NORTHERN TERRITORY GOVERNMENT

DEPARTMENT OF
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Dear Dr Walsh

RE: 2018 PORTS ACCESS AND PRICING REVIEW DRAFT REPORT

I welcome the opportunity to provide comment on the Utilities Commission (UC) Draft Report following the review of the price and access regime established for the regulation of ports under the *Ports Management Act*, noting that, at this stage, Darwin Port is the only declared Port.

I further note that these comments are made ahead of the UC submitting its final report to the Minister for Infrastructure, Planning and Logistics for Northern Territory Government consideration in November 2018. Nothing in the comments is intended to in any way limit or remove the discretion of the Minister to form a view on UC recommendations made in the final report.

Background to Price and Access Regime
Recognising the need to carefully balance the imperatives of commercial port operators against the NT Government desire to ensure open and fair competition for port facilities and services, the NT Government policy position is for a light handed approach to port pricing and access regulation. This is the regulatory framework which supported the Government's lease of Darwin Port.

The *Ports Management Act* and Regulations outline a port access and pricing regime which is overseen by the UC as the designated independent regulator. The regime was designed and enacted by the Government following consultation with stakeholders, including the UC. Details of the UC's role and the regime were set out in the Information Memorandum which was provided to all bidding parties, and in the *Ports Management Act* and Ports Management Regulations which we finalised ahead of contractual close on the Darwin Port Lease transaction.

Under section 123 of the *Ports Management Act*, the UC is to conduct a review of the operation of the port access and pricing regime and provide a report to the Minister within three years after the commencement of the regime, and every five years thereafter. The purpose of the review is to determine, among other things, whether there is an ongoing need for regulatory oversight of price and access and whether any amendments need to be made to the regime.

The review provisions were aimed at ensuring that there is an appropriate opportunity for the independent regulator to consider the effectiveness of the regime,

in consultation with the private port operator and port users, once the regime had been in operation for a sufficient initial period.

The light handed regime adopted by the NT involved, a port operator setting prices for prescribed services based on a price determination as follows:

- The UC is to have the power to make a price determination for the prescribed services in accordance with the Regulations and the access and pricing principles specified in the *Ports Management Act*.
- Any price determination must be consistent with the Regulations, and the Minister may specify matters to which the UC must have regard in making a price determination.
- The regime will enable the Minister to specify the form of price regulation. The Minister has declared the use of monitoring of price levels of the prescribed service of price regulation, with the threat of a more heavy handed form of price regulation.
- The UC will have the power to require a facility operator to provide information or documents about a particular charge, subject to a reasonableness and cost test. The facility operator may claim confidentiality over the information provided in response to such a request on specified grounds, and the UC must maintain that confidentiality unless authorised under the Act, including where disclosure is in the public interest.
- The UC will be required to notify the Minister if at any time it becomes aware that the facility operator is imposing, or proposes to impose, a price for a prescribed service which the UC considers to be inconsistent with the price determination and/or the access and pricing principles.

The second element of the light handed regulatory regime was an access arrangement based on open access with a negotiate/arbitrate approach to resolution of disputes. The negotiate/arbitrate arrangement was introduced following feedback from the Australian Competition and Consumer Commission.

At the time consideration was given to the regulatory regime to be applied, it was noted that the Darwin Port shared similar economic characteristics to other ports in Australia, the majority of which were not subject to economic regulation. Being a critical part of the Northern Territory's import and export supply chain, Darwin Port was recognised to potentially enjoy market power in many of the services it provides.

However, it was also recognised that the current and forecast economic trade environment for Darwin Port indicates practical constraints on its ability to exercise its market power. While the then Darwin Port Corporation had, ahead of the lease arrangement, raised tariffs, challenging economic conditions for several major trades were considered likely to limit the ability of Darwin Port to effect substantial future price increases. Port users, particularly bulk cargo users, were considered to possess strong countervailing power. The Government view was that Darwin Port's primary incentive would be to provide conditions that will facilitate trade growth, and not misuse its market power by constraining trade.

A light handed access and price regulation framework was considered to deliver port users a level of safeguard and certainty, without imposing a significant burden on a port operator or the NT from a more heavy-handed regulatory approach. The proposed light-handed price monitoring regime was not expected to directly impact the way in which prices for port services would be determined, which would continue to be set according to standard business practice. Rather, an economic regulator would have oversight over prices for prescribed services.

At the time, the NT also commissioned investigations into indicative outcomes should a more heavy handed form of economic regulation be applied. This was based on a 'shadow' regulatory model applying a building block approach, with the initial regulatory asset base estimated using depreciated optimised replacement cost.

This exercise demonstrated a gap between forecast revenue, including from known INPEX activity, and the annual required revenue otherwise likely to be allowable by an independent regulator. The gap decreased over time as port throughput grows, primarily as a result of pilotage and port dues, but was shown to remain over the short to medium term.

At the commencement of the lease, the Government took a line in the sand approach to port prices on the basis that the Northern Territory Government and Darwin Port Corporation had, in advance of the lease transaction, undertaken a detailed pricing review with prices rebased based on an efficient capital structure, an appropriate Weighted Average Cost of Capital and demand assumptions reflective of known and anticipated throughput.

Comments in Relation to Specific UC Draft Findings and Recommendations
I note the UC's overarching finding that while Darwin Port has 'substantial' market power, there is no evidence to suggest that this market power has been exercised in the preceding three year period. The price benchmarking exercise undertaken by the UC found that prescribed services for Darwin Port are generally comparable to services in other Australian ports and the UC states that there is no indication that Darwin Port is generating excessive profits for the current review period.

I also note the UC's view that there is no need to change the form of regulatory oversight for access and price.

Clause 6 Competition Principles
Notwithstanding the abovementioned overarching findings, the UC considers there are deficiencies in the current regime, with this view primarily based on the UC's assessment of whether the price and access regime would satisfy clause 6 of the Competition Principles Agreement.

However, the clause 6 principles have a different function to the one the UC is performing in carrying out its review.

The function of the clause 6 principles is to act as a guide to the Commonwealth Treasurer in making a decision as to whether the statutory access and pricing regime in Part IIIA of the Competition and Consumer Act 2010 (CCA) should be prevented

from applying to a service provided by a facility that is the subject of a State or Territory access regime. In short, the principles guide a decision by the Commonwealth to withdraw jurisdiction over an activity it would otherwise have jurisdiction over.

At present, the NT is not concerned about the application of the CCA to the Port. Rather, it seeks to ensure that the port access and price regulation regime is being implemented in a way which meets the broader needs of port users, the port operator and promotes the growth of the broader NT economy. As a consequence, I consider the clause 6 principles to have limited relevance to the current review.

As noted in the draft report, the UC's function in performing its review is to determine:

- whether there is a need for ongoing regulatory oversight;
- whether there is a need to change the form of regulatory oversight for access or prices, and if so, how; and
- whether amendments should be made to the statutory access and price regime.

The UC's role should be focused on a careful examination of how the access and price regime is working in practice, taking into account the conduct of the port operator, the experience of port users and customers interacting with the port operator, and the factors impacting demand for the port's services.

Sub-lease of Land
In relation to the current exemption of services provided under a lease, the UC suggests that once the current agreement for the marines supply base (MSB) expires, regulatory oversight for the prescribed services provided at the MSB may be appropriate, and suggests that the application of regulation 12(2) to all leases granted by a private port operator may be an unintended consequence of excluding MSB operations from the regime.

I note that the sub-lease of land which forms part of the area leased to Darwin Port is not a prescribed service. Sub-leasing of port land is covered under the port operating arrangement which provides protections to current and potential sub-lessees, including providing for a reasonableness test in relation to market rents.

In light of this, there does not appear to be any compelling reason to amend the current application of the regime insofar as it relates to the sub-leasing of land which forms part of the port lease area.

Negotiate/Arbitrate
In relation to the current negotiate/arbitrate access model, the UC recommends that the model be specified in the *Ports Management Act*, rather than set out as criteria for the approval of the Access Policy.

I note that the *Ports Management Act* and Regulations require that negotiate/'arbitrate framework is incorporated in the port operator's Access Policy.

This requirement is not framed, as the UC draft report indicates, as criteria for the UC approving the Access Policy.

In this context, I note Mr Rod Sim, Chair of the Australian Competition and Consumer Commission's, comments:

> *"In relation to the Port of Darwin, … the NT Government initially proposed a price monitoring regime to apply to limited services provided by the Port of Darwin ... We had concerns about how effective this regime would be to constrain the monopoly power of the port and discussed with staff from the NT Government the benefits of a negotiate/ arbitrate regime, as envisaged by Hilmer."*
>
> *Pleasingly, the NT Government decided to strengthen the regime to set out a form of negotiate/arbitrate through an 'access policy' that is to be developed by the successful bidder and must be approved by the NT Utilities Commission. This regime appears to be similar to the process by which access is gained under a Part IIIA access undertaking."*[1]

In light of the above, it does not appear necessary to amend the regime insofar as it relates to the negotiate/arbitrate model.

Threat of stronger regulatory intervention
I note the UC comments regarding the UC not possessing the power to implement an alternative form of price regulation. The threat of stronger regulatory intervention is the premise of the Government access and price regime. It remains the intention that discretion on the need for more heavy handed regulation continues to reside with the Minister.

As the UC notes, the current legislation review process is for subsequent reviews to be conducted on a five yearly basis. However, the regime also allows for the UC to conduct a review outside of these timeframes if Darwin Port seeks to exercise its market power in a manner inconsistent with the *Ports Management Act* price and access model.

The current regime of access and price monitoring is consistent with the approach in the Council of Australian Governments Competition and Infrastructure Reform Agreement 2006 to which the NT is a party, namely:

- wherever possible, third party access to services provided by means of ports should be on the basis of terms and conditions agreed between the operator of the facility and the person seeking access;
- price monitoring for services should be considered for services where this would improve the level of price transparency as a first step where price regulation may be required in the future; and

[1] Mr Rod Sims, *How did the light handed regulation of monopolies become no regulation*, 29 October 2015

- where regulatory oversight of prices is warranted, it should be undertaken by an independent body which publishes relevant information.

More intrusive forms of price regulation, including that suggested by the UC whereby the independent regulator examines the profitability of the port operator, may be warranted in circumstances where there is concern about the port operator's conduct towards port users or the port operator's conduct as a competitor in downstream markets. For example, if the port operator provides stevedoring or truck transport services.

If the port operator is vertically integrated in this way, then there is almost always a legitimate concern that the port operator may subsidise the cost of its downstream activities with profit from its ports operations, leading to higher than necessary port prices. In that situation, it is usually appropriate to impose additional measures such as an obligation on the port operator to maintain separate accounts for the prescribed and non-prescribed services the port operator provides.

It is worth noting that the Port Lease prohibits the port lessee and port manager from becoming an "integrated operator", which is defined as owning, operating or having the capacity to materially influencing specific services provided to a port user including stevedoring and transport and logistics services.

Requirement for the Port Operator to maintain separate accounts
I note the potential implications of the recommendation that Darwin Port be required to provide the UC with sufficiently detailed information to enable it and port users to assess profitability, including separate accounts for prescribed services.

Noting the ambiguity in the latter recommendation (is the recommendation for separate accounts for each prescribed service or separate accounts for prescribed services a whole), as noted above, such requirements are an escalation in regulatory intervention which is not warranted at this time, particularly given the UC conclusions that market power has not been inappropriately exercised, and there is no indication that Darwin Port is generating excessive profits.

I have been advised that the financial systems Darwin Port utilises do not currently provide capacity for separate accounts, with the information sought not currently available to the port operator, and with potential significant costs associated with providing for separated accounts.

In the current situation where there are no material concerns with the port operator's behaviour, there would appear to be little practical or competitive benefit to be gained from imposing the additional costs of accounting separation on the port operator.

Enforcement and Compliance
In relation to enforcement and compliance, the UC finds that the regime does not provide the UC with investigatory powers. The UC further finds that it does not have the ability to levy penalties for breaches or non-compliance with the Access Policy. I note that these are matters which were considered and addressed in the specific design of the framework.

The *Ports Management Act* declares the provision of prescribed services to be a regulated industry for the purposes of the *Utilities Commission Act* thereby arguably providing authority for the UC to, among other things make, monitor the operation of, and review rules relating to the conduct or operations of a regulated industry; and develop and monitor standards and conditions of service and supply. The NT did not intend that the UC have the capacity to levy penalties for breaches, rather they would be matters which would be reported to the Minister for his/her consideration of appropriate actions or sanctions.

Conclusion

In light of the UC's conclusions that there is no evidence that Darwin Port has exercised its market power, that there is no reason to change the current form of regulatory oversight, and the various positions outlined above, there does not appear to be any compelling need for the various amendments proposed by the UC to be made to the port access and pricing regime at this stage.

However, any recommendations contained in the UC's final report will be considered by the Minister and Northern Territory Government in the context of the high level findings of the review, overarching policy and objectives supporting the current price and access regulatory regime, any material changes in the Port operating environment since the regime was introduced that may impact this policy position or the regime's effectiveness, and the transaction documents reflecting the agreed contractual arrangements surrounding the Port lease

Again, thank you for the opportunity to provide comment and the extensive work and consultation the UC has undertaken in completing the review and preparing its draft report.

Yours sincerely

Jodie Ryan

JODIE RYAN

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