

Port of Melbourne
Corporation



Port of Melbourne Corporation

Response to the ESC Ports Regulation Review Issues Paper

February 2009

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1 Executive summary

Port of Melbourne Corporation (PoMC) is pleased to make this submission in response to the Issues Paper released by the Essential Services Commission (ESC) on 7 January 2009 to commence its review of the regulation of “prescribed services” under section 53 of the Victorian *Port Services Act 1995* (PSA).

The ESC’s 2009 review takes place in the wider context of:

- The framework for achieving a simpler and nationally consistent approach to economic regulation of significant infrastructure agreed by Council of Australian Governments (COAG) in February 2006 and, in particular clauses 4.1(a) and (b) of the Competition and Infrastructure Reform Agreement (CIRA).
- The strategic direction set by the Victorian Government in its December 2008 “Freight Futures” strategy and the proposed release of a “Port Futures” strategy in 2009 to ensure that the policy framework for Victoria’s ports can respond to the pressures and challenges of the future.
- The dynamic commercial environment for global trade and international shipping in which PoMC makes its investment decisions.

PoMC’s understanding is that, following the ESC’s final report under section 53 of the PSA, the Minister administering the *Essential Services Commission Act 2001* (ESC Act) will determine whether “prescribed services” should continue to be subject to price regulation having regard to the principles in clause 4.1 of the CIRA, in particular the principle that ports should be subject to economic regulation only where there is a clear need for regulation to promote competition in dependent markets or to prevent misuse of market power.

If the Minister determines that “prescribed services” are to be subject to continued price regulation under the PSA, Section 54 of PSA provides that price determinations will then be made by the ESC in accordance with Part 3 of the ESC Act.

PoMC's position is that:

- PoMC does not itself enjoy substantial market power within the supply chain and a distinction between the port of Melbourne and PoMC needs to be made. Whilst PoMC has a broad role in facilitating trade and recognises the large number of customers of the port, PoMC's immediate commercial customers in the supply chain are the shipping lines where PoMC lacks power and influence.
- PoMC is a statutory entity established under the PSA to support the growth of the port in an economically sustainable manner and on a fair and reasonable basis. The requirements of the PSA guide the operations of PoMC and are reflected in its corporate planning. Regulation of "prescribed services" under the PSA does not promote competition
- Continued regulation of PoMC under the PSA regime does not meet COAG principles for the regulation of essential infrastructure and in particular the principles in clause 4.1 of the CIRA relating to the economic regulation of ports. CIRA reviews in Queensland and New South Wales have determined that regulation of their ports is not required.
- PoMC is subject to direct competition from other ports and continues to invest in trade and business development to secure and grow trade throughput and to further support the growth and investment in the Victorian economy.
- Requiring PoMC to operate within a regulatory template does not further PoMC's ability to respond in an innovative manner to a changing commercial environment, potentially impacting on Victoria's competitive advantage for exporters and importers.

2 Introduction

Port of Melbourne Corporation (PoMC) is pleased to take this opportunity to respond to the Issues Paper released by the Essential Services Commission (ESC) on 7 January 2009 to commence its review of the regulation of “prescribed services” under section 53 of the Victorian *Port Services Act 1995* (PSA).

The ESC’s 2009 review takes place in the wider context of:

- The framework for achieving a simpler and nationally consistent approach to economic regulation of significant infrastructure agreed by the Council of Australian Governments (COAG) in February 2006 and, in particular clause 4.1(a) and (b) of the Competition and Infrastructure Reform Agreement (CIRA).
- The strategic direction set by the Victorian Government in its December 2008 “Freight Futures” policy statement and the proposed release of a “Port Futures” policy statement in 2009 to ensure that the policy framework for Victoria’s ports can respond to the pressures and challenges of the future.
- The dynamic commercial environment for global trade and international shipping in which PoMC makes its pricing and investment decisions.

PoMC’s submission focuses on the following critical issues:

1. The analytical framework for understanding the dynamics of the market environment in which PoMC operates and assessing whether or not PoMC has genuine market power. This goes to the heart of the rationale for regulation, particularly in light of the principle agreed by COAG in 2006 as part of the National Reform Agenda that ports should be subject to economic regulation only where there is a clear need for regulation to promote competition in dependent markets or to prevent misuse of market power.
2. PoMC’s role under the Port Services Act.
3. The COAG framework for the regulation of essential infrastructure and the specific commitments made by the Victorian Government regarding economic regulation of ports, in particular the issue of

whether continued regulation of PoMC under the PSA regime meets the principles in clause 4.1 of the CIRA.

4. Competition between ports and the investment PoMC makes in business development to secure and grow trade throughput in the contestable areas.
5. The consequences of on-going regulation on the flexibility of PoMC to respond in an innovative manner to the competitive challenges of the marketplace, and to maintain and grow a commercially sustainable business which delivers competitive advantage to the State of Victoria.

The starting point then is to understand what PoMC (as the regulated legal entity) does, the services it supplies and its legal relationships with users of its services. These are discussed in section 3 of this submission. Section 4 outlines the role PoMC plays in accordance with the PSA, Section 5 addresses the question of regulation relative to the CIRA principles, Section 6 discusses competition between the ports and Section 7 considers PoMC's future challenges and the impact of on-going regulation on PoMC's ability to respond to future challenges. Conclusions and comments as to process are set out in section 8.

3 The market in which PoMC operates

PoMC's role and supply relationships

The structural approach reflected in the ESC's 2004 review of Port Services relied on defining the structure of the relevant market and from that drawing conclusions about competition and market power. Under the *Trade Practices Act 1974*, the Australian Competition Tribunal, the Federal Court and the High Court have had considerable experience in analysing market power and the conditions under which it exists. Lessons from the Courts have revealed the shortcomings in the structural approach and the need for a more dynamic framework for analysis based on identifying commercial relationships and the nature of constraints on firms under analysis.

For example, the Competition Tribunal has stated that:

*"In order to assess whether there will be competition in a market, the traditional approach has been to look to the structure of the market...However we believe that to determine whether participants in a market are in a position to compete, that is, to contest for the business of consumers, one should look at a number of factors that contribute to the way parties interact in the market."*¹

and that market share is a mere snapshot that:

*"...tells us nothing about the conduct in the market leading to that market share, or about the potential dynamic interaction in that market with other competitors within the market who have either recently entered it or who have recently commenced an expansion of their activities in it."*²

Further, the High Court has explained that "the essence of [market] power is the absence of constraint" and that "matters of degree are involved".³ The sources of these constraints may or may not be obvious

¹ Qantas Airways Limited [2004] ACompT 9 at paragraph 304.

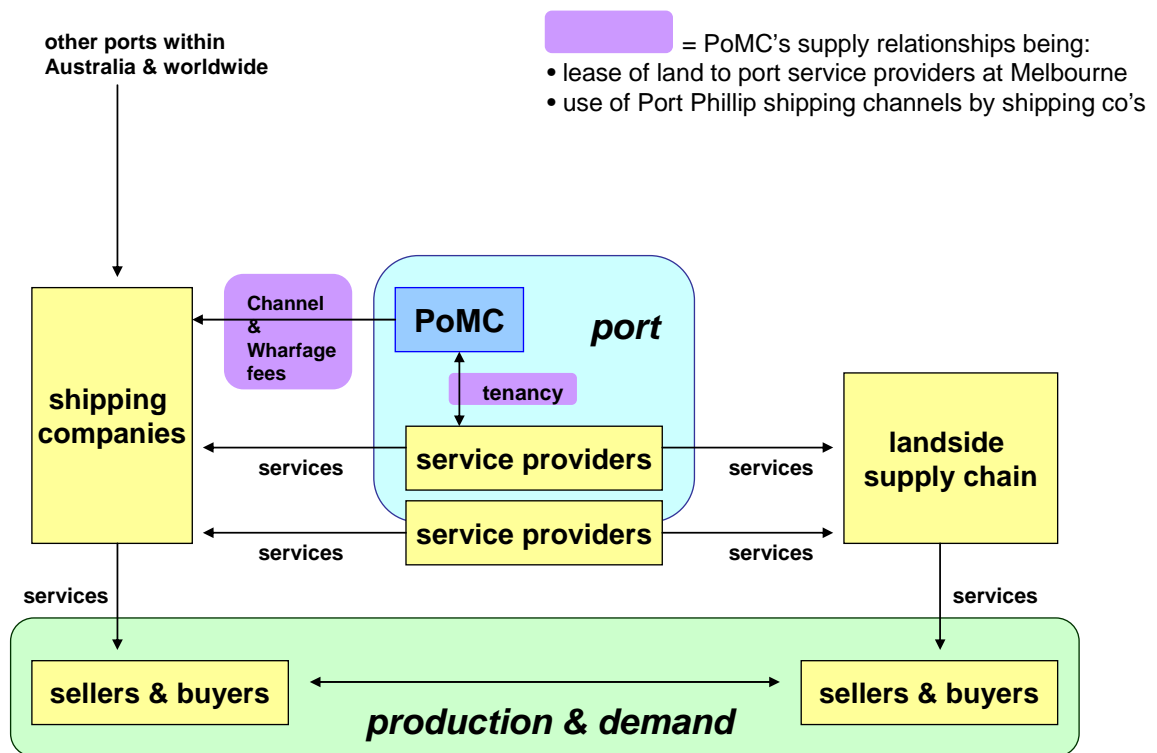
² Qantas Airways Limited [2004] ACompT 9 at paragraph 430.

³ Boral v ACCC [2003] HCA 5 at paragraph 121.

in the structural approach. As French J of the Federal Court (now Chief Justice of the High Court) commented:

“The competitive process is informed by the rivalry of the participants and the potential rivalry of potential participants. Competition so understood is conceptually distinct from the idea of the market and the elements of market structure which may constrain or facilitate it.”⁴

The diagram below represents PoMC’s role and supply relationships.



⁴ AGL v ACCC (No3) [2003] FCA 1525 at paragraph 350.

International freight is generated by commercial buy/sell transactions between shippers of goods who deal directly or indirectly with a range of sea and land transport providers, such as international shipping lines, to ensure delivery of the goods from origin to destination.

Basically, PoMC's business is to provide the physical infrastructure for ships to load/unload freight at the port of Melbourne; it is not generally directly involved in the actual provision of port services to ships or the movement and storage of freight at the port. Hence, a distinction must be drawn between PoMC and the port of Melbourne.

The port of Melbourne customers are diverse in need and base, from international shipping lines, through terminal operators, tenants, service providers, transport operators, cargo owners etc. PoMC has a role as (as outlined by the PSA) to facilitate trade and recognises and works with the broad customer base of the port to achieve this. From a technical supply chain perspective, PoMC's commercial customers are the shipping lines, to whom PoMC charges fees for the use of this physical infrastructure (to cover capital costs and maintenance). These 'fees for use' comprise a per vessel charge (on a gross tonne basis) and a per TEU or per revenue tonne basis on the volume of cargo loaded or discharged.⁵

In accordance with normal supply chain relationships, many of these charges will be passed through to the cargo owner.

The shipping lines also deal with a range of other service providers at the port (in particular, stevedores/terminal operators) who charge 'fees for their services'.

PoMC's relationship to the stevedores and other service providers is generally based on commercial property lease agreements. These include periodic rental reviews and in some cases determinations as would be in a typical landlord/tenant relationship. Rental income is 22% of PoMC's total revenue which is already subject to external market review and independent determinations.

⁵ Where vessels use the common berth facilities, there is sometimes an additional charge by PoMC for use of the berth.

Does PoMC have genuine market power?

The Courts have consistently emphasized that market share or large size does not equate to market power. What is important are the constraints that exist in commercial reality, regardless of whether those constraints come from within or outside the traditional market definition used for competition analysis.

Given that a critical relationship for analyzing the existence of market power on the part of PoMC is its relationship with the shipping lines who are its customers, it is necessary to understand the market(s) in which these shipping lines operate. Considerable analysis of international liner shipping has been undertaken by the ACCC and other competition bodies around the world: for example see the ACCC's 6 September 2005 Public Competition Assessment in relation to the acquisition of P&O Nedlloyd by Møller-Mærsk; the ACCC's April 2006 report to the Minister in relation to the Australia to Europe Liner Association; the ACCC's 2004 report to the Minister in relation to the Asia Australia Discussion Agreement; and the OECD's April 2002 Report on Competition in Liner Shipping.

The ACCC in the documents mentioned above has described the following dynamic characteristics of international liner shipping, which are relevant to this analysis:

- shipping lines operate across geographical markets defined in terms of trade routes between regions (e.g. North Asia and Australia) rather than port pairs;
- for trade routes to / from the Australian region there are two different submarkets within Australia, being the east coast including Adelaide on the one hand and Fremantle on the other;
- there are low barriers to switching between trade routes (vessels can enter and exit trade routes with minimal sunk costs);
- there are low regulatory barriers to entry or expansion;
- customers of the shipping lines (i.e. shippers) are able to switch between shipping lines;
- low barriers to entry and expansion and the ability of customers to switch means there is competitive pressure on shipping lines;

- there is no single point of entry for ships servicing Australia and shipping lines generally have no sunk investment or commitment to any Australian port;
- shipping lines typically decide which of the two stevedores/terminal operators it will use in Australia and then enter into a single contract with the stevedore covering any or all of the five mainland ports for a contract period of one to five years; and
- the Australian stevedores compete for shipping line business on price and service (given their sunk cost investment in port facilities) and are under competitive pressure to provide an efficient turnaround in unloading / loading ships in order to win business.

What this reveals is that the environment in which shipping lines operate is a competitive environment in which no Australian port has market power. Specifically, the market in which PoMC operates is characterised by:

- a supplier (in this case PoMC) with large and long term capital investment in one location (Melbourne) which is recovered by “fee for use” on volume passing through that location;
- volumes which are subject to fluctuations in supply / demand in underlying product markets and other factors affecting global trade;
- customers (shipping lines) who control that volume with no sunk investment or other commitment to any one location and the ability to by-pass that location; and
- a resulting exposure to volume risk for PoMC as customers do not contractually commit volume to PoMC.

Given the commercial reality described above, the notion of exerting market power by “giving less and charging more” to its customers is inconceivable to PoMC as the port must be seen as attractive to its customers (and their customers) in order to encourage them to use the port bringing more volume through the gateway. This is a very strong competitive driver.

The conclusion drawn from examining such dynamics is that PoMC does not have genuine market power.

4 PoMC's role under the PSA

The objectives of the PoMC are defined by the *Port Services Act 1995* (PSA) Section 13(1) as:

- a) to manage and develop the port of Melbourne in an economically, socially and environmentally sustainable manner;
- b) to ensure that essential port services of the port of Melbourne are available and cost effective;
- c) to ensure, in co-operation with other relevant responsible bodies, that the port of Melbourne is effectively integrated with other systems of infrastructure in the State;
- d) to facilitate, in co-operation with other relevant responsible bodies, the sustainable growth of trade through the port of Melbourne;
- e) to establish and manage channels in port of Melbourne waters for use on a fair and reasonable basis.

PoMC must carry out its functions in accordance with the requirements of Section 13(2) of the Act in a manner that:-

- a. is safe and secure
- b. is environmentally sustainable
- c. is effective and efficient
- d. has regard for the persons living or working in the immediate neighbourhood of the port of Melbourne.

PoMC's performance management framework in its Corporate Plan distinguishes between those activities over which PoMC has direct control and those over which PoMC may only exert influence. For example:

- factors over which PoMC has direct *control* include compliance with safety, security and environmental regulations, availability of navigational aids, PoMC's investment program and internal costs and the satisfaction of its customers (shipping lines) with its charges; and
- factors over which PoMC may only exert *influence* include container crane rate, container ships delayed, reportable incidents in the port,

TEU per berth metre, port interface costs, port throughput carried by rail, average TEU per truck movement, cruise ship arrivals per season, trade volume growth (revenue) and the satisfaction of shippers, land transport operators and the wider business community.

The financial cost impact of port efficiency is an important driver for trade. If port efficiency decreases in the long term, then the response will be for industry and jobs to move interstate, as freight generators re-allocate their production and distribution resources to access more efficient supply chains – a reality recognised by the Victorian Transport Association (whose members service the majority of the freight moving through the port of Melbourne) in its Priority Report #33 January / February 2008.

This sensitivity to the financial impact of port efficiency is a significant source of competitive pressure as the port has to work hard to win the volume it needs to be commercially sustainable and “self-funding”. Ongoing capital investment is a key factor in supporting the competitive advantage of the State which means more economic activity and hence growth in trade. However, to fund this investment and remain competitive, the port needs to deliver the increased volumes to achieve greater economies of scale.

Market pressure therefore forces PoMC to act as a facilitator of trade for Victoria. This means understanding and being responsive to the key variables that affect volume and the drivers of port choice. These include factors such as infrastructure availability to the particular pack types and end customer requirements such as timing, and cost.

Competition for PoMC is ultimately the ability to expand and grow trade for and investment in the State of Victoria. Facilitating and promoting the efficiency of the port and investing in infrastructure for the future growth of the port of Melbourne is the means by which PoMC can facilitate this.

PoMC’s Corporate Plan identifies a number of key objectives to facilitate and expand trade and trade related business opportunities. These include, for example:

- promoting and marketing port facilities and services to existing and potential users;
- developing effective, high quality relationships with customers and port services providers and business;
- facilitating cargo transfer from contestable regions to strengthen and improve market share;
- enhancing the port's competitive advantage and maintaining the port's premier position; and
- facilitating business and logistics solutions to attract and grow trade through the port.

These can only be achieved by seeking to influence the choice of those parties who can generate and/or direct the flow of cargo. In short, PoMC has to continually assess how customers see its competitive position relative to each of the other major Australian ports and actively market the port's "brand" as a competitive gateway to position it as the "port of choice".

5 Regulation not consistent with CIRA principles

The COAG framework for the regulation of essential infrastructure

The COAG landscape has changed significantly since the PSA was introduced in 1995 and since the report of the ESC on the “Regulation of Victorian Ports” pursuant to section 53 of the PSA in June 2004 which lead to the current price monitoring regime.

The rationale for economic regulation of infrastructure such as ports is the public interest in ensuring that effective competition can take place in markets that are dependent on monopoly facilities which create a ‘bottleneck’ problem. This was the main policy driver of National Competition Policy in 1995. However, the inherent risk involved in such regulation is that it will impede the incentives to invest in necessary infrastructure, which is itself contrary to the public interest.

Lessons learnt from a decade of National Competition Policy have shown the need to prevent regulation from imposing unnecessary cost and impeding investment. This has been the main policy driver of the COAG National Reform Agenda to which all Australian Governments committed themselves in 2006, hence the focus of the current COAG Business Regulation and Competition Working Group, and the Victorian Government’s “Reducing the Regulatory Burden” initiative.

The fundamental aim of the National Reform Agenda is *“to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure”*.

The economic regulation of ports has been the subject of specific commitments by Australian Governments under the COAG National Reform Agenda, in particular the CIRA signed by all Australian Governments on 10 February 2006. The background to this was the 2005 report by the Prime Minister’s Exports and Infrastructure Taskforce, also known as the ‘Fisher Report’, which was established *“to identify any bottlenecks of a physical or regulatory kind that may impede the full realisation of Australia’s export opportunities”*.

The Communiqué issued by COAG on 10 February 2006 stated that:

“At its June 2005 meeting, COAG noted the recommendations of the Exports and Infrastructure Taskforce and agreed that the regulation of ports and export-related infrastructure be considered in the COAG Review of [National Competition Policy].”

“COAG signed a Competition and Infrastructure Reform Agreement to provide for a simpler and consistent national system of economic regulation for nationally significant infrastructure, including for ports, railways and other export-related infrastructure. The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.”

“The Agreement also includes...that each jurisdiction review the regulation of its ports and port authority, handling and storage facility operations at significant ports to ensure that where economic regulation is warranted it conforms with agreed access, planning and competition principles”

Accordingly, the CIRA principles to which the Victorian Government is committed state under “Port Competition and Regulation” that:

- *“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” – clause 4.1(a); and*
- *where a State decides that economic regulation of a port is warranted, it should conform to a consistent national approach based on a number of principles set out in clause 4.1(b) including “(ii) where possible, commercial outcomes should be promoted by establishing market frameworks that allow competition in and entry to port and related infrastructure services, including stevedoring, in preference to economic regulation”.*

In addition to these clauses 4.2 (c) states that, *“Commercial charters for port authorities should include guidance to seek a commercial return while not exploiting monopoly powers”.*

Currently under the PSA, PoMC is required to manage and develop the port of Melbourne in an economically, socially and environmentally sustainable manner which is consistent with the CIRA principles.

The NSW and Queensland CIRA reviews

The COAG Reform Council reports annually on progress in implementing the National Reform Agenda including the CIRA commitments. The COAG Reform Council's report to COAG in March 2008 referred to the reviews conducted under CIRA principles by the NSW and Queensland Governments in relation to regulation of their significant ports, none of which are presently subject to economic regulation (with the exception of the DBCT facility at the Port of Hay Point in Queensland).

Some of the conclusions reached by these reviews in light of the agreed principles in CIRA are as follows:

The Queensland review concluded (at page 18) that: *"Stakeholders have not identified any need for ports to be regulated to further promote competition in other markets. Additionally, stakeholders have not raised any concerns regarding the misuse of market power by port authorities in Queensland"*.

This view of stakeholders that the activities of port corporations do not involve the misuse of market power was also acknowledged in the NSW review. In particular, the NSW review stated (at page 93) that:

"It is the finding of this review that there is no significant evidence that port corporations abuse the market power they have conferred on them under the ports regulatory framework. This was also the generalised view from submissions. As stated by the MUA, 'we say there is no evidence of any misuse of market power in relation to the role of port corporations or in the commercial relationships that port corporations are involved in, and therefore there is no evidence that economic regulation is warranted.'"

Further findings of the NSW review (on page 3) were as follows:

"Port corporation charges are a relatively small component of total costs. Port corporation prices are too small to materially affect up and downstream competition, either adversely or positively."

Further at page 5-6:

“It is the finding of this review that expanding or establishing economic regulation of port corporation prices would not have a material impact on competition or contestability. This is largely because regulated price outcomes are unlikely to yield notably different price outcomes, compared to current arrangements which already allow for Ministerial oversight, and whereby port corporations are obliged to facilitate trade and not ‘overprice’ services.

Any change to the prices charged by port corporations as a result of economic regulation would not be expected to significantly affect market entry decisions for the users of port infrastructure. This is because port corporation prices are a small component of port interface costs, and because prices have not been shown to be higher than they would be if port services were provided on a more competitive basis. Hence no significant evidence has been presented to this review to suggest that port corporations abuse the market power conferred on them under the regulatory framework.

Market entry decisions for users of stevedoring services are more likely to be affected by stevedoring prices (and possibly the terms of access to such services) than those of port corporations, given these comprise a higher proportion of port interface costs. While legitimate concerns have been raised regarding certain terms and conditions of stevedoring services, there are not sufficient grounds to state that the pricing behaviour of stevedores imposes net costs on the community, nor (more importantly in the context of the CIRA) that economic regulation would improve matters. This is largely because of the need for stevedoring prices to recover the high capital cost of stevedoring services, coupled with the existing oversight arrangements of stevedoring operations.”

The structure of how the NSW and Queensland port corporations operate (essentially providing the infrastructure acting as landlord to providers of port services such as stevedores / terminals) is basically the same as for PoMC. Further, the dynamics of the market environment are almost identical (they deal with the same shipping lines as their customers and have the same stevedores as tenants). It is not possible

for one of these port corporations (PoMC) to have sufficient market power to warrant economic regulation if the others do not.

Historical “market power” concerns relate more to stevedores

The “market power” concerns historically raised in relation to ports actually relate to the interface between stevedores and landside transport operators – for example, see the ACCC *Container Stevedore Monitoring Report* October 2008; the ESC Report on *Port Planning* 30 January 2008; and IPART’s *Reforming Port Botany’s links with inland transport—Review of the interface between the land transport industries and the stevedores at Port Botany* March 2008.

The ACCC has noted that stevedores do not need to compete for the business of landside transport operators – once the containers are on the wharf, road and rail transport operators must deal with the stevedore for those containers. Whether or not that translates to genuine market power is not part of this review. The relevant point is that any such market power concern is not addressed by regulating PoMC. The NSW Government through its Port Botany Landside Improvement Strategy released in September 2008, relies on giving Sydney Ports Corporation a leadership role in achieving industry solutions rather than imposing economic regulation on Sydney Ports Corporation.

Continued regulation of PoMC under the PSA regime

The current economic regulation of PoMC applies to “prescribed services” as defined in section 49 of the PSA to cover shipping channels, berth services and short term storage or cargo marshalling facilities. However, as noted above, only the first of these relates to a “service” provided by PoMC. In majority of cases the other services are provided by third parties on PoMC land. (The exception to this is common user berths where PoMC provides the service).

The regulatory template for “ports” does not properly fit with the commercial reality of what “the port” actually is – and in particular the complex legal and commercial relationships that exist. Regulation (even “light-handed” regulation) simply forces the regulated entity to try to fit its business into the regulatory template.

There has been increasing recognition that regulation is not a next best substitute for competition; it is very much a last resort with views expressed that organisations should either answer to the market or, where that is not possible, answer to a regulator. This has seen an underlying policy shift in the national reform agenda.

The key issue looking ahead is the scope for conflict between responding to competitive challenges and the expectations of the market on the one hand, and accommodating the regulatory template on the other.

6 Competition

Competition - "captive" freight and "contestable" freight

The argument has been previously made that a large proportion of the trade moving through the port of Melbourne has an origin or destination close to the port (for imports an estimated 80% of trade destination is within 100km of the port) making it "captive" freight which gives PoMC the power to raise price.

However, this approach is too simplistic. It does not consider the overall supply chain and treats "the port" as a single entity rather than looking through to the actual legal relationships and asking: "to whom would PoMC be raising prices and can it commercially afford to behave in this manner".

All else being equal it will be more efficient to use the nearest node that reduces the distance freight is transported using the least efficient mode. However, sometimes it may result in a more efficient end to end supply chain to use a less efficient mode for a longer distance so as to by-pass an inefficient node or bottleneck. In this way, different permutations and combinations of putting together supply chains can put very real competitive pressure on each other.

Thus it is not always possible to draw conclusions about competitive dynamics solely based on the origin and destination of freight moving through a particular node, or to look only for "head to head" competition from another equidistant node. In particular, it would be wrong to conclude that the cost of land transport is a barrier to inter-port competition simply on the basis of observing that most trade passes through the port that is closest to the point of production or consumption if that outcome is the result of competitive behaviour by ports.

The reality for PoMC is that it cannot discriminate in price/service between "captive" and "contestable" trade and winning contestable trade is an important focus for PoMC (up to 30% of trade is highly contestable.) Trade from Sunraysia, Riverina and South Australia is all contestable to other ports such as Port Adelaide, Port Botany and Port Kembla (bulk cargo).

PoMC has invested in offices in Griffith, Adelaide, and Hobart reflecting the need to continually invest in trade and business development to secure and grow throughput for the port of Melbourne. This is in direct competition to other ports.

Much of what PoMC does and how it behaves is explained by a fundamental pro-competitive driver to influence trade flows precisely because it has no power over captive volume: in other words, the essence of competitive behaviour – offering a better value proposition to win customers.

7. Future challenges and the impact of economic regulation

PoMC developed a Port Development Plan (PDP) (consultation draft issued August 2006) which outlines a clear and achievable vision of the development of the port over the next thirty years. It presents a flexible infrastructure strategy that will be gradually implemented to meet forecast trade needs and requires substantial investment to meet the projected trade growth forecasts.

As a result of the significant ongoing investment PoMC is under constant pressure to ensure the ongoing increment in volume passing through the port. Unlike other infrastructure businesses which can secure volume via long term contractual throughput commitments from users, PoMC cannot do this with its customers.

To enable PoMC to continue to fund infrastructure projects and meet future challenges as defined in the PDP and the "Freight Futures" strategy a flexible business and investment model will be required and this will not be best served by the unavoidable loss of flexibility imposed by regulation.

PoMC is required to operate in a self funded commercial environment. The nature of the business is that long term capital investment requirements are made ahead of incremental revenue streams. Combined with the tightness of the credit markets, the ability to secure funding at optimal rates for infrastructure projects may be adversely impacted within a regulated environment.

On-going regulation means that PoMC faces not only the normal significant market risk (its volume exposure) experienced in commercial environments but also regulatory risk (due the level of discretion exercised by the ESC under the current regime). Typically borrowers face one risk or the other (because the existence of the former means no need for regulation).

Regulation can only place commercial restrictions on PoMC operating in an optimal way to develop the future infrastructure needs and hence provides uncertainty for the business.

Finally, the focus of the current economic regulation with a five year pricing focus is not aligned with the longer term investment program of PoMC for the port and can only lead to pricing inefficiency.

8. Conclusions

PoMC has been subject to light handed regulation since 2005. This has worked comfortably as a transition from heavier regulatory overlays but for the reasons presented herein there is a need for this to change – and to reflect current market and economic reality.

Port corporations have a strong incentive to see competitive pressure throughout the landside logistics chain and Governments want to see them extend their sphere of influence beyond the port gate. However, regulation runs counter to this. It seeks to minimize the sphere of influence of the regulated business (which is, of course, reasonable if the rationale for regulation is genuine market power). That is why the CIRA commitments are so important.

One of the key commitments in the CIRA is for each State to review the regulation of its ports to determine if regulation is warranted, with the agreed principles being that:

- *“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” – clause 4.1(a); and*
- *where a State decides that economic regulation of a port is warranted, it should conform to a consistent national approach based on a number of principles set out in clause 4.1(b) including “(ii) where possible, commercial outcomes should be promoted by establishing market frameworks that allow competition in and entry to port and related infrastructure services, including stevedoring, in preference to economic regulation”.*

The port corporations in Brisbane and Sydney have the same functional role in the supply chain as PoMC in Melbourne; they deal with the same shipping line customers and have the same stevedore/container terminal tenants; and they are subject to the same dynamic marketplace pressures. The NSW and Queensland Governments recently reviewed these port operations and both concluded that economic regulation of port corporations (such as the price monitoring regime currently applying to PoMC under the PSA) is not warranted under CIRA principles as:

- there is insufficient market power to justify economic regulation on the grounds of preventing any misuse of market power by port corporations; and
- the charges by port corporations are too small to materially affect upstream or downstream competition therefore economic regulation of these charges cannot be justified on the grounds of promoting competition in upstream or downstream markets.

Given the wider context in which the ESC's 2009 review takes place, PoMC understands that the process will be as follows:

- The Victorian Government, in its "Port Futures" statement, will address the matters dealt with in clause 4.1 of the CIRA⁶ independently of, but taking into account, the ESC's section 53 review.
- Following the ESC's final report under section 53, the Minister administering the ESC Act will decide whether "prescribed services" should continue to be subject to price regulation under the PSA having regard to the principles in clause 4.1 of the CIRA⁷.

If the Victorian Government believes that, under the CIRA principles, regulation of PoMC's dealings with its customers (shipping lines) is warranted, PoMC believes that the issue of dual regulation needs to be addressed.

The "prescribed services" PoMC provides to shipping lines essentially relate to shipping channels. The PSA regime regulates these as "prescribed services" as well as establishing a specific access regime for declared channels⁸. PoMC is not clear on the need to have both price

⁶ The ESC's 2008 review addressed the commitment in clause 4.2(a) of the CIRA regarding port planning, not clause 4.1.

⁷ Section 54 of PSA says that price determinations are to be made by the ESC in accordance with Part 3 of the ESC Act if the Minister determines that "prescribed services" are to be subject to price regulation.

⁸ No channels have been declared so the access regime has been described by the ESC as inactive.

regulation (even if “light-handed” monitoring) and an access regime under the PSA for the same activity.

In conclusion, PoMC’s position is that:

- **PoMC does not itself enjoy substantial market power within the supply chain and a distinction between the port of Melbourne and PoMC needs to be made.**
- **PoMC is a statutory entity established under the PSA to support the growth of the port in economically sustainable manner and on a fair and reasonable basis. The requirements of the PSA guide the operations of PoMC and are reflected in the corporate planning. Regulation of “prescribed services” under the PSA does not promote competition.**
- **Continued regulation of PoMC under the PSA regime does not meet COAG principles for the regulation of essential infrastructure and in particular the principles in clause 4.1 of the CIRA to which the Victorian Government is committed. The COAG landscape has changed significantly since the June 2004 ESC report on the “Regulation of Victorian Ports”.**
- **PoMC is subject to direct competition from other ports and continues to invest in trade and business development to secure and grow trade throughput.**
- **Requiring PoMC to operate within a regulatory template diminishes PoMC’s ability to respond in an innovative manner to the changing commercial environment, potentially impacting on Victoria’s competitive advantage for exporters and importers.**