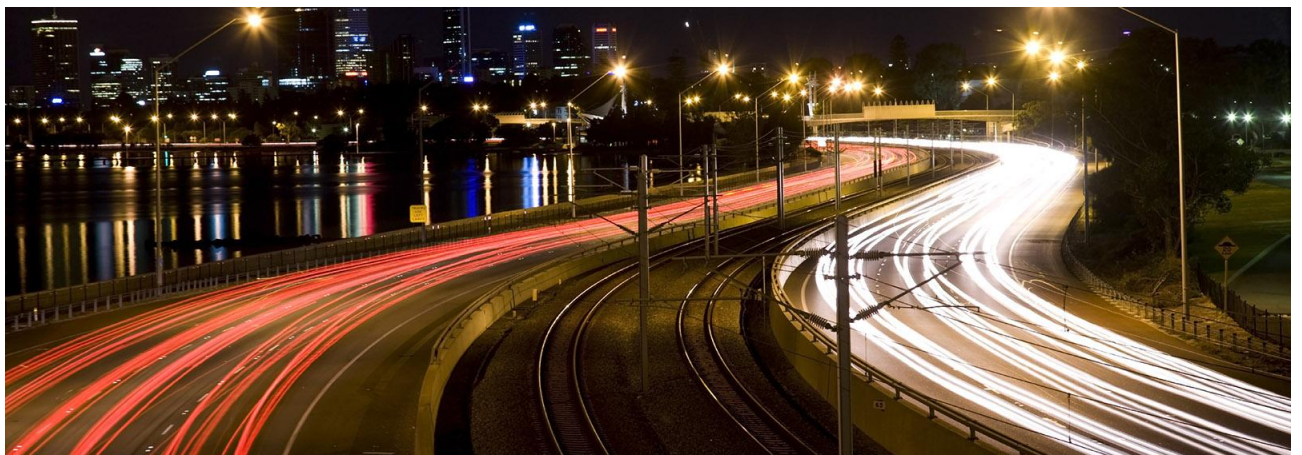

Report prepared for the Federal Chamber of Automotive Industries

Submission to the Productivity Commission inquiry into the National Access Regime and the Competition and Infrastructure Reform Agreement

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1. Introduction

- This report has been prepared as a submission to the Productivity Commission inquiry into the National Access Regime (NAR) and the Competition and Infrastructure Reform Agreement (CIRA) and has been commissioned by the Federal Chamber of Automotive Industries (FCAI).
- The focus of this report is on competition issues surrounding the provision of automotive terminalling services at seaports around Australia and the CIRA.
- The provision of automotive terminalling services plays a vital role in the automotive supply chain for Australian exporters and importers of motor vehicles.
- An automotive terminal is a piece of infrastructure that is suited to the loading, unloading and storage of motor vehicles. The process of moving motor vehicles from a ship to land or vice versa requires a terminal facility of sufficient size and strength to handle the ship and automotive stevedoring services to load and unload the cargo.
- Automotive terminal operators provide terminal space for the temporary storage of cargo after it is discharged from a vessel or prior to it being loaded onto a vessel.
- Automotive stevedoring involves driving motor vehicles on and off ro-ro ships and is relatively labour intensive. Stevedores contract with terminal operators for the use of the terminal space and related equipment.
- The major supplier of automotive terminalling services around the country is Australian Amalgamated Terminals Pty Limited (AAT).

2. Access to an essential facility

- An *essential facility* has been defined as a facility that exhibits natural monopoly characteristics which permits the owner to reduce output and/or service and charge monopoly prices, to the detriment of users and the economy as a whole. Examples of essential facilities include electricity transmission grids, telecommunications networks, rail tracks, major pipelines, ports and airports.
- The problem with an unregulated essential facility is that a facility owner may be able to set prices that substantially exceed its forward looking, long run economic costs - the level of prices that would prevail in the presence of effective competition. Regulatory concern arises when a firm possesses significant and durable market power leading to prices that substantially deviate from proper economic costs and which generate persistent supracompetitive returns.
- Impeding access to an essential facility can result in vertical foreclosure through the facility owner denying or limiting access to its input.
- The fundamental effect of any successful foreclosure is a restriction of output in both the upstream and the downstream markets, with a corresponding increase in price coming at the expense of customers in the downstream product market.
- The NAR is a policy response to the problem created by access to essential facilities.

3. Competition problems with seaports

- Major seaports in Australia are monopoly suppliers of the provision of port services for the transport of motor vehicles.
- One of the reasons for retaining port authorities in public ownership has been to guard against the abuse of market power.
- While there may have been no overt exercise of market power by publicly owned port corporations, concerns remain they may still have an interest in inflating land values in order to maximise financial returns for state governments who are under increasing financial pressure.
- While there may be some restraint on the exercise of market power by publicly owned port corporations by virtue of their adherence to legislative objectives, this is not the case for other major ports hosting automotive terminals.
- The exercise and abuse of market power has been mitigated in relation to Port Adelaide through South Australian regulatory arrangements covering pricing and third party access that accompanied privatisation in 2001
- On the other hand, there is no provision for any regulatory oversight of charges imposed by the port operator at the Port of Brisbane.
- NSW will introduce a price monitoring scheme for its privatised ports that imposes a reporting obligation on the part of port operators but which bypasses the NSW price regulator altogether, the Independent Pricing and Regulatory Tribunal (IPART). Under the NSW arrangement, port operators will report directly to the relevant state Minister on an annual basis and the Minister will also have power to compel port operators to provide information on request.
 - The Productivity Commission has observed that the credibility of the prices oversight can be enhanced by giving regulating entities some independence from government, as this reduces pressures for decisions based on short-term political considerations. The Productivity Commission has also recommended that prices oversight should be undertaken by a regulator that is independent of government, such as a statutory authority.
- Where independent state price regulators have been commissioned to conduct CIRA port reviews they have recognised the potential for major seaport operators to exercise market power even if it has been acknowledged that operators have not done so. As such, price monitoring regimes operate in Victoria and South Australia consistent with those states' obligations under the CIRA.
- On the other hand, where CIRA port reviews have been left in the hands of government agencies, and in some instances contracted out to private economic consultants, they have tended to find no evidence of the abuse of market power and on that basis concluded there was no need for the imposition of economic regulation. This may be a reasonable enough position to adopt in the case of publicly owned port corporations where adherence to legislative objectives may restrain the abuse of

potential market power by port operators. However, there are no such restraints on port operators where ports have been privatised.

- The situation in relation to the Port of Brisbane is inadequate where there is no check on the potential abuse of market power by the now privately owned port operator. The policy response on the part of the Queensland Government to the potential abuse of market power at the Port of Brisbane so far has been one of inaction.
- While a price monitoring regime is being implemented in NSW following the privatisation of Port Kembla and Port Botany, it does not engender confidence given it will bypass the NSW price regulator IPART. The policy response on the part of the NSW Government to the potential abuse of market power at its privatised ports should be consistent with the policy principles of the CIRA that recommend that price monitoring should be conducted by an independent body.
- CIRA has not proven to be an effective instrument in preventing the potential abuse of market power by private operators of major seaports in Queensland and New South Wales.
- While Victoria and South Australia have implemented price monitoring regimes consistent with their obligations under the CIRA, one area of oversight within these regimes may be in regard to attempts by port operators to inflate land values which in turn could be used to inflate port lease rentals. This is one area where existing price monitoring regimes could be extended.
- In regard to the provision of automotive terminalling service the states have generally not complied with their CIRA obligations to allow competition unless a transparent public review finds that the benefits of restricting competition outweigh the costs as it has generally been overlooked. The only state that appears to have fully complied with this requirement, NSW, urgently needs to revisit this matter in light of the privatisation of Port Kembla.

4. Monopoly provision of automotive terminalling services

- The provision of automotive terminalling services in Australia is dominated by AAT which is a monopoly provider at the Port of Brisbane and Port Kembla while a duopoly exists at Port Adelaide and an oligopoly exists at the Port of Melbourne.
- AAT was created as a joint venture between the stevedoring and terminalling duopolists, the then Toll/Patrick Group (Patrick) and the then P&O Group (P&O) during the period from September 2001 to April 2002.
- While there have been ownership and name changes since 2002, AAT is still a joint venture between essentially the same stevedoring and terminalling duopolists.
- In response to the creation of AAT, the Australian Competition and Consumer Commission (ACCC) claimed that Patrick and P&O entered into arrangements in 2001 and 2002 which had the purpose or effect, or likely effect, of substantially lessening competition in markets for the supply of automotive terminals at ports in Brisbane,

Sydney and Melbourne in contravention of section 45(2) of the then Trade Practices Act (TPA), now the Competition and Consumer Act (CCA).

- Before any proceedings went to judgement, the ACCC reached a settlement agreement with Patrick and P&O under which both parties agreed to pecuniary penalties of \$1.9 million for contraventions of section 45(2) of the TPA. As part of the settlement, AAT would apply to the ACCC for authorisation of the contractual arrangements establishing AAT.
- Authorisation is the process of seeking an exception from the application of competition law on public benefit grounds. Despite expressing concern that there were limited public benefits and potentially significant detriments from the operation of AAT, the ACCC granted authorisation to AAT until December 2019 in December 2009 conditional on AAT providing:
 - an open and non-discriminatory process for the offer of access to stevedores;
 - a non-discriminatory approach to pricing and the provision of terminal services; and
 - an efficient and effective dispute resolution process in the event that AAT and the access seeking stevedore are unable to negotiate a mutually acceptable agreement.
- Under the terms of the ACCC authorisation, it is possible for a stevedore to refer an access dispute to arbitration to be conducted either by the ACCC or independent arbitrator. In the event that the ACCC is the arbitrator, it will have powers set out in Subdivisions C-E and G of Division 3 of Part IIIA of the CCA.
- The practical effect of the ACCC's authorisation in this regard has been to impose a *de facto* access declaration upon AAT, complete with references back to provisions contained in Part IIIA of the CCA. A major problem with the ACCC's approach is that it denies parties access to the protections afforded under Part IIIA such as through merits review.
- The ACCC authorisation also provides for binding determination by an independent price expert in the event of a complaint in relation to a price dispute.
- The practical effect of the ACCC's authorisation in this regard has been to privatise the price regulation process. This is a highly unusual situation that is without precedent.
 - The ACCC authorisation is arguably deficient in that it does not require the independent price expert to publish reasons for their decisions.
 - An important aspect of accountability is answerability. On this basis, there is effectively no accountability with the appointment of an independent price expert.
- The monopoly position enjoyed by AAT in the two major automotive seaports gives it the capacity to impose inefficient input costs upon automotive stevedores. While the ACCC authorisation ensures non-discriminatory access to all prospective automotive stevedores, it does not provide absolute protection against inefficient charges imposed by AAT.
- It is possible for a stevedore to refer an access dispute to arbitration to be conducted either by the ACCC or independent arbitrator under the terms of the authorisation. However, given that both existing automotive stevedores are related parties to AAT, the practical reality is that they are extremely unlikely to initiate an access dispute requiring arbitration and there is no other independent automotive stevedore operating from an AAT terminal. The arbitration process provided for under the ACCC authorisation is

only likely to be of any benefit in delivering an efficient price in the event of the potential entry of another automotive stevedore who is not a related party to AAT.

- The ACCC authorisation also provides for binding determination by an independent price expert in the event of a complaint in relation to a price dispute. The fundamental problem with the ACCC pricing principles imposed on AAT is that it imposes rate-of-return regulation (ROR) on its operations that may not necessarily be compatible with an efficient pricing regime.
 - A critical problem with ROR regulation is the lack of incentive for the regulated firm to reduce its costs.
- While it could be argued that the ACCC's authorisation overcomes the deficiency associated with ROR regulation through specifying that the independent price expert must take into account "efficient input costs", the practical application of this requirement has so far been to rely on AAT's word that it has adopted efficient input costs in the past in order to determine whether projected future input costs are reasonable.
- The relevant economic literature suggests that ROR regulation coupled with historical costs for a monopolist is likely to be an inappropriate basis on which to be setting efficient prices.
- There have been a number of other deficiencies associated with the operation of the independent price expert.
 - In deliberating on a reasonable ROR for the operations of AAT, the independent price expert settled on a rate of return that was actually higher than originally proposed by AAT based on their assessment of risk. Given the information asymmetries that would exist, it seems strange that the independent price expert would have a better grasp on the risk of AAT's operations than AAT would have itself. This decision was highly contestable and a price regulator should be accountable for their decision making under such circumstances. This higher rate of return was subsequently utilised by AAT in following price determinations for its terminal operations.
 - The process provided for under the ACCC authorisation lacks transparency due to its reliance on commercially sensitive and confidential information and AAT's pricing model which is essentially a black box and beyond the scope of any external scrutiny with the exception of the independent price expert.
- Competition law generally exists to at least scrutinise and sometimes prohibit joint ventures between market rivals. However, rather than pursue the dissolution of AAT in its prosecution for breaches of the TPA, instead the ACCC entered into a plea-bargain with the owners of AAT and then later sanctioned its operation through authorisation. In an attempt to constrain the exercise of market power by AAT, the ACCC has imposed a number of conduct or behavioural conditions on AAT.
 - It appears the ACCC has adopted a different standard in relation to the AAT authorisation than it generally does in relation to mergers as it has failed to address any of the underlying structural problems associated with the provision of automotive terminalling services by AAT through the imposition of behavioural remedies.

5. Double monopoly problem

- Any abuse of market power by port operators through the charges they levy on automotive terminal operators will be further exacerbated where an automotive terminal operator in turn exercises market power through the charges they impose on automotive stevedores and shippers.
 - Double marginalisation occurs wherever there is any market power exercised at successive vertical stages of production. This double mark up on the product leads to lower total sales and lower total profit than if the port operator and the automotive terminal operator were vertically integrated.
- The risk of double marginalisation in regard to the provision of automotive terminalling services at the Port of Brisbane and at Port Kembla is a very real prospect.
 - There is no regulatory oversight of prices charged by the private port operator at the Port of Brisbane coupled with a monopoly provider of automotive terminalling services subject to an inadequate price control regime.
 - The regulatory oversight of prices at a privatised Port Kembla will be inappropriate coupled with a monopoly provider of automotive terminalling services subject to an inadequate price control regime.

6. Why efficient port charges matter

- Economic theory suggests that the abuse of market power through inefficient port and terminal charges will be passed through to new motor vehicle buyers to some extent both domestically in the case of imported motor vehicles and overseas in the case of exported passenger vehicles.
- The price increase in vehicles due to inefficient port and terminal charges means consumers will purchase less imported new vehicles and Australia will export less vehicles to overseas markets.
- An increase in the price of new vehicles will increase demand for and the price of used vehicles.
- An increase in the price of new vehicles is also associated with a decrease in the rate at which older vehicles are scrapped. Older vehicles lack the most up-to-date safety features and are less safe than newer vehicles.

7. Conclusions

- There is no check on the potential abuse of market power by the privately owned port operator at the Port of Brisbane.
- The policy response on the part of the New South Wales Government to the potential abuse of market power at its privatised ports could be considered inappropriate.

- The CIRA has not proven to be an effective instrument in preventing the potential abuse of market power by private operators of major seaports in Queensland and New South Wales.
- The potential for abuse of market power by port operators is further exacerbated by the creation of a monopoly provider of automotive terminalling services in AAT.
- The provision of automotive terminalling services appears to have fallen between the cracks when it comes to mitigating the potential abuse of market power by private port operators coupled with the sanctioned operation of a monopoly provider of automotive terminalling services. This in turn creates conditions conducive to double marginalisation.
- The CIRA along with competition law enforcement and administration have failed the workably competition test set by Jesse Markham given there is clearly a change that can be effected through public policy measures that would result in greater social gains than social losses in relation to ports and the provision of automotive terminalling services to mitigate the potential abuse of market power.

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