



Australian  
Competition &  
Consumer  
Commission

# ACCC submission to the inquiry into the proposed lease of the Port of Melbourne

10 September 2015

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## 1. Executive summary

On 5 August 2015, the Victorian Legislative Council resolved to establish a Select Committee of eight members to inquire into the proposed lease of the Port of Melbourne to a private sector entity. This submission responds to calls from the Select Committee for comment on the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015 (the Bill)* that was introduced into the Victorian Parliament in May 2015 and which sets out the relevant frameworks that will apply to the private sector lessee.

The Australian Competition and Consumer Commission (**ACCC**) is of the view that the privatisation of government owned assets, if implemented appropriately, is an effective way in which to promote efficient use of infrastructure in the interests of users and the wider community. However, it is important that governments selling public assets ensure that the appropriate market structure and/or access and pricing arrangements have been put in place as part of the privatisation process.

These are particularly important considerations for the Port of Melbourne, Australia's largest container and general cargo port. Almost all consumer products imported to and exported from the State of Victoria by sea pass through this port. Given this, any monopoly pricing at this port will be paid for by Victorian consumers and exporters. It will also negatively impact upon the productivity of Victoria's economy, impeding growth, international competitiveness and living standards.

The ACCC notes that the majority of the detail on the proposed arrangements for the privatisation of the Port of Melbourne will be in regulations, which are yet to be tabled, and in the relevant lease agreement itself. The ACCC's observations are therefore restricted to the information that has been released thus far by the Victorian Government.

With regards to the proposed privatisation of the Port of Melbourne, the ACCC makes the following comments:

- If the proposed compensation regime does allow for the lessee to receive compensation for losses incurred due to competition from a second port, this will be an unfortunate outcome from a competition policy perspective. Such a compensation regime would be likely to hinder the prospects of future competition, entrenching substantial market power at the Port of Melbourne.
- The proposed price monitoring regime with annual price increases capped at the Consumer Price Index (**CPI**) will go some way to addressing concerns about monopoly pricing for the first 15 years. However, the ACCC is concerned that, if price monitoring alone applies after that time, then this is unlikely to provide a sufficient constraint on substantial market power. The ACCC is of the view that an effective publish-negotiate-arbitrate model should apply after the first 15 years so as to provide a greater incentive for the Port of Melbourne lessee to offer reasonable access terms and conditions.
- The scope of services proposed to be covered by the price monitoring regime does not include all those services to which substantial market power exists. Specifically, the ACCC notes that land rent costs are excluded from the proposed monitoring framework. The ACCC's concerns about the incentive and ability to exercise substantial market power in land rent costs at the Port of Melbourne has been highlighted in the recently-resolved dispute between the Port of Melbourne Corporation (**PoMC**) and DP World. Given this, the ACCC is of the view that land rent costs should be included in the regulatory regime.

While the ACCC has provided more detailed comment on the proposed arrangements in the remainder of this submission, the ACCC would also welcome the opportunity to discuss

directly with the relevant persons the specific market structure and regulatory arrangements being proposed.

The remainder of this submission is structured as follows:

- **Section 2**—Privatisations, realising the potential benefits by getting the balance right between short-term and long-term interests
- **Section 3**—Market structure considerations, including observations about the application of the compensation regime and restrictions on vertical integration
- **Section 4**—Economic regulation, including getting the scope of services right

## 2. Privatisations

The ACCC considers that, if implemented appropriately, privatisation can facilitate innovative management and improve the efficiency of infrastructure in the interests of users and the general community.

However, the economic efficiency benefits will only be realised where there is strong potential for competition or where, in the absence of competition due to monopoly or near monopoly characteristics, there are appropriate structural reforms and/or sufficient regulatory oversight to ensure that competition in upstream or downstream markets is not hindered.

The ACCC considers that governments should appropriately deal with these issues early and upfront in the privatisation process. This provides greater certainty for bidders than ex-post arrangements and is essential for promoting efficient investment incentives. By understanding how assets will be structured and regulated upfront, potential acquirers of assets can factor these arrangements into their purchase price and bid accordingly.

These are not new issues. The 1995 Competition Principles Agreement recognised that in relation to structural reform of and prior to the privatisation of public monopolies, governments should undertake a review into, relevantly:<sup>1</sup>

- (b) *the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;*
- (c) *the merits of separating potentially competitive elements of the public monopoly;*
- ...
- (g) *the price and service regulations to be applied to the industry.*

Experience with government privatisations over recent decades has shown that acting in accordance with these principles promotes competitive outcomes. In the electricity sector, for example, getting the market structure right was key to facilitating effective competition during the development of the National Energy Market (**NEM**) in the 1990s.

In recent years, Australian governments have made a series of announcements regarding the privatisation of key infrastructure assets and have also announced the projects they will invest in as a result of the profits generated from these privatisations.

This creates a strong incentive for governments to structure their privatisation processes in a manner that maximises the sale price they receive. There is a risk that, in order to maximise sale prices, governments will have little incentive to closely examine whether the market structure and regulatory arrangements that will apply post-privatisation are conducive to competition. For example, while privatising two potentially competing assets as a package may increase the sale price (as compared to selling the assets to separate owners) this increased sale price would be received at the expense of competition. In the longer term, a less competitive market structure will lead to higher priced and lower quality goods and services for consumers. It will also negatively impact upon the productivity of Australia's economy, impeding growth, international competitiveness and living standards.

As the ACCC has noted in a number of fora, this scenario can be considered to effectively impose a tax on future generations of Australians.<sup>2</sup>

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<sup>1</sup> Competition Principles Agreement – 11 April 1995 (as amended to 13 April 2007), section 3.

This is not just a theoretical possibility. When Sydney Airport was sold for \$5.6 billion in June 2002, the Commonwealth Government provided the acquirer the valuable right of first refusal to operate a second Sydney airport (which has since been announced to be located at Badgery's Creek). The National Audit Office has found that the sale price for Sydney Airport was higher than a number of possible valuation benchmarks, including the government's own estimate of the sale price in the 2001-02 budget. The ACCC considers that the higher sale price was likely a reflection of a valuation premium associated with the right of first refusal option. The right of first refusal confers on Sydney Airport a monopoly over the supply of aeronautical services for international and most domestic flights in the Sydney Basin, and forecloses the potential for competition between Sydney Airport and an independent operator of a second airport. In the ACCC's view inclusion of this right of first refusal increased the sale price but is likely to have had an anti-competitive impact on the aviation sector.<sup>3</sup>

Regarding the proposed privatisation of the Port of Melbourne, the ACCC notes that the majority of the detail will be in the regulations, which are yet to be tabled, and in the relevant lease agreement itself. The ACCC has already expressed concern in other fora about the use of rent increases as a method to increase the sale price of the Port of Melbourne, and would have similar concerns to those raised above if the privatisation of the Port of Melbourne occurs without appropriate consideration of the above issues.

### 3. Market structure

The ACCC is of the view that governments should consider the potential merits of structural reform when privatising assets. As no regulator in Australia has the statutory power to impose compulsory functional separation in any industry sector, it is a matter for governments to make policy decisions to implement structural measures in particular industries. The ACCC notes that the merits of structural reform, and the form they take, need to be considered on a case by case basis.

This aligns with the recommendations by the Organisation for Economic Co-operation and Development (**OECD**) which call for governments to consider the costs and benefits of separating the structure of a regulated firm's activities, particularly in the context of privatisation, liberalisation or regulatory reform.<sup>4</sup> The OECD notes that:

*When a firm provides products or services regulated by government, structural separation may be required so as not to hinder the entry of competitors in the market.<sup>5</sup>*

With respect to the Port of Melbourne, the ACCC can provide comment on certain aspects of the proposed lease that are relevant to market structure considerations. For example, the features of the proposed compensation regime that have been raised publicly and the importance of governments giving consideration to vertical integration issues.

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<sup>2</sup> This issue was raised by the ACCC in its submission to the Senate Economics References Committee on the Federal Government's Asset Recycling Initiative, noting that the scheme has the potential to exacerbate this issue by further incentivising states and territories to seek a higher sale price in order to maximise the 15 per cent incentive payment they would receive.

<sup>3</sup> ACCC, *Reinvigorating Australia's Competition Policy – Australian Competition & Consumer Commission Submission to the Competition Policy Review*, 25 June 2014, p. 36.

<sup>4</sup> OECD, *Recommendations concerning Structural Separation in Regulated Industries*, accessed on 9 September 2015 at <http://www.oecd.org/daf/competition/recommendationconcerningstructuralseparationinregulatedindustries.htm>

<sup>5</sup> Ibid.

### 3.1. Proposed lease terms for the privatised Port of Melbourne

The ACCC understands that the proposed privatisation is for a 50 to 70 year lease of all commercial operations at the Port of Melbourne, with functions relating to safety, security and the environment remaining in public hands. The ACCC understands that the proposed lease terms include a compensation regime that compensates the lessee of the Port of Melbourne if a subsequent policy of the state government affects the international throughput at the port prior to it reaching capacity.

#### Compensation regime

Regarding the proposed compensation regime, the ACCC has not seen the details of the provision as it is envisaged that this will be a term of the relevant lease rather than being provided for in legislation. However, the Victorian Government has stated that:

*The leaseholder may be compensated if a second port is developed by the State [of Victoria] during the lease term and takes international container capacity that would have been accommodated at the Port of Melbourne away from it.<sup>6</sup>*

The ACCC understands that there are a number of limitations on the operation of the compensation regime, namely:

- the compensation regime will not apply after throughput at the Port of Melbourne reaches 'capacity'<sup>7</sup>; and
- the regime does not apply if a private party decides to build a new port.

Despite these limitations, the proposed compensation regime would be an unfortunate outcome from a competition policy perspective.

While the ACCC appreciates that governments have broader interests than competition policy to consider, the ACCC has consistently said that it is important that privatisation does not create or maintain a market structure that will hinder future competition. The ACCC is concerned that the compensation regime will have this effect and will entrench monopoly power at the port.

#### Restrictions on vertical integration

While the ACCC cautions against imposing unnecessary restrictions on firms' ability to participate in markets, the ACCC encourages governments to consider integration issues that could raise competition concerns in the future.

Where the sale of an asset is likely to confer enduring market power, governments should carefully consider at the beginning of a privatisation process whether legislative restrictions on vertical integration might be warranted. If deemed appropriate, this may involve the exclusion of certain parties who operate up and/or downstream from bidding for the Port of Melbourne or the imposition of limits on the vertical integration interests the port lessee may have in the future.

For example, the Commonwealth Government used legislative measures to address vertical integration concerns in the telecommunications industry by imposing wholesale-only

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<sup>6</sup> Victorian Department of Treasury and Finance, *Frequently asked questions about leasing the Port of Melbourne*, accessed on 4 September 2015 at <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne/Frequently-asked-questions#HasTheStatepromisednottobuildasecondportduringthelease>.

<sup>7</sup> According to the Victorian Department of Treasury and Finance's FAQ's (see above footnote), Port of Melbourne container capacity for the purposes of determining any possible compensation will be defined through the bid process, but will be capped at an amount that is less than the full natural container capacity potential of the Port of Melbourne.

restrictions and provision for ownership restrictions on the National Broadband Network (**NBN**). Having these restrictions in legislation ensures structural separation should not be subverted in the future by allowing NBN to directly supply services to retail customers, or entering into ownership arrangements with retailers and other carriers.

## 4. Economic regulation

The appropriate form of economic regulation and the mechanism used to implement the arrangements is not a 'one size fits all' exercise and depends on the type of market and the nature of the competition concerns relevant to the circumstances. As recognised in the 1995 Competition Principles Agreement, there is a broad spectrum of possible regulatory tools, including:

- monitoring and information gathering, which can be a useful tool to provide information to governments, regulators and the wider community about the transitional impact of deregulation and other reforms on price levels in particular industries;
- negotiation and arbitration, such as where access is required to a structurally separated monopoly service in order to compete in an upstream or downstream market; and
- ex-ante (upfront) determination of terms and conditions, such as where access is required to a vertically integrated monopoly service, or case-by-case negotiation is impractical.

The ACCC understands that the Victorian Government has proposed a strengthening of the current price monitoring regime for the privatised Port of Melbourne. As discussed below, the ACCC has some concerns about the sufficiency of a monitoring regime to effectively constrain substantial market power. The ACCC also has some concerns about the scope of services proposed to be covered by the regime. These concerns have been highlighted by the recently-resolved land rent charge dispute between PoMC and DP World, which is also discussed.

### 4.1. Proposed regulation for the privatised Port of Melbourne

The Essential Services Commission of Victoria (**ESC**) has found that the Port of Melbourne has substantial market power in relation to the shipping channels it manages, the provision of prescribed port services to containerised trade and the provision of prescribed port services to the motor vehicle trade.<sup>8</sup> Under the *Port Management Act 1995*, the ESC currently oversees a price monitoring framework that applies to these services at the Port of Melbourne. The ESC states that the current price monitoring framework is a light-handed form of regulation whereby the ESC monitors prices for the prescribed services, but the ESC has no power to set prices or direct the PoMC to charge prices.<sup>9</sup>

The ACCC understands that the Victorian Government has proposed that the ESC will have a strengthened price monitoring role once the Port of Melbourne is privatised. The leaseholder will be required to set prices for port users in accordance with economic pricing principles and a deemed asset base. In addition, annual price increases will be capped at CPI for at least 15 years with compliance monitoring by the ESC.<sup>10</sup> The services that will be covered include wharfage and channel fees, while property rents will continue to be set by

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<sup>8</sup> Essential Services Commission of Victoria, *Review of Victorian Ports Regulation: Final Report*, June 2014, pp. xviii-xix.

<sup>9</sup> *Ibid.*, p. xv.

<sup>10</sup> Victorian Department of Treasury and Finance, *More about the Port of Melbourne Lease Transaction*, May 2015, accessed on 4 September 2015 at <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne>.

separate contracts negotiated directly between the leaseholder and its users.<sup>11</sup> Further, the ESC will be required to conduct reviews of the Port of Melbourne leaseholder's compliance with the pricing principles every five years with a trigger for potentially more direct forms of price controls if non-compliance of a 'significant and sustained manner' detected in those reviews.<sup>12</sup> The ACCC understands that the Governor in Council, on the recommendation of the ESC Minister, may impose more direct forms of regulation.<sup>13</sup>

## Form of regulation

The ACCC is of the view that, while price monitoring with a CPI cap on annual price increases is not a perfect substitute for a cost-based approach to regulation, it will go some way to addressing concerns about monopoly pricing for the first 15 years and for those services covered by the price monitoring regime. However, the ACCC is concerned that, if price monitoring alone applies after that time, then this is unlikely to provide a sufficient constraint on substantial market power at the Port of Melbourne.

The ACCC notes that the price monitoring is proposed to include pre-determined pricing principles, periodic reviews of compliance by the ESC and triggers for more direct forms of price controls. In this way, the price monitoring may provide some level of deterrence from exercising the full degree of substantial market power at the Port of Melbourne after the CPI cap ceases to apply. However, the ACCC is concerned that five-yearly reviews by the ESC are too infrequent to detect inappropriate conduct in a timely manner. Moreover, as the Bill does not define precisely what will qualify as non-compliance in a 'significant and sustained manner', this creates some uncertainty as to when non-compliant conduct would qualify as a trigger. Further, even if triggered, the ACCC is concerned there may be significant delays before any decision is made about whether (and what) more direct forms of regulation should apply. By this time, harm resulting from the exercise of substantial market power will already have occurred and may not be possible to be undone.

The ACCC considers that, together, the above factors weaken the likelihood of price monitoring alone to sufficiently and effectively constraining the exercise of significant market power at the Port of Melbourne after the first 15 years. The ACCC is of the view that an effective publish-negotiate-arbitrate model can provide greater incentives for a service provider to offer reasonable access terms and conditions in commercially negotiated access arrangements.

The key features of a publish-negotiate-arbitrate regime are:

- a requirement that the access provider publish its standard terms and conditions (including price) for regulated services;
- a robust negotiation framework to facilitate negotiations between access providers and access seekers over the standard terms and conditions; and
- recourse to arbitration by an independent economic regulator in the event that negotiations fail.

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<sup>11</sup> Victorian Department of Treasury and Finance, *Frequently asked questions about leasing the Port of Melbourne*, accessed on 4 September 2015 at <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne/Frequently-asked-questions#WhatarePortofMelbournescharges>.

<sup>12</sup> Section 92 of the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015* which inserts new Division 2A into Part 3 of the *Port Management Act 1995*.

<sup>13</sup> *Ibid.*

## Scope of services

It is important to ensure that the scope of the services captured is sufficiently broad to cover all the elements of the service to which access is required. In the absence of correctly defining the scope, the incentive and ability to exercise substantial market power in those services not covered (and in which market power exists) will remain, essentially rendering the price monitoring regime ineffective.

The ACCC is concerned that the scope of services proposed to be covered does not include land rent costs, with property rents continuing to be set by separate contracts negotiated directly between the leaseholder of the Port of Melbourne and users.<sup>14</sup> This is in line with the current monitoring framework at the Port of Melbourne.

The ACCC's view is that this is a significant exclusion from the proposed regime given that a significant amount of market power clearly exists for land at the port. The ACCC's concerns about the exclusion of land rent costs from the proposed monitoring regime were highlighted in the recently concluded dispute at the Port of Melbourne. As the ACCC understands, the PoMC sought to revalue land at the Port of Melbourne to take into account the lease price paid by the new terminal operator at the port, the Victorian International Container Terminal Limited, and then use this as a basis for calculating increased property rents for DP World by a reported 767 per cent.<sup>15</sup> As the ACCC has said publicly on this matter, this approach to valuation is inappropriate as it would lead to a continuing upward spiral in prices.

The ACCC's long-held view is that there should be appropriate access and/or pricing regulation in place for monopoly or near monopoly assets of such national significance as the Port of Melbourne that covers all of the elements of the service to which access is required.

## 5. Further information

The ACCC would welcome the opportunity to discuss directly with the relevant persons the specific market structure and regulatory arrangements being proposed

For further information, please contact Ms Sarah Sheppard, A/g General Manager, Infrastructure & Transport – Access & Pricing Branch on 03 9290 1992.

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<sup>14</sup> Victorian Department of Treasury and Finance, *Frequently asked questions about leasing the Port of Melbourne*, accessed on 4 September 2015 at <http://www.dtf.vic.gov.au/Infrastructure-Delivery/Leasing-the-Port-of-Melbourne/Frequently-asked-questions#WhatarePortofMelbournescharges>.

<sup>15</sup> DP World, *Tasmanian govt (sic), DP World Australia working together for Melbourne rent hike solution*, 14 May 2015, accessed at <http://www.dpworldaustralia.com.au/news-and-media/media-releases/tasmanian-govt-dp-world-australia-working-together-for-melbourne-rent-hike-solution/>.