



Essential Services Commission
Review of Victorian Ports Regulation

Submission in response to the Issues
Paper

February 2009

1 EXECUTIVE SUMMARY

The Essential Service Commission's ("the Commission") review of Victorian Ports in 2004 concluded that for their core trades regional ports operated in contestable markets, with a credible threat of entry and cross ownership did not limit competition. The key factors that led the Commission to these conclusions, (market structure, rivalry between players and market outcomes) have not substantially changed since 2004. In particular:

- there has been no significant change in market structure;
- port customers still have a real choice between ports for many cargoes;
- those that have less choice are protected by countervailing power and long term contracts;
- service quality remains high; and
- price increases have been small and Victorian ports remain competitive with national benchmarks.

On this basis, Asciano concludes that regional ports are workably competitive. As a result Asciano believes the Commission should consider the removal of the price monitoring regime which imposes significant cost on operators and delivers very limited benefit given the competitive nature of the market.

However, if the Commission determines regulation needs to continue there is certainly no evidence that would support the introduction of a more intrusive regime than the current price monitoring. If price monitoring is retained then the Commission should review the specific obligation of its price monitoring regime to reduce the regulatory burden on operators.

The remainder of the submission is set out as follows: Section 2 discusses market power and market developments; Section 3 discusses the appropriate regulatory framework; and Appendix 1 answers the specific questions raised by the Commission in its Issues Paper which are relevant to Asciano.

As joint owner and operator of the Port of Geelong and as manager of the Port of Hastings, Asciano's has focused its comments on those issues directly related to the operation and regulation of the Victorian regional ports.

2 MARKET POWER AND MARKET DEVELOPMENTS

2.1 2004 Review of Regulation of Victorian Ports

In the 2004 review of regulation of Victorian ports¹ the Commission included in its conclusions on market power that:

- for regional ports the core trades of dry bulk and general cargoes were generally contestable;
- "Market power situations" were confined to major users (eg BlueScope, Alcoa) who were often protected by long-term agreements;
- many ports users had countervailing power;

¹ ESC, June 2004, "Regulation of the Victorian Ports: Final Report".

- the threat of entry was credible; and
- cross ownership did not limit competition.

As illustrated below, the key factors that led the Commission to these conclusions, (market structure, rivalry between players and market outcomes) have not substantially changed since 2004. On this basis Asciano believes the view expressed by the Commission in the 2004 Review that regional ports operate in a workably competitive market is still valid.

2.2 Market Structure

The market structure has not significantly changed since the last review. There has been a change of control, namely Asciano and not Toll is now part owner and operator of Geelong and operator of Hastings. This change, a result of the demerger of Toll Holdings into two companies Toll and Asciano on 6 June 2007, has not influenced the competitive dynamics of the market.

As noted by the Commission in 2004 cross ownership, more correctly cross operation in Asciano's case, does not hamper competition. It is important to recognise that Asciano does not make investment decisions at either port and is subject to performance obligations under its management contracts.

2.3 Contestability

Table 1 below illustrates the contestability between ports for dry bulk and general cargoes. The ports of Geelong, Melbourne Hastings and Portland do handle or have the capabilities to handle many of the same cargoes, which ultimately provide port users with effective choice.

Table 1: Cargoes Handled/Capability Summary

<u>Port</u>	<u>Woodchips</u>	<u>Bulk Liquids</u>	<u>Fertiliser</u>	<u>Steel Products</u>	<u>Logs</u>	<u>Bulk Products</u>	<u>Mineral Sands</u>	<u>Livestock</u>	<u>Grain</u>
Geelong	Yes	Yes	Yes	Yes	Yes	Yes	No (but capable)	Very rare	Yes
Hastings	No	Yes	No	Yes	No	No	No	No	No
Portland	Yes	Yes	Yes (but rare)	No (but capable)	Yes	No (but capable)	Yes	Yes (rare)	Yes (rare)
Melbourne	No	Yes	No	Yes	No	Yes (gypsum/cement)	No	No	Yes

The option for customers who import or export petroleum products from either the port of Geelong or Hastings is somewhat more restricted due to the specialised infrastructure constructed at these sites along with the financial and environmental hurdles to new development. However, these customers enjoy countervailing market power and as indicated in the Commission's 2004 Review these users are generally provided some additional form of protection through the operation of specific long-term agreements and through the ownership of relevant berth facilities (as in the case of BlueScope Steel).

As noted by the Commission in Figure 2.7, on page 26 of the Issues Paper, there is substantial berth capacity available (between 55% and 80%) at the various Victorian

ports. Such high vacancy rates of berths provides incentives for port operators to be more competitive, while providing port users additional bargaining power when negotiating prices and access with port operators.

Market share statistics are also supportive of a workably competitive market. These statistics indicative a reasonable change in market shares. For example Melbourne's share of other break bulk trade increased from 37% in 2002/03 to 44% in 2006/07 while Geelong's share decreased from 13% in 2002/03 to 11% in 2006/07 and then increased to 13 % in 2007/08.

2.4 Service Quality

A further indicator of the lack of market power is the continued excellent service quality provided by the ports. In particular:

- Geelong and Hastings in 2007 and 2008 had zero non-compliances with its Safety and Environmental management Plan (SEMP) and also zero formal non-compliances with environmental and security legislation.
- Geelong had 0% of vessels delayed from the scheduled berthing time or advised arrival time in 2005/05, 2006/07, and 2007/2008.
- Hastings average ship turnaround time has reduced from 40 hours in 05/06 to 36 hours in 2007/08 and Geelong's average turnaround time from 72 hours in 2005/06 to 65 hours in 2007/08.²

2.5 Pricing

Since 2004 Geelong ports real reference prices have increased only modestly, namely by 5% by 2007/2008.

The Commission's figures for Hastings show that reference prices have doubled over the period. However, these figures are not a true reflection of the real price changes at Hastings as, amongst other factors, they: use reference and not actual prices; utilise both inclusive and exclusive GST figures; and include revenues from new services which are not provided in each year.

Asciano believes that the most appropriate way to illustrate actual changes in prices is to look at changes in revenue per vessel and revenue per tonne. Table 2 below shows that the increases using this approach are significantly lower than the Commission's analysis.

² The increase in turnaround time in 2006/07 for Geelong was due to the data containing information not only on vessels in operation, but also vessels under repair or laid-up at the port during the reporting periods. This inclusion resulted in higher than normal turnaround times being reported to the Commission. At present no data filter exists to allow the business to separate these different events.

Table 2³: Real Increases in Hastings Prices

Year	% Increase revenue per vessel	% Increase revenue per tonne
2005/06	5	11
2006/07	5	1
2007/08	-3	17

The increase in prices shown for 2007/08 resulted from the introduction of a new flagfall component of \$3,500 per ship. This mechanism was introduced to better reflect the nature of operations within the Port where increased numbers of small gas vessels were calling and costs could not be recovered through the traditional GRT method. The introduction of the flagfall was discussed with the Commission, customers and port operators prior to its introduction and no complaints were received.

These price comparisons are of course only relative to previous years and not external benchmarks, for example the original Hastings prices may have been too low compared to the wider ports market.

We note that the Commission has received no formal complaints from Geelong or Hasting customers regarding pricing at these ports.

Interestingly, the Commission's Issues Paper (Figure 2.4, on page 22), shows that in 2007 Geelong was price competitive when compared with other Australia ports for Liquid Bulk Vessels. This is especially relevant as these were the commodities that the Commission thought might be subject to "market power situations".

3 APPROPRIATE FORM OF REGULATION

Asciano supports the Commission's approach in weighing the benefits against the costs of alternate regulatory forms and that the more substantial the market power, the more likely that "heavy handed" forms of regulation is appropriate.

As illustrated above regional ports operate in a workably competitive market and to our knowledge there is no evidence that regional port operators having misused any alleged market power during the five year period from 2003-04 to 2007-08. In addition given the current market conditions there is no reasonable expectation that this will occur over the next regulatory period. Asciano thus believes an opportunity exists to transition further to deregulation, especially given the costs of the price monitoring regime. The threat of the Commission reverting to price monitoring or even price capping (in extreme circumstances) to address any issues regarding the misuse of market power would provide sufficient incentives for regional port operators to operate in a fair and reasonable manner.

However, if the Commission determines regulation needs to continue there is certainly no evidence that would support the introduction of a more intrusive regime than the current price monitoring. The introduction of a price control has significant implementation costs and risks. The key risk is regulatory error in price setting that could lead to inefficient under investment.

³ The calculation utilise revenue from Table 2.2 of Hastings ESC returns adjusted for inflation and deducting the new ship to ship transfer revenues which are not present in each year.

If the Commission does determine price monitoring should continue then Asciano believes the Commission should look at ways of minimising the costs of the regime. The current requirement to have the financial statements audited (full balance sheet audit) by an accredited auditor is one of the key costs (Asciano expects to incur around \$100,000 in auditing fees alone in 2008/09). A full formal audit is not necessary in providing the Commission with assurance regarding the accuracy and validity of a port operator's financial statements.

Asciano believes there are a number of possible alternatives which could be considered. These include:

- certification of the financial statements to be true and accurate by a responsible officer only (i.e. a letter of comfort);
- accepting information published for company half yearly and annual reports (group financial statements);
- reduced scope of the financial information currently required by the Commission. For example an income statement audit only, together with a cost allocation statement, and disclosure of the accounting policies in use and assurance that they are in conformity with generally accepted accounting policies; and
- auditing of financial statements every second year, or as instructed by the Commission in situations where the Commission believes it is necessary.

Appendix 1 – Asciano’s Response to Key Questions Raised in the Issues Paper

Commission’s Proposed Approach

- 1. Is the Commission’s proposed approach of focussing on whether the benefits of regulation exceed the costs appropriate? Is its proposed approach to assessing these benefits and costs appropriate?**
- 2. Is the Commission’s emphasis on the question of market power and its approach to assessing market power appropriate?**
- 3. Has the Commission adequately identified the alternative forms of regulation? Are the principles proposed by the Commission for assessing the form of regulation appropriate?**

Asciano supports the Commission’s framework for the review including its approach to the costs and benefits of regulation, the alternative forms of regulation and its market power analysis.

Key Questions to be Addressed in the Review

- 4. Should the existing prescribed services continue to be subject to regulation? Berth services? Channel services?**
- 5. To which Victorian ports should regulation continue to apply?**
- 6. If any services should continue to be regulated, what form of price regulation should apply? For example, should price monitoring continue, or should there be price controls or some other form of price regulation? If so, what form of price regulation?**

Asciano believes that the regional ports are workably competitive and an opportunity exists to end the price monitoring regime without any significant impact on competition.

If the Commission determines that regulation should continue the most intrusive form of regulation that could be justified would be price monitoring. Asciano believes that fully contestable services such as the warehousing and long-term distribution centres within the precincts of each commercial trading port should remain excluded from the definition of prescribed services.

Market Power and Market Developments

- 10. Is there substantial market power in the provision of any berth services? Does PoMC continue to enjoy substantial market power in vehicle and container trade? Have the core trades of the regional ports (dry bulk and general cargoes) remained contestable?**

Regional ports operate in a workably competitive market. Asciano believes the core trades of the regional ports regarding dry bulk and general cargoes remain contestable. As indicated in Table 1, the ports of Melbourne, Geelong, Portland and Hastings can or have the capabilities to handle similar cargo, which ultimately provides port users options to change ports should they become unhappy with the price or quality of service they are provided.

12. Has the structure of the market for port services changed in material respects since the previous review? Has competition between ports increased or decreased for any types of cargoes?

The structure of the market for port services has not changed in material respects since the previous 2004 Review.

13. To what extent has the pricing behaviour of the ports been constrained by competition between ports, or countervailing power of shipping lines?

Given the contestability of many cargoes, ports have to be cognisant of the alternative options available to its customers and potential customers. Shipping lines do have power in selecting port calls and stays to maximise their margins and minimise port charges. The significant difference between reference charges and actual charges for each port illustrate the constraints.

14. What changes have there been in cross ownership and control of ports or port terminals, and what influence has this had on the degree of competition in port services?

The market structure has not significantly changed since the last review. There has been a change of control, namely Asciano and not Toll is part owner and operator of Geelong and operator of Hastings. This change, a result of the demerger of Toll Holdings into two companies Toll and Asciano on 6 June 2007, has not influenced the competitive dynamics of the market.

16. How has the level of seaborne trade changed since the last review? What are the future prospects for growth? How does this affect competition between the ports, if at all? How does it affect their market power?

The ongoing drought has reduced grain trade through Geelong and Melbourne (to a lesser extent). Fuel prices have seen fluctuations in supply and price due to market demand. The cost of shipping has also fluctuated due to the spike in demand for iron ore and bulk commodities, as illustrated in the "Baltic Dry Index". Larger ships are more common these days to benefit the economies of scale for shipping lines.

Benefits and Costs of Regulation

17. What compliance costs have been imposed on port providers by the price monitoring regime? Have the compliance costs been unduly high? Are they commensurate with the extent of market power and with the potential economic cost of the abuse of that market power?

In addition to significant management time the major costs associated with the regime are the annual audit requirements. Asciano expects to have audit costs in 2008/09 of around \$100,000.

Asciano would support the removal of price monitoring, however if the Commission wishes to maintain it then we believe a less costly form should be implemented which is less onerous on operators. Any move to more intrusive regulation would ultimately result in even higher compliance costs for questionable benefits and such a move would not be supported by Asciano.

19. Does the price monitoring regime inhibit commercial flexibility in price negotiations?

The current arrangements do not seem to inhibit commercial flexibility in pricing negotiations.

20. What potential is there for future increased competition in port services? Would this potential be impeded by the presence of the price monitoring regime?

The attractiveness of a port to a potential customer is based on a number of factors including price, quality of service, location, compatibility of the ports infrastructure to the cargo and the existence of critical supportive infrastructure, such as railway lines and terminals and highways.

In our opinion the presence of a price monitoring regime has played little role in impeding competition.

21. Do the social benefits of the current regulatory regime exceed the social costs (ie combined costs to all parties including long term costs)

No. For regional ports given that they operate in a workably competitive market, the benefits of price monitoring is small, while the costs for operators and the Commission are significant.

Adequacy of the Existing Framework

22. Have the ports exercised market power with respect to any trades over the last three years since price monitoring was introduced?

To our knowledge there is no evidence that port operators have exercised market power during the five year period from 2003-04 to 2007-08, or that this will occur over the next regulatory period.

Nothing leads us to believe that customers at Geelong and Hastings ports are unhappy with the current port tariffs or how Patrick has conducted itself since the introduction of price monitoring in 2005. Furthermore, no formal complaints from port users were lodged to the Commission regarding our operation or management of the ports of Geelong or Hastings during the regulatory period.

28. Is the Commission's approach to complaint handling appropriate?

Yes. Asciano supports the Commission approach.

29. Are the prescribed services defined adequately?

If regulation is to continue, then the current definition of prescribed services seems to be adequate. Asciano believes that contestable services such as the warehousing and long-term distribution centres within the precincts of each commercial trading port should remain excluded from the definition of prescribed services.