties employing this measure in practice, which has resulted in its limited use. Most importantly, there is the need for annual revaluations of assets to be undertaken to estimate the capital component of economic income.

In light of the advantages and disadvantages of the RoA and ERR, the Commission proposes to continue using the RoA. This is the measure against which PoMC has been reporting in the current and preceding regulatory period. Consequently, it provides a consistent data series that will allow the Commission to monitor trends in PoMC's rate of return over time.

Rate of return benchmarks

Having established an applicable measure of rate of return, there are various benchmarks which can be used to assess the reasonableness of PoMC's reported profitability in providing its prescribed services. The Commission considers there are four possible benchmarks:

- PoMC's Weighted Average Cost of Capital (WACC)
- PoMC's target rate of return
- The long term risk free rate and
- Other capital city ports.

Each of these benchmarks is discussed in turn.

PoMC's WACC

An infrastructure service provider, such as PoMC, generally requires significant funding to invest in and operate its capital-intensive business. These funds must be raised either from its shareholder, the Victorian Government (through equity) or lenders (through debt). The sum of the returns required by equity and debt holders — weighted by the proportions of equity and debt used in the capital structure — is often referred to as the weighted average cost of capital (WACC) or rate of return.

Regulatory processes often seek to assign a high degree of precision to the calculation of the WACC, particularly in the context of deterministic price regulation (that is, where a regulator actually sets prices). This is because it is a key determinant of maximum allowable revenues and much effort is invested in its development (with the associated costs) both by the regulator and regulated entity. However, in a price monitoring context, there is a question as to the need for the Commission to invest such an effort in estimating PoMC's WACC because it would not be used for revenues or price setting purposes.

The Commission has not developed an estimate of PoMC's WACC for the purpose of price monitoring in the current regulatory period and does not propose to do so in the next regulatory period.

PoMC's target rate of return

It would be possible for the Commission to benchmark PoMC's reported rate of return against its target rate of return that its owner, the Victorian Government, requires it to earn.

It would be reasonable to accept that this target rate of return appropriately recognises the risks of PoMC's business without incorporating any excess return reflective of the exercise of substantial market power. However, a problem with this target return for price monitoring purposes is that it applies to the whole of PoMC's business not just its prescribed services. PoMC's reported rate of return for prescribed services in the current regulatory period has generally been higher than that earned for the whole of its business.

Given price monitoring is focused on prescribed services, the Commission does not propose to use PoMC's target rate of return as a benchmark.

Long term risk free rate

The risk free rate is the return an investor would expect from a risk free asset. The risk free rate is a key component of the calculation of the return on equity (when using the Capital Asset Pricing Model) and the cost of debt in estimating the WACC.

Australian regulators have generally used the interest rate on a long term Australian Government reference bond as the proxy for the risk free rate, either for a 10 or 5 year term to maturity.

Any commercial business should consistently earn in excess of the risk free rate because of the business risks that it faces. A business consistently earning less than the risk free rate would be non-commercial. As such, the risk free rate provides a lower bound for a rate of return benchmark but it is unlikely to provide any insight in determining whether excess returns are being earned by PoMC.

Rates of return of other Australian capital city ports

It would be possible for the Commission to benchmark PoMC's reported rate of return against other Australian capital city ports. However, using such a benchmark, it would only be possible to compare whole-of-business rates of return not just the subset of prescribed services provided by PoMC that is the subject of the Commission's price monitoring.

In light of this limitation, the Commission does not propose to use other Australian capital city ports to benchmark PoMC's rate of return for its prescribed services.

4.4.1 RATE OF RETURN MOVEMENTS IN THE CURRENT REGULATORY PERIOD

As discussed above, the Commission proposes to continue using the RoA for regulated prescribed services. This is the measure against which PoMC has been reporting in the current and preceding regulatory period. Consequently, it provides a consistent data series that will allow the Commission to monitor trends in PoMC's rate of return over time.

Table 4.4 presents PoMC's reported return on assets since 2008-09.

TABLE 4.4 PoMC'S ACCOUNTING RETURN ON NON-CURRENT PRESCRIBED SERVICE ASSETS

Year ending June	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)
Return on assets	5.71	4.39	5.5	5.5	7.4

Source: Essential Services Commission

The Commission notes there has been a step-up in PoMC's accounting return on assets to 7.4 per cent in 2012-13, reflecting a strong increase in its earnings before interest and tax (EBIT) of around 35 per cent. This increase was driven by revenues increasing more strongly than expenses, notwithstanding the imposition of the Port Licence Fee (the largest expense in the year).

The Commission does not consider that conclusions can be drawn about the reasonableness of reported rates of return from one observation. Rather, this assessment should be based on evidence of sustained above normal profitability over a number of years.

Based on PoMC's reported accounting rate of return data between 2008-09 and 2012-13, there does not appear to be any reason to suspect that it is exercising a substantial degree of market power in the provision of its prescribed services. In the period prior to 2012-13, PoMC's reported returns appear to have been closer to the lower bound benchmark of the long term risk free rate. This conclusion is also consistent with PoMC's reported rate of return data over the preceding regulatory period.

4.5 COMMISSION'S CONCLUSION REGARDING THE EXERCISE OF MARKET POWER BY PoMC

The Commission considers that the observed movements in PoMC's prices, service quality and profitability in relation to its prescribed services over the current regulatory indicate that it is not mis-using its substantial market power to the detriment of its

customers or to the competition in related markets. By the same token, the available evidence does not justify the imposition of more heavy-handed form of economic regulation on PoMC in the next regulatory period.³⁰

The Commission considers that there continues to be a role for a light-handed form of regulation, namely price monitoring, to provide early detection of the exercise of PoMC's substantial market power in relation to its prescribed services in the future.

The next chapter of the draft report analyses the operation of the current price monitoring framework and proposes an amended framework for the next regulatory period.

³⁰ There are several types of economic regulation that can be presented along a spectrum of light-handed regulation through to heavy-handed regulation. These are outlined in Appendix F.

5 ASSESSMENT OF THE CURRENT REGIME

This chapter assesses the existing price monitoring regulatory regime.

5.1 IDENTIFYING THE REGULATORY PROBLEM

The Commission has previously undertaken reviews of port competition and associated market power issues in Victoria to determine the appropriate form of regulation, if any, to apply to prescribed services. The Commission's 2004 and 2009 reviews resulted in a progressive scaling back of the form of regulatory control and the number of services and ports regulated, reflecting an assessment of the limited extent of market power concerns. Since the 2009 review, a light-handed price monitoring framework has applied to a limited number of prescribed services at the Port of Melbourne as this was considered to be appropriate given the limited extent of the market power issues identified at this time.

In this 2014 review, the Commission's analysis in chapter 3 has found that PoMC has a substantial degree of potential market power in relation to the provision of its prescribed services. As an infrastructure service provider with a substantial degree of market power, the potential remains for PoMC to use its market position to charge higher prices than would be possible in a workably competitive market and, in so doing, sustainably earn above normal profits.

The nature of the regulatory problem in relation to PoMC therefore can best be characterised as the potential for PoMC to exercise its substantial market power and engage in 'monopoly' pricing with associated adverse consequences for economic efficiency (including due to reduced investment and port throughput). As a result, there is a case for economic regulation. However, the choice of the *form of that regulation*

needs to be tempered by the extent to which PoMC has actually exercised, that is, used its substantial market power. The Commission's analysis of the available evidence (chapter 4) indicates that PoMC has not mis-used its substantial market power in the current regulatory period. It is within this context that the Commission has assessed the appropriateness of the design and operation of the existing price monitoring framework.

5.2 APPROPRIATENESS OF THE CURRENT PRICE MONITORING FRAMEWORK

The Commission has used the following criteria reflecting good regulatory practice to guide its assessment of the appropriateness of the current price monitoring framework:

- Transparency – are the objectives and operation of the current regulatory framework clear?
- Effectiveness – is the framework appropriately addressing the regulatory problem?
- Proportionality – are the elements of the framework proportional to the nature of the regulatory problem, including the obligations currently placed on PoMC under the framework?
- Accountability – does the framework provide robust governance arrangements, which ensure the integrity of the regime's operation?

An assessment of the current regime against these criteria is set out below.

5.2.1 TRANSPARENCY OF CURRENT PRICE MONITORING

The current price monitoring framework is established by the 2010 PMD. The Commission's current price monitoring framework is a light-handed regulatory regime that requires PoMC to report to the Commission various price, service quality and financial information in relation to its prescribed services and imposes obligations on PoMC in relation to its price transparency. A key question for the Commission in this review is whether the purpose and the operation of the current price monitoring framework is clear to all key stakeholders, including PoMC, port customers/users and the Victorian Government.

In terms of the objectives of the framework, the 2010 PMD notes that it gives effect to the Commission's recommendations in its Final Report of the 2009 review, having regard to the Government response and the Minister for Finance's determination under section 54(1) of the PMA. In making the PMD, the Commission was guided by its objectives under the PMA and ESC Act. In relation to the obligations on PoMC to report business and financial information, the 2010 PMD notes that the purpose is to enable the Commission to monitor compliance with this PMD.

The current framework provides for PoMC to consult with users regarding port prices when it is developing its reference tariffs. Reference tariffs must also be published.

STAKEHOLDER VIEWS

PoMC has stated in its submission that it should not be subject to any form of price regulation. PoMC's arguments are elaborated in section 5.2.2 (stakeholder views) of this chapter.

The Tasmanian Department of Infrastructure, Energy and Resources (TDIER) has expressed concerns in its submission about the pricing of Tasmanian trades, in particular, due to the imposition of the Port Licence Fee (PLF).

Shipping Australia advises that there was no negotiation in relation to the factoring of the PLF into PoMC's prices. Shipping lines had wanted the PLF to be identifiable and separately listed in the charges, however, despite representation to this effect, this did not occur.

Both Patrick Ports and DP World support continuation of price monitoring of the port.

The Australian Peak Shippers Association (APSA) note concerns with transparency due to the fact that port users are not charged directly for port costs but rather they are recovered indirectly through the shipping lines. This makes it very difficult for shippers to compare PoMC's Schedule of Rates & Charges and those passed on to them by the shipping lines. APSA would like to see greater accountability through the logistics chain and not just between PoMC and its direct customers.

COMMISSION'S ASSESSMENT

An important function of a monitoring framework is to transparently provide information to port users and potential users about important aspects of pricing and service provision at the port. In particular, users have expressed an interest in understanding the basis of the charges that PoMC levies. This information can help inform commercial negotiations with the port.

In light of stakeholder views and the Commission's own assessment of the content of the PMD, the Commission has some doubts whether there is sufficient transparency about the objectives and operation of the current price monitoring framework regarding how PoMC's prescribed service prices are being determined.

The Commission considers that the transparency of the price monitoring framework would be improved if there was greater clarity in the PMD about the objectives of the framework. This could be achieved by inclusion of a statement in the PMD setting out the objectives of the regime, namely:

- to prevent the exercise of significant market power by PoMC, specifically by engaging in monopoly pricing in relation to its prescribed services
- to enable the Commission to monitor PoMC's compliance with the PMD and
- to enable the Commission, port users and other stakeholders to be informed about the price, service and financial performance associated with PoMC's provision of prescribed services.

These objectives recognise the role of the price monitoring framework in providing relevant information to the Commission and all other stakeholders, which should facilitate a more focused regulatory regime likely to benefit all stakeholders.

To achieve greater transparency regarding PoMC's price setting activity, users need to be able to understand the basis of the charges being levied for the use of port services, as well as terms and conditions of access. This includes the basis for allocation of costs amongst various prescribed and other services. Such information would be valuable to users when PoMC is consulting about its annual reference tariff setting. Service quality information will also be important in understanding the quality of service provided by PoMC.

The Commission sees merit in the continued reporting of key price and service quality information by PoMC as part of a price monitoring framework applying to prescribed services. The Commission considers that, to ensure that the intended benefits of economic regulation are being achieved (and that these are not outweighed by the costs), it would be beneficial if PoMC published key price and service quality information annually under the monitoring regime. Annual publication of specified information would promote transparency. Such published information would also need to be sufficient to ensure that the Commission can perform its function of monitoring compliance with the PMD. The content of information to be published is discussed in chapter 6 (section 6.4).

To promote greater transparency of the price monitoring arrangements, the Commission considers that PoMC should 'self-report' the required information rather than report directly to the Commission. Self-reporting would involve the publication on PoMC's website and in PoMC's annual report of required information (as determined by the Commission as part of this review) on an annual basis. The Commission considers that this approach would be more cost-effective than the current approach whereby a great deal of information is submitted by PoMC to the Commission.

COMMISSION'S CONCLUSION ON TRANSPARENCY

The Commission considers that a price monitoring form of regulation remains appropriate to address the economic regulatory problem of potential exercise of market power by PoMC. A light-handed approach is consistent with the nature of market power issues identified in relation to PoMC's prescribed services and also the Competition Infrastructure Reform Agreement principles (see Appendix D).

The Commission considers that the transparency of the price monitoring regime would be improved by:

- a statement of the objectives of the regime in the PMD, namely:
 - to expose any exercise of a substantial degree of market power by PoMC in relation to its prescribed services; and
 - to enable the Commission, port users and other stakeholders to be informed about the prices and service performance associated with PoMC's provision of prescribed services.

- the introduction of a self-reporting regime, whereby PoMC is required to publish the information specified in the PMD on its website and PoMC's annual report on an annual basis (and replace the need to provide information to the Commission). This information should be sufficient to enable the objectives of the regime to be achieved

5.2.2 EFFECTIVENESS OF CURRENT PRICE MONITORING

The Commission considers that the fundamental test of the effectiveness of the current price monitoring framework is whether PoMC has consistently exercised significant market power to the detriment of port users, competition in related markets and the Victorian economy more broadly.

Evidence of the exercise of market power can be ascertained by assessing whether PoMC:

- has charged excessive prices (ie. earned above normal profits over time)
- provided access on unfair or unreasonable terms and/or
- allowed service quality to decline.

STAKEHOLDER VIEWS

PoMC reasserts its long-standing position that it should not be subject to price regulation and that there are sufficient external factors and market forces to ensure that its prices remain competitive.³¹

PoMC states that it has reviewed its operating environment against the ESC Act objectives and notes that there have been significant changes to this environment since the Commission's 2009 Review, which are relevant to achievement of the objectives. These changes have impacted on the nature and level of competition faced by PoMC and include the following:

³¹ Port of Melbourne Corporation submission to the ESC's Review of Victorian Ports Regulation 2014.

- the introduction of the PLF in July 2012, which has significantly increased PoMC's prices and brought them in line with competitor ports
- the impact of the global financial crisis and re-stabilisation of global economies, which has meant that trade growth rates are now well below what they were in the pre-GFC period
 - lower trade growth volumes, which have impacted on ports ability to generate revenue and thus has intensified the competition between ports to protect market shares, in particular, the share of trade from areas that are highly contestable
- the operation of Port of Melbourne within a broader competitive transport system
 - the relevant port charges (wharfage and channel fees) of PoMC contribute only around 12 per cent of the total port interface costs
- increased concentration of international shipping alliances and the associated potential increase in countervailing power associated with this development, including impacts on which Australian ports to call, the number of services scheduled and the frequency of visits.

TDIER notes that Tasmanian businesses are extremely reliant on the services provided by PoMC and that these businesses account for a significant proportion of PoMC's customer base. This is particularly the case for Tasmania's inbound and outbound non-bulk freight task, which constitutes around 25 per cent of the freight flow through the port.

TDIER notes that the current consultation process associated with PoMC's annual Reference Tariff Schedule Review has ensured a level of consultation and transparency in how the Port Licence Fee is being recovered. However, the Tasmanian Government questions the appropriateness of PoMC's tariffs incorporating a significant cost pass-through (such as the Port Licence Fee) that is unrelated to actual port services or costs.³²

³² Tasmanian Department of Infrastructure, Energy and Resources submission to the ESC's Review of Victorian Ports Regulation 2014.

In consultations with the Commission, Shipping Australia noted that ship owners' costs have been rising considerably, including port costs, while net revenues are declining, and that these factors have impacted their members' competitiveness. In particular, Shipping Australia noted that the PLF had a direct impact on trade at the Port of Melbourne, noting that trade at the port had decreased for the last year in comparison to increases at other east coast ports.

Similarly in its consultations with the Commission, Patrick Ports noted very high price increases at the port and also delays in spending by PoMC on necessary maintenance at the port, such as repairs to the quay line and crane rails. DP World also noted concerns about delays in responding to general maintenance issues at the port.

COMMISSION'S ASSESSMENT ON EFFECTIVENESS

Based on the available evidence as set out in chapter 4, the Commission concludes that:

- PoMC does not appear to be earning above normal profits in relation to the provision of its prescribed services. If anything, PoMC's return on assets appears low
- price increases for prescribed services over the regulatory period have generally been above CPI but not significantly so. However, the biggest contributors to price increases over the current regulatory period have been in relation to the Channel Deepening Project (CDP) (a major new investment) and introduction of the Port Licence Fee (PLF) and
- based on the indicators monitored by the Commission, service quality at the port has been maintained over the current regulatory period.

Should this situation change and evidence emerge of PoMC earning above normal profits in the provision of prescribed services or otherwise misusing its market power, then the option remains for the Commission to propose a more direct and prescriptive form of regulatory control (i.e a threat of heavy-handed regulation).

The Commission considers that the threat of applying more heavy-handed forms of regulation provides a credible and effective constraint on the exercise of monopoly power. A credible threat of the application of more prescriptive regulation if market

power is misused may be triggered through scheduled reviews (such as this review) or through references to the Commission from the Victorian Government.³³

COMMISSION'S CONCLUSION ON EFFECTIVENESS

The Commission considers that stakeholder consultations and its review of the available evidence have indicated that PoMC is not misusing its market power to the detriment of its customers or to competition in up and down stream markets.

It is difficult to attribute the extent to which this situation (PoMC not exercising substantial market power) is due to the price monitoring regime or to other factors. For example, as a statutory port authority, PoMC has a number of objectives specified in relevant legislation, such as facilitation of trade and enhancing the efficiency of the landside interface of the port.³⁴ These statutory objectives provide at least some degree of constraint on PoMC exercising its market power.

Nevertheless, the Commission considers that a price monitoring framework provides a robust and effective mechanism for monitoring PoMC's performance in relation to the provision of prescribed services. In addition, the Commission considers that the possibility of restoring a more prescriptive form of regulation is an important element of the effectiveness of the price monitoring form of regulation. The threat of more prescriptive regulation provides an incentive for PoMC to avoid the exercise of a substantial degree of market power.

Should concerns emerge in the future about the exercise of substantial market power by PoMC, it remains open to the Commission to conduct an inquiry under Part 5 of the ESC Act following a referral by the relevant Minister.

³³ Section 41, ESC Act.

³⁴ For example, section 48 of *the Port Management Act* and sections 141D and 24 of the *Victorian Transport Integration Act 2010*.

5.2.3 PROPORTIONALITY OF CURRENT REGULATORY FRAMEWORK

Proportionality refers to ensuring that any framework is appropriate in that its identifiable benefits outweigh the identifiable costs, particularly those imposed on PoMC and, in turn, its users.

This section examines the appropriateness of each of the key elements of the current price monitoring framework established under the 2010 PMD, which include:

- a) a requirement for PoMC to maintain a published set of reference tariffs for prescribed services, including requirements regarding the notification of port users and the Commission of changes to the schedule of reference prices
- b) a requirement for PoMC to comply with pricing principles contained in the PMD
- c) a requirement for PoMC to publish a Pricing Policy Statement (PPS) in consultation with port users and the Commission and
- d) a requirement for the provision of information to the Commission to support its monitoring role.

These elements of the framework are discussed below followed by an assessment of the costs and benefits of the existing regime.

a) *Published reference tariffs*

The PMD requires 30 days' notice be provided to users and the Commission prior to a change to the Reference Tariff Schedule on 1 July of each year, and 60 days notice of changes that occur within a financial year.

PoMC has published a Reference Tariff Schedule as required over the current regulatory period. Regardless of the regulatory obligation, the Commission considers it to be good business practice for PoMC to do this. Other than the development of the PPS every five years, this process seems no more onerous than the normal commercial processes undertaken by businesses in workably competitive markets.

PoMC has also consulted with port users as part of the development of its reference tariffs, as required by the PMD. The main concern raised by stakeholders in relation to this consultation was the extent to which PoMC took into account stakeholder concerns.

b) Pricing principles applying to PoMC

The PMD imposes 'general pricing principles' and 'shared channel pricing principles' on PoMC (which are reflected in the PPS). These principles are consistent with pricing principles established in the Competition Infrastructure Reform Agreement (CIRA – see appendix D) and regulatory practice in Australia more generally. In addition, PoMC applies 'overarching principles' in the PPS which apply to the provision of all its services. As a result, the PPS incorporates three sets of pricing principles.

The Commission considers that three sets of pricing principles is unnecessary and likely to be confusing. The Commission remains of the view that pricing principles can provide valuable guidance to PoMC and stakeholders with respect to the setting of infrastructure prices. As a result, pricing principles continue to have merit as part of the price monitoring framework, but should be refined and simplified (see next section discussion on PoMC's pricing policy statement).

c) PoMC's Pricing Policy Statement

The Commission recognises that there is the potential for the focus of each five year price monitoring term to be misaligned with PoMC's longer term investment program. This is more likely if the PPS constrains PoMC's pricing flexibility within a regulatory period.

The Commission also recognises that port development often involves large incremental investments in new capacity, such as the Channel Deepening Project and the current expansion of container and motor vehicle capacity at the port. PoMC therefore has a legitimate concern that some of its prescribed charges will need to be planned over longer time horizons than five years.

The Commission continues to see merit in the PPS as identifying how PoMC proposes to address the general principle of earning a commercial return on its investment while not exercising significant market power.

In light of these considerations, should the Commission's recommendations be accepted by the Government, PoMC should re-frame the content of its PPS to provide greater clarity in its contents (see section 6.3 of chapter 6). Further, the Commission's view is that there would be some advantages in PoMC having a greater degree of

flexibility with respect to making changes to its PPS from time to time subject to appropriate consultation arrangements applying.

d) Information reporting

PoMC must provide, on an annual basis, audited financial accounts, service and throughput information to the Commission. The nature of information currently being provided by PoMC can be summarised as follows:

- existing corporate documents (the Annual Report, Business Plan and Port Development Plan)
- a partitioning of its annual financial accounts that provides information on each of the prescribed services and the residual aggregated non-regulated services, and information on how this apportioning is undertaken
- volume, revenue and price information on different prescribed services
- selected profit per unit and rate of return measures in relation to prescribed services
- quality of service information, including a measure of customer satisfaction in relation to PoMC.

The Commission has considered whether all of the information currently being reported to the Commission is actually necessary and, if so, if it is already available from other sources in a similar form. While the Commission no longer uses this information for annual reporting, it has been used in the preparation of this Draft Report.

The Commission considers that the current information being reported is likely to be more than is necessary to assess whether PoMC is exercising a substantial degree of market power.

The Commission considers that a self-reporting regime will be a more cost-effective and timely way to provide the information required to be reported under the price monitoring framework for the next regulatory period (2015-2020). This will allow port users and other stakeholders more complete and timely access to relevant information, while at the same satisfying concerns about monopoly pricing for users and the Commission.

This matter is discussed further in section 6.4 of chapter 6.

COSTS AND BENEFITS OF CURRENT PRICE MONITORING

Given the light-handed nature of the current price monitoring framework, the costs associated with the regime are the administrative and compliance costs imposed on PoMC. This reflects the primary burden of the framework falling on PoMC in complying with the Notice for the Provision of Financial and Business information on an annual basis (the Information Notice). The Commission also incurs administrative costs associated with ensuring PoMC's compliance with the Information Notice, undertaking any analysis in relation to the data provided, as well as preparing any price monitoring reports (although the Commission has not decided to prepare such reports in the current regulatory period).

The Commission understands that PoMC's compliance costs associated with its regulatory reporting is around \$150 000 to \$250 000 per annum. These ongoing costs are comparable with those reported by the Productivity Commission that are being incurred under the Commonwealth's current airport price monitoring regime, which entails comparable (if anything, slightly more onerous) reporting requirements. These compliance costs represent less than 0.5 per cent of PoMC's prescribed service revenues in 2013-13.

Offsetting these costs, the principal identifiable (although unquantifiable) benefit of the Commission's existing price monitoring framework relates to the effectiveness of the ongoing regulatory oversight of PoMC's prescribed service prices, to the extent that it reduces the risk of PoMC exercising market power. This benefit has been confirmed in the stakeholder consultation undertaken for this review.

The Commission considers that the effectiveness of the price monitoring framework and the transparency and accountability it provides in relation to port pricing will provide port users with greater confidence that negotiations with the port are conducted on a fair and reasonable basis and without the exercise of market power. As noted above, the Commission has no powers in relation to price approvals or dispute resolution. However, it has scope to undertake inquiries, at the request of the relevant Minister, where there is concern about the exercise of substantial market power and related adverse consequences, with the potential for more heavy-handed regulation to be applied.

Consistency with other regimes

The current price monitoring framework is also consistent with prices oversight arrangements currently being applied to the port sector in other Australian jurisdictions. While there are differences in design and operational details of the jurisdictional regimes, light-handed price monitoring is the preferred form of economic regulation at Port of Brisbane, Port Botany and Port Adelaide. Appendix E of this Draft Report summaries other Australian port regulatory regimes.

COMMISSION'S CONCLUSION ON PROPORTIONALITY

Notwithstanding the light-handed nature of the current price monitoring framework, the Commission recognises that it still imposes some administrative and compliance costs on PoMC and it is important that there is a net benefit from the imposition of this regulatory burden.

Reducing the regulatory burden

The Commission considers that there is scope for a reduction in the regulatory burden imposed on PoMC through the current annual reporting process, while still maintaining the effectiveness of the regime. However, this will need to be balanced against the need for users and the Commission to have access to sufficient information to be confident about the basis of prescribed service pricing and that PoMC is not exercising substantial market power. Importantly, information that PoMC is required to report should be carefully targeted to ensure it reflects what is required to enable the objectives of the regime to be met.

The regulatory burden for PoMC will be minimised if the Commission is able to utilise information that PoMC already releases publicly (such as annual reports, statements of corporate intent, port throughput data, individual service prices), or collects for other reporting purposes (such as participation in external benchmarking).

The Commission therefore considers that the 2015-20 regulatory framework should place a greater emphasis on self-reporting by PoMC than is currently being applied, subject to oversight by the Commission. The proposed self-reporting arrangements are discussed further in section 6.4 of chapter 6.

5.3 ACCOUNTABILITY UNDER CURRENT FRAMEWORK

The Commission considers that accountability refers to whether the reporting arrangements under the regime support the achievement of regime objectives.

STAKEHOLDER VIEWS

Shipping Australia noted it had been consulted in the PoMC reference tariff reviews each year. However Shipping Australia also indicated that PoMC did not always adequately respond or take notice of its concerns. Moreover, Shipping Australia favoured having an external body overseeing pricing for all trades in the Port of Melbourne.

The Victorian Regional Channels Authority (VRCA) noted it had regular contact with PoMC, which had taken a consultative approach.

COMMISSION'S ASSESSMENT

The key assumption underpinning the current light-handed price monitoring framework is that contractual relationships should drive commercial behavior in relation to the provision of prescribed services at the Port of Melbourne. The Commission does not see its role as becoming involved in the negotiation or administration of these contractual arrangements.

The primary form of regulatory accountability under the current framework is achieved through:

- the nature of reporting arrangements
- the periodic reviews of its effectiveness.

That is, the main form of regulatory accountability has come through obligations placed on PoMC in relation to provision of pricing, financial and service quality information to the Commission and in the development of PoMC's prescribed service prices, including development of the PPS and consultation with port users. Periodic public reviews of the regulatory framework like this current review also build accountability into the regulatory process.

Commission's conclusion on accountability

The Commission recognises that the open disclosure of output-focused key performance indicators associated with the provision of prescribed services is likely to be of most relevance to stakeholders, in particular, port customers and users. The Commission believes a modified approach would enhance accountability of PoMC in relation to its pricing and service performance. The inclusion of a complaints notification requirement would also enhance PoMC's accountability under the regime. This is discussed in the next chapter.

5.4 SUMMARY

The Commission's conclusion regarding the appropriateness of the current price monitoring framework is that it has met the relevant objectives in the PMA and ESC Act. The framework also appears to have been effective in that the evidence reported to the Commission and that is available on the public record indicates that PoMC has not mis-used its market power in current regulatory period.

The identifiable costs of the regime are primarily in the nature of compliance and administrative costs imposed on PoMC and the Commission considers that, while these are relatively low, there is scope for them to be reduced further without compromising the framework's effectiveness.

The Commission considers that PoMC's substantial degree of market power in relation to the provision of its prescribed services justifies the retention of some form of light-handed price oversight. Finally, a light-handed price monitoring framework is consistent with the economic regulation that is currently applied to major capital city ports elsewhere in Australia.

6 PROPOSED NEW PRICE MONITORING FRAMEWORK

This chapter sets out the Commission's proposed new price monitoring framework.

6.1 INTRODUCTION

In light of the Commission's analysis and findings regarding PoMC's market power and the appropriateness of the current price monitoring framework, the Commission has identified the key elements of a proposed new price monitoring framework. These are:

- retention of the existing prescribed services defined in the 2010 PMD
- PoMC should prepare and seek the Commission's approval of a new PPS at the commencement of the next regulatory period and place the approved PPS on its website
- PoMC should continue to place its annual Reference Tariff Schedule on its website
- PoMC should publish (self-report) the weighted average change in prices of each of its wharfage and channel fees for prescribed services
- PoMC should publish (self-report) a small set of service quality indicators of most relevance to port users on its website
- PoMC should publish (self-report) the Rate of Return earned on each of its prescribed services on its website
- PoMC will no longer be required to provide to the Commission annual financial accounts in relation to its prescribed services
- PoMC should provide to the Commission an annual summary of the outcomes of all of its consultation processes including stakeholder views in relation to each of its

prescribed services, including all Reference Tariff Schedule consultations. PoMC should publish on its website submissions from stakeholders

- the Commission proposes a complaints notification requirement which will enable port users to bring any matters of significant concern regarding the provision of PoMC's services to the Commission's attention.

The details of these key elements of the proposed new price monitoring framework are explained in the sections below.

It should be noted that these elements reflect the Commission's draft recommendations about the form of price regulation. The detail regarding their implementation would be considered further when establishing the next price monitoring determination.

6.2 RETENTION OF EXISTING PRESCRIBED SERVICES

The Commission considers that the potential for PoMC to exercise substantial market power in relation to PoMC's existing prescribed services justifies a monitoring regime and the proposed set of tailored price, service quality and profitability obligations applying to PoMC for the next regulatory period.

However, the Commission notes that the complaints notification element of the proposed new framework may apply more broadly than for prescribed services. This issue is discussed in section 6.6.

6.3 POMC'S PRICING OBLIGATIONS

The two key pricing-related obligations to be imposed on PoMC under the proposed new framework are:

- preparation and publication of a Pricing Policy Statement (PPS)
- preparation and publication of an annual Reference Tariff Schedule
- self-reporting of the weighted average annual changes in each of its wharfage and channel fees in relation to prescribed services.

As previously noted, the first two obligations represent a continuation of obligations already imposed on PoMC under the current price monitoring framework. However, the Commission intends that a number of changes should be made to the PPS and Reference Tariff Schedule to better inform port users of the way in which PoMC's wharfage and channel fees for prescribed services are constructed. Specifically, the Commission recommends that PoMC:

- clearly distinguish between its prescribed and non-prescribed service wharfage and channel fees in the Reference Tariff Schedule
- bring the existing overarching, general pricing and shared channel pricing principles in the PPS into one set of pricing principles applicable to the development of wharfage and channel fees for prescribed services
- provide a full explanation of the underlying basis of prescribed service wharfage and channel fees in the PPS, including the cost allocation methodology adopted
- explain the basis of the recovery of the PLF across each cargo trade
- clearly identify and explain the underlying pricing methodology for any other charges applied to the provision of prescribed services.

The self-reporting obligation proposed by the Commission in relation to weighted average annual changes in wharfage and channel fees for prescribed services will draw upon price and unit volume data that PoMC currently collects and reports to the Commission. Self-reporting of this data will improve the transparency of movements in PoMC's wharfage and channel fee increases over time.

6.4 SELF-REPORTING

SERVICE QUALITY MONITORING

The Commission sees a continued role for service quality monitoring under the proposed new price monitoring framework. However, rather than reporting a range of service quality indicators *to the Commission* as currently occurs, the Commission considers it to be of greater value to port customers and users if PoMC were *to publicly report* a small set of indicators of most relevance to port users.

The Commission recommends that PoMC should report the following service quality indicators during the next regulatory period:

- per cent of vessels delayed (berth not available)
- per cent of port users reporting satisfaction in customer surveys

The Commission's reasons for this small set of indicators are as follows.

The 'per cent of vessels delayed' indicator measures the per cent of vessels that are delayed due to a berth not being available. The Commission considers this to be the key indicator of whether PoMC has invested sufficiently in the port's infrastructure and facilities. To improve the quality of analysis of the outcomes under this indicator over time, the Commission considers that it should be reported on an 'on window' (scheduled arrival of vessel) and 'off window' (unscheduled arrival of vessel) basis. It should also be reported separately for containers and motor vehicles. The Commission notes that PoMC reports this indicator under the current price monitoring framework and no change to the way in which it is reported is necessary.

The Commission considers the indicator 'per cent of port users reporting satisfaction in customer surveys' to be an important general measure of PoMC's performance across all trades. Importantly, the outcomes under this indicator are likely to provide an early warning sign of declining service quality at the port. The Commission notes that PoMC reports this indicator under the current price monitoring framework and no change to the way in which it is reported is necessary.

The Commission's proposed small set of service quality indicators represents a reduction in the number of service quality indicators that PoMC is currently required to report. The Commission considers that public reporting of the proposed indicators will provide important information to port users on PoMC's service quality over time, as well as providing the Commission with any early warning signs regarding the potential exercise of market power by PoMC. The self-reporting obligations that have been proposed to be applied to PoMC for the next regulatory period will also reduce the regulatory burden currently imposed on PoMC.

MONITORING OF PROFITABILITY

The monitoring of profitability is a key indicator for the Commission of the potential exercise of significant market power by PoMC. Consequently, reporting of this indicator is critical to the objectives of the proposed new framework.

Return on Assets (RoA) has often been used in economic regulatory processes as a proxy for profitability. An advantage of the measure is that it is readily comparable with the Weighted Average Cost of Capital (WACC), which is often used in setting prices for regulated businesses.

An important feature of the RoA is that it is positively correlated with asset utilisation. Hence, when infrastructure is relatively under-utilised, RoA will be below the WACC and vice versa when it is congested. Asset revaluations will impact on the reported RoA, which is likely to be variable over time. This may be due to many factors other than the exercise of market power and so needs to be interpreted carefully.

However, the Commission considers that RoA can still provide a robust indicator of the exercise of market power if careful judgment is applied in relation to the estimates of RoA derived.

PoMC currently publicly reports EBIT and asset value data in relation to both its whole business and prescribed services which enable estimates of its RoA to be derived and monitored.

Under the new price monitoring framework, the Commission proposes that PoMC should publicly report the return on assets earned for its prescribed services. This will enable the Commission and port users to monitor the profitability of these services.

The Commission does not propose to make any changes to the way in which the current return on asset estimates are being calculated by PoMC.

6.5 PoMC'S CONSULTATION WITH PORT USERS

In light of the differing views expressed by stakeholders as to the nature of consultation undertaken by PoMC, the Commission sees merit in PoMC being required to provide an annual summary of stakeholder views and the outcomes of each of its consultation processes in relation to its prescribed services, including all Reference Tariff consultations.

This will enable the Commission to better understand the nature of the consultation undertaken by PoMC, as well as the associated outcomes. This information will supplement the service quality and complaints handling aspects of the proposed new framework. In so doing, it should contribute to the Commission's understanding of how PoMC interacts with port customers/users and in a general sense provide context for the Commission's assessment of market power issues during the next regulatory period.

6.6 COMPLAINT NOTIFICATION REQUIREMENT

To supplement the proposed self-reporting regime and consistent with a light-handed regulatory framework that favours resolution of issues by commercial negotiation between the parties, the Commission considers that some form of complaints notification requirement should be developed with the objective of building the Commission's understanding of the nature of complaints and associated commercial behavior of PoMC. While such a requirement would not give the Commission any role in complaints investigation or dispute resolution, it would ultimately assist the Commission to form a view about the appropriate nature of economic regulation, if any, that is required in the future.

The purpose of a notification requirement would be to enable the Commission to stay informed about emerging issues of concern at the port. It would provide an opportunity for port customers/users to raise general, or systemic issues, about port performance, including concerns about the nature or quality of consultation undertaken in setting Reference Tariffs. This may extend to matters beyond the provision of prescribed services because it would be difficult in practice to effectively ring fence complaints solely to prescribed services.

The Commission envisages the notification requirement could encompass complaints made by port users and customers, as well as industry-based complaints made through industry associations.

The Commission notes that, consistent with the intent of a light-handed price monitoring framework, any complaints notification requirement would not be an independent dispute resolution process. Rather, its purpose would be to keep the Commission informed of emerging concerns of port users and customers.

To ensure that the complaint notification requirement reflects a light-handed monitoring regime, the Commission envisages that the notification requirement would include the following elements:

- when a port user or customer (or potential user or customer), or industry association, notifies PoMC of a complaint in writing, PoMC must notify the Commission as soon as reasonably practicable
- PoMC must advise the Commission of its response to the complaint and any steps taken to address the issue raised
- the port user or customer may also notify the Commission in writing of any concerns
- the Commission would keep a record of and provide any relevant commentary in its Annual Report on the number and nature of complaints received and addressed by PoMC.

The Commission is seeking comments from stakeholders on the desirability of including a complaints notification requirement and, if so, its design. The Commission is open to alternatives to the one it has proposed.

6.7 CONCLUSION

The Commission's proposed price monitoring framework is based largely on the existing monitoring framework but with a greater reliance on PoMC self-reporting information that is of most relevance to port users.

The intent of this change is to minimise the regulatory burden on PoMC by reducing its current reporting obligations, while allowing the Commission access to sufficient information that it is able to meet its statutory objectives, including being able to monitor whether any significant market power is being exercised.

In proposing greater reliance on self-reporting, the Commission recognises that PoMC already collects a large amount of information on its price, financial and service performance and reports this information in various forums. Consequently, the Commission has attempted to avoid duplicating existing reporting obligations but rather to ensure that all required information is presented in a manner that is easy for all stakeholders to access.

7 DRAFT RECOMMENDATIONS

This chapter provides a summary of the Commission's draft recommendations.

7.1 PRESCRIBED SERVICES

The Commission proposes no changes to the existing prescribed services. That is, the prescribed services should continue to be:

- shipping channels in Port of Melbourne waters, including the shared channels used by ships bound either for the Port of Melbourne or the Port of Geelong
- berths, buoys or dolphins for the berthing of vessels carrying container or motor vehicle cargoes in the Port of Melbourne and
- short-term storage or cargo marshalling facilities for the loading or unloading of vessels carrying container or motor vehicle cargoes in the Port of Melbourne.

7.2 FORM OF REGULATION

The Commission considers that continuation of a light-handed price monitoring form of regulation is most appropriate to address the economic regulatory problem of potential monopoly pricing by PoMC.

However, the Commission has proposed some changes to the price monitoring framework established in the 2010 PMD which it considers will promote greater transparency and reflect a better balance in the costs and benefits of regulation. These proposed changes are designed to ensure the price monitoring framework is effective while minimising regulatory burden on PoMC.

The Commission's draft recommendations for the price monitoring framework are:

OBJECTIVES OF PRICE MONITORING FRAMEWORK

- The Commission proposes that the PMD include a statement of the objectives of the regime, namely:
 - to prevent the exercise of substantial market power by PoMC, including engaging in monopoly pricing in relation to its prescribed services, through price monitoring
 - to enable the Commission, port customers, users and other stakeholders to be informed about the prices and performance associated with the provision of prescribed services.

POMC'S PRICING OBLIGATIONS

The Commission proposes that:

- PoMC prepare and seek the Commission's approval of a new Pricing Policy Statement (PPS) at the commencement of the next regulatory period and place the approved PPS on its website.
- PoMC continue to place its annual Reference Tariffs Schedule on its website.
- PoMC prepare and place the weighted average annual changes in each of its wharfage and channel fees applied to prescribed services on its website

In relation to these pricing obligations, the Commission proposes that PoMC:

- clearly distinguish between its prescribed and non-prescribed service wharfage and channel fees in the Reference Tariff Schedule
- bring the existing overarching, general pricing and shared channel pricing principles in the PPS into one set of pricing principles applicable to the development of wharfage and channel fees for prescribed services
- provide a full explanation of the underlying basis of prescribed service wharfage and channel fees, including the cost allocation methodology adopted in the PPS
- explain the basis of the recovery of the Port Licence Fee across all trades and

- clearly identify and explain the underlying pricing methodology for any other charges applied to the provision of prescribed services.

SERVICE QUALITY

- The Commission proposes that PoMC publish the following service quality indicators on its website:
 - % vessels delayed (berth not available)
 - % of port users reporting satisfaction in customer surveys and

PROFITABILITY

- The Commission proposes that PoMC publish the Rate of Return earned on its prescribed services on its website.

CONSULTATION WITH PORT USERS

- The Commission proposes that PoMC provide to the Commission an annual summary of stakeholder views and outcomes of all of its consultation processes in relation to its prescribed services, including all Reference Tariff Schedule consultations. The Commission would provide relevant commentary in its annual report.

REGULATORY REPORTING

The Commission proposes that:

- PoMC will no longer prepare and report annual regulatory financial accounts to the Commission.
- a self-reporting regime will be introduced, whereby PoMC will publish the price, service quality and profitability information identified above on its website and in its annual report on an annual basis. The publication of this information should be sufficient to enable the objectives of the regime to be achieved.

COMPLAINT NOTIFICATION REQUIREMENT

The Commission sees merit in the introduction of a complaints notification requirement.

The Commission envisages that this notification requirement will include the following elements:

- When a port user or customer (or potential user or customer), or industry association, notifies PoMC of a complaint in writing, PoMC must notify the Commission of this occurrence as soon as reasonably practicable
- PoMC must advise the Commission of its response to the complaint and any steps taken to address the issue raised
- The port user or customer may also notify the Commission in writing of any concerns.
- The Commission would keep a record of and provide any relevant commentary in its Annual Report.

The complaints notification requirement would not give the Commission any role in complaints investigation or dispute resolution. Rather, it would ultimately assist the Commission to stay informed about emerging issues of concern at the port and form a view about the appropriate nature of economic regulation, if any, that is required in the future.

The Commission welcomes feedback from stakeholders on the merits of this complaint notification requirement, including any proposed amendments or alternatives.

APPENDIX A — THE PORT OF MELBOURNE

This appendix provides an overview of the major facilities and users of the Port of Melbourne.

PORT FACILITIES AND USERS

The Port of Melbourne has five main operating areas:

- **the Inner Yarra berths** — Swanson Dock, Appleton Dock, Victoria Dock, Coode Island terminals and the Southbank terminal
- **the Outer Yarra berths** — berths and terminals that handle liquid and dry bulk products
- **Webb Dock** — East Webb Dock (Tasmanian and general freight) and West Webb Dock (dedicated to vehicle imports and exports)
- **Gellibrand Pier** — located at Williamstown and dedicated to bulk imports of petroleum products and
- **Station Pier** — located at the Port of Melbourne and is a multipurpose facility used by cruise ships, visiting Navy ships and the TT-Line which operates twin RORO passenger freight vessels (Spirit of Tasmania I and II) between Melbourne and Devonport on a daily service.

Each of the five main operating areas is explained below. Figure A1 provides an overview of the main berths at the Port of Melbourne.

FIGURE A1 PORT OF MELBOURNE



Source: Port of Melbourne Corporation website

Inner Yarra berths

Swanson Dock contains the two international container terminals, which are operated by DP World and Patrick respectively:

- **West Swanson Dock** — is operated by stevedore DP World, which commenced operations in March 2011. DP World is a global marine terminal operator based in Dubai. It operates over 65 terminals around the world, including four in Australia (at the ports of Melbourne, Sydney, Fremantle and Brisbane), with container handling being the company's core business.³⁵
- **East Swanson Dock** — is operated by Patrick, which is part of Asciano. Asciano has three major entities undertaking stevedoring in containers, breakbulk and automotive and related logistics services across Australia.

PoMC is developing a third international container terminal at Webb Dock (T3), which is expected to commence operations in 2016. PoMC is currently evaluating a range of proponents.

Victoria Dock — is a single berth which is operated by Qube Ports and Bulk (Qube) and is used for breakbulk cargoes and temporary layup of vessels. Qube have until recently, solely operated Appleton Dock Berths B, C, D and E. However, PoMC has taken full control of these berths and moved to an open access system for stevedoring services across the Appleton Docks. Qube does not at present operate in container cargo handling services.

Appleton Dock Berth F — is dedicated to grain handling, with the Melbourne Port Terminal (MPT) comprising grain handling facilities and rail and road access. Grains, primarily wheat, are exported from this facility. MPT is owned by the Australian Bulk Alliance (a subsidiary of Emerald Group), and its operations are vertically integrated into upstream grain storage, logistics, shipping and marketing. MPT operates under an access undertaking approved by the ACCC.³⁶

³⁵ http://webapps.dpworld.com/portal/page/portal/DP_WORLD_WEBSITE/About-DP-World/Overview [Accessed: 28 April 2014].

³⁶ Australian Competition and Consumer Commission 2013, *Emerald Logistics Pty Ltd, Port Terminal Services Access Undertaking*, Decision to Accept, 26 September 2013.

There are seven commercial wharves at Southbank, which are used for: bulk cement (operated by the Melbourne Cement Facility); project cargo (operated by Continental Freight Services, a wholly owned subsidiary of Qube Ports and Bulk); and towage operators. The Coode Island Terminals handle the bulk import and storage of a range of hazardous and non-hazardous liquids and chemicals via the common user Maribyrnong 1 berth.

Outer Yarra berths

Berths in the Outer Yarra port precinct contain the major bulk shipping activities at the port (including gypsum and sugar or liquid bulk cargoes), utilising 5 main berths:

- Yarraville 5 – sugar, gypsum
- Yarraville 6 – bulk cargo common user operated by PoMC, used for bulk products including fertilizer
- Maribyrnong 1 – imports and exports of chemical and hazardous liquid bulk chemicals
- Yarraville Terminal/Holden Dock – jointly owned by Mobil and BP, used for refined petroleum products.

Gellibrand Pier/Breakwater Pier

The Gellibrand Pier at Williamstown is operated by Mobil Australia. The pier is used to berth Aframax oil tankers of up to 162 000 dead weight tonnes (DWT) with a cargo of up to 120 000 tonnes of crude oil.

Breakwater Pier is used to shelter operations at Gellibrand Pier and to layup small vessels.

Webb Dock

The Webb Dock precinct (figure A2) contains two separate shipping terminals: Webb Dock East and Webb Dock West. There is a large area of vacant land in the precinct which is earmarked for future terminal development for motor vehicle imports and to allow the potential development of container storage.

FIGURE A2 WEBB DOCK PRECINCT



Source: Port of Melbourne Corporation website.

Webb Dock East has three main sites leased to private operators — Toll Shipping and SeaRoad Shipping for Tasmanian freight (berths 1 and 2), and Patrick Bulk and Automotive Port Services (berths 3 to 5) (see figure A3). The latter comprises breakbulk activity and the delivery of cars. Patrick’s breakbulk services will cease before 2015 due to the redevelopment of the Patrick terminal into the third international container terminal.

FIGURE A3 BERTHS AT WEBB DOCK EAST AND WEST



Source: Port of Melbourne Corporation website.

- E1 Webb Dock East Berth 1 (Toll Shipping)
- E2Webb Dock East Berth 2 (SeaRoad Shipping)
- E3Webb Dock East Berth 3 (Patrick Ports – General Cargo)
- E4/5Webb Dock East Berths 4/5 (Patrick Ports – Car Imports)
- W1Webb Dock West Berth 1 (AAT – Car Imports and Exports)

The Eastern side of Webb Dock East has been sub-leased to firms involved in the pre-delivery inspection (PDI) and fit out of cars. Patrick Automobile operates at Webb Dock East as a full service provider from wharf to car dealer delivery (Patrick Stevedoring’s Pure Care Carrier operations and Patrick Autocare). However, Patrick will cease to conduct its automobile business at Webb Dock East by 2015. It is understood that Patrick will lease space at the Australian Amalgamated Terminals Pty Ltd at Webb Dock West and conduct limited PDI services there, with the majority of their PDI business conducted at its Laverton facility.

The longer term planning for all port automotive services in Victoria will depend on arrangements for the new leases for the automobile terminal and pre-delivery facility in 2016. Patrick Autocare is one of two successful bidders to operate at the new PDI hub at Webb Dock West.

Webb Dock West berth is used primarily for car carriers. Operations at this dock were taken over by the Australian Amalgamated Terminals Pty Ltd (AAT) in 2005 from Toll. AAT operates as a multi-user facility, with AAT providing berthing infrastructure, facility access for import and export of vehicles, stevedore access, PDI sub-lease premises and storage. AAT operates terminals in all major Australian ports, with the exception of Fremantle. While not providing stevedoring services itself, AAT provides facilities and access to stevedores holding licences for AAT terminals.

AAT is 50 per cent owned by Asciano and 50 per cent by Qube Logistics. Commercial and access arrangements between AAT and its subsidiaries in the stevedoring market are governed by an authorisation from the ACCC, which is valid until December 2019.

Station Pier

Station Pier is a multipurpose facility used by cruise ships, visiting Navy ships and the TT-Line which operates twin RORO passenger freight vessel services (Spirit of Tasmania I and II) between Melbourne and Devonport on a daily basis.

OTHER COMMERCIAL VICTORIAN PORTS

This appendix focuses on the Port of Melbourne (managed by PoMC) as it is the only Victorian port providing 'prescribed services' under the *Port Management Act 1995* (PMA). To provide context, a brief overview of other major commercial Victorian ports is given in Box A1.

BOX A1 VICTORIA'S MAJOR COMMERCIAL PORTS

PORT OF GEELONG

The Port of Geelong is Victoria's second largest port and is the largest port in regional Victoria. The port was privatised in July 1996 and is now managed by Geelong Port, a business arm of Asciano.

All commercial wharves and piers are managed by Geelong Port, with the exception of Point Wilson Explosives Pier (Commonwealth Government) and Bulk Grain Pier Number 3 berth (Graincorp). The port channels are controlled by the Victorian Regional Channel Authority. The port primarily handles liquid bulk, mainly crude oil (imports) and exports refined petroleum products; woodchips/timber products and bulk grain.

PORT OF PORTLAND

The Port of Portland is a deep water bulk port located between Melbourne and Adelaide. The Port of Portland, privatised in 1996, is owned and managed by the Port of Portland Pty Ltd (PoPL), which is vested in two infrastructure funds each with 50 per cent share: Utilities Trust of Australia (a fund managed by Hastings Fund Management) and Palisade Ports Pty Ltd (an investment managed by Palisade Investment Partners Pty Ltd).

The Port of Portland has six berths, one of which is under a long term lease to Alcoa. The port primarily handles bulk commodities, in particular, agricultural, forestry and mining products as well as aluminium and fertilizer.

Continued next page

BOX A1 (CONTINUED)

PORT OF HASTINGS

The Port of Hastings (WesternPort) has natural deep water access and is located close to Melbourne's south-eastern growth corridor. The port currently handles commercial cargo including crude oil, petroleum, and liquified petroleum gas (LPG). Facilities include three piers: Stony Point (small non-liquid vessels); Crib Point (petroleum products); and Long Island (two piers, one previously for steel and the other for LPG and crude oil).

While the port is owned by Port of Hastings Corporation, a statutory government owned corporation, it is managed by Patrick Port Hastings (PPH) (a division of Asciano) under a Port Management Agreement. This agreement covers harbour control, operations, port administration and maintenance.

The Victorian Government is currently considering its approach to strategic and commercial options for Victoria's ports. As part of this, a scoping study is being undertaken which will consider, among other things, future ownership options for the Port of Hastings and the Port of Melbourne.

APPENDIX B — EXISTING VICTORIAN ECONOMIC REGULATORY FRAMEWORK FOR PRESCRIBED SERVICES

RELEVANT LEGISLATION

The two key legislative instruments underpinning the Commission's economic regulation of the Victorian ports sector are:

- The Port Management Act (PMA) 1995 (Vic)
- The Essential Services Commission (ESC) Act (Vic).

The PMA establishes the regulatory framework that applies to Victoria's sea ports and the ESC Act establishes ESC's regulatory powers in respect of prices charged for the provision of, or in connection with, prescribed services.

The objectives which the Commission must have regard to in carrying out its functions are set out in the PMA and ESC Act (see Appendix C)

Other regulatory instruments in the ports economic regulatory framework applying to PoMC are:

- The Price Monitoring Determination for Victorian Ports 2010 (the 'PMD')
- PoMC's Pricing Policy Statement (PPS) and
- The Information Notice for PoMC 2011.

An overview of each of these regulatory instruments is given below.

PORT MANAGEMENT ACT (PMA)

The services currently prescribed under the PMA are:³⁷

- provision of channels for use by shipping in the port of Melbourne, including shared channels used by ships bound either for the Port of Melbourne or for the port of Geelong
- provision of berths, buoys or dolphins in connection with the berthing of vessels carrying container or motor vehicle cargoes in the port of Melbourne and
- the provision of short-term storage or cargo marshalling facilities in connection with the loading or unloading of vessels carrying container or motor vehicle cargoes in the port of Melbourne.

A price monitoring form of regulation applies to these prescribed services — this is given effect through the Price Monitoring Determination (explained below).

PRICE MONITORING DETERMINATION (PMD) 2010

The PMD is the key regulatory instrument that imposes obligations on PoMC in relation to the pricing and financial reporting of its prescribed services. It gives effect to the Government's response to the Commission's 2009 review recommendations and the Minister for Finance's determination under section 54(1) of the PMA.

The PMD applies for the five year period 1 July 2010 to 30 June 2015.

The main elements of the price monitoring framework are:

- an annual requirement for PoMC to maintain a published set of reference tariffs (that is, publish its prices)
- a requirement for PoMC to comply with pricing principles contained in the PMD and to prepare and publish a Pricing Policy Statement (PPS) at the start of the regulatory period

³⁷ PMA, section 49(c).

- clear requirements on PoMC to provide information to the Commission to support the Commission’s monitoring role and
- the publication of an monitoring report by the Commission the timing of which is at the discretion of the Commission.

Reference Tariff Schedule requirement

The PMD requires that PoMC will publish its Reference Tariff Schedule annually, as well as provide a copy to the Commission.

The Reference Tariff Schedule must specify:

- the charge or charges for each regulated prescribed service
- a description of the service provided for each Reference Tariff
- any applicable standards of services (service levels) that will be met in return for the payment of the Reference Tariff.

The Reference Tariff Schedule must not include charges or fees for services that are not regulated prescribed services and must separately identify the Reference Tariffs for services provided for use of or in connection with the Shared Channels.

Commission’s Pricing Principles and PoMC’s Pricing Policy Statement

The PMD sets out pricing principles, determined by the Commission, which guide PoMC in setting prices for prescribed services. The aim of these principles is to balance the legitimate commercial interests of PoMC against the public interest in ensuring that market power is not exercised. Specifically, the PMD states that PoMC should have regard to the following principles when establishing Reference Tariffs:

- a. Should generate expected revenue that is sufficient to meet the expected efficient long-run costs of providing regulated prescribed services, including a return on assets commensurate with risk
- b. Should not provide a sustained level of revenue that is significantly above that which would be or would have been sufficient to meet the efficient long-run costs of providing the regulated prescribed services, including a return on assets commensurate with risk
- c. Should not be structured to advantage the operations of the PoMC over those of a competitor in a related market, except on the basis of costs of supply

- d. Should not discriminate between users of equivalent services where those users compete in a related market, other than on the basis of differences in the costs of supply
- e. May reflect efficient forms of price discrimination as follows:
 - 1. multi-part pricing and price discrimination should be employed when these will promote efficient outcomes and
 - 2. the expected revenue raised from the prices applying to a particular service should be:
 - A. no lower than the forward-looking avoidable cost of providing that service and
 - B. no higher than that required to support the provision of that service on a stand-alone basis.

In addition to these principles, PoMC must have regard to the following pricing principles when establishing Reference Tariffs for use of the shared channels:

- a. charges for use of a shared channel should generate expected revenue equal to the specific costs of providing the shared channel and a reasonable allocation of common costs (including an appropriate return on capital)
- b. the rules by which common costs are allocated should be reasonable, the allocation basis verifiable, and the rules consistently applied
- c. the cost of improvements to a shared channel that can be demonstrated to benefit only the users of one port should be borne by users of that port and
- d. except for (c), charges for use of a shared channel should not discriminate between users on the basis of port or berth that will be used by the vessel, except on the basis of cost.

PoMC pricing policy statement

The PMD also requires that PoMC publish a PPS, following consultation with port users and the Commission. In accordance with the requirements of the PMD, PoMC's PPS includes, in addition to the PMD pricing principles outlined above, the following overarching pricing principles:

- PoMC considers pricing from a ‘whole of port’ perspective and that, when aggregated, will allow PoMC to earn a rate of return on assets that is commensurate with the risks involved. In doing this, PoMC will aim to:
 - generate an internal rate of return approaching its Weighted Average Cost of Capital
 - maintain a level of financial strength that will support an investment grade credit rating and
 - ensure that PoMC does not make a loss in any financial year.
- Each year, PoMC will communicate to the users of port services its intentions for any price increases and will take into account the views of users
- PoMC will seek to smooth price increases to minimise large steps when planned investments are scheduled
- PoMC will aim to ensure port users are charged for all uses of port facilities and that set charges are published and
- PoMC will aim to be an honest, fair and efficient port manager.

The PPS also acknowledges the Government’s expectations in terms of providing a return on capital appropriate for the risk profile of the Government’s investment and maintaining adequate financial strength to support future investment.

The PPS contains commitments regarding cost recovery of capital works. In general, these will be recovered through the normal tariff structure, although for major infrastructure capital projects, recovery may be achieved through specific charges. In this case, specific charges would be based on identified benefits to classes of port users and will be decided after consultation with port users and other stakeholders.

The PPS also acknowledges that multi-part pricing and price discrimination may be used when necessary to promote economic efficiency.

Commission’s Business and Financial Information

As part of the price monitoring framework, the PMD sets out the business and financial information that PoMC must provide to the Commission. The aim of these obligations is to enable the Commission to monitor PoMC’s compliance with the PMD and to inform

itself about the terms on which prescribed services are being provided to users. This information includes:

Financial statements

PoMC must provide, for each financial year, audited separate financial statements relating to the whole of the business and each business segment.

These statements must include:

- a profit and loss statement
- a statement of financial position
- details of capital expenditure and asset disposals
- details of any asset revaluations
- information about the provision of related services, including operating and capital expenditure (in accordance with the Information Notice (see below), obligations relating to information provision about related services is waived until otherwise notified by the Commission) and
- details of any related party transactions.

These statements must be accompanied by a Directors' Responsibility Statement, unless the Commission otherwise agrees to certification by a competent officer of PoMC.

Cost allocation statement

The PMD also provides that, for each financial year, where PoMC provides services in more than one business segment, it must prepare a Cost Allocation Statement which provides detailed explanation of how costs have been allocated between each business segment. The PMD provides guidance on appropriate cost allocation approaches.

The Cost Allocation Statement must provide the Commission with information about the value of assets employed in the provision of regulated prescribed services and associated depreciation information. However, in accordance with the Information Notice issues in 2010 (see below) this obligation is presently waived by the Commission until further notice.

Additional information

The PMD also specifies additional information that PoMC must provide to the Commission annually. This additional information includes:

- information about the source of regulated prescribed revenues
- information about the use of regulated prescribed services and related services by port users and
- indicators of service quality and productivity (to be determined by the Commission following consultation with PoMC).

The PMD also gives the Commission the ability to require PoMC to provide other business and financial information

ESC's annual monitoring report

The PMD further provides that the ESC may use the business and financial information provided by PoMC to prepare and publish Annual Monitoring Reports. Annual Monitoring Reports may contain the following information:

- changes to Reference Tariffs
- developments in structuring of reference tariffs and extent of discounting
- changes to the costs of providing regulated prescribed services
- changes in profitability of PoMC
- capital expenditure undertaken by PoMC
- statistics on use of the port, including types of cargoes and number of ships
- trends in port efficiency
- trends in service levels and
- complaints made to the Commission about the market conduct of PoMC.

The Commission last produced a Ports Monitoring Report in March 2011 for the 2009-10 financial year.

ESC'S 2011 INFORMATION NOTICE

In November 2011, the Commission issued an Information Notice to PoMC which sets out the detailed reporting requirements that PoMC must provide to the Commission on an annual basis for the 1 July 2010 – 30 June 2015 regulatory period.

This includes template tables setting out the format required for information provision. In determining the information to be reported by PoMC, the Commission considered the type of information that may be useful to users in their negotiations with PoMC and that is required by the Commission to monitor performance and resolve disputes, as well as being cognisant of the need to minimise the regulatory burden on PoMC.

The requirements set out in the Information Notice satisfy PoMC's reporting obligations under the PMD.

The Information Notice states that, for each year, PoMC must provide to the Commission:

- PoMC's Annual Report
- the information specified in the schedules to the Information Notice, in accordance with the templates provided, namely:
 - financial statements
 - cost allocation statements
 - business information and
 - certification and audit statements.
- a detailed statement of the methodologies applied to allocate each cost in the cost allocation statement
- information relating to contracts for the supply of regulated prescribed services and
- the current PoMC Business Plan and Port Development Plan.

The Information Notice also specifies which reporting obligations in the PMD are waived until further notice by the Commission. These are the obligations to report information for 'related services' and the value of assets used in providing regulated prescribed services.

Service quality

In addition to the business and financial information outlined above, PoMC must provide quality of service information in accordance with the PMD requirement. The Information Notice specifies service indicators to be provided. These include:

- For channel services
 - proportion of container vessels visiting the port that are draught constrained
 - container ships delayed (berth not available)
 - motor vehicle ships delayed (berth not available)
 - proportion of container vessels arriving at berth outside advised arrival time.
- Berth services
 - berth utilization — for whole of port, containers and general stevedore berths (used for motor vehicles)
 - moves per berth hour — for containers
 - truck turnaround time — for trucks carrying containers and motor vehicles
- Trade facilitation
 - shipping lines visiting the port — for containers, PCC vessels and non-regulated services
 - cargo throughput — for containers, motor vehicles, non-containerised breakbulk, liquid bulk and dry bulk.

PoMC must also report the results of its survey of customer satisfaction.

APPENDIX C — LEGISLATIVE OBJECTIVES

Sections 48 of the *Port Management Act 1995* provides that the Commission's objectives in relation to the regulated port industry are (in addition to the objectives under section 8 of the ESC Act):

- (a) to promote competition in the regulated industry*
- (b) to protect the interests of users of prescribed services by ensuring that prescribed prices are fair and reasonable whilst having regard to the level of competition in, and efficiency of, the regulated industry*

Section 8(1) of the ESC Act sets out the objective of the Commission:

- (1) In performing its functions and exercising its powers, the objective of the Commission is to promote the long term interests of Victorian consumers.*
- (2) Without derogating from subsection (1), in performing its functions and exercising its powers in relation to essential services, the Commission must in seeking to achieve the objective specified in subsection (1) have regard to the price, quality and reliability of essential services.*

To the extent that the specific objectives in section 48 of the PMA conflicts with the general objective under the ESC Act, the specific objective in the PMA prevails.

The ESC Act specifies a number of factors to which the Commission must have regard in performing its functions under the ESC Act. Section 8A provides that the Commission will have regard to the following matters, to the extent that they are relevant in any particular case:

Efficiency in the industry and incentives for long term investment

- (a) The financial viability of the industry
- (b) The degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries
- (c) The relevant health, safety, environmental and social legislation applying to the industry
- (d) The benefits and costs of regulation (including externalities and the gains from competition and efficiency) for –
- (e) Consumers and users of products or services (including low income and vulnerable consumers)
- (f) Regulated entities
- (g) Consistency in regulation between States and on a national basis
- (h) Any matters specified in the empowering instrument.

APPENDIX D — COMPETITION AND INFRASTRUCTURE REFORM AGREEMENT

The Victorian Government is a signatory to the Competition and Infrastructure Reform Agreement (CIRA), which was agreed to in February 2006 by the Council of Australian Governments (COAG). Accordingly, the Victorian ports regulatory framework must be consistent with CIRA commitments on port competition and regulation.

A summary of the CIRA commitments on port competition and regulation is given in Box D1 below.

This assessment has therefore had regard to the requirements of clause 4.1(a) of CIRA, which states that a port should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream and downstream markets, or to prevent the misuse of market power. Additionally, where the regulation of ports is warranted, it should ideally conform to a consistent, national approach.

BOX D1 CIRA COMMITMENTS ON PORT COMPETITION AND REGULATION

Port competition and regulation

4.1. The Parties agree that:

- a. ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power and
- b. where a Party decides that economic regulation of significant ports is warranted, it should conform to a consistent national approach based on the following principles:
 - i. wherever possible, third party access to services provided by means of ports and related infrastructure facilities should be on the basis of terms and conditions agreed between the operator of the facility and the person seeking access
 - ii. where possible, commercial outcomes should be promoted by establishing competitive market frameworks that allow competition in and entry to port and related infrastructure services, including stevedoring, in preference to economic regulation
 - iii. where regulatory oversight of prices is warranted pursuant to clause 2.3, this should be undertaken by an independent body which publishes relevant information and
 - iv. where access regimes are required, and to maximise consistency, those regimes should be certified in accordance with the Trade Practices Act 1974 and the Competition Principles Agreement.

Continued next page

BOX D1 (CONTINUED)

4.2. The Parties agree to allow for competition in the provision of port and related infrastructure facility services, unless a transparent public review by the relevant Party indicates that the benefits of restricting competition outweigh the costs to the community, including through the implementation of the following:

- a. port planning should, consistent with the efficient use of port infrastructure, facilitate the entry of new suppliers of port and related infrastructure services
- b. where third party access to port facilities is provided, that access should be provided on a competitively neutral basis
- c. Commercial charters for port authorities should include guidance to seek a commercial return while not exploiting monopoly powers and
- d. any conflicts of interest between port owners, operators or service providers as a result of vertically integrated structures should be addressed by the relevant Party on a case by case basis with a view to facilitating competition.

4.3. Each Party will review the regulation of ports and port authority, handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with the principles set out in clauses 4.1 and 4.2.

- a. Significant ports include:
 - i. Major capital city ports and port facilities at these ports
 - ii. Major bulk commodity export ports and port facilities, except those considered part of integrated production processes and
 - iii. Major regional ports catering to agricultural and other exports.

Data source: Competition and Infrastructure Reform Agreement, National Competition Policy Review, Attachment B, Appendix E, 10 February 2006, p. 44. Available at: http://archive.coag.gov.au/coag_meeting_outcomes/2006-02-10/docs/attachment_b_ncp_review.pdf [Accessed 18 March 2014]

APPENDIX E — SUMMARY OF ECONOMIC REGULATION AT AUSTRALIAN PORTS

QUEENSLAND

The *Transport Infrastructure Act 1994* (Qld) establishes the rights and powers of port authorities, including the right to levy charges for a broad range of activities associated with the operation and maintenance of the port facilities (section 279A). This section requires port entities to publish standard charges and conditions on their websites. There are no prices oversight provisions established in the Act.

PRICES OVERSIGHT

The Queensland Competition Authority (QCA) has the power under Part 3 of the *Queensland Competition Authority Act 1997* to undertake investigation and reporting about pricing practices relating to monopoly business activities.

While the QCA can conduct investigations of monopoly business activities, it does not have the power to make pricing determinations. Rather, under Division 3 section 22 of the Act, a price monitoring investigation in relation to a monopoly business activity means an ongoing investigation in which the QCA monitors pricing practices relating to the activity, or reports periodically to the relevant Ministers about the results of the investigation.

The person carrying on the monopoly business activity must give its written response to the QCA's report, including details of any action the person will or may take in response to each recommendation contained in the report.

Under Division 5 section 37B, the QCA may, if requested by a government agency or another person carrying on a monopoly business activity, give the person advice about pricing practices relating to the activity. This advice is non-binding on the recipient.

No government or private service providers have been declared for a pricing investigation since the establishment of the QCA in 1997.

THIRD PARTY ACCESS REGIME

Part 5 of the QCA Act establishes an access regime that can be applied in relation to significant infrastructure services, including port infrastructure, subject to specified access declaration being satisfied.

Under section 76, the QCA can recommend that a service be declared by the Ministers and the Ministers can declare a service if the access criteria are satisfied.

Under section 77, a person may ask the QCA to recommend that a particular service be declared by the Ministers. The Ministers may ask the QCA to consider whether a particular service should be declared by the Ministers.

Dalrymple Bay coal Terminal

The Dalrymple Bay Coal Terminal (DBCT) at the Port of Hay Point is the only port in Australia that is subject to deterministic price regulation. This form of regulation was first applied as part of the Queensland Government's sale of a 99 year lease in the terminal.

DBCT coal handling services are regulated by the QCA under Part 5 of the QCA Act. The QCA is required to approve access undertakings that are submitted by DBCT Management, the terminal owner. The access price for DBCT's regulated terminal services is determined by applying the building block cost of service model (a heavy-handed form of regulation).

Access declaration application

There has only been one declaration application in relation to port services under Part 5 since the QCA Act was established.

On 17 July 2009 (revised 15 September 2009), the Federal Chamber of Automotive Industries (FCAI) lodged an application under section 77 of the QCA Act requesting the QCA recommend that the Ministers declare for access 'the motor vehicle import services provided by the Fisherman Islands cargo terminal' operated by Australian Amalgamated Terminals Limited. On 21 April 2011, the Authority determined that the vehicle import service is not a 'candidate service' within the meaning of the QCA Act as in force at the time the Application was made. Accordingly, the QCA stated that it was not empowered to make a recommendation to Ministers on whether the service should be declared.

Port of Brisbane's reporting obligations

Under section 20.3 of the Port Lease, Port of Brisbane Propriety Limited (PBPL) must prepare annually and publish on its website within 120 days after the end of its financial year, a limited financial statement on its marine side (channels and wharves) operations. The data currently being published on its website includes:

- operational revenues, broken down into harbour dues, wharfage and other river dues categories
- operational expenses
- depreciation
- overhead allocation
- operating profit from marine side operations and
- asset base value.

PBPL must also publish on its website 30 days after the end of each quarter, its current port charges and volume data for each of the containers, motor vehicle and bulk cargo trades.

Under section 20.4 of the Port Lease, PBPL must provide specified trade data to the State Government for the purpose of assisting the State prepare a number of trade statistics publications and reporting and planning activities.

PBPL has also published an access undertaking to facilitate the provision of access to port services and facilities at PoB on a commercial and non-discriminatory basis. However, this access undertaking is voluntary and not a lease obligation, nor is it approved by an economic regulator.

NEW SOUTH WALES (NSW)

The NSW Government has recently made amendments to the *Ports and Maritime Administration Act 1995* (NSW) (PMAA) to establish a price monitoring regime for the following ports:

- Botany Bay
- Sydney Harbour
- Port Kembla
- Port of Newcastle
- Port of Eden and
- Port of Yamba.

The PMAA also provides the framework for port charges generally. Notably, the price monitoring regime under Part 6 of the Act is administered by the Minister for Roads and Ports (the Minister) and not the state-based independent economic regulator, IPART.

A summary of the PMAA framework as it relates to price monitoring is set out below.

PRICE MONITORING

Obligations to publish information

The PMAA requires the port owner to publish service charges for the port. This excludes rent and other amounts payable under a lease, as well as charges made under an agreement, but includes navigation and pilotage charges, site occupation, wharfage, and port infrastructure charges.

The operator must also notify the Minister in advance of implementing any proposed change in the port service charges and must publish any proposed change on its website prior to that change occurring.

If a new charge is to be levied, the port operator must publish information about the basis of the charge and the calculation of the amount of the charge and to whom the charge applies. For new port infrastructure charges, the port operator must publish details about the charge, provide the basis for the amount of the charge, who must pay the charge and the period of time the charge is proposed to apply.

Annual reporting to Minister

The port has an obligation under the price monitoring regime to report annually to the Minister, in respect of the previous financial year:

- a list of the types of service charges charged by the port operator
- the revenue received by the operator from service charges (showing the amount received for each separate charge)
- the total number of units charged for where applicable (ie. where service charge is based on number of chargeable units, such as vessel gross tonnage) and
- if the amount of a charge was varied during the financial year, the amount of variation and reason for it.

The Minister also has the power to require information relating to port service charges from the port operator, where the Minister is reasonably satisfied this is necessary to achieve the scheme objective and that the likely cost to the port operator of complying is not disproportionate to the benefit.

Reports by Minister

The PMAA provides for the Minister to, from time to time, publish reports and statements about the charges at a port.

SOUTH AUSTRALIA (SA)

In 2001, the privately owned Flinders Ports Pty Ltd (Flinders Ports) acquired a 99 year lease and operating license for Port Adelaide and six regional ports (Port Giles, Wallaroo, Port Pire, Port Lincoln, Thevenard and Klein Point). The *Harbour and Navigation Act 1993* (SA) gives a delegated power (from the Minister) to Flinders Ports to set charges for the use of its facilities and services and for entry of vessels into controlled waters.

RELEVANT LEGISLATION

Economic regulation of ports in SA only applies to ‘proclaimed ports’ under the *Maritime Services (Access) Act 2000* (the MSA Act). This Act came into operation in October 2001 and provides for access to South Australian ports and maritime services on fair commercial terms and to regulate the price of essential maritime services. Essential maritime services are declared under the *Essential Services Commission Act 2002* (the ESC SA Act).

REGULATED PORTS AND SERVICES

The access regime prescribed by the MSA Act applies to those 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. In accordance with section 5 of the MSA Act the following ports were proclaimed on 25 October 2001 to be subject to the requirements of the MSA Act:

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

The first six remain proclaimed ports and are operated by Flinders Ports. Ardrossan was removed from the coverage of the Access Regime following Essential Services Commission of South Australia’s (ESCOSA) port and access pricing review in 2007.

ESCOSA regulates three types of port services – Essential Maritime Services; Regulated Services; and Maritime Services. Section 4 of the MSA Act defines Essential Maritime Services as:

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

ESCOSA specifies that the term ‘Essential Maritime Services’ encompasses the following services:

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

These services are typically covered by three port charges – Navigation Services Charge; Harbour Services and Mooring Charge; and Cargo Services Charge. While in aggregate these three charges are intended to cover the Essential Maritime Services that are provided at the ports, there is no particular requirement for each individual charge to correspond to the precise definitions provided in section 4 of the MSA Act.

A similar set of services is also classified as ‘Regulated Services’. These include:

- channels
- common user berths
- bulk handling facilities as defined in the *South Australian Ports (Bulk Handling Facilities) Act 1996* (operated by Viterria) 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 Harbour bulk loader at Port Adelaide.

A ‘Maritime Service’ is a service provided on a commercial basis of any of the following kinds:

- providing or allowing for access of vessels to a proclaimed port
- a pilotage service facilitating access to a proclaimed port
- providing berths for vessels at a proclaimed port
- providing port facilities for loading or unloading vessels at a proclaimed port

- providing for the storage of goods at a proclaimed port
- providing access to land in connection with the provision of services of any of the kinds mentioned above

but does not include any of the following:

- a towage service for facilitating access to a proclaimed port
- a bunkering service provided at a proclaimed port
- a service for the provisioning of vessels (including the supply of electricity and water) within a proclaimed port
- a service for the removal of waste from vessels at a proclaimed port.

GENERAL APPROACH TO PRICING

Under Part 3 of the ESC Act, ESCOSA may make determinations regulating prices for goods and services in a regulated industry if authorised to do so (section 25). Section 6 of the MSA Act provides this authorisation for ESCOSA to make price determinations relating to essential maritime industries. ESCOSA has a wide discretion to make such determinations including:

- fixing a price or the rate of increase of a price
- fixing a maximum price or maximum rate of increase of a price
- fixing an average price for a bundle of goods or services
- specifying an amount determined by reference to a general price index
- monitoring price levels.

In 2007, ESCOSA made a price determination that required regulated service providers to publish a list of prices for Essential Maritime Services and authorised itself to monitor the prices of these services.

ESCOSA has subsequently continued to publish price monitoring reports on an annual basis under its price monitoring regime. The purpose of these reports is to provide port customers with information regarding port costs at the proclaimed ports. For the 2008 and 2009 reports, ESCOSA has adopted the approach of monitoring prices by focusing on trends rather than seeking to benchmark prices charged by ports in South Australia against prices charged by ports outside of South Australia.

In its recent assessments, ESCOSA has adopted the approach of requiring port operators to justify their price increases where a price is shown to increase by more than CPI. For example, in its most recent price monitoring report where price increases were observed to be above CPI, ESCOSA examined information provided by Flinders Port as well as price movements that have occurred in other jurisdictions. It also considered the level of investment required at the port to meet expected future demand and improve efficiency. It also published an independent report by BDO verifying that the regulatory accounts of Viterra and Flinders Port had been prepared in accordance with ESCOSA's guideline.

Maritime services are subject to a range of review and notification processes, including:

- notification (a form of price regulation) of changes to pilotage charges
- development of service standards as appropriate and
- keeping maritime industries under review to determine whether regulation (or further regulation) is required.

SA PORT ACCESS REGIME

Regulated Services are subject to regulation under the ports access regime established under section 3 Part 3 of the MSA Act. A Regulated Service is a maritime service declared by proclamation.

This legislation provides a framework for the negotiation of access to Regulated Services on 'fair and commercial terms' (section 11). Fair terms are consistent with ESCOSA's current pricing determination on a Regulated Service. If a commercial agreement cannot be reached, a dispute can be referred to ESCOSA (section 15), with the Act providing for conciliation (by ESCOSA) and arbitration (by an independent arbitrator) for unresolved disputes between parties.

In May 2011, the SA access regime was certified as an effective regime under Part IIIA of the *Competition and Consumer Act 2010*. It is currently the only effective port access regime under Part IIIA.

SOUTH AUSTRALIA 2012 PORTS PRICING AND ACCESS REVIEW

ESCOSA has recently completed a review of the continued need for prices oversight of services provided by Flinders Ports. ESCOSA concluded that the existing price

monitoring regime and third-party access regime should continue beyond 30 October 2012, for at least another five years. This conclusion was based on its key finding that there were no persuasive arguments for the extension of the access regime's coverage and the introduction of a more intrusive form of ring-fencing arrangement going forward.

ESCOSA's findings are consistent with a Government review of market power and competition issues at the ports in 2008.

WESTERN AUSTRALIA

In Western Australia, the *Port Authorities Act 1999 (WA)* establishes eight government owned port authorities: Fremantle Port Authority; Albany; Broome; Bunbury; Esperance; Geraldton; and Port Hedland.

There is no Ministerial approval of port charges of these port authorities, nor is there independent regulatory oversight of their port charges. section 27 of the Act gives the port authorities the power to levy "such port charges as the port authority determines". However, the port authorities' discretion in performing their functions is subject to directions of the Minister (sections 71 and 72).

Ports in WA are not a 'regulated industry' for the purpose of the *Economic Regulation Authority Act 2003*. However, the relevant Minister is able to direct the Economic Regulation Authority of WA (ERA) to inquire into or report on non-regulated industries.

Industry-specific port-related legislation also exists in WA that facilitates access to specified port facilities, in particular through the *Western Australian Bulk Handling Act 1967*, *Wheat Export Marketing Act 2008 (Commonwealth)* and the *Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004*.

Access to iron ore ports in Western Australia is generally subject to State Development Agreements between the WA Government and the infrastructure developer/provider. None of the port access regimes in WA, including the one owned by The Pilbara Infrastructure, have been certified as an effective regime under Part IIIA of the Competition and Consumer Act.

TASMANIA

The Tasmanian Ports Corporation (TasPorts) was established under the *Tasmanian Ports Corporation Act 2005* (the TPC Act).

TasPorts is fully owned by the Tasmanian Government and is responsible for the operations and management of all ports in Tasmania.

The TPC Act is silent regarding TasPort's ability to levy fees and charges. There are also no provisions regarding access to TasPort's infrastructure.

Section 6 of the *Economic Regulator Act 2009*, provides scope for the Minister to declare services to be prescribed monopoly services, if the Minister is satisfied that it is a service for which:

- there are no other suppliers to provide competition in the relevant market and
- there is no contestable market by potential suppliers in the short-term.

Declaration will trigger an investigation by the Office of the Tasmanian Economic Regulator into the pricing policies of a monopoly service provider providing prescribed monopoly services.

However, none of TasPort's services have been declared as prescribed monopoly services.

Tasmania is the only Australian jurisdiction that does not have any significant ports identified under the CIRA.

NORTHERN TERRITORY

Port charges of the government owned Port of Darwin are approved by the relevant shareholding Minister under the *Darwin Port Corporation Act 2009* (NT). Changes in the port's pricing structure must be approved by the Minister, although individual variations do not (section 17A).

Under the current legislative framework, there is no independent regulatory oversight of port charges.

APPENDIX F — FORMS OF REGULATION

There are several types of economic regulation which may be presented along a spectrum of light-handed regulation through to heavy-handed regulation.

Heavy-handed forms of economic regulation typically are highly prescribed and include some form of price control whereas light-handed forms of regulation generally involve no direct price control but rather some kind of monitoring or notification role. How heavy or light-handed a form of regulation should be is usually determined by the context and degree of market power and the scope to misuse that power.

The following are the most common forms of economic regulation:

- **Formal price/revenue control (cost of service regulation)** — this form of regulation heavy-handed and is aimed at controlling the prices charged and revenue collected by monopolists via the regulator capping prices and/or setting the amount of revenue a regulated firm may raise such that it only covers the expected efficient costs associated with providing the regulated service. This form of regulation is based on cost of service regulation
- **Negotiate arbitrate models or access regulation** — this form of regulation provides customers with a legislated right to negotiate access with a provider of an essential facility so that a business or firm can compete in a related market. For example, a train operator wishing to compete in the market for hauling freight would need access to the rail track. This form of regulation is usually backed up by arbitration where disputes occur or negotiations fail. Negotiation arbitrate regimes are often supported by some form of access undertaking/arrangement and pricing principles which set out up-front the terms and conditions for negotiating access. Can be light-handed but often heavy-handed in practice.

- **Monitoring regimes** — this form of regulation is a light-handed form of regulation and includes price monitoring, public reporting and service quality regimes. This form of regulation requires regulated firms to disclose certain business and financial information to facilitate the monitoring of prices, service quality and performance standards.
- **Index based regulation** — combines the initial cost base and subsequent escalation of prices in line with a broad based price index. This approach is generally less information intensive than cost of service regulation. It generally relies on existing cost and price levels and escalates in line with an index such as CPI or an industry wide price index.