INDEPENDENT CONSUMER & COMPETITION COMMISSION

PNG PORTS CORPORATION LIMITED - MIDTERM REVIEW OF COMPETITION

FINAL REPORT AND FINDINGS

29th AUGUST 2012
EXECUTIVE SUMMARY

The Independent Consumer and Competition Commission ("Commission") was established in 2002 under the Independent Consumer and Competition Commission Act 2002 ("ICCC Act") to promote competition and fair trading; regulate the prices of certain declared goods and services; undertake industry specific productivity reviews; protect consumer interests in Papua New Guinea; and for related purposes. One full time Commissioner and two Associate Commissioners constitute the statutory body, the Commission. The current members of the Commission are:

- Dr. Billy Manoka, Ph. D - Commissioner & Chief Executive Officer
- Dr. Eric Omuru, Ph. D - Associate Member (Resident)
- Mr. David Dawson – Associate Commissioner (Non-resident)

As part of its functions, the Commission regulates certain State-owned enterprises (defined as 'regulated entities' under the ICCC Act) in relation to the prices they charge for certain services they provide (defined as 'regulated services'). The rationale underpinning the regulation of such entities is that they possess substantial market power, which necessitates regulation, else the public interest would be exposed to economic harm from the possible exercise of such market power which could result in prices reflecting economic rents, rather than efficient costs, as would prevail in competitive markets. As these entities operate in sectors regarded as 'key enablers', influencing 'downstream' markets, they are significant for the national economy in terms of the charges they make and the efficiency with which they operate.

PNG Ports Corporation Ltd ('PNGPCL') is one such State-owned enterprise regulated by the Commission under a regulatory contract, which commenced on 01st February 2010 and concludes on 31st December 2014.

By way of background, the first such regulatory contract with PNGPCL was promulgated by the Minister responsible for Treasury matters on 01st January 2002, the Commission not having commenced its operations at that time. That contract operated for a period of eight years, and was replaced by the current contract between the Commission and PNGPCL.

Under the current contract, PNGPCL is entitled to seek a mid-term competition review by the Commission under clause 4.3 of the contract. The implication of such a review is that if it is found that the substantial market power, which justifies the regulation, no longer exists in the relevant geographic areas, for those services the subject of the review, then the regulation should be removed because sufficient competition is likely to constrain the regulated entity in the relevant markets.

PNGPCL has invoked its right to seek a competition review by lodging a request for such a review, in respect of 'infrastructure ports services' in Fairfax Harbour (the port of Port Moresby) on 30th April 2012 (the competition review request), the latest possible date that it could exercise that right under the contract.

The competition review request relates to the provision of (a) berthing services; (b) berth reservation services; and (c) wharfage services; in the port of Port Moresby, in which PNGPCL claims competition is provided by (a) Motukea Port operated by Curtain Brothers Ltd; (b)
Steamships MES at its own wharf; (c) Bismark Maritime Ltd, at its own wharf; and (d) Inter-Oil Ltd, at its own facilities at Napa Napa, with ship-operating customers of all players, including PNGPCL, using the aquatory of Fairfax Harbour to access those facilities.

Concurrently with the competition review request, PNGPCL has sought the Commission's agreement to vary its pricing structure to permit it to offer discounts off the tariff approved by the Commission to certain customers in the ports of Lae and Port Moresby (\textit{the tariff variation request}). There is no specific contractual right to seek such a variation to the tariff, but the contract does provide for its variation by mutual agreement of the parties, without limitation as to the subject-matter.

The competition review request and the tariff variation request are dealt with first in this draft report and draft findings.

Following consideration of the above matters, the Commission initiates discussion on the merits of inclusion of port storage services and provision of marine pilotage services within the regulatory framework; examines the implications for competition of the existing structure of charges in the approved tariff, suggesting structural change; describes the approach of PNGPCL to the regulatory regime; the shortcomings of the current regulatory system; and invites consideration of proposed changes to remedy those deficiencies; in the interest of improving port management efficiency, which has a crucial impact on Papua New Guinea’s national economic performance as an archipelagic nation, and the living standards of its people.

The Commission is required to release a draft report and findings on the request by 30\textsuperscript{th} June 2012 and its final report and findings by 31\textsuperscript{st} August 2012. It is the Commission’s intention to undertake the review in a transparent manner; hence the review process encompasses the following stages:

1. Submission of Competition Review Statement by PNG Ports – made on 30\textsuperscript{th} April 2012
2. \textbf{Release of the Draft Report by Commission – 30\textsuperscript{th} June 2012}
4. \textbf{Release of the Final Report – 31\textsuperscript{st} August 2012}

The Commission has considered the two requests by PNGPCL and finds:

(a) Competition in Fairfax Harbour in Port Moresby for the provision of relevant infrastructure port services is insufficient to constrain the market power of PNGPCL; and
(b) The request to vary the pricing structure as proposed should be denied.

In addition, the Commission has, in the draft report and findings and this final report and findings, made findings or initiated an inquiry into the other matters respectively, which were examined in the draft report, namely, whether it should declare the provision of:

- ‘in-port’ cargo storage services; and
- marine pilotage services;

in relevant ports as ‘declared services’ under the provisions of paragraph 33 (1) (b) of the ICCC Act.
In respect of ‘in-port’ cargo storage services; further enquiries are to be conducted before a decision is made on declaration, while in respect of marine pilotage services, a finding is made that the Commission should decide that they are ‘declared services’ under the provisions of paragraph 33 (1) (b) of the ICCC Act.

Alternatively, if the provisions of the ICCC Act are incapable of introducing such changes, the Commission will explore the possibility of utilizing the provisions of the Prices Regulation Act (Chapter 320) to introduce the changes proposed.

The Commission also considers that:

- the regulatory framework for PNGPCL should be reformed to secure an adequate level of dynamic, allocative and productive efficiency in PNGPCL and in downstream markets to:
  - change the structure of charges, as distinct from the level of particular charges and the total revenue cap, including in the latter, cargo storage charges and marine pilotage charges;
  - include regulation of operational expenditure;
  - ensure the integrity of the system by adopting an holistic approach which includes cost allocation requirements across the enterprise and reconciliation of the accounts for regulated services with the statutory accounts of the enterprise, in accordance with generally accepted accounting principles.

- the Customs/NAQIA procedures, which are seriously deficient and impose significant and unnecessary costs on users, which detrimentally affect national economic progress and living standards of all citizens, is in urgent need of substantial reform;

- licensing of stevedoring service providers should be examined for anti-competitive consequences;

- The problems of the waterfront sector merit a wide-ranging inquiry, particularly of the plethora of regulatory bodies involved in various elements of the sector, to establish the range of reforms necessary to allow it to fulfill its part in contributing to national economic growth.

Special Acknowledgement

The Commission would also like to acknowledge Mr. Winston Rodrigues, Principal of Reform Strategies Pty Ltd, for his significant contribution to this midterm competition review of the ports industry in PNG, but of course, the report is issued by the Commission and it takes responsibility for the contents.
Inquiries on how to obtain a copy of the Final Report and Findings and copies of PNGPCL’s submissions should be directed to Mr. Paulus Ain, Executive Manager Regulated Industries Division or Mr. Jack Timi, Manager Regulatory Affairs (Ports/Postal), on telephone 325 2144 or by fax on 325 3980 or via email on pain@iccc.gov.pg or jtimi@iccc.gov.pg. Written requests for the Final Report and Findings should be directed to the address below:

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CONTENTS

1. INTRODUCTION ................................................................................................................................. 7

2. STATUTORY AND REGULATORY FRAMEWORK ............................................................................. 13

3. APPROACH TO ASSESSING COMPETITION .................................................................................. 16

4. ASSESSMENT OF COMPETITION IN FAIRFAX HARBOUR ......................................................... 17

5. PRICING FOR LARGE CUSTOMERS ............................................................................................... 46

6. OTHER ISSUES AFFECTING THE MARKETS FOR PORT SERVICES AND ANCILLARY SERVICES ................................................................................................................................. 53

7. FINAL DETERMINATION ..................................................................................................................... 97
1. INTRODUCTION

The Independent Consumer and Competition Commission ("Commission") was established in 2002 under the Independent Consumer and Competition Commission Act 2002 ("ICCC Act") to promote competition and fair trading; regulate the prices of certain declared goods and services; undertake industry specific productivity reviews; protect consumer interests in Papua New Guinea; and for related purposes. One full time Commissioner and two Associate Commissioners constitute the statutory body, the Commission. The current members of the Commission are;

- Associate Prof. Billy Manoka - Commissioner & Chief Executive Officer
- Dr Eric Omuru - Associate Commissioner (Resident)
- Mr. David Dawson - Associate Commissioner (Non-resident)

At the time of commencement of this review, Mr. Dawson’s term had expired and, therefore, he has not been involved in the matter until his automatic re-appointment, by operation of law, 90 days later. Furthermore, at his attendance at the first Commission meeting following his re-appointment, Mr. Dawson orally declared that he had a conflict of interest in this matter and recused himself. Hence, this matter has been the subject of consideration and decision by the Commissioner and Chief Executive Officer, Associate Professor Billy Manoka and the Resident Associate Commissioner, Dr Eric Omuru.

As part of its functions, the Commission regulates certain State-owned enterprises (defined as ‘regulated entities’ under the ICCC Act) in relation to the prices they charge for certain services they provide, which are defined as ‘regulated services’. The rationale underpinning the regulation of such entities is that they possess substantial market power, which necessitates regulation, else the public interest would be exposed to economic harm from the possible exercise of such market power which could result in prices reflecting economic rents, rather than efficient costs, as would prevail in competitive markets. As these entities operate in sectors regarded as ‘key enablers’, influencing ‘downstream’ markets, they are significant for the national economy in terms of the charges they make and the efficiency with which they operate.

PNG Ports Corporation Ltd (PNGPCL) is one such State-owned enterprise regulated by the Commission under a regulatory contract, which commenced on 01st February 2010 and concludes on 31st December 2014.

By way of background, the first such regulatory contract with PNGPCL was promulgated by the Minister responsible for Treasury matters on 01st January 2002, the Commission not having commenced its operations at that time. That contract operated for a period of eight years, and was replaced by the current contract between the Commission and PNGPCL.

1.1 BACKGROUND TO THIS REVIEW, REPORT, FINDINGS AND EFFECTS

In 2010 when the Independent Consumer and Competition Commission (‘Commission’) reviewed the PNG Harbours Regulatory Contract, PNG Ports Corporation Limited (PNGPCL) submitted that there was competition in the industry and requested the Commission to discontinue regulation. The Commission, however, formed the view that there was not sufficient competition in the industry to justify removal of regulation. The Commission and PNGPCL (‘the parties’) agreed to the inclusion of
a provision in the PNG Ports Regulatory Contract (2010-2014) to conduct a mid-term review of competition in the market for port infrastructure services in 2012. This provision is contained in clause 4.3 of the current regulatory contract (‘regulatory contract’ or ‘contract’), a copy of which has been placed on the public register for this matter and is available for inspection at the Commission’s Offices. In normal circumstances, a copy would be accessible from the Commission’s website at www.iccc.gov.pg; but as the website is currently down, that option is not now available.

In the submission in response to the Commission’s draft report and findings, PNGPCL asserts: “PNG Ports did not seek complete removal of regulation at Port Moresby”. There was no suggestion in the contract provision or other documentation prior to the latest submission by PNGPCL that such a review would, as contended by it, be for the purpose of deregulating the relevant markets at some indeterminate date in the future. The original submission by PNG Ports said

“A provision was therefore made in the Regulatory Contract for a mid-term review of the extent of competition in the market, allowing PNG Ports to submit its views on the need for and extent of continued regulation of port infrastructure services. In particular, the ICCC noted that the purpose of the mid-term review is to identify where there are any significant changes to the competitive landscape that would require an adjustment to the regulatory settings.”

Nothing in the above suggests that the purpose of the mid-term review was to look to future possibilities beyond the current contract; rather, a reasonable interpretation of the sentences above is that the objective of assessing current competition with the explicit purpose of identifying ‘significant changes to the competitive landscape that would require an adjustment to the regulatory settings’, means that where such changes are found, regulation is unnecessary. While the original submission by PNG Ports did seek a mechanism which allows re-opening of the contract or other adjustment to the regulatory settings at page 4, in the circumstances it identified, if the review found that competition in Fairfax Harbour existed to the requisite extent, a reasonable outcome would be that regulation be removed without delay, as the purpose of regulation is to constrain market power and if that were to be found to be absent, there would be no purpose in continuing regulation. Hence, the Commission’s view expressed in its draft report that, in effect, removal of regulation upon a finding of sufficient competition is a consequence thereof, is correct; else, why go to the trouble of assessing competition in Fairfax Harbour in the very services that are the subject of regulation? Any competition review relates to a time period of about one to two years, by which time the current contract would approach expiry; hence, if the intention was to seek deregulation after that period, there would be no point in seeking a review now.

PNGPCL invoked clause 4.3 of the Regulatory Contract and sought a mid-term review of competition in the market for port infrastructure services within Fairfax Harbour in Port Moresby, on 30th April 2012 (‘the competition review’), the last possible date on which it could do so under the contract. A copy of the request has been placed on the public register for this matter and is available for inspection at the Commission’s Offices.
PNGPCL highlighted the operation of the Curtain Brothers-owned Motukea Port, Bismark Maritime Wharf, Steamships MES Wharf and Napa Napa InterOil Port (‘InterOil Port’) as competitors to its operation in the provision of ‘ports infrastructure services’ in Port Moresby Port (‘POM Port’).

The initial submission identifies the particular services in respect of which PNGPCL claims it is competitively constrained. Those services are berthing reservation, berthage and wharfage and are the only services covered by the contract and, in effect, PNGPCL is seeking complete removal of regulation at POM Port. PNGPCL’s submission outlines its views on competition in the port infrastructure services market in POM Port.

As the regulation of regulated services supplied by regulated entities is underpinned by the public policy purpose to constrain the exercise of market power by such entities, the inference to be drawn by any findings that the markets for the relevant services are competitive, to the extent that the regulated entity is sufficiently constrained in the exercise of market power for those services, would logically lead to removal of regulation, in relation thereto, in the relevant ports – in this case, Port Moresby, the subject of the request.

1.2 THE CURRENT REVIEW, REPORT AND FINDINGS

This Final Report and Findings outlines the Commission’s assessment of the claims in the submission, relying on certain information in PNGPCL’s submissions, together with its own knowledge of the relevant markets and other submissions from stakeholders.

The request for review of competition was accompanied by a request to vary the regulated tariff to permit discounts to certain large customers, classes of customers, or products, in the ports of Port Moresby and Lae (‘the tariff variation request’). Presumably, this request on pricing, insofar as it relates to Port Moresby, is made in the alternative to the competition review because, if the claim that the POM Port market for port infrastructure services is successful, that would mean the removal of regulation in that port for the relevant services and PNGPCL would have complete discretion on pricing; whereas if the competition review request is unsuccessful, the tariff variation request for both ports would continue to subsist for assessment. These alternative scenarios are not specified in the submission. The tariff variation request is dealt with simultaneously in this report.

Clause 4.3 of the contract, which provides for the competition review and outlines the framework therefore, requires

“the Regulator to publish a draft report that presents the Regulator’s findings on:

(i) Whether ports [sic] have substantial market power in the provision of ports [sic] infrastructure services, and if so at which port(s) and in connection with the provision of which services substantial market power exists; and

(ii) The need for and extent of continued regulation of the provision of ports [sic] infrastructure services in PNG on a port-by-port basis (in particular, the need for and extent of declaration of ports [sic] services under the ICCC Act).”
The contract defines **essential port services** as “Berth Reservation Services”, “Berthing Services” and “Wharfage Services”. Clause 4.3 and PNGPCL’s submission, however, refer to ‘**ports infrastructure services**’, for which no definition exists. The factual claim refers to “berth reservation services, berthing services and wharfage services, which are claimed to comprise ‘ports [sic] infrastructure services’”. Arguably, a request for a competition review under clause 4.3, purporting to relate to ‘ports [sic] infrastructure services’ has no force or effect as those services are not defined to encompass “berthing services”, “berth reservation services” and “wharfage services”, as defined in the contract. The Commission, however, treats ‘essential port services’ and ‘ports infrastructure services’, made in the submission by PNGPCL, interchangeably in this report, rather than rely on legal technicalities, in the interests of progressing consideration of the substantive issues, as clearly intended by clause 4.3.

The provisions of sub-clause 4.3 (ii), which requires the assessment of the need for continued regulation, on a port-by-port basis of regulation of any of the services comprising port infrastructure services, in such a review, appears excessive and well beyond the scope of the request, in the context where a review is requested in respect of a more circumscribed scope of ports (in this case, Port Moresby) or services (although in this case, the scope of services claimed to be competitive encompasses all the services included in the contract). The Commission sees no necessity, in this case, to examine the competitive situation in any port other than POM port in respect of such services. To avoid any technical legal point being taken by PNGPCL, to the extent the regulatory contract requires such extensive and unnecessary assessments, draft and final reports and findings, for the competition review in this case, the Commission makes the assessment and reports on its findings for the purposes of this review, at the outset of this report, that competition in “essential port services” or “ports [sic] infrastructure services”, as the contract may require, at all ports other than POM port, currently subject to regulation under the contract is insufficient to remove regulation of any of such services, but not including any assessment relating to the tariff variation request in respect of Lae port (as that forms part of the concurrent tariff variation request). The basis of such assessment is that no information has been submitted by PNGPCL to form a view that competition circumstances at any other port have changed since the commencement of the contract, nor does the Commission’s knowledge of such circumstances suggest that the competitive environment at those ports has changed in respect of any of the services comprising port infrastructure services.

**FINDING**

The Commission makes the assessment and reports on its findings for the purposes of this review, that competition in “essential port services” or “ports [sic] infrastructure services”, as the contract may require, at all ports other than POM port, currently subject to regulation under the contract is insufficient to remove regulation of any of such services, the exception of POM Port being discussed and assessed separately below.
The Commission now proceeds to review competition in the provision of port infrastructure services at POM Port, the subject of the request by PNGPCL, and the accompanying tariff variation request.

1.3 OTHER MATTERS
After consideration and decision on the matters requested by PNGPCL, certain other matters are examined by the Commission, in relation to the geographic scope and range of PNGPCL’s business activities including:

- The question of inclusion of port storage services and marine pilotage within the scheme of regulation;
- The need for efficiency-enhancing changes to the structure of pricing, as distinct from the level of prices and total revenue, to encourage competition in stevedoring;
- Issues likely to arise in the near future relating to the management of ports;
- PNGPCL’s approach to complying with its regulatory obligations under the ICCC Act;
- The need for examining the current basis of regulation, with proposals for key changes;
- The need for quantum improvements in the efficiency of Customs and NAQIA; and
- The desirability of a wide-ranging inquiry into the waterfront sector, particularly the plethora of regulation with anti-competitive effects.

To the extent a legalistic view is taken that the Commission’s final report and findings on the competition review should be a complete and separate document, not extending into other areas, whether the latter are initiated by PNGPCL or the Commission, this report and those findings relating to the competition review request is intended by the Commission to be severable from the rest of the report. Similarly, and for the same reasons as outlined in the previous sentence, the report and findings on the tariff variation request for charges for certain users in Lae and Port Moresby, are intended by the Commission to be severable from the rest of this report and findings. In this connection, it is noted that the request for the competition review was not made separately from the request for tariff variation and, on that basis, this caveat should not be necessary, but is made out of abundant caution.

1.4 PNGPCL’S APPROACH TO THIS REVIEW, DRAFT REPORT AND DRAFT FINDINGS
PNGPCL has initiated this review, of its own volition, invoking its right to do so under the contract. In the preamble to its submission in response to the Commission’s draft report and findings on the competition review it requested, however, it states:

“Where PNG Ports is silent on a particular statement made by the ICCC, either framed as a contention, allegation, observation or insinuation, is by no means implying that PNG Ports agrees with the statement”.
This is a disingenuous way of avoiding giving a response to the point in question. The whole purpose of a draft report and findings is to expose the issues to public scrutiny and seek a response, either by way of rebuttal, agreement, or refinement, from the applicant or other interested parties. The party with the largest commercial interest is PNGPCL, it having requested the review and its businesses being the subject of the review, report and findings of fact. If PNGPCL does not respond, then the regulator has no means of establishing its view on the point, or accessing any evidence it may have, that it may call in aid of its contention. In these circumstances, the Commission has no option but to accept the view of other parties and/or its own assessment of the validity of the point, based on extraneous information that may have come into its possession or by its own inquiries. The draft is a method of affording natural justice to the applicant and if the opportunity made available by that avenue is ignored and the outcome is not palatable to PNGPCL, then PNGPCL will have no one else to blame as it would have brought the consequences of its failure to fully inform the Commission, about relevant facts and circumstances, upon its own head.

The particular matters upon which PNGPCL has failed to respond with facts, market circumstances, contentions and arguments are

1. The contractual nature of services to be provided by the straddle carriers (known in PNG as ‘rubber tyred gantries’) i.e.
   a. whether to be
      i. hired out to stevedores under an equipment hire agreement;
      ii. made available under a service-provision agreement to stevedores inclusive of labour;
      iii. used by PNGPCL as a supplier of relocation services for containers between the unloading point on the wharf and the storage area of the port
   b. The charging regime, if settled.
   c. The date of deployment if commenced or such proposed date
   d. The cost of acquisition and whether funded by budget subvention, own financial resources.

2. Ship loading data for the Steamships MES and Bismark wharves respectively.

3. Implications for competition of the Deed of Agreement with Motukea Port, particularly in the context of the arrangement constituting a ‘franchise; outsourcing; or agency’ arrangement, with the provider providing services ‘under’ the agreement, with payment of a levy to the franchisor or landlord, under a ‘landlord’ model port management structure.
4. No evidence has been provided that suggests that supply side substitution is a commercially viable, realistic option.

5. The description in the draft report about PNG PCLs reneging on its contractual agreement to agree to re-opening of the contract in respect of 4 items, has remained uncontested by PNGPCL.

6. The issue of ‘gifted’ assets, relevant to the calculation of the regulated asset base as a criterion for price regulation, in the context of in-port storage charges, has not been addressed.

7. On the matter of delay in issue of gate passes, PNGPCL has not responded to the draft report and findings by
   
   a. Providing evidence which supports its contention that they are issued promptly; and, if not, the reasons
   
   b. Responding to the matter of perverse incentives to delay their issue.

No evidence on the costs of provision of marine pilotage services was provided. No clear information or guidelines on the acquisition of towage services was provided.

1.5 CURTAIN BROS LTD

It is disappointing that, despite numerous efforts to obtain a submission from Curtain Bros Ltd, the operator of the Motukea Port under an agreement with PNGPCL, no submission was made by that company. The commercial interests of Curtain Bros in this review is second only to those of PNGPCL and in respect of certain key facts and market circumstances, it is best placed to provide information and its contentions and arguments. That it has not done so is a matter of significant concern to the Commission which, had Curtain Bros done so, would have greatly assisted the review and the consequent report and findings.

2. STATUTORY AND REGULATORY FRAMEWORK

The ICCC Act governs the regulation of PNGPCL, with Sections 32 to 39 creating the framework for regulation of ‘regulated entities’ in ‘regulated industries’. Those provisions outline the principles and mechanics of regulation, with the initial regulatory instruments being promulgated by the Minister for Treasury, in the situation where the Commission had not commenced operations at that time. With the commencement of the Commission’s operation, in practical terms, such regulatory responsibility passed from the Minister to the Commission, although, in appropriate circumstances, for ‘first time’ declaration of regulated entities and industries respectively, the Minister appears to have the power to so declare them and enter into regulatory contracts with them.
The scheme of regulation essentially operates through regulatory contracts, formed with the regulated entity proposing a draft contract, the Commission exposing it to public consultation; and, with any amendments considered appropriate, giving it binding force and effect by the execution of the contract by the parties.

Sections 5 to 7 outline the objectives, functions and powers of the Commission under the ICCC Act, with the regulatory scheme generally requiring regard to be had by the Minister and Commission, as the case may be, to those precepts in their administration of the contract respectively. A copy of Sections 5 to 7 and 32 to 39 of the ICCC Act forms Annexure A to this draft report. The ICCC Act itself is usually accessible from the Commission’s website at www.iccc.gov.pg; but as the website is currently down, that option is not now available, but the legislation is accessible at paclii on www.paclii.org.

2.1 MID-TERM COMPETITION REVIEW

In assessing the request for mid-term competition review, the ICCC is permitted to take into account any other factors it considers to be relevant to this review, including its objectives under Section 5 of the ICCC Act. Clearly, the objectives of the ICCC Act and, in particular, of Section 5 thereof, are highly relevant and must be given the significance they explicitly require; and the Commission proposes to do so in this report and findings.

2.2 TARIFF VARIATION REQUEST

The request for review of competition was accompanied by a request to vary the tariff, to allow preferential pricing for some customers or classes of customers or products in the ports of Port Moresby and Lae. The contract allows amendment of any provision of the contract by agreement of the parties, including those relating to tariffs, thereby permitting variation thereof. PNG Ports has previously sought tariff amendment for certain pricing initiatives, which were declined by the Commission. The Commission will assess this tariff variation request concurrently with the mid-term competition review. Obviously, the comments made in the preceding paragraph in relation to the Commission’s objectives apply equally to the tariff variation request.

2.3 REVIEW OF OTHER SERVICES IN THE CONTEXT OF THE MID-TERM COMPETITION REVIEW

While the provisions of the contract allow PNGCL to initiate a mid-term competition review, the Commission considers that it does not constrain the Commission’s assessment of the request by restricting its review to those specific services raised by PNGCL and that other relevant services fall for consideration in this review, as appropriate to the assessment of the market circumstances in which PNPCL operates, and in keeping with the objectives of the ICCC Act and the objectives of Section 5 thereof. On this basis, the ICCC considers that it is necessary to widen the scope of the review to include other markets and competition issues not covered in the submission by PNGCL. Indeed, there is no legal barrier to the Commission reviewing such services, whether or not PNPCL applies for a competition review, as the ICCC Act empowers the Commission to ‘declare’ regulated entities or regulated industries and services provided by them for regulation. Obviously, such declaration would not be made capriciously, but only on the basis of proper consideration of the
criteria and, although not specifically required, with adequate consultation with the entity involved, interested parties, and public exposure of proposals, as incumbent on a responsible regulator.

A consequence of reviewing those other services is that, if the Commission forms the view that some or all of those services merit regulation, if it has the power to declare those services to be ‘regulated services’, pursuant to paragraph 33 (1) (b) of the ICCC Act, it could proceed to do so. Such declaration must meet the requirements of paragraph 33 (2) (b), which, essentially stipulates that the relevant regulated entity must possess substantial market power in the supply of those services; and the declaration is appropriate having regard to the Commission’s objectives set out in Section 5.

The consideration of competition in certain services, namely, the provision of

(a) In-port storage services for ‘in-transit’ cargo and

(b) marine pilotage services;

in this draft report and findings, was intended to initiate such consultation, with a view to informing the Commission of the market circumstances relating to them, as a basis for possible declaration under paragraph 33 (1) (b) of the ICCC Act. This report and findings makes a finding in respect of marine pilotage services, but does not do so now in respect of ‘in-port’ cargo storage services, as it considers further inquiry and assessment is necessary in respect thereof; hence, will continue to inquire into in-port storage services and, when a concluded view is formed, act thereon.

2.4 OBLIGATION TO PROVIDE INFORMATION AND TARIFF SUBMISSION BY SPECIFIED DATES

Among various other obligations by each party, the contract provides for annual submission by PNGPCL of proposed tariffs for the forthcoming year, in respect of which it seeks approval, together with certain accounting information, by 30th June of the prior year. Failure to comply with those obligations gives rise to certain consequences and removes certain obligations on the part of the Commission. The failure by PNGPCL to meet that obligation in 2011, in respect of tariffs it proposed to charge in 2012; certain actions that were proposed by the Commission and agreed to by PNGPCL, to resolve that failure; the deliberate decision by PNGPCL to negate its binding, legal commitments that had been agreed between the parties in relation to such actions; and the implications for regulation, will be discussed in further detail in this review. The purpose of such discussion is to inform the public, as the Commission is empowered to do, of matters relating to the performance of its functions; and to raise for consideration the need for review of the regulatory framework of PNGPCL.

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1 This is the term used by PNGPCL to describe port cargo storage services provided within the secure precincts of the port.
3. APPROACH TO ASSESSING COMPETITION

PNGPCL’s initial submission outlined the approach taken by PNGPCL in its assessment of competition in the market for “ports infrastructure services” at Fairfax Harbour and, in particular, the competition it views as emerging from Motukea Port. This includes reviewing the following:

- ICCC 2010 FINAL REPORT ON THE PNG PORTS REGULATORY CONTRACT REVIEW
- ICCC 2007 REVIEW OF THE SHIPPING INDUSTRY
- ESSENTIAL SERVICES COMMISSION (‘ESC’) OF VICTORIA 2009 REVIEW OF VICTORIAN PORTS REGULATION
- AUSTRALIAN COMPETITION & CONSUMER COMMISSION (ACCC) MERGER GUIDELINES

PNGPCL has drawn on the ACCC’s merger guidelines in assessing the effects of mergers on competition, in particular, with respect to the interpretation and application of concepts such as demand side substitution, supply side substitution and countervailing power.

In summary, the approach taken by PNGPCL in its submission for the mid-term competition review is as follows:

1. Definition of the markets and submarkets;

2. Assessment of competition, in particular, whether or not any of the following may act as a constraint on the ability of PNG Ports to exercise market power:
   - Demand side substitution
   - Supply side substitution
   - Countervailing buyer Power

Competition regulators broadly regard the temporal dimension of the market generally as between one and two years, presumably because forecasting events and dynamic factors influencing the nature and intensity of competition beyond that period involves such a high level of uncertainty, that it makes such forecasts unreliable.
4. ASSESSMENT OF COMPETITION IN FAIRFAX HARBOUR

The focus of this competition review is the market for the supply of port infrastructure services at Fairfax Harbour which includes Port Moresby and Motukea with particular emphasis on claimed changes in the competitive environment since the 2010 review of the contract including the competition outlook for Fairfax Harbour after the construction phase of the PNG LNG Project ends.

4.1 MARKET DEFINITION

The Commission concurs in the theoretical approach by PNG Ports that, in any competition assessment, defining the market is critical to determining whether the ‘product’ under consideration (in this case, actually, certain ‘services’) is substitutable in both demand and supply sides.

A ‘market’ is defined in Section 33(8) of the ICCC Act, for the purposes of Section 33, which governs the regulation by the Commission of regulated services supplied by regulated entities, as

“........a market in the whole or any part of Papua New Guinea for goods and services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them, including imports.”

PNGPCL has also adopted the approach taken in the 2010 Regulatory Contract Review and added a product dimension from the Essential Services Commission (‘ESC’) of Victoria to its assessment. In summary, the approach taken in assessing competition by that regulator was largely based on the following:

Geographic dimension (i.e. taking into account the area in which it might be realistically possible to substitute service from an alternative port in both demand and supply);

- Vessel size and cargo destination and origin;
- Whether port facilities were servicing their own demand; and
- Product dimension (the handling of vessels carrying particular cargo types).

The Commission broadly concurs in the general approach taken by PNGPCL in its theoretical approach to market definition.

In regard to the product dimensions of the relevant markets, after dealing with the specific services identified by PNGPCL, the Commission in this review process has considered certain ancillary services and whether they should be regulated under the contract, because, in the Commission’s view, those ancillary services do exhibit characteristics that support the view that PNG Ports has, and exercises, substantial market power in the supply of those services, which, in turn, have a significant effect on competition in downstream markets for those services.
PNG PORTS SUBMISSION

In its submissions in response to the draft report and findings, PNG Ports has taken an approach regarding market definition that is similar to the approach taken by the ICCC in its 2010 final report, with additional consideration of the product dimension identified by the ESC (i.e. cargo type), to define a market or submarket based on the general cargo types in the case, where there are specialised ship-side and land-side infrastructure requirements to serve the cargo type in question. It supported its claim by stating that distinction by cargo type is applied in commercial pricing and regulatory regimes for port infrastructure services in a number of jurisdictions.

The Commission has no difficulty with incorporating the product dimension into the theoretical definition of the market as proposed by PNGPCL and its contention that “the way the market is defined can have important implications for market power analysis. The assessment can be influenced by whether the market is narrowly or broadly defined”2 Indeed, the draft report is replete with references to various types of cargo such as LNG project cargo, break-bulk cargo, containerized cargo of a type that is repeatedly traded through ports, further subdivided into international and coastal cargo trades.

4.1.1 Market for ports infrastructure services in Fairfax Harbour

Given the statutory provision on the definition of a market, the first step is to identify the relevant market or markets for the purpose of competition analysis. It begins with consideration of the products of a firm or firms whose behaviour is under consideration; then proceeds to consider substitution possibilities in both the demand and supply sides.

Despite the request referring to ‘ports infrastructure services’, the subject of clause 4.3 of the contract, the ‘product’ market under consideration is ‘essential port services’, with separation into particular services, where relevant, which are regulated by the Commission and the focus of this report, and findings therein, is the market within Fairfax Harbour. This is because the substance of the request relates to services, defined, in effect, to constitute ‘essential port services’, namely:

1. Berthing services, which, under the definitions in sub-clause 1.1 of the contract, are defined as

   ‘(a) a port service consisting of providing berths for Vessels at a Declared Port, and

   (b) all services supplied in connection with the supply of such port services.’

2. Berth reservation services, which, under sub-clause 1.1 of the contract, are defined as

   ‘(a) a port service consisting of providing berth reservations for Vessels at a Declared Port, and

   (b) all services supplied in connection with the supply of such port services.’

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3. **Wharfage Services**, which, under clause 1.1 of the contract, are defined as

“(a) a port service consisting of providing port facilities for loading or unloading Vessels at a Declared Port, and

(c) all services supplied in connection with the supply of such port services.’

Hence, in this report and findings,

(a) ‘ports infrastructure services’ and ‘essential port services’ are used synonymously to give meaning and effect to the provisions of clause 4.3 of the contract; and

(b) ‘Berthing’ and ‘berthage’ are treated as synonyms herein as PNGPCL has used the latter as meaning the former.

PNG Ports identified, in section 5 (Table 1) of its submission, the providers of essential port services within Fairfax Harbour, which is reproduced below.

<table>
<thead>
<tr>
<th>Port Facility Operator</th>
<th>Services</th>
<th>Cargo types</th>
</tr>
</thead>
</table>
| PNG Ports              | Berth reservation, berthage and wharfage | International and coastal;
|                        |                                   | • Containers
|                        |                                   | • Break bulk and dry bulk including motor vehicles, wheat, timber, fish and construction materials
|                        |                                   | • Liquid bulk (petroleum and bunker fuel)
|                        |                                   | • Passengers
| Curtain Bros Motukea   | Berthage and wharfage             | International;
|                        |                                   | • Containers
|                        |                                   | • Break bulk and dry bulk including construction materials, logs (export) etc
| InterOil Napa Napa Napa | Berthage and wharfage              | International and coastal;
|                        |                                   | • Liquid bulk (crude oil and refined petroleum)
Steamships MES Wharf  | Berthage and wharfage  | Coastal;  
|                  |                        | • Containers  
| Bismark Maritime  | Berthage and wharfage  | Coastal;  
|                  |                        | • Containers  

These port services providers include PNG Ports, Curtain Brothers Motukea, InterOil Port, Steamship MES Wharf and Bismark Maritime Wharf. As highlighted in the PNG Ports submission and above:

- Curtain Brothers Motukea only handles international cargoes;
- PNG Ports handles both international and coastal cargoes; whilst
- Bismark and Steamship wharves only handle coastal cargoes.
- InterOil Port only handles crude oil and refined petroleum products (both international and coastal).

While the InterOil facilities are mentioned in the table, no specific argument or substantiating data have been provided by PNG Ports in support of its implied contention that those facilities constitute a competitive constraint on the services provided by PNGPCL, the subject of the competition review request and, hence, no more consideration need be given to the services provided through that facility.

**SUBMISSIONS**

With regards to the Commission’s discussion in the draft report on the market for ports infrastructure services in Fairfax Harbour, the Commission has received the following comments from PNGPCL and Trukai Industries Ltd.

**PNG Ports Response submission**

PNG Ports is of the view that concerning the provision of berthage and wharfage services to the coastal shipping market, it is clear that PNGPCL, Steamships, MES Bismark Maritime all provide services to broadly the same cargo types, and therefore, provide a potential source of competition.
Trukai Industries Limited

Trukai was of the view that PNGPCL had a clear monopoly on “on-wharf” storage created by the need for importers to get clearance from Customs and NAQIA. Its capital improvement plan had failed to deliver in both Port Moresby and Lae. PNGPCL therefore, have directly contributed to the congestion; firstly by reducing the key (sic) face and space available, and secondly goods get ‘buried’ behind other goods due to reduced operating space, meaning it is difficult to move the buried goods quickly. This in turn increases the storage charges revenue to PNG Ports.

DISCUSSION

This is a view consistent with the Commission’s draft report and findings, as the market shares of those players have been taken into account in the Commission’s analysis therein.

While PNGPCL argues that Motukea competes with it across all cargo types, the Commission’s view is that, in large part, competition is restricted to project cargo, more particularly, the PNG LNG project. While the evidence is not clear on containerised and non-containerised cargo, of a type usually traded, due to the lack of response by Motukea Port, even if the cargo under that heading were considered competitive with PNG Port, the applicability of concentration tests usually used by regulators worldwide shows that Motukea does not even remotely exercise the requisite constraint on PNGPCL that justifies a finding of workable and effective competition in POM port. Concentration is discussed in the succeeding section.

PNGPCL says it is not clear about the implications of ICCC statement that “Steamships and Bismark wharves [are] located within the precincts of PNG Ports POM Port”, although it concedes that they are located within the secured area adjacent to the PNG Ports wharves. The implications are that these are the only competing facilities for port storage, which do not incur significant additional transport and handling costs to avoid the storage charges of PGNPCL and, with Customs/NAQIA attendance, can compete fully with PNGPCL facilities.

Subject to any future decision on container scanning or other customs or security procedures, that is currently understood to be the same position with Motukea Port.

Trukai’s views reiterate the fact that port storage is an ongoing problem that still has to be rectified by PNGPCL. As per Trukai’s views, PNGPCL are seen to be also directly responsible for the congestions caused, and they then benefit financially the longer a container remains at the wharf.

4.1.2 Market Concentration

It is necessary, in any competition analysis, to look at the market concentration. That is because high concentration is a necessary condition, although not a sufficient condition, for the exercise of market power. Concentration, therefore, is a starting point for analysis. Without a level of concentration that suggests the likelihood of market power, no further analysis need be pursued. Both, the number, as well as the size distribution, of competitors is relevant to a consideration of concentration.³

PNGPCL highlighted the increase in demand at Motukea to justify its claims that demand side substitution is taking place but did not discuss the market share for each market participant nor the significance for competition of concentration. Therefore in its analysis, the ICCC has extended its analysis to include the market share for both ports within Fairfax Harbour. There was no data provided by PNGPCL to verify the market share for Steamship and Bismark Wharves, which are two smaller wharves within the precincts of PNGPCL’s POM Port. This is despite the fact that vessel loading data are understood to be collected by PNGPCL for all vessels calling at Port Moresby, where both Steamships MES and Bismark, are located and regarded by PNGPCL as competitors. Furthermore, PNGPCL did not specifically claim that Steamships MES or Bismark, exercise the degree of constraint that constitutes effective and workable competition in POM port to its own operations in the relevant markets under consideration.

Based on the information supplied by PNGPCL in Table 2 of its submission, the market is overwhelmingly dominated by PNGPCL, as the table below shows.

Table 2

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Port</th>
<th>2010</th>
<th>2011</th>
<th>absolute change</th>
<th>Actual Change</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Containers TEU</td>
<td>POM</td>
<td>87,688</td>
<td>87,889</td>
<td>201</td>
<td>0%</td>
<td>99%</td>
<td>94%</td>
</tr>
<tr>
<td></td>
<td>Motukea</td>
<td>703</td>
<td>5,207</td>
<td>4,504</td>
<td>641%</td>
<td>1%</td>
<td>6%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>88,391</td>
<td>93,096</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vessel calls (number)</td>
<td>POM</td>
<td>1,617</td>
<td>2,133</td>
<td>516</td>
<td>32%</td>
<td>94%</td>
<td>92%</td>
</tr>
<tr>
<td></td>
<td>Motukea</td>
<td>99</td>
<td>190</td>
<td>91</td>
<td>92%</td>
<td>6%</td>
<td>8%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1,716</td>
<td>2,323</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Tonnes (RT)</td>
<td>POM</td>
<td>1,839,516</td>
<td>1,986,567</td>
<td>147,051</td>
<td>8%</td>
<td>92%</td>
<td>81%</td>
</tr>
<tr>
<td></td>
<td>Motukea</td>
<td>165,747</td>
<td>464,430</td>
<td>298,683</td>
<td>180%</td>
<td>8%</td>
<td>19%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>2,005,263</td>
<td>2,450,997</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 2 indicates that in 2010 PNG Ports had a market share of 99% of the container-handling market within Fairfax Harbour and in 2011 it declined by 5% to 94% of the total container-handling market. The market share of Bismark and Steamship MES wharves for the container-handling market is considered to be minuscule compared to PNGPCL, based on industry
information gathered by the Commission in relation to an investigation of a business acquisition in the coastal shipping sector.

In assessing the market for container handling, regard must be had to the fact that a proportion of cargo destined for the construction of the LNG liquefaction plant may also be packed in containers and that not all containers handled at Motukea are necessarily of the same type of ‘general containerized cargo’ handled at PNG Port wharves, in the nature of ‘usually traded goods’ which are shipped in and out of Port Moresby.

A similar size contrast as between PNGPCL and Motukea also exists in the overall market for cargoes (in ‘revenue tonnes’ or ‘RT’) and vessel calls for both ports. Despite Motukea Port’s market share of vessel calls increasing considerably from 8% in 2010 to about 19% of total vessel calls in 2011 within Fairfax Harbour (excluding vessel calls for Steamship and Bismark, for which PNG Ports has not provided data), however, PNGPCL still holds a substantial 81% share of the market for vessel calls compared to Motukea Port.

Given the construction profile of the LNG liquefaction plant, it is not surprising to observe a ‘spike’ in vessel calls at Motukea, as construction of that plant progresses. Two points need to be made in relation to this dynamic. First, the increase occurs off a very low base, hence percentage increase figures are misleading in terms of the degree of competitive constraint. Secondly, while ‘dynamic factors’ are relevant to competition assessment, there is no suggestion that in the long term such volumes are likely to be maintained and, hence, this particular dynamic appears to have little relevance for competition. While supply side possibilities merit consideration, they need to be put in context and the mere technical possibility, of itself, without more, is an insufficient basis to conclude that a likely long-term competitive constraint has emerged, or is likely to do so, within a reasonable period of time. For reasons to be discussed under entry barriers, the viability of Motukea as a competing port, handling directly competitive cargoes, on an ongoing basis, is far from established.

The above market data indicates that even though Bismark and Steamship Shipping MES (actually “Steamships Trading Company Ltd” and, possibly, in combination with some of its subsidiary and associated companies), which is a major player in the coastal shipping industry and both have wharves within POM port, many of their vessels continue to utilise PNGPCL port and wharf facilities in Port Moresby largely due to the physical limitations of their own wharves rendering them unable to handle larger vessels and larger cargo volumes.

**SUBMISSIONS**

With regards to the Commission’s Draft Determination on market concentration, the following comments were received from PNGPCL only.
PNG Ports Response Submission

PNGPCL argued that there is evidence of demand-side substitution from customers increasing utilisation of Motukea, and a high probability of further supply-side substitution on the part of Curtain Brothers in terms of price and non-price competition -encroaching on the market position of PNG Ports.

They consider that, Port Moresby is equally capable of handling the same ship and cargo types as Motukea, therefore, the increase in volumes at Motukea effectively represents demand-side substitution and a loss in market share (or potential market share) to PNG Ports.

DISCUSSION

The Commission acknowledges the above submissions and with data provided on the port structures for PNG Ports, Interoil Napanapa Refinery and Curtain Bros Motukea wharves, suggests that PNGPCL Ports are capable of handling a wider range of coastal and international cargoes compared to the other two wharves which can only allow for certain types of vessels carrying certain types of cargoes to berth. This indicates that PNGPCL has a competitive advantage for the provision of essential port services over the other port facility operators. Furthermore, from the data provided by PNGPCL demonstrating the overall growth in trade, the rate of market shares from Containers TEU, Vessel calls and Revenue tonnes from 2010-2011 for Motukea Port increased significantly over this time period. There was no data provided by PNGPCL to verify the market share for Steamships and Bismark wharves, which are two smaller wharves next to the precincts of PNGPCL’s POM Port, and, through their stevedoring operations, also utilize PNGPCL port and wharf facilities at the latter’s wharves.

The Curtain Bros Motukea Wharf is seen by PNGPCL to be the only actual or potential competitor and data provided by PNGPCL relates entirely to it. Evidence considered by the Commission in its present litigation concerning an acquisition in the waterfront sector strongly suggests that Bismark and Napa Napa are miniscule in terms of competing with PNGPCL as a port operator. Evidence relating to Steamships MES strongly suggests that its share of throughput through its own facilities in the port operations market are insufficient to trigger the concentration thresholds usually adopted. Hence, this report and findings concentrates mainly on whether Motukea Port is, or may become a competitor in the near future disregarding Interoil, Napanapa, Steamships MES and Bismark Maritime wharves which are deemed to have market shares that do not affect the issue and they are not seriously contended by PNGPCL as being actual or potential competitors such that

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4 Handbook of Information Revised 2008, Port Moresby p.39-43

5 Derived from website: http://www.hydrocarbons-technology.com/projects/napanapa/


7 PNGPCL Confidential Submission for Mid Term Review of Competition 2012, Table 2: Comparison of Growth in Trade at Port Moresby and Motukea.
they constrain it; and that their operations justify removal of regulation on PNGPCL in Port Moresby.

In its draft report, the Commission queried whether any or most of the cargo handled by Motukea Port consisted of truly competitive cargo in the sense of being of a type repeatedly traded through the port. PNGPCL argued that it based its submission that they were competitive on statistical returns provided by Motukea Port under the Deed of Agreement between the two, which provides for payment of fees by the latter to the former and that it had no means of establishing whether or not cargo through Motukea consisted of repeatedly traded cargo.

The Commission examined the Deed of Agreement and nothing therein requires description of cargo as consisting of cargo destined for the PNG LNG project or not. Hence the evidence is not persuasive that the containerized cargo or total cargo measured in revenue tonnes is actually competitive with PNGPCL, in the sense of consisting of cargo repeatedly traded through the port.

Nevertheless, even if containers through Motukea were considered competitive with PNGPCL, the absolute share of the market they represented was so small that it did not come anywhere near the levels of concentration that would trigger a detailed analysis of other factors of a kind stipulated in Section 69 (5) of the ICCC Act and usually considered in assessments of competition, whether for assessing business acquisitions or for any other competition issue.

There is an additional dimension to the issue of competition from Motukea Port. On one view, Motukea could be regarded as an operation that has been ‘franchised’ or ‘outsourced’, with a proportion of its income accruing to PNGPCL as ‘landlord’ (and it often claims to be a landlord port), without the latter incurring direct costs related to the income. While the Commission has not emphasized this point in its draft report and findings, it is a significant point. Franchised or outsourced agents, providing services, in effect as ‘agent’, on behalf of the franchisor can hardly be regarded as a true, independent competitor. The deed of agreement was drawn up with the consent of PNGPCL and it is a signatory to the deed. It receives an income which could be regarded as a ‘franchise’ fee. Hence the point needs to be made that a service provider providing services under a franchise agreement cannot really be regarded as an independent competitor, when a part of its income, decided mutually by agreement between the parties, is appropriated by the franchisor.

If, on the expiry of the agreement, the franchisee retains control over the relevant assets and provides services independently, without any ‘toll’ being paid to the franchisor, it could legitimately be claimed that it was an independent competitor.

**Veracity of Data**

The Commission, in its draft report and findings, also noted an interesting aspect of the data supplied by PNGPCL. Despite an increase in the number of vessel calls between 2010 and 2011 of more than 516 vessels (i.e. a 32% increase), PNGPCL had claimed in its submission that demand actually remained flat at its Port. The two positions appeared to be inconsistent, and required
clarification by PNGPCL to resolve the matter. If the data related exclusively to vessel calls and cargo throughput at PNGPCL’s own facilities, the Commission was of the view that an increase in vessel calls of such a magnitude would likely have translated to an increase in containers or cargo throughput at its port. The draft report said: “If the data relates exclusively to vessel calls and cargo throughput at PNGPCL’s own facilities, the Commission is of the view that an increase in vessel calls of such a magnitude would likely have translated to an increase in containers or cargo throughput at its port. On the other hand, if the vessel call data includes vessel movements within the aquatory at Fairfax Harbour, in respect of which PNGPCL exerts navigation control, that have not utilized its wharf facilities, then it may well be valid. Arguably, if vessel visits to the Steamships MES and Bismark wharves or other vessel calls, are included, that may account for the apparent discrepancy between the increase in vessel movements and the claimed static volume of cargo throughput at PNGPCL’s own wharf facilities, but that is hypothetical, and there may be an alternative explanation. The Commission requires clarification about the basis of the data submitted by PNG Ports, as it could go to the veracity of the data, depending upon the basis on which they are put forward.”

SUBMISSIONS

Response Submission by PNG Ports

From the Commission’s Draft Determination, PNG Ports was the only stakeholder to comment on the veracity of the data they had supplied.

PNGPCL defined vessel call data as a register of all vessels that go through Port Moresby Port. It encompasses all kinds of ships- fishing vessels, yachts, research vessels, log ships, cruise ships, barges, tankers, bulk carriers, container ships, military ships etc. However they stated that, not all vessels entering Fairfax Harbour, that are registered as vessel calls, take berth and conduct operations (i.e. loading and discharging cargo) at PNG Ports’ Port Moresby wharves. Some examples were given such as vessels staying at anchorage points for customs clearance and restocking of food supplies before making their onward journey to the next port of call; other vessels take berthage at private facilities such as Steamships; while others that berth at PNGPCL’s wharves are non-cargo vessels like passenger vessels, yachts, cruise ships, barges etc. In all the cases mentioned, trade or cargo throughput volume is not affected.

PNGPCL stated that cargo throughput volume is affected only when vessels take berth and conduct cargo operations (discharge and load cargo) at the PNG Ports Port Moresby wharves, therefore, an increase in the vessel calls does not necessarily mean that cargo TEU throughput will increase in the same proportion.

In response to this point, PNGPCL said: “vessel calls data is a register of all vessels that go through Port Moresby Port. It encompasses all kinds of ships- fishing vessels, yachts, research vessels, log ships, cruise ships, barges, tankers, bulk carriers, container ships, military ships etc. However not all vessels entering Fairfax Harbour, that are registered as vessel calls, take berth and conduct operations (i.e. loading and discharging cargo) at PNG Ports’ Port Moresby wharves For example, some vessels stay at
anchorage points for customs clearance and restocking of food supplies before making their onward journey to the next port of call; other vessels take berthage at private facilities such as Steamships; while others that berth at PNGPCL’s wharves are non-cargo vessels like passenger vessels, yachts, cruise ships, barges etc. In all the cases mentioned, trade or cargo throughput volume is not affected”.

Two points need to be made about this issue. First, as quoted above, the draft report allowed for a possible explanation, which PNGPCL has now provided. The second is that although, as PNGPCL says, no data are collected for loadings and unloading at the Steamships MES and Bismark wharves, PNGPCL is understood to collect data on shipping, including details of cargo carried on vessel for arrival and departure, which are good proxies for loadings and unloadings. The explanation provided by PNGPCL for vessel calls are accepted by the Commission in relation to the apparent inconsistency between the number of vessel calls (increasing substantially) and cargo throughput (virtually static); but it is noted that no response has been provided in relation to data understood to be collected by PNGPCL on cargo carried on vessels.

4.1.3 Deed of Agreement with Curtain Brothers Ltd

DISCUSSION

As highlighted in the 2010 Regulatory Contract Review, the 25 year Deed of Agreement between PNGPCL and Curtain Brothers calls into question the degree of competition between Motukea and PNGPCL in markets for port services within Fairfax Harbour. This is because the Deed of Agreement provides for PNGPCL to collect a portion of the revenues generated by Motukea Port from wharfage services without having to actually provide the wharfage services at Motukea.

The Deed of Agreement also calls into question PNGPCL’s concerns about the competition consequences of the increase in demand at Motukea Port given it is entitled to revenue from wharfage services rendered to the cargoes at Motukea Port. This issue has already been discussed in detail earlier in this report, as exhibiting characteristics of ‘franchising; outsourcing; or agency arrangements’.

The implications of the Deed of Agreement between PNGPCL and Curtain Brothers need to be considered for its competition consequences and, to that end, the Commission has requested a copy of that agreement to be provided to it by PNGPCL for examination, in the context of its request for this competition review. It has now been received and its consideration, analysis, and discussion leads to an assessment in this report and findings that Motukea Port is not a ‘true’ competitor in the sense usually accepted in industrial organization thinking, because, if Motukea Port increases trade, PNGPCL obtains a share of it as ‘landlord’. Presumably, in entering into the agreement, PNGPCL made assessments of the cost of provision of the service itself; and returns on the investment; and decided that the ‘franchise; outsourcing; or agency’ model offers an acceptable return almost

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8 ICCC Review of the PNG Harbours Regulatory Contract Final Report, p.29
without risk, or at least considerably reduced risk. In such circumstances, it is inconceivable that Motukea Port could be considered a competitor during the currency of the agreement.

The Commission refers to the data provide by PNGPCL and infers that, as a direct consequence of the "strong growth in the volume of trade handled at Motukea since the start of the regulatory period", PNGPCL has benefited profitably as per the provision of the Deed of Agreement which ensures that Curtain Brothers makes payments of fees and charges for pilotage services and cargoes passing over the wharf. Further should demand side substitution occur in preference of the Motukea Wharf, there would not be any competitive pressure put on PNGPCL, they would still benefit through the fees being paid to them. Further the review of tariffs and pilot fees after every 12 months until the 25 years lapses, taking into consideration the CPI, ensures that PNGPCL still has a significant financial interest and income. With regards to any termination of the Deed of Agreement, the Commission after perusing the Agreement determines that Curtain Brothers will be severely penalised for their part in defaulting in the payment of tariffs and failure to comply with statutory requirements applicable. PNGPCL would have nothing to lose.

**FINDING**

The Commission is of the view that, for the next 15 years until the expiry date of the Deed of Agreement, there will be no scope for independent competition between PNGPCL and Motukea wharf as per the provisions of the Deed of Agreement ensuring that payments of fees and charges for pilotage services and cargoes passing over Motukea wharf are still made to PNGPCL by Curtain Brothers.

### 4.2 Demand side substitution

Section 5.2 of the PNGPCL submission offers a definition of demand side substitution and also discusses the key issues for consideration of potential demand side substitution, which are summarized as follows:

- As defined by the ACCC merger guidelines, demand side substitution refers to the likelihood of switching behaviour from customers in response to an increase in price or reduction in quality.
- This behaviour is influenced not just by characteristics and functionality, but also the geographic availability of the 'product' to customers.

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9 PNGPCL Confidential Submission for Mid Term Review of Competition 2012, Table 2: Comparison of Growth in Trade at Port Moresby and Motukea
In its final submission, PNGPCL asserts that it has provided compelling evidence of demand-side substitution at Motukea Port. That claim relates to percentage increases in certain cargo. PNGPCL’s final submission repeated the statistics it provided in its original submission. The draft report dealt with that contention by pointing out that the increases were off a very low base and, in competition analysis, concentration is a starting point for assessment. That discussion is reproduced under the heading ‘concentration’ in this report and findings and is elaborated on below.

4.2.1 Evidence of demand side substitution

Since 2010, when the Regulatory Contract was reset, PNGPCL has pointed to a significant increase in the volume of cargo at Motukea Port including vessel calls and has claimed that this is a market trend which, in its preliminary submission, can be attributed to demand-side substitution.

PNGPCL further claimed that trade volumes, in particular, containerized cargo, has remained flat at Port Moresby over the same period and it attributes the increased volumes of cargo at Motukea Port to demand-side substitution.

The discussion below constitutes an alternative argument about the lack of competitive constraint on PNGPCL if, on review, a superior decision-maker rejects the argument that Motukea operates as a ‘agent; franchisee; or outsourced provider’ of services on behalf of PNGPCL.

The Commission was not able to separate the actual proportion of LNG cargoes from the general cargoes for Motukea Port. Containerised and non-containerised general cargo shipped from PNGPCL facilities consist of goods that are ‘usually traded and repeatedly shipped’. The data for containers and general cargo handled at Motukea do not explicitly disaggregate goods of a kind that are ‘usually traded and repeatedly shipped’ from LNG project cargo, necessary to verify whether the increase in cargoes at Motukea Port was related to demand-side substitution.

Additional Information was sought from PNGPCL in regard to its claim on demand-side substitution. In particular, the ICCC requested data constituting clear evidence of demand-side substitution taking place at Motukea, disaggregating containerized cargo relating to the LNG project from usually traded goods of a kind repeatedly shipped through PNGPCL’s facilities. PNG Ports informed the Commission that the level of information available to it for Motukea was limited to the information submitted. The Commission notes that PNGPCL acknowledged that manifest information for Motukea cargo is, and has been, available to PNGPCL. If PNGPCL seriously contends that such cargo is competitive with that passing through its own facilities, it is incumbent upon it to extract and make available such information to the Commission as part of this transparent public consultation process. In the absence of such data, the inference is reasonably available to be drawn that PNGPCL has a reason to conceal the data. However, quite apart from the concentration measures and other criteria for assessing competition, it also needs to address the point about Motukea being a provider of services on PNGPCL’s behalf under a ‘franchise; outsourcing; or agency’ arrangement.
### Table 3

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Port</th>
<th>2010</th>
<th>2011</th>
<th>absolute change</th>
<th>Actual Change</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Tonnes</td>
<td>Motukea LNG</td>
<td>132,965</td>
<td>413,894</td>
<td>280,929</td>
<td>211%</td>
<td>80%</td>
<td>89%</td>
</tr>
<tr>
<td>Motukea General Cargo</td>
<td>32,782</td>
<td>51,325</td>
<td>18,543</td>
<td>57%</td>
<td>20%</td>
<td>11%</td>
<td></td>
</tr>
<tr>
<td>Motukea Total</td>
<td>165,747</td>
<td>465,219</td>
<td>299,472</td>
<td>181%</td>
<td>100%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

#### 4.2.2 Commission’s Analysis on evidence of Demand-side Substitution

Based on the additional information in Table 3 from PNG Ports, the Commission makes the following observations:

- The increase in cargo volumes for Motukea Port is mainly attributable to, and reflects, the increase in LNG construction activities. This is because from 2010-2011 Motukea Port actually experienced a significant increase of 211% in the volume of LNG project cargoes.

- The proportion of LNG cargoes compared to general cargoes that were handled at Motukea Port actually increased from 80% of total cargoes to 89% of total cargo in 2011 (an increase of 9%).

- At the same time, the proportion of general cargo handled at Motukea Port actually declined from 20% of total cargo in 2010 to 11% of total cargo in 2011 (a reduction of 9%, or almost half in proportionate terms). This is despite an increase in the absolute volume of general cargo of 57% from 2010 to 2011, the significance of which must be put into the context that (a) the increase is off a relatively low base; and (b) the description ‘general cargo’ does not necessarily equate with ‘repeatedly shipped traded goods’, of the type with which we are primarily concerned in this competition review. While some ‘general cargo’ may constitute ‘repeatedly shipped traded goods’, the proportion needs to be established.

Furthermore, it was noted from the submission that vessels visiting Motukea Port only tend to carry general cargoes if that particular vessel is also carrying LNG project cargoes, quite possibly because the general cargo (including break-bulk and containerized cargo) may well constitute cargo ‘related to and associated with’ the construction of the LNG Plant, in the sense of equipment more appropriate to be packed in containers or in break-bulk form, which could be mistaken for cargo of the type usually traded and repeatedly shipped. As noted above, PNGPCL itself conceded that while relevant information is contained in cargo manifests lodged with it, no analysis has been done to identify and disaggregate ‘once only LNG project’ cargo from ‘repeatedly shipped traded
goods’. No evidence, therefore, has been provided that the general cargoes carried by vessels that berth at Motukea are of a kind that are usually and repeatedly shipped traded goods, that are competitive with that handled at PNGPCL’s facilities. Such information is crucial to an assessment of competition and, in its absence, there would be no basis for the Commission to accept, at face value, the submission that all, or a significant proportion of containerized cargo handled at Motukea, is competitive with that handled at PNGPCL’s facilities at Port Moresby.

4.2.3 Demand side substitution

PNGPCL highlighted the following key issues for consideration of the potential for demand side substitution:

- Suitability of infrastructure
- Cost of switching between providers
- Whether any examples exist of switching behaviour

Whilst Motukea Port has suitable infrastructure for the provision of port services, the costs associated with switching from use of PNGPCL’s POM Port facilities to Motukea Port are considered below.

4.2.4 Transport cost barrier

The Commission considers that the barriers to demand side substitution, as discussed in section 5.2 of the submission; are in fact very high barriers for cargo-shippers and consignees to substitute Motukea for Port Moresby Port. The additional cost of transporting a container from Motukea to anywhere in Port Moresby is a significant cost factor for cargo-shippers and consignees to consider including the high cost of port interface charges.

For example, if we look at transport costs alone, the following costs barrier exists as outlined in Table 4:

<table>
<thead>
<tr>
<th>Trucking Company</th>
<th>A -(K)</th>
<th>B -(K)</th>
<th>C- (K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motukea to 4 Mile</td>
<td>1828</td>
<td>1100</td>
<td>600</td>
</tr>
<tr>
<td>POM Port to 4 Mile</td>
<td>799</td>
<td>900</td>
<td>300</td>
</tr>
<tr>
<td><strong>Cost Barrier</strong></td>
<td><strong>1029</strong></td>
<td><strong>200</strong></td>
<td><strong>300</strong></td>
</tr>
</tbody>
</table>

A, B & C denotes the trucking companies. The above TEU charges do not include GST.

Furthermore, Motukea Port is nearly twice the distance to 4 Mile than from POM Port to 4 Mile. Table 4 shows that if a customer uses Motukea Port instead of POM Port, for each 20 foot container the customer is expected to pay K1,029 more if it uses the services of trucking company A, K200 Kina more if it uses trucking company B and K300 more if it uses trucking company C. The transport cost barrier increases when one factors in GST (10%), fuel surcharges, opportunity cost of time and distance, and Motukea Port’s higher port interface charges plus, etc.
The generally accepted test of market definition adopted in competition analysis is ‘cross elasticity’ in demand or supply i.e. whether disproportionate substitution is likely when a hypothetical monopolist raises its prices by between 5 and 10 per cent. The table above shows that, of the three alternative transport providers, only one falls within the 5% - 10% range of additional cost for users and there is no evidence that substitution in excess of that percentage differential is likely to result, if indeed cost increases are limited to percentages within that range. In practice, whether demand switches more than proportionately to the higher price, is highly problematical, as the price comparison does not take account of other factors as yet unknown; and potential retaliation by the incumbent, to substitution.

On the above analysis, applying the ‘hypothetical monopolist test’, well known to competition regulators worldwide, the Commission finds itself unable to conclude that Motukea is practically substitutable for PNGPCL facilities at Port Moresby.

4.2.5 Customs clearance

The Commission understands that special customs clearance arrangements have been provided for LNG cargo. It is not clear, however, whether such arrangements apply to ‘repeatedly shipped traded goods’. If customs clearance procedures at Motukea for the latter class of goods is not equivalent in terms of time, that could constitute an economic barrier to entry, as extra time equates to additional cost. More information is required to establish the comparable position for customs clearance at Motukea for ‘repeatedly shipped traded goods’.

The Commission understands that container scanning facilities are to be located at PNGPCL’s Port Moresby facilities. To the extent ‘repeatedly traded goods’ handled at Motukea are to be subject to scanning for Customs and security purposes, the additional costs associated with double handling and an additional transport leg would be likely to add significantly to the costs of cargo-shippers and consignees who may wish to use Motukea port for such goods.

4.2.6 Commission’s Position on Evidence of Demand-Side Substitution

Therefore, based on the information from tables 2 and 3 including the associated barriers to demand-side substitution, the Commission is not convinced that the growth in cargo volume and vessel calls at Motukea Port is primarily a result of demand-side substitution.

While the data in Table 3 indicates that there was an increase in LNG cargoes at Motukea Port, PNG Ports has not provided clear evidence that demand side substitution is actually taking place. Furthermore, evidence is required to establish the comparable customs clearance situation for cargoes handled at Motukea that are actually competitive with PNG Ports’ facilities at Port Moresby.

The Commission concludes that significant impediments to demand-side substitution do exist and pose challenges for customers in deciding whether or not to utilise the Curtain Brothers facility at Motukea.
SUBMISSIONS

With regards to the Commissions Draft Determination PNG Ports and Trukai made comments relevant to our assessment of demand-side substitution.

PNG Ports

PNGPCL submitted that key issues for consideration of the potential for demand-side substitution would be:

- Suitability of infrastructure
- Cost of switching between providers, including relative prices, and other costs such as travel time and processing time through port.
- Whether any examples exist of switching behaviour, or whether customers have noted any intention to do so.

PNGPCL put forth that since the establishment of the 2010 Regulatory Contract, it is clear that the competitive environment influencing the above issues has changed and there is evidence of demand-side substitution from customers increasing utilisation of Motukea, and a high probability of further supply-side substitution on the part of Curtain Brothers in terms of price and non-price competition -encroaching on the market position of PNG Ports.

Despite stakeholders comment concerning the barriers to demand-side substitution to Motukea, data on the volume of trade handled at Motukea since the start of the Regulatory Contract period which they have collated, indicates that there has been strong growth in activity and trade volumes and particularly containerised trade volumes for PNGPCL, have been relatively flat at Port Moresby.

PNGPCL clarifies that the differentiation of cargo into LNG and non-LNG cargoes is based on information provided by Curtain Bros, and this information is used to determine applicable wharfage rates paid by Curtain Bros to PNG Ports under the Deed of Agreement. Given that Curtain Bros pay a lower wharfage rate to PNG Ports for LNG related cargoes handled at Motukea, PNG Ports considers that it is highly unlikely that Curtain Bros would classify any cargo that is related to the construction of the LNG Plant as non-LNG cargo. PNG Ports rely fully on the accuracy of the data provided by Curtain Bros and has no evidence to suggest that it should not so rely on this data.

PNG Ports considers that the distinction between project and non-project cargo is irrelevant for containerised cargo when considering substitutability between ports. The contents of a container are irrelevant when assessing substitution and competition.

PNG Ports argues that, Port Moresby is equally capable of handling the same ship and cargo types as Motukea, therefore, the increase in volumes at Motukea effectively represents demand-side substitution and a loss in market share (or potential market share) to PNG Ports. It is seen that, while some project specific cargoes are not supported by PNG Ports at regional ports, the majority of speciality or project cargoes would be able to be processed at Port Moresby (particularly containerised cargo).
PNG Ports reiterates that an agreement between Customs and Motukea will eventuate for the container scanners to be located at Motukea, rather than at Port Moresby, which will provide Motukea with a favourable advantage in terms of decreased container processing times and clearance which will attract more general liner trade away from Port Moresby. The time for container clearance will be much shorter for the wharf which is closer to where the scanner is located and containers through the wharf further away from the scanner will take more time to clear customs checks, as customs inspection will need to follow current manual processes. Customers of PNG Ports will then have to pay additional fees to transport containers from Port Moresby to the scanner at Motukea, particularly when Customs insist on its use, or customers seek a route to faster clearance.

PNG Ports submits that if the scanner goes into Motukea, rather than a neutral and central location between Motukea and Port Moresby wharfs, there is a possibility of anti-competitive behavior to be displayed by either security and administrative staff attached to the Motukea wharf causing further delays and cost. Such additional delays will increase the competitive disadvantage of Port Moresby for PNG Ports.

**TRUKAI INDUSTRIES**

Trukai Industries Limited submitted that there is no substantive competition for PNG Ports.

**DISCUSSION**

PNGPCL argues that the contents of a container are irrelevant to competition analysis. Ordinarily, this would be an acceptable argument. In the context of the LNG project, for which ‘production line’ efficiency was and is required, it does make a difference. The Motukea Port is understood to have been specifically established to ensure that no delays in handling material for the LNG Project occurred. That includes all LNG Project cargo, whether containerised or not. A specific purpose port, therefore, does not fall for assessment under normal competition criteria, especially where volumes of containerised cargo that may ordinarily be considered competitive with the main port, are so miniscule as to fall below the concentration thresholds normally triggering a detailed competition analysis.

In any case, the point has been made repeatedly in this report that Motukea operates under a ‘franchise; outsourcing; or agency’ model under the Deed of Agreement with a fee payable to the landlord port, PNGPCL, and cannot reasonably be regarded as a competitor to PNGPCL under normal analytical approaches adopted by industrial organisation analysts.

It is also a commentary on the efficiency of PNGPCL that the investors in a large project would not allow the progress of its construction to be held captive to PNGPCL’s efficiency levels.

With regards to Customs scanners, PNGPCL reiterated that to its understanding, Customs and Motukea had reached an agreement for the container scanners to be located at Motukea, rather than Port Moresby, ensuring Motukea had a favourable advantage in relation to container
processing times and clearance, attracting more general liner trade away from the Port Moresby wharf. In its draft report, the Commission was of the view that:

“....Container scanning facilities are to be located at PNGPCL’s Port Moresby facilities. To the extent that ‘repeatedly traded goods’ handled at Motukea are to be subject to scanning for Customs and security purposes, the additional costs associated with double handling and an additional transport leg would be likely to add significantly to the costs of cargo-shippers and consignees who may wish to use Motukea port for such goods”\(^{10}\).

In response, PNGPCL appears to be confident that the scanner will be located at Motukea and unsure that a second scanner will be located at POM Port. These are speculative views and until the matter is resolved, no assessment of the implications for competition can be made with certainty, in relation to the location of scanning facilities.

Interestingly and inconsistently, while PNGPCL points to the competitive disadvantage of location of scanning facilities with consequent transport and handling costs, it does not appear to accept those very same cost factors and timing issues in relation to the issue of storage facilities. This is a position that requires explanation and reconciliation and will be discussed further below, under the heading of ‘storage services’.

For the above reasons, the Commission finds, as a matter of “fact and commercial common sense”, as required by section 33 (8), that PNGPCL is not under competitive constraint such that regulation should be removed before the conclusion of the regulatory contract, at the very least.

In view of the above analysis and information available to the Commission, it is of the view that PNGPCL is still the major operator of essential port services amongst other operators in Port Moresby. It is also of the view that competition for provision of essential port services in Port Moresby is constraint at this moment due to transport costs that would be incurred if consignees transport their cargo from Motukea to other locations in Port Moresby compared to the costs that would be incurred if PNGPCL’s port is used.

The above factors, 4.2.2 and additional barriers outlined in 4.2.4-4.2.5, determine that there are impediments to demand-side substitution by customers. The Office of Fair Trade states “A significant factor in determining whether substitution takes place is whether customers would incur costs in substituting products. High switching costs relative to the value of the product will make substitution less likely.”\(^{11}\)

Among others, as noted above, competition authorities use sources from patterns in price changes of the product(s) under consideration and switching patterns of consumers in the market place;

\(^{10}\) ICCC Draft Report and Findings for PNG Ports Corporation Limited-Midterm Review of Competition, 28th June 2012.

\(^{11}\) OFT403, Market Definition, Understanding Competition Law, Competition Law Guideline, Competition law 2004.
and the costs of switching that would be incurred by customers as a result of doing so to identify the competing product(s).

In doing so, the Commission considers that market for the provision of essential port services does not have very close substitutes due to the fact that type of cargo imported into PNG cannot be done by using land transport and/or air transport. The possibility of using airfreight carriers would be very costly and specific cargos cannot be carried by air freighters; hence it could not be considered as a close substitute also.

With respect to geographical market, the Commission also thinks that consumers in Port Moresby cannot access similar port services in other centers in PNG; but only through operators operating within the vicinity of Port Moresby. With several operators as identified above, the Commission thinks that the costs of switching would not be significant enough to prevent customers from moving away from using the PNGPCL port facilities to using other facilities, to the extent they are available, considering the likely costs that would be incurred, as discussed above.

The Curtain Bros Motukea wharf has been and will continue to experience an increase in activity from 2010-2014 because this is when the LNG Project will be undergoing its construction phase. However, after the construction phase this may change. As per the PNG LNG Project Overview\(^{12}\) there are plans to construct their own marine facilities “the 700 hectare LNG plant site...has a protected harbor and close proximity to the deep water required for LNG tankers.....the construction of two 160,000 m\(^3\) LNG storage tanks and marine facilities to allow access for LNG tankers with capacities ranging from 125,000 m\(^3\) to 220,000 m\(^3\).” This is one of the many reasons that demonstrate that Motukea cannot be seen as a competitor to PNGPCL because its position with regards to receiving LNG cargoes is also likely to change in the near future.

**FINDING**

**In view of the above discussion, when assessing the demand side substitution from the product/service perspective, the Commission has determined that that there are no close substitutes.**

### 4.3 SUPPLY-SIDE SUBSTITUTION

PNGPCL submitted that the ACCC merger guidelines define supply-side substitution as relating to the ability of potential competitors, in response to an increase in price, to switch production, quickly and without significant investment, to supply a demand side substitute to the incumbent’s customers.

\(^{12}\) Derived from website: [www.oilsearch.com/Our-Activities/PNG-LNG-Project/PNG-LNG-Project-Overview.html](http://www.oilsearch.com/Our-Activities/PNG-LNG-Project/PNG-LNG-Project-Overview.html)
The ease with which supply side substitution can take place depends largely on the height of barriers to entry including sunk costs, the expected profitability of making the switch, an assessment by potential entrants of the likelihood of retaliatory action by the incumbent; and access to inputs and customers.

The PNGPCL submission highlighted issues for consideration which it claimed were key to an assessment of competition in the relevant markets. During the 2010 regulatory contract review, the Commission formed the view that there was limited competition because private ports were focused on servicing their operational needs hence constituted facilities limited to ‘own demand’ operations, rather than competitive or potentially competitive with PNPCL facilities.

PNGPCL submitted that the assessment of competition should be based on whether the potential for market entry by private port operators acts as a constraint on PNGPCL in relation to the exercise of market power- that is if operators of private ports would find it profitable to switch their operations and compete for demand currently serviced by PNGPCL if the latter were to attempt to exercise market power (presumably by raising prices significantly or reducing service standards equating to such a price increase).

**DISCUSSION**

The sunk costs (essentially, costs not recoverable by the market entrant, in the event of exit from the market) of diversifying the activities of single product, ‘own use’ ports to compete with a multi-product port serving the full range of customers and vessels, are significant. Furthermore, the risk of retaliation by PNGPCL to competitive entry calls into question the accessibility of market entrants to customers. Scale of operations is relevant to the ability to retaliate. PNGPCL, with its overwhelming share of the relevant markets, dwarfs other players and can engage in ‘disciplinary’ pricing to dissuade entry or effective actual competition, if unregulated. The tariff variation request appears to fall within such a description. Even though no realistic attempt at competition appears to be observable, PNGPCL appears to be positioning itself to ‘discipline’ entry by seeking to secure the flexibility to engage in such ‘disciplinary’ or ‘retaliatory’ conduct.

The Commission needs to assess the realistic likelihood, rather than the theoretical possibility, of such supply side substitution, such that entrants consider risk constituted by the magnitude of sunk costs; and their likely accessibility to customers, who are able to access the alternatives without significant nett switching costs; to be acceptable to justify entry. No evidence has been provided so far that suggests that supply side substitution is a commercially viable, realistic option.

At page 4 of its final submission, PNGPCL reiterates its argument that private port operators like Steamships and Bismark can expand output if PNGPCL exercises market power. As previously mentioned, concentration is the starting point for industrial organisation analysis. On that criterion, the analysis need go no further. Furthermore, expansion also depends on barriers to entry, identified as the key competitive criterion in re: QCMA. Space limitations constitute a significant barrier to expansion of those two operators. In addition, the ability of PNGPCL to
discipline entry by price cuts would weigh heavily in any consideration of expansion by the two private operators.

As for single cargo ports, also argued by PNGPCL to be sources of potential competition to itself, economies of scale and scope and sunk costs are at least two further factors that would discourage entry, in addition to those identified in the paragraph above.

PNGPCL relies on statistical returns provided by Motukea to base its argument that containerised cargo handled there is of a type that is repeatedly traded. There may be a variety of reasons for statistical returns for containers not being shown as LNG cargo and until established, the contention cannot be accepted at face value.

4.3.1 Potential for supply side substitution by coastal shipping operators

PNGPCL submitted that the private wharves of Steamships and Bismark do present a potential source of competition to PNGPCL because they service broadly the same cargo types. The potential source of competition is in relation to their ability to increase the provision of services to other shipping lines in the event that it was considered profitable to do so.

PNGPCL also submitted that the light handed approach to regulating the PNG coastal shipping industry recommended by the Commission in 2006/07 suggests that it is of the view that the industry is competitive (i.e. compared to an industry required to be subject to a price setting regime).

A number of points need to be made about the above submissions.

• First, the facilities operated by Steamships and Bismark offer limited space, such that both operators utilize PNGPCL facilities, to a significant extent, as well as their own.

• Secondly, for import cargo, the requirements of the Customs Act and Regulations, appear, in effect, to restrict vessels to using PNGPCL facilities. Consequently, for export cargo, those same facilities are likely to be used, the vessels having been berthed there for discharge of import cargo. Hence, for international cargo, PNGPCL facilities are not substitutable by those operated by Steamships and Bismark.

• Third, in relation to the submission that the light-handed approach to regulation of coastal shipping espoused in the Commission’s report on the PNG coastal shipping industry implied that the industry was competitive and, therefore, that constituted evidence of supply side substitutability, it is not clear that even if the coastal shipping markets were competitive, that that would necessarily mean that supply side substitutability flows from that situation. Moreover, such assessments by the Commission are made on a ‘case-by-case’ basis and are conclusions based on information available to it at the time and, therefore, should be regarded as views prevailing at the relevant time, based on then available information, rather than ‘cast in stone’ for all time. That report was made some 5 years ago and markets do not remain static.
In November 2011, the Commission instituted proceedings against Steamships Trading Company Ltd; some of its related companies; and Consort Express Lines Ltd and Kambang Holdings Ltd, in respect of an acquisition of shares by the former in Consort which led to the control of Consort passing into the hands of the former, alleging that the acquisition had, or was likely to have the effect of substantially lessening competition in a number of markets, including coastal shipping markets. This litigation represents the current view of the Commission in respect of the existing and likely future level of competitiveness of coastal shipping markets. The outcome of the proceedings will be determinative of the state of competition in coastal shipping markets.

SUBMISSIONS

The Commission received the following comments from industry stakeholders for the assessment of supply-side substitution.

PNG Ports Submissions

Key issues for consideration of the potential for supply-side substitution they have presented include:

- Ability of other port facility operators to switch current operations to a service that competes with PNG Ports (including time and cost dimensions)
- The likelihood of switching operations on the basis of expected returns
- Any other barriers to entry

PNG Ports is of the view that there was limited competition in the market because many private ports were focussed only on servicing their own demand, but that however, did not constitute evidence that these ports do not represent a competitive threat to PNG Ports. They believe, the assessment should be based on whether the potential for market entry by private port operators acts as a constraint on PNG Ports in relation to the exercise of market power.

From stakeholder views, they have derived that, there is a general agreement that once project cargoes from the construction phase of the LNG Project begin to wind down (expected to be in mid 2014), Motukea is expected to expand its capacity and reduce prices to emerge as a strong, and even dominant competitor to PNG Ports. Further, Curtain Brothers appear to be clearly positioning Motukea as a competitor port to Port Moresby, in that PNG Ports understands that the Government is funding the provision of container scanners to be located at Motukea. Should this eventuate, it will provide Motukea with a substantial competitive advantage over PNG Ports due to the following:
- A number of stakeholders in our consultations noted that Customs clearance times for containers were one of the key challenges in improving efficiency at Port Moresby; and

- As noted above, the lack of a permanent Customs presence at Motukea was identified by Stakeholders as being one of the key barriers to increased use of Motukea.

Concerning the provision of berthage and wharfage services to the coastal shipping market, it is clear that PNG Ports, Steamships, MES and Bismark Maritime all provide services to broadly the same cargo types and therefore provide a potential source of competition.

PNGPCL believes that the ICCC's relatively light-handed approach to regulating the coastal shipping industry as set out in its 2007 Final Report on the Review of the PNG Coastal Shipping Industry suggests that the ICCC considers that the coastal shipping industry is relatively competitive (i.e. in comparison with an industry subject to a price setting regime.). PNG Ports is of the view that the alternative coastal shipping wharves do present a certain level of competition to PNG Ports - particularly with respect to their ability to increase the provision of services to other shipping lines. PNG Ports submits that their impact on competition should be assessed in terms of the impact on volumes and also the potential for further supply-side substitution.

**Riback Stevedores**

Riback Stevedores Limited, which is a subsidiary company of Consort Express Lines Limited and operates stevedoring services mainly in Lae port, has articulated concerns of wharf congestion at the Lae port. From their observation, this is mainly due to factors such as slow Customs clearance, slow NAQIA clearance, lack of trucks, increase in cargo volumes, all generally posing a need for additional wharf storage space.

**IPBC**

IPBC were concerned as to the depth of analysis that the ICCC has applied, particularly given the complexities of the issue of containers being held at the ports for customs purposes and the need to link any action on storage with the activities of other agencies that are outside the control of Ports. They maintained that, a regulatory approach to the setting of storage charges has all the dangers of being a second best option which will only discourage competitive tension in the provision of storage services and potentially result in the ports being choked to the detriment of the economy.

**Agility Logistics**

PNG Ports supply of infrastructure port services also drew comment from Agility Logistics who maintained that, “there are only two (2) berthing spaces in POM compared to the Lae Port, with many ships calling in, and delays of processing the vessels”, and that, the Port storage costs for containers is extremely high.
**DISCUSSION**

Supply-side substitution as per 4.3 is considered to be unviable and an unrealistic option because though there is the theoretical possibility of entry into and exit from the relevant market, entrants consider risks present because of the magnitude of sunk costs.

Besides the sunk costs, the Commission also takes into consideration the size of wharfs and the type of cargo each port operator allows. It also takes into consideration the possibility of switching the supply of other services to the provision of port services by potential entrants; and the costs of expanding the existing facilities by the small incumbent players.

PNG Ports submits that their impact on competition should be assessed in terms of the impact on volumes and also the potential for further supply-side substitution.

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**FINDING**

**Taking into consideration the above observation and without views from the existing competitors and other market players, the Commission could not make a finding here that there are possibilities of supply side substitution that could constrain PNGPCL.**

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**4.4 COUNTERVAILING POWER**

Section 5.4 of the original submission by PNGPCL discusses countervailing power and, in effect, submits that it constitutes a viable constraint on its market power. Countervailing power is defined by the ACCC in its merger guidelines as occurring where one or more customers are able to constrain the supplier in any increase in prices, due to characteristics such as size or commercial significance to a supplier.

Key considerations when in assessing whether countervailing power exists are:

1. Whether bypassing the supplier would be commercially viable
2. Whether effective bypass is likely
3. The proportion of the market that is capable of effective bypass.

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**4.4.1 Evidence of countervailing market power**

PNGPCL submitted that it considers that the bypass of its facilities by shipping operators is generally consistent with the definition of countervailing buyer power in the ACCC’s merger guidelines. PNGPCL pointed to the fact that the vertically integrated nature of coastal shipping operations suggests that they possess at least some countervailing power. Again, no line of argument or analysis has been provided to substantiate that claim.

PNGPCL also submitted therein that it is likely that there has been some exercise of countervailing market power. Presumably, the operations of Bismark and Steamships MES and, possibly, Motukea, are claimed to represent examples of countervailing market power, although that argument is not
explicitly made. It is not clear what circumstances led to the establishment of those facilities, apart from the ‘contracting out’ that Motukea represents. If they do owe their origins to a demand side response to high prices or other price-equivalent competition-related cause, both operations appear to represent a minuscule proportion of the market, as discussed in the section of this report on concentration, not even approaching market shares that represent a level that suggests countervailing market power. The earlier discussion of Motukea also supports that conclusion. It is clear, therefore, that the presence of Bismark, Steamships and Motukea does not represent a significant enough proportion of the overall customer or revenue base of PNGPCL such that it would act as a constraint on monopoly power in the event that PNGPCL was not subject to regulation.

In essence, PNGPCL submitted that the impact of port bypass in the future should be assessed in terms of the impact on volumes and also the potential for further supply-side substitution. On both counts, the evidence does not support the propositions in terms of likelihood of claimed effects.

4.4.2 Commission’s analysis and view on countervailing market power

PNGPCL currently has the overwhelming share of relevant markets as highlighted in Table 2 in relation to the volume of cargo throughput for its port facility at Fairfax Harbor. Cargo information provided for Motukea compared to PNGPCL port indicate that PNGPCL has such a strong market position within Fairfax Harbor as to support the conclusion that it enjoys market power in the provision of services constituting the relevant markets. Hence, the evidence necessary to support an argument that countervailing market power exists needs to be at least as weighty to allow it to be taken seriously.

The Commission’s view is that until clear evidence or market data emerges in relation to the effects of demonstrated countervailing power, or the real likelihood thereof, the Commission considers that it should not rely on this argument. Further, there are physical capacity constraints at the Bismark and Steamship wharves and other current barriers to customers possible use of Motukea Port which appear to contradict this argument by PNG Ports.

SUBMISSIONS ON CONUNTERVAILING POWER

As per the Commissions Mid-term Competition Review draft report, other stakeholders had no comments to make, only PNG Ports commenting on the issue of countervailing power as follows:

PNG Ports Response submission

PNG Ports considers that bypass of its facilities by a private operator is generally consistent with the definition of countervailing buyer power in the ACCC’s Merger guidelines. In particular, the vertically integrated nature of coastal shipping operations suggests that they possess at least some countervailing power. Given that private port facilities have been constructed in the past, it is likely that there has been some exercise of countervailing power in the market for wharfage and berthing services for both international and coastal cargoes.
DISCUSSION
As discussed above regarding the structure of the Ports and impediments to demand-side substitution, it would not be possible for countervailing power to exist because it would not be commercially viable to bypass the PNGPCL ports in preference for Motukea Wharf which is the main competitor here. The Commission also understands that main cargos handled at Motukea wharf are for Curtain Bros, which is the owner of the port, and mostly the LNG projects cargos. The handling of coastal and international cargos, to the Commission’s view, are minimal. The Commission also understands that Exxon Mobil is also constructing a port near its LNG plant purposely for LNG production and transportation.

Other wharf owners like InterOil at Napanapa, Bismark and Steamships are concentrating on their own vessels and cargos than opening them to other shippers and consignees who uses other liners then theirs.

Little has been said about the regulatory barrier to entry. PNGPCL operates and exercises powers under the Harbours Act and its own enabling legislation, both of which give it considerable powers to control activity in the aquatories it is responsible for. A recent example is refusal to allow Garamut Enterprises to offload timber it required for a project not involving the provision of port services, but construction of a retail mall in Port Moresby.

This clearly exemplifies the ability of PNGPCL to control, deter and prevent entry. In this particular case, Garamut was not even a potential competitor, but sought ‘own-use’ access to the aquatory. That PNGPCL is intent on maximizing its revenue, is clear, as Garamut posed no competitive threat, only seeking to minimize costs and time in unloading its timber at the shoreline it could easily access, rather than incur the port, transport and double handling costs at PNGPCL facilities.

PNGPCL attributed its refusal to safety concerns and these are being explored with PNGPCL. Of course, it is noteworthy that safety was the cornerstone of PNGPCL’s opposition to the liberation of the marine pilotage market as well.

FINDING
In view of the above observations and considering that Motukea wharf’s market share is insignificant compared to PNGPCL’s and the quantum of coastal and international cargoes other than LNG project cargoes compared to those of PNGPCL are minimal, the Commission cannot conclude that there would be a realistic and significant likelihood of effective bypass by consumers. No evidence has been provided for the other two port facility operators (Steamships MES and Bismark) by PNGPCL to further substantiate the claim that a proportion of the market is capable of effective bypass. In any case, PNGPCL’s ‘landlord-francisee’ agreement with Motukea eliminates the possibility of the latter being considered a competitor for the duration of the agreement at least.
Congestion

In recent months the Commission has also noted that the number of vessels waiting to berth has increased considerably; hence it is clear that Port Moresby at this stage is becoming congested even though there is Motukea Port on the other side of the harbor. This indicates the preference of customers for PNGPCL's Port Moresby facilities, due to the various barriers associated with utilizing Motukea. Furthermore Bismarck and the Steamship MES wharves only service their own smaller vessels and their larger vessels still use the PNGPCL’s facilities. The magnitude of this ‘own service’ segment of the market, therefore, is minute compared to the segment serviced by PNGPCL.

For example, in May 2012 Swire Shipping as part of its planned quarterly review of delays due to congestion announced the following port congestion fees (in US$) for Lae and Ports Moresby. The fee increases were made effective as of 7th June 2012 are as follows:

Table 5: Port Congestion Charge

<table>
<thead>
<tr>
<th>Cargo Type</th>
<th>Rate in USD</th>
<th>Rate in Kina*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Containers</td>
<td>US$165/TEU</td>
<td>K367/TEU</td>
</tr>
<tr>
<td>Break-bulk</td>
<td>US$10/RT</td>
<td>K22/RT</td>
</tr>
</tbody>
</table>

*Converted based on exchange rate of K1=US$0.45.

In order to clearly demonstrate the level of congestion and its impact on the national economy, based on this congestion levy and on the market data for POM Port for TEUs and the assumption that Swire Shipping will apply this levy on 30,000 TEUs in 1 year, the extra costs to the economy based on the above rates will be approximately K7.3 million in Port Moresby alone. These extra costs are inevitably passed onto consumers in the longer term in the form of higher retail prices.

The persistent existence of congestion, and the proposal by PNGPCL to discriminate between customers and products (discussed below), both strongly suggest the existence of market power. In competitive markets, competitors would attract the ‘queued’ customers and it is well accepted that discrimination is generally, although not exclusively, practiced by firms with substantial market power, when it is first introduced into a market.

SUBMISSIONS

The Commission received a number of comments from industry stakeholders for the assessment of this section.

Riback Stevedores submission

Riback Stevedores Limited, which is a subsidiary company of Consort Express Lines Limited and operates stevedoring services mainly in Lae port, has articulated concerns of wharf congestion at the Lae port. From their observation, this is mainly due to factors such as slow Customs clearance, slow NAQIA clearance, lack of trucks, increase in cargo volumes, all generally posing a need for additional wharf storage space which would seem to imply, that PNG Ports has been failing to meet the minimum standards of service at its ports.
Further, the fact that PNG Ports are now no longer doing anything about the long stay units at the Lae Port – thus not alleviating storage problems at the Lae Port is of serious concern to Riback.

**NAQIA submission**

National Agriculture Quarantine Inspection Authority (NAQIA) submitted that, amongst other constraints, it also encountered insufficient dedicated areas for quarantine inspection purposes as the only dedicated area, Yard 5, is also used by PNG Ports for storage and when space is available, only 1 or 2 containers can be fumigated per 24 hours.

**IPBC submission**

IPBC were also concerned as to the depth of analysis that the ICCC has applied, particularly given the complexities of the issue of containers being held at the ports for customs purposes and the need to link any action on storage with the activities of other agencies that are outside the control of Ports.

**TRUKAI INDUSTRIES LIMITED**

Trukai Industries Limited maintains that storage charges should be regulated by the ICCC.

**DISCUSSION**

The Commission acknowledges the above submissions and notes the fact that congestion at the Port Moresby Port is a very big problem which is penalising consumers by making them pay extremely high costs for the delay in processing containers/cargoes. PNGPCL has redirected the blame to Customs, NAQIA and stevedores, but as per the submissions and the Commission’s views, inadequate wharf space and inefficient ancillary services provided at the wharf are all part and parcel of congestion and until PNGPCL plays its part by correcting its inefficiencies, Customs, NAQIA, Stevedores and other services providers will continue to blame them for congestion, even though some of the blame may well rest with these other waterfront participants.

The Commission is particularly concerned about the claim that inoperative machinery is stored on PNGPCL’s facilities, thus depriving users of additional storage space, thus exacerbating scarcity of space and delaying operations.

The IPBC submission, while proffering cautionary advice to the Commission, does not offer any suggestion on overcoming the problem.
FINDINGS

The Commission is of the view that the problem of congestion at wharves which has been identified by stakeholders should be improved to increase efficiencies at the ports of PNG where high volume of containers is expected to be handled. PNGPCL should increase its efforts to remedy this problem which is identified not only at its Port Moresby Wharf but also at its other ports throughout PNG. PNG Ports should work closely with other key stakeholders and port users, who comprise the waterfront transport chain, rather each than shifting blame on the others.

RECOMMENDATION ON NEXT STEPS

PNGPCL should observe its agreement with the Commission to re-open the contract to review the matters the subject of that agreement, including a review of pricing structures. Alternatively, PNGPCL should urgently apply for a variation to the pricing regime and introduce efficiency-enhancing pricing structures for its wharves and adjoining facilities, such that incentives to improve performance would be dynamic, ongoing and effective. The Commission, of course, has, and continues to, reserve its rights under the agreement, to seek its enforcement by any means whatsoever.

The above section of this report concludes consideration of the market circumstances relevant to the competition review request.

5. PRICING FOR LARGE CUSTOMERS

In section 6 of PNG Port's preliminary submission, it submitted that it may be appropriate in some circumstances to diverge from the tariffs and conditions of service set out in the Contract to prevent loss of market share or improve business outcomes.

In particular, it claimed that it should be entitled to offer large/and or unique customers individualized terms and conditions of service, so long as, such commercial arrangements do not result in the rest of the customer base being made worse off than it would otherwise be.

In response to the draft determination, the following comments have been received from PNG Ports and the Stakeholders.

Response from PNG Ports

a) PNG Ports suggested that customers that differ in the following way should not be considered in the same circumstance:
   i. Differing and specific infrastructure requirements to serve customers, e.g., bulk commodity vs container cargo vs liquid cargo,
   ii. Differing costs to serve customers, eg, reefer vs standard container,
iii. Competitive nature of the market for providing service to customers.

b) The ability of PNG Ports to offer different prices for customers that differ in these ways in certain circumstances has been fundamental to promoting:
   i. economic efficiency,
   ii. promote and facilitate competition in areas of market open to competition, and,
   iii. facilitate the efficient allocation of resources by ensuring that price reflect costs.

c) PNG Ports claimed that the above principles were recognized and enshrined in the Regulatory Contract that provided for different prices for different classes of customers as set out in Schedule 1.

d) Ports further claimed that the price differences for different essential port services have been in place since the commencement of the regulatory contract in 2002 and were allowed as they clearly enhanced economic efficiency.

e) In addition, price controlling mechanisms set out in the regulatory contract also promoted these principles by entitling PNG Ports to increase or decrease price to one group of customers than another in its annual tariff submission to ICCC.

f) Ports claimed that the allowance of the reasonable price discrimination promoted the objectives of the ICCC Act set out in the following sub-sections: i. 5 (1)(b) and 5 (2)(b) on economic efficiency, 5 (1) (C) and 5 (2) (a) price of services for the benefits of consumers, 5 (2) ( C) facilitation of competition, and 5 (2) (e) on promotion of efficient investment, and 5 (2) (g) promotion of a fair market.

g) PNG Ports claims that the current framework and regulatory contract provided PNG Ports with high powered incentives to achieve operating efficiency gains and to maintain pricing levels which encourage usage of its ports and ensure maximum through put across each wharfage.

h) PNG Ports claimed that under the weighted average price cap applied, price increase to any customer group in any one year has been capped at the x-factor plus CPI, plus or minus the rebalancing control. Thus regardless of any pricing strategy introduced by PNG Ports for large or unique customers, price was not to be affected. Hence, under the weighted average price cap applying to PNG Ports, offering price discount will not lead to an exacerbation of price increase to non-preferred customers.

i) The relative kina charges being applied under the regulatory contract were very competitive when compared to Motukea as claimed by PNG Ports. They therefore urged ICCC to explore this difference by approaching Curtin Bros for the pricing information. Therefore, an excessive regulatory focus on the price increases allowed under the regulatory contract defeated the purpose and intent of the regulatory contract, which is to improve PNG Ports performance for the benefit of customers in financially and sustainable manner.

Response from the Stakeholders

Agility
a. According to Agility as one of the stakeholders, delay in processing of ships during berth has cost more or extra charges which were never recovered by these particular ships. Charges are applied when ships were idle.

b. Agility further claimed that there were some charges that ports charge which were lumped into wharfage and handling, and were above the normal wharfage charges set by the ICCC,
and the 3 main unpublished wharfage rates charged by the Ports were (i) refrigeration charge, (ii) Yard charge, and (iii) Cleaning charge.

c. Agility claimed that similar charges were also levied to the coastal shipping vessels. This is because of the fact that the coastal freight rates were very expensive shipping cargos between local ports than shipping from overseas.

d. It is further claimed that freight rates for Asian/PNG routes were also much lower than Australia/PNG route. There was more competition in Asia/PNG route than in Australia/PNG route when the rates for Australia/PNG were very high.

e. The port storage costs for containers were extremely high as it took about 7 to 8 days or even longer period of time to get cargos cleared off the wharf.

Trukai Industries Limited

a. According to the Trukai Industries Ltd, they have paid PNG Ports in excess of K1.5m on an annual basis.

b. TIL also claimed that PNG Ports have increased storage charges although PNG Ports have failed in their part to improve on the congestion of spaces for the container storage areas. They have directly attributed to this failure to congestion.

c. TIL further said that it was paying congestion surcharge fees to Swire Shipping due to port congestion and PNG Ports was responsible for this congestion and thus these fees.

d. PNG Port's charges to the TIL have tremendously increased over 5 years above inflation rates and as a result consumers paid increased prices for inefficient cost rise.

Discussion on Pricing for Large Customers

As PNGPCL indicated in subsection 6.1 of its preliminary submission, clause 2.3 of the Regulatory Contract prohibits discrimination in the following circumstances:

“The tariffs PNG Ports charges for the supply of an Essential Port Service (including any discounts allowed in respect of those tariffs), must not discriminate unreasonably between Customers who are in substantially the same circumstances. The Declared Ports which are grouped together and which are determined to be in substantially the same circumstances for the regulatory period commencing 1 February 2010, are provided in Schedule 1”.

In its initial submission, PNGPCL expressed the view it should be allowed to offer discounts to its large customers because Schedule 1 of the contract states that:

“PNGPCL may choose to apply lower tariff if this is deemed to be appropriate by management and consistent with the developmental goals of a port”.
In its final submission, the above views were, in effect, restated by PNGPCL.

As the Commission said in its draft report, the interpretation of PNGPCL of the above provision is disingenuous. The provision quoted immediately above is intended to allow tariffs below the regulated tariff, which are maxima, rather than fixed rates, which are indeed what Schedule 1 provides for; hence, the above clause in Schedule 1 allows PNGPCL to apply tariffs to all customers below the maximum rates set annually but not to offer lower tariffs to only a selected group of customers, as this is discriminatory and inconsistent with the contract.

As to the non-discrimination provision itself, a proper reading suggests that it is concerned with two classes of discriminatory conduct. The first is discrimination between “customers who are in substantially the same circumstances”. Discounts to large customers, would appear to breach the prohibition as discrimination on the basis of size alone is likely to amount to unreasonable discrimination between customers who are in substantially the same circumstances. Customers competing in the same product market serviced in the same port as well as those serviced by different ports fall within this category. There is no suggestion that the fact that the ‘large’ size of some customers of itself, means that ‘smaller’ customers are in different circumstances. Indeed, their smaller size places them at a competitive disadvantage in their markets, which should not be exacerbated by an ‘enabling’ infrastructure provider discriminating in favour of their larger competitors.

There is a second class of discriminatory conduct implied in the prohibition “…The Declared Ports which are grouped together and which are determined to be in substantially the same circumstances”. That wording indicates that customers served by the ports in the same group cannot be discriminated against, whether in the same port or not; and whether they compete in the same product market or not, so long as they are served by ports in the same group. That implies prohibition of geographic discrimination. Clearly, discrimination which distorts resource allocation, whether between customers in the same product market or between customers in different geographic locations that is served by the same port class, is prohibited.

There is good reason for the non-discrimination provision. Favouring one or some customers or classes of cargo gives them a relatively advantageous position vis-à-vis others by lowering their costs relative to others. Hence, it distorts the allocation of resources between favoured customers or classes of customers and those not so favoured. The regulatory contract specifically excludes such discrimination because the policy position behind it can be assumed to be that PNGPCL should not be empowered to engage in such conduct because it should not be the arbiter of resource allocation.

Arguably, the wording of the non-discrimination provision has another dimension. Arguably, all exporters and all importers respectively are ‘in similar circumstances’ in the sense that all seek to minimize their costs and maximize their international and domestic competitiveness by maximizing trade in their respective commodities, including relatively to other commodities. It is the differential in total costs that determine the competitiveness of particular goods. It is inappropriate, therefore, for PNGPCL to arrogate to itself the resource allocation power, which should reside in industry costs and efficiency.
Of relevance to this point is the port congestion situation. Demand is clearly much greater than supply and PNGPCL appears to be attempting to exploit its market power by its proposed approach of favouring some customers or classes of customers to exclude even the incipient or very limited competition that could emerge from Steamships MES; Bismark; or Motukea. This is classic monopoly behaviour. Indeed the ability to discriminate between customers strongly indicates the economic rent-taking that monopolies or firms enjoying substantial market power usually engage in, although smaller competitors without significant market power could do so as well, to withstand similar conduct by firms with substantial market power. The circumstances here strongly suggest that the discrimination proposed by PNGPCL is of the type usually engaged in by firms with substantial market power rather than small competitors attempting to defend their market position. The fact that PNGPCL is proposing discriminatory pricing undermines its argument that competition in the provision of port infrastructure services is effective, or is imminently likely to become effective.

From the viewpoint of a strict application of the ‘no prejudice to other customers’ principle implied in the prohibition of discrimination in the regulatory contract, any reduction in prices (or price equivalent standard of service preference), would appear to result in a corresponding disbenefit to other customers in aggregate, given that a revenue cap operates. It is significant that PNGPCL has not suggested that the revenue cap is intended to be reduced by the aggregate value of any preference granted. In a zero-sum game, any gain to one party or class of customers, must, by definition, come at an equivalent cost to the others.

PNGPCL is regulated using a price cap approach. In accordance with its capital expenditure (capex) requirements and cost structures its price path for the current regulatory period was established. Using this regulatory approach, PNG Ports’ tariffs are designed to recover its costs and spread the costs equitably among its customers (i.e. Tier 1 customers separately from Tier 2 Ports users). PNGPCL’s regulated tariffs have been increasing by 10% - for tier 1 ports and 20% - for tier 2 ports annually since the commencement of the current Regulatory Contract. Any discounts, therefore, should be applied equally across all customers to avoid discrimination and an exacerbation of price increases to non-preferred customers.

There is a further significant economic issue relating to the entire matter of price discrimination in principle. The discriminatory approach is based on assessments of ‘relative elasticities of demand’ for the relevant products”. This approach has its origins in the transport sector and is long and well known as ‘charging what the traffic will bear’. In modern economic parlance, the most common example has come to be known as ‘Ramsey pricing’.

While complex arguments are put forward to justify the efficiency-enhancing characteristics of discriminatory pricing, the generally accepted conclusion is that actual implementation of such a complex pricing structure is fraught with the practical obstacle that elasticities of demand are notoriously difficult to establish and implement, even by extremely efficient enterprises with highly skilled management personnel. It is far from clear that PNGPCL falls within that description. Hence, the risk of considerable economic harm being perpetrated by PNGPCL through discriminatory pricing schemes are considered to outweigh their possible efficiency-enhancing effects.

PNGPCL argues that Schedule 1 supports price discrimination. However, the distinctions in Schedule 1 are based on cargo types, not customers. In any case, that pricing structure is
considered to be inefficient, as pointed out in the Commission’s Draft Report, in that, in effect, it amounts to a ‘tax’ on cargo-shippers and consignees, without any redeeming efficiency-enhancing feature, particularly with respect to increasing efficiency in stevedoring, or downstream markets such as land transport, in the waterfront logistical chain, by providing incentives to increase throughput. A much more efficiency-enhancing approach, proposed by the Commission in its Draft Report is to adopt the same pricing approach as adopted for berthing charges i.e. a fixed rate of rental, whether by hour, shift or day, for use of the wharf facilities, thereby encouraging stevedores to maximise throughput. That approach has the advantages of simplicity as well as enhancing efficiency considerably. It is incomprehensible that a ‘landlord port’, which PNGPCL claims to be, refuses to enhance efficiency with such a structural change to its pricing strategy.

An example given by PNGPCL, in claimed support for its proposed discriminatory pricing for large customers, or those susceptible to a potentially competing port, is for refrigerated containers, on the basis that additional costs e.g electricity supply costs, are incurred. There is no objection to cost-related recoupment for specific cargo types where such costs are cargo-specific and specific charges for storage of reefers is unobjectionable. That is a distinction based on cargo type involving additional costs of service provision, rather than customers, contrary to the claim by PNGPCL in its final submission. Such cargo type - specific charging, to recover costs distinctly attributable to such cargoes, however, does not amount to discriminatory pricing as between customers, which is what is understood to have been originally proposed to ‘meet competition’.

This issue is discussed further below, to correlate with the relevant heading in PNGPCL’s latest submission, and should be read together with that section.

**Weighted average price cap; discriminatory pricing; and ‘no-prejudice’ to other customers**

PNGPCL argues that the weighted average price cap prevents an exacerbation of price increases to non-preferred customers, as claimed by the Commission. A number of points merit consideration in this context.

- While it is true that although prices are fixed on the basis of a revenue cap, they cannot be increased, despite discounts to preferred customers during the current year, that is a ‘snapshot’ view.
- Looked at from a dynamic perspective, investment in facilities to serve such preferred customers increases the revenue cap, which, because of the absence of a service-specific cost allocation methodology, is calculated across both preferred and non-preferred customers (‘global’ revenue cap).
- As the revenue cap is fixed on the WACC on investment, in the ‘out years’, discounts to preferred customers, therefore, inevitably requires raising prices to other customers higher than they would otherwise have been, to achieve the required ‘global’ revenue quantum.
- On the above basis, PNGPCL’s argument that there is no prejudice to non-preferred customers is invalid. Nevertheless, the additional points below are made.
• Even in a ‘snapshot’ sense, but also in a ‘dynamic’ sense, preferring customers on the basis of charges alone is unlikely to attract them in a competitive market, if indeed, and when, the market becomes competitive, when turnaround time for cargo is of primary concern to such customers. Hence, improving the turnaround time and other service quality aspects for preferred customers means that it is likely that non-preferred customers will be ‘neglected’ in a comparative service level sense, in an environment of limited facilities.

• Thus, on a ‘quality-corrected’ basis, non-preferred customers are likely to receive inferior service to that provided to preferred customers, both in a ‘snapshot’ sense and a ‘dynamic’ sense. This amounts to the charging of regulated prices set for regulated standards of service, but delivering reduced service levels to non-preferred customers.

• If some customers can be given preferential prices, there would appear to be no bar to such reductions being shared among all customers.

• Under true incentive regulation, the operator has an incentive to reduce prices to maximise throughput. PNGPCL claims the regulatory regime is incentive based, but is not prepared to offer price reductions to all customers.

Likely breach of ICCC Act

• PNGPCL admits that the objective of such proposed discriminatory pricing between customers is ‘to meet competition’, which clearly has not yet eventuated, hence, by its own description amounts to pre-empting competition, even before its incipiency.

• A firm with substantial market power, which PNGPCL claims it does not have, but which the evidence shows it has, in anticipating competition and attempting to pre-empt such competition is at risk of breaching section 58 (2) of the ICCC Act, which provides as follows:

“A person that has a substantial degree of power in a market shall not take advantage of that power for the purpose of (a) restricting the entry of a person into that or any other market; or (b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or (c) eliminating a person from that or any other market. “

• Were the Commission to acquiesce in such price discrimination, it would be complicit in a probable breach of the above section by condoning such conduct.

• Again, these questions would not arise under a pricing regime recommended by the Commission, which is structured with built-in incentives to enhance efficiency throughout the waterfront chain – stevedoring, handling, land transport into and out of the port. This would reduce congestion in storage facilities, an objective claimed by PNGPCL. In such a regime, the question of preferential treatment for particular customers would not arise, as it would be unnecessary in an environment of substantially improved waterfront efficiency.

• The possibility of bypass by customers not offered preferential terms, was claimed by PNGPCL to be real. PNGPCL’s rights to control the aquatory, under its enabling legislation, are likely to preclude competitive entry without its agreement (see discussion earlier on Deed of Agreement for Motukea Port and the circumstances relating to Garamut). In such circumstances, therefore, the claim of possible bypass can only be described as highly speculative, if not fanciful and, if the legislation gives PNGPCL the necessary ‘gatekeeper’ powers, highly misleading.
• PNGPCL has described its charges as comparable to other operators internationally. For reasons outlined in the Commission’s draft report (page 31), such as overseas terminal operators bearing significant lease costs; investing in high-cost capital equipment for cargo handling; portainer cranes; hard stand; perimeter fencing etc, the comparison in invalid. PNGPCL argued that its investment in port facilities is significant. The Commission does not consider PNGPCL’s investment comparable to those in Singapore or Australia. If comparisons with other countries are to be considered, the detailed data needs to be submitted.

• For the above reasons, the Commission finds, based on market circumstances, that the request by PNGPCL to be allowed to discriminate between customers on prices or levels of service, should be denied.

Taking into consideration the current regulatory settings and the price path, the Commission considers that any such discriminatory arrangement is unfair on the wider customer base. This is because ordinary customers will be forced to pay more per unit of service they receive in order to compensate for revenue foregone by discounts to preferred customers.

It is the Commission’s view, therefore, that such a proposal by PNGPCL, if approved by the Commission, would have the effect of discriminating against other port users and, if implemented without approval, would contravene the regulatory contract.

The issue of introducing efficiency-enhancing pricing structures for PNGPCL is far more effectively approached under the framework proposed by the Commission later in this report.

FINDING

The Commission finds, based on market circumstances, that the request by PNGPCL to be allowed to discriminate between customers on prices or levels of service, should be denied.

6. OTHER ISSUES AFFECTING THE PORT SERVICES MARKET AND ANCILLARY SERVICES

In conducting this review, the Commission concluded that it was necessary to widen the scope of the review to look at other issues that have an impact on port infrastructure services and competition in the relevant markets, including the costs affecting the competitiveness of downstream markets. These issues include;

1. Whether provision of
   a) storage services at port precincts; and
   b) marine pilotage services;
should be regulated.

2. The lack of efficiency-enhancing incentives in existing pricing structures and urgent changes necessary to remedy that deficiency.

3. Deficiencies in the regulatory contract relating to;
   - The lack of regulatory control over operating costs
   - Time frames for the Commission’s regulatory actions;
   - One-party entitlement to review the contract

4. The approach by PNGPCL to compliance with its legal obligations

5. Anti-competitive consequences of the administration of regulatory functions for;
   - Stevedoring; and
   - Towage

PNG Ports Response Submission

PNG Ports submitted that it was extremely concerned over the apparent mismatch between the ICCC’s approach in its Draft Report, which has enlarged the scope of the Review, beyond that allowed and intended in the Regulatory Contract. PNGPCL highlighted that it was particularly concerned because it was of the view that there are clearly defined avenues for addressing such concerns under the ICCC Act and Regulatory Contract. PNGPCL considered that it was extremely unfortunate for the ICCC’s current (and unexpected) approach to undermine the regulatory certainty provided by this Regulatory Contract with PNGPCL and other regulatory Contracts with other State-owned entities.

IPBC also highlighted its concerns regarding the legality of actions being proposed in the context of the Regulatory Contract and the commission’s powers under the ICCC Act and Prices Regulation Act. IPBC suggested that a precautionary approach is needed if the commission is to maintain the high standing in which it is held, particularly as there are appeal provision and ministerial discretion issues that some of the options being proposed would bring into play.

Commission’s Rationale for Widening the Scope of the Review

The Commission is confident that in conducting this review, proper processes were followed. One of the requirements of this review was for the ICCC to consider other factors that it considered were relevant to this review, hence the scope of the review was widened to look at these other issues, including downstream competition issues, for which there appears to be no restriction either in the contract or in the ICCC Act.
Furthermore, the Commission considers that it was proper to look at these issues because these factors have an impact on the market for essential port services/port infrastructure services and, consequently, on the cost of goods and services that the people of PNG pay at the retail level. This is clearly consistent with the objectives and functions of the ICCC as set out under section 5 and 6 of the ICCC Act 2002 therefore, to suggest otherwise is unfortunate on the part of PNGPCL and IPBC.

Whilst the IPBC is concerned about the legality of the course of action being proposed and its potential impact on the high standing of the Commission, the Commission would like to set the record straight that it has always acted in the best interest of the people of Papua New Guinea, within the scope of the Regulatory Contract and the ICCC Act. However if there are flaws in the Regulatory Contract and current Regulatory framework, the Commission is of the view that PNGPCL needs to co-operate with the Commission in order to correct these anomalies.

**FINDING**

The ICCC has acted within its mandate outlined under sections 5 and 6 of the ICCC Act and the requirements of the Regulatory Contract in conducting this review and in making the decision to widen the scope of this midterm competition Review.

### 6.1 REGULATION OF PROVISION OF PORT STORAGE SERVICES

During the Draft Determination, the Commission noted that stevedoring, storage and pilotage services are purportedly defined as contestable services in the Regulatory Contract. The precise wording of the definition is as follows:

“A service other than an Essential Port Services that is provided using or that is otherwise related to Essential Port Services and includes stevedoring, pilotage and storage services.”

The Commission, in its draft report, expressed the view that the definition itself is internally inconsistent at best and misleading, possibly intentionally, at worst. The provision of the services purportedly defined as contestable, do, in fact, require the use of ‘Essential Port Services’. For example, pilotage requires use of the berth because completion of the pilotage operation requires secure mooring of the vessel with hawsers to the bollards on the quayline; storage requires use of the berth and wharf, without which no cargo can be loaded or unloaded before or after storage; and the provision of berthing services itself, the essential input to which is the service of pilotage and is itself the essential input to the provision of in-port storage services, is, on any logical approach, an essential port service.

Furthermore, in terms of the definition of contestable services, pilotage and storage, on an ordinary interpretation cannot but be considered to be ‘related to Essential Port Services’, being conducted within the secure port precincts controlled by PNGPCL, and gazetted to be the areas within which the Customs Act and Regulations apply. These basic facts would have been known to PNGPCL at the time the draft contract was prepared and submitted to the Commission. The information asymmetry between regulators and regulated firms, in favour of the latter, is well accepted and understandable – regulators cannot be experts in every detailed aspect of operations of the
As a consequence, ‘gaming’ is not unknown. The above facts and circumstances, therefore, giving rise to the possible inference that the definition was intended to mislead and distort the regulatory scheme in respect of those services, both of which are understood to generate significant revenues.

PNGPCL was requested to provide a break-down of revenues to show the proportion of total revenues earned by storage charges over the last five years. PNGPCL has clearly intentionally refused to do so in its response submission because it is of the view that this issue is outside the scope of the review. Had PNGPCL provided this information it would have clearly showed the magnitude of the windfall it is currently receiving from its storage charges and penalties.

In its Draft determination the ICCC also noted that while similar considerations about the necessary use of ‘Essential Port Services’ also apply to stevedoring, those services are currently being provided by the private sector and are irrelevant to the regulatory contract in the current circumstances. It is relevant, in this context, to mention that the Commission has a price-monitoring function in relation to stevedoring and handling services, in implicit recognition of the view taken by the Minister, in ‘declaring’ those services under the *Price Regulation Act (Chapter 320)*, that market power subsists the provision of those services.

The Commission was also of the view that whether a service is contestable, or not, is matter of fact to be established by a competition analysis, and not just by its definition in the contract. Therefore, the Commission needed to establish whether the definitions are accurate in the first place, and, if not, whether, and to what extent, they require amendment.

The Commission informed PNGPCL at the draft determination stage of this competition review that it would include the examination of storage services and PNGPCL made a supplementary submission, dated 4 June 2012, on storage services, with a particular focus on the market for storage services in POM and Lae.

The basis of the inclusion of storage services in the competition review is Section 33 (2) (b) of the ICCC Act, under which the Commission may declare a good or service to be a regulated good or service in the event that it is satisfied that:

1. the goods or services concerned are supplied or are capable of being supplied by the regulated entity in a market in which the regulated entity concerned has a substantial degree of market power in a market; and

2. the declaration is appropriate having regard to the Commission’s objectives set out in Section 5.

**6.1.1 PNGPCL supplementary submission on storage services**

PNGPCL, in its supplementary storage submission (refer to the attached storage submission for more details), submitted that the market for storage services is relatively competitive and barriers to entry are relatively low. PNGPCL presented its case that the market for storage services is
competitive by pointing to the availability of storage facilities outside its port precincts of Lae and Port Moresby. An updated list of alternative storage facilities in Lae and Port Moresby was provided in section 4.2 of its response submission to the Draft Report and is reproduced overleaf:

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<th>PORT MORESBY</th>
<th>LAE</th>
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<td>PNGPCL</td>
<td>PNGPCL</td>
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<tr>
<td>East West Transport (bonded)</td>
<td>Express Freight Management (bonded)</td>
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<td>Express Freight Management (bonded)</td>
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<td>Goodman Fielder</td>
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<td>SP Brewery</td>
<td>Coke</td>
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PNGPCL currently allows for five free storage days before storage charges are applied to consignees. Transshipment cargo is allowed 10 free storage days in the port of transshipment. The storage pricing principles were outlined in section 3 of the storage submission by PNGPCL (copies can be obtained from the Commission). It also emphasised that its current approach to applying penalties on storage services at its port is common in other jurisdictions. The purpose of the charge is to discourage customers from using the port area to store their cargoes (both containerized and non-containerized) for longer periods than absolutely necessary. The storage penalties are claimed to have effectively cleared all empty containers off the limited storage space within the ports.

PNG Ports has also suggested in the past that it is not in the business of providing storage services and that the limited storage space at its facility in Port Moresby is only for the facilitation of customs and quarantine services.

6.1.2 Market for Storage Services
PNGPCL, in its submission, defined the market for storage services as the market for in-transit storage service for cargo, with a particular focus on Port Moresby and Lae Ports.

In its assessment of the storage services market at Port Moresby in its draft report, the Commission considered that PNGPCL’s storage customers within its ports fall into two categories. There are customers that do not require cargo clearance by Customs or National Agricultural Quarantine
Inspection Authority (NAQIA) at the port and there are customers that do require such cargo clearance at the port.

In studying the market for storage services, the Commission noted that there are supply and demand-side barriers that do exist within POM port which restricts entry to the market for provision of storage services for cargo loaded or unloaded from vessels using PNGPCL facilities within PNG.

6.1.3 Customs/National Agricultural Quarantine Inspection Authority clearance

The Commission also noted in its draft determination that a significant demand side barrier to outside storage services appears to be the Customs and NAQIA clearance requirement. Customers cannot uplift import cargo without such clearances as appropriate to their goods.

A complaint from a stakeholder, at the time when the current storage rates initially came into force, indicates that PNGPCL advised port users at the PNG Port User Group meeting in July 2010 that the PNGPCL’s wharves are not storage depots and the wharf storage rates would increase dramatically with a view to force consignees/Customs agents/forwarding companies to place an emphasis on the Customs/NAQIA clearance and delivery process.

The complainant claimed that this reason in itself is flawed as all Customs clearance houses/forwarders do, is place an emphasis on clearing cargo, to minimize costs.

The complainant also emphasised that apart from Customs clearance houses'/forwarders' occasional inefficiencies and negligence, most delays are due to the inefficiencies of PNG Customs and/or NAQIA or other third party contractors. There have been regular occurrences in which PNG Customs misplace paperwork or cheques. Many times a Customs Officer has not turned up for work and the clearance has been neglected. On a few occasions NAQIA have instructed containers to be fumigated and due to lack of space on the PNGPCL owned wharf, the container could not be fumigated in a timely fashion. According to the stakeholder, each and every time a clearance is delayed by Customs or NAQIA, PNGPCL profits.

Clearance delays are beyond the control of customers if they are caused by the inefficiencies of PNG Customs and NAQIA. Customers by law are not allowed to take delivery of cargo before clearance by Customs (and NAQIA, where applicable). There is one exception in the case of Customs clearance – storage at bonded warehouses. Such warehouses allow cargo owners to store their goods without payment of duty and only pay proportional duty for release of part of the cargo shipment. The Commission also notes that only some of the storage facilities outside the port are customs bonded and mostly used for long term storage. According to Customs, these bonded facilities allows for the storage of dutiable goods, where duties have not been paid for a period not exceeding 12 months. At any time before the end of the 12-month period the duty can be paid and goods released for home consumption. If goods are not entered for home consumption within the 12-month period they are forfeited to the state and resold/auctioned to recover duty and GST forgone. Storage depots such as wharves and airports are short term storage facilities, primarily intended for the facilitation of international trade and clearance procedures. Goods can be held in such depots for a maximum of 30 days storage. This accords with PNGPCL's definition of the market.
as being one for ‘in-transit storage of goods’, rather than the long-term storage facilities offered by bonded warehouses.

It is often the case that victuallers and providores, who import food and beverages for supply to numerous customers at various times, utilize such facilities to avoid paying ‘lump sum’ duty on the entire shipment. That facility, however, is not easily and economically accessible to ordinary traders importing cargo for immediate uptake in total.

The cost of moving cargoes between the bonded areas prior to clearance is also a significant barrier. An indication of the transport cost barrier is highlighted in Table 3 of this Report.

As a consequence, the overwhelming proportion of import cargo requires Customs clearance (and/or NAQIA clearance) before uplift from the port precincts.

For export cargo, Customs declaration is required and the cargo must be available at the gazetted port precincts for inspection if required.

Comments were invited from stakeholders in relation to the clearance delays as a result of claimed inefficiencies of PNG Customs and NAQIA processes.

SUBMISSIONS ON CLEARANCE DELAYS

According to the Customs and NAQIA Submissions, most of the delays are caused by the inefficiencies of shipping agents not submitting their manifest on time (i.e. 48 hours prior to a vessel’s arrival). These manifests take about 24 hours to be loaded onto the Customs ASYCUDA System in order to facilitate cargo clearance in a timely manner. Most of the time manifests are often submitted by shipping agents a few hours prior to a vessel’s arrival or when the vessel has berth. This is the single most cause of cargo clearance delays. Lack of NAQIA and customs manpower can also cause delays therefore it is vital submit manifest on time. Both Customs and NAQIA are in the process of increasing their manpower across the PNG.

In the Trukai and NAQIA submission, it was also highlighted the lack of space within the port for fumigation and timely stevedoring is also a factor contributing to delays and this has been confirmed in the Trukai submission.

Section 6.5 of this Report provides a further discussion on this matter.

While such Customs and NAQIA clearance is not required for coastal cargo, gate passes issued by PNGPCL are required (as they are for receipt and release of international cargo as well).

Gate Passes

The Commission has been informed on a confidential basis that it could take up to 4 days to obtain a gate pass from PNGPCL. PNGPCL stated that no statistics are kept on the time or dates applications are received for gate passes and the actual dates when they are issued. In these circumstances, it is incumbent upon PNGPCL to provide evidence that no, or insignificant, delays on
its part are responsible for cargo being required to be stored on its premises. PNG Ports in this instance may have a perverse incentive to delay the timely issuance of gate passes because it profits from storage charges.

PNGPCL also stated that gate passes can only be given for Customs-cleared goods. Discussion in this paper about the inefficiencies of Customs and NAQIA indicate that those organizations are not prompt with clearance. In the case of import cargo, therefore, delays by Customs/NAQIA, when added to the claimed delay by PNGPCL in issuing gate passes, means that most, or all, of the 5 free storage days are exhausted and, possibly, storage charges are being incurred even before clearance and gate passes are issued. From the customers’ point of view, if it is not legally possible to uplift cargo from port precincts for the duration of time required to obtain Customs (and NAQIA) clearance and gate passes, then they are ‘captive’ to the port storage facilities and substitutability is impossible, whatever the charges to dissuade such storage.

In its submission on storage services, PNGPCL drew attention to the Commission’s comments on the subject as follows:

“In January 2010, the ICCC published its Final Report on the Review of the PNG Harbours Regulatory Contract as well as the 2010 Regulatory Contract. In its Final Report, the ICCC elected not to regulate the provision of storage services by PNG Ports, noting the following:

“Private companies operated their own storage facilities in the form of bonded and free warehouses at the larger ports; and

Any return on the underlying value of PNG Ports’ land should be excluded from the charges in the Regulatory Contract, which are designed to cover the costs of physical infrastructure of the port.13”

“In addition, the ICCC made the following observation regarding PNG Ports’ approach to charging for the provision of storage facilities at that time.

“The Commission also notes that historically, [PNG Ports’] storage and warehousing charges have typically been below the level that would otherwise be set in the open market. Irrespective of the number of free days included in the regulated charges, the Commission would expect PNG Ports to be charging prices reflective of the competitive market price for land. Failure to do so concerns the Commission that PNG Ports is not maximizing its potential revenue.14”

“The approach to the provision of storage services and pricing adopted by PNG Ports in 2010, and currently applied, is generally consistent with practices in other jurisdictions, with the key principles of charging on a per unit basis of containers, allowing a number of

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14 Ibid, p. 24
days of free storage, and a schedule of tariffs which increase in line with dwell time broadly applied in the sector.”

The facts, as reported above, of course, have changed in the intervening period, By way of example, PNGPCL’s storage charges have increased substantially. On the other hand, PNGPCL rightly claims that charges are necessary to dissuade unnecessary storage being availed of and appropriate pricing signals are essential to create the incentive to reduce dwell times for cargo in ports and to the extent the strategy prevents unnecessary storage, that is justifiable, PNGPCL, however, is regulated by a revenue cap, linked to service charges. The revenue for storage, therefore, should be included in the revenue cap, so that other charges are correspondingly reduced, thus avoiding the effective ‘tax’ on customers for storage being added to the other charges they face for the use of essential port services. Few, if any fixed assets are involved in the provision of storage services, the land being ‘legacy gifted’ assets, on which no revenue is attributable in the way of return on the relevant regulated asset base.

In economic incentive terms, however, there is a perverse incentive for PNGPCL to delay the issue of gate passes or to delay resolution of lack of availability of adequate physical facilities for fumigation/washing of containers for NAQIA purposes to maximize storage revenue. Whether it does those things is a matter for investigation.

In its draft report, the Commission said: ‘*The general proposition that services should be priced at economically efficient levels is incontrovertible. What is relevant, however, is whether those revenues should be included in the revenue cap, so that the charges for the provision of port infrastructure services, as a whole, are no higher than they need be.*’ This issue is discussed in greater detail in the context of PNG Ports objectives; the Government policy implicit in ‘gifting’ all assets existing at the time to PNG Ports; and the objectives of the ICCC Act.

In terms of claimed competing port-located storage facilities, there are physical capacity limitations on Bismark and Steamship to compete or act as alternative storage options for customers within the port. Furthermore, these two wharves also do not handle international cargoes, which require Customs (and NAQIA) clearance.

**SUBMISSIONS ON STORAGE SERVICES**

**PNG Ports Response Submission**

In its response to the Commission's draft determination on the definition contestable services, PNGPCL countered that clearly pilotage and storage services are not regulated under the current and prior regulatory contract as these have been services delivered in an open market environment for over ten years. PNG Ports also argued that the service definitions in the Contract are clearly appropriate for the markets within PNG. Furthermore, PNGPCL reiterated that the ICC has not made a compelling case that there is market failure, in the Contract. It argued that the definitions enhance the objectives in sub-section 5(1) and 5(2) of the ICCC Act.

PNG Ports also countered that the practice of enabling storage facilities to be 'bonded' clearly
demonstrates that off-port storage and on port storage can be substitutes. Customs advised that this system was established in 2010 to actively encourage shipping companies to open bonded storage facilities (or customs depots in order to move cargo off the premises of the ports and improve operating efficiency, hence the Commission’s assertion that storage is ancillary to wharfage services is factually wrong, as there is no storage services monopoly. Customs require a bonded area to be located close enough to the nearest regular customs operation (i.e typically a port) means additional transport costs are unlikely to be significant. Furthermore, PNGPCL argued that the bonded facilities are typically operated by transport providers; as such any additional handling and transport costs will be rolled into the overall charge for the land transport leg of the logistics chain. If these additional charges did not allow a competitive pricing structure that was competitive to port storage facilities. PNGPCL argues that, clearly, competition is working in the provision of these services and there is no monopoly.

PNGPCL submitted that the establishment of off port facilities provides clear evidence that the market for storage service including cargoes requiring customs clearance is competitive, substitutes are available and PNGPCL does not have substantial degree of market power.

IPBC Submission

IPBC submitted that there is a need to give greater consideration to the need for an incentive for containers to be moved from the ports particularly when there are clearly other competitive options available. IPBC is off the view that until this is addressed, a regulatory approach to the setting of storage charges has all the dangers of being a second best option, which will only discourage competitive tension in the provision of storage services, and potentially result in the ports being choked to the detriment of the economy.

Trukai Submission

TIL submitted that rice is the staple food in PNG and as such, such costs imposed and port inefficiencies drive increased costs to consumers.

TIL ships significant volumes across PNG annually hence it is very interested in seeing PNGPCL operate as efficiently and inexpensively as possible.

TIL submitted that PNGPCL has clear monopoly on 'on wharf' storage created by the need for importers to get clearance from Customs and NAQIA. Customs and NAQIA are clearly under resourced and delays can occur.

While TIL has a bonded yard located next to Lae wharf, this yard is solely for the sole use of TIL and therefore is not providing any practical competition to other port users.

Furthermore TIL submitted that PNGPCL’s capital improvements plan has failed to deliver in both POM and Lae. In both cases PNG Ports’ poor planning and poor execution have resulted in less key faces for vessels and less hard stand being available.
Trukai submitted that PNGPCL is storing its own inoperative equipment in storage areas, thus reducing storage space available. This has two significant economic aspects, if true. First, due to the reduction of space, stevedores are compelled to stack containers higgledy-piggledy, resulting in containers from small importers or exporters becoming ‘buried’ in large stacks, thus becoming unavailable for delivery before the containers are accessible. Secondly, such behaviour is consistent with the ‘perverse incentives’ discussed under ‘gate passes’ to increase storage revenue.

When combined with inefficient charging structures, which create no incentive for stevedoring efficiency, the ‘buried’ cargo issue assumes considerable significance for users being ‘captive’ to the ‘in-port cargo storage’ system and any consideration of competition facilities becomes a sophistry. This problem affects export; import; and coastal cargo across the board and changing the pricing structure for use of the wharf and hard stand would create incentives for stevedoring efficiency which would minimise inefficiency, including the problem of ‘burying’ of cargo.

While economically correct, that storage charges should
(a) reflect economic costs; and

(b) operate as an incentive to users to reduce cargo ‘dwell’ time;

as PNG Ports submits, some other issues arise. First, it is a matter of economic principle that in effectively competitive markets, prices approach costs. In this case, that principle conflicts with the principle contended for by PNGPCL, that they should reflect economic costs, because of the ‘gifted’ assets issue, where PNGPCL has inherited these assets at no cost. Secondly, the concept of ‘economic costs’ imply ‘efficient costs, which have not been established in this case. Third, for reasons of PNG Ports own shortcomings, highlighted in submissions, or possible perverse incentives, ‘dwell’ times are increased well beyond those possible under efficient operational conditions – see earlier discussion on ‘buried’ cargo; inoperative PNGPCL equipment reducing port storage space; and perverse incentives applying to gate pass issuance. Fourth, there are Governmental policy issues. By ‘gifting’ land and all other assets at the time of corporatisation, without payment obligations on the part of PNG Ports for such assets, it is arguable that the objective of Government was to reduce, to the maximum extent possible, PNG Ports’ cost structure, with the implied intention that such savings be passed on to users, to boost national economic performance. If users are to pay economic costs, then, arguably, (a) they should only pay ‘efficient costs’ of the service; and (b) the supplier should pay such costs for its inherited assets, as is the general practice in most countries which have corporatized their business enterprises. In this respect, PNG Ports cannot ‘have it both ways’. The fact that the first regulatory contract issued by the Minister, who, at the time, was responsible for the regulation of SoEs under the ICCC Act, and provides for the exclusion of ‘gifted’ assets from the regulatory asset base, a key variable in the price regulation formula, supports such an argument. Furthermore, the stricture contained in the definition of ‘market’, in its definition in Section 33 (8), that it reflect ‘reality and commercial commonsense’ supports such a proposition which takes account of Government policy and the objectives of the ICCC Act, concerning the interests of citizens. It is almost inconceivable that the Minister would have intended that by ‘gifting’ all existing assets to PNGPCL at the time of
corporatisation, he would have had the objective of enriching PNGPCL, with the likelihood that a significant proportion of the ‘rents’ would be appropriated by management and staff, at the expense of the users of essential port facilities. These issues are yet to be teased out, as the Commission accepts that the issue is complex, but will persist in seeking an outcome in the best interest of the citizens of PNG.

Therefore PNG Ports has directly attributed to the congestion; firstly by reducing the quay face and space available; secondly goods get "buried" behind other goods due to reduced operating space available; and thirdly, failure to initiate efficiency-enhancing charging structures reducing incentives for stevedoring efficiency, including moving goods quickly and efficiently to reduce the incidence of ‘buried goods’ quickly. This in turn increases storage charges revenue to PNGPCL.

TIL is currently paying a congestion surcharge to its Shipping Company of US$167 per TEU due to port congestion. PNGPCL is responsible for the congestion therefore these fees.

**Riback Submission**

Riback submitted that in December 2012, PNG Ports publicized that they were opening a 30,000 m2 bonded storage facility called the 2 Mile Wakuc Storage Area. PNG Ports announced to shipping Lines, Stevedores and the general public that it would be a ‘Timeout’ Facility where cargo which was in storage at Lae Port for more than 14 or 28 days would be required to be moved.

However, PNG Ports subsequently advised its stakeholders that the planned storage area is now being leased to a ‘PRIVATE OPERATOR’ (Trans wonderland or TWL- Landowner company from Hides) which carry most of the LNG Plant cargo to the Highlands.

The fact that PNG Ports is now no longer doing anything about the long stay units at the Lae Port thus not alleviating storage problems at the Port (which in turn affect our productivity) is of serious concern to Riback Stevedores.

**6.1.4 Discussion on Storage Services**

The Commission’s draft report and findings clearly articulated the difference between international cargo and coastal cargo in the context of market definition and PNG Ports’ final submission adds nothing to this issue.

What PNGPCL fails to acknowledge, in the case of both, but particularly in the case of coastal cargo, that does not require Customs/NAQIA clearance, that gate passes are necessary. The failure by PNG Ports to provide data on the time required to obtain a gate pass is noteworthy. Arguably, that alone is sufficient to create a separate ‘in-port storage service market’ in which PNG Ports has a monopoly.

Furthermore, the charging structure issue which stultifies incentives for stevedoring efficiency, is likely to be a key contributor to longer ‘dwell’ times, particularly for ‘buried’ cargo.
The Commission considered that given the structure of the market for storage services within the port, most customers do not have countervailing power for storage services, in the accepted regulatory meaning of the term, in the sense of 'bypassing' or 'organising bypass' of PNGPCL facilities on a substantial and sustainable basis.

Therefore the Commission considered that the storage services market outside of the port precincts is quite separate from the market for storage services within the ports precincts. For storage customers that are required by law to undergo clearance procedures (mostly overseas inbound cargoes), the storage market that applies to these customers is confined to the port boundaries. This is because there is a lack of suitable substitutes and no countervailing power within the port precincts, which are customs controlled areas.

Whilst the Commission concurs in the use of a storage charging regime to maintain productivity at the ports, the Commission considered that storage should be a regulated service because it is an ancillary service to wharfage services; uses essential port facilities; and is a monopoly service; within the ports. Therefore it should be included in the regulated services basket of the regulatory contract and, if no agreement can be reached between the parties, an alternative regulatory approach is necessary.

Furthermore, the Commission was of the view that storage services should be regulated to ensure that PNG Ports’ significant tariff increases for services that are presently regulated are minimized in the future, which can be achieved through the rebalancing of revenues and costs to include those applicable to storage services for in-transit cargoes provided within port boundaries.

PNGPCL argued that storage charges are broadly comparable to those in other countries, providing some examples. The appropriate level of charges is a matter for future consideration, following acceptance and implementation of the regulation of port storage charges, whether within the existing price regulatory framework, or under a framework created by the invocation of declaration powers under paragraph 33 (2) (b), and no detailed examination of the issues are attempted here, save to say that the comparison provided by PNGPCL appears to be superficial. In Australia and Singapore, container terminals are leased and the lessee-operator pays rent for the land as well as invests in expensive container cranes ('portainers'); straddle carriers; computerized cargo tracking equipment etc. PNGPCL does none of those things and has been the beneficiary of receiving all its assets at the time of its corporatisation as a ‘gift’ as a result of Government policy. Recently acquired rubber tyred gantries are likely to be introduced in the future, but presumably their deployment would be on a cost-recovery basis. If their use is compulsory, clearly the applicable charges need to be regulated.

PNGPCL submits that the consideration of port storage facilities as a possible monopoly service is ‘extraneous to the Mid-term review of competition’, without providing any supporting argument. There is no obvious bar to consideration of such services in this review, which is concerned with ‘competition’, not necessarily with competition only in those services the subject of PNGPCL’s review request. This point was made in the Commission’s Draft Report, but, apart from the sweeping assertion above, it has not been addressed by PNGPCL.
PNGPCL has not made a convincing case about competing storage facilities. While very large customers can ‘bypass’ port storage facilities, that option is not available for all customers. Furthermore, the absolute limitation on availability of land means that apart from current storage operators, no new participants can enter, at costs that allow effective competition with PNG Ports.

The Trukai example as a competing storage service is not valid as that company is understood to only store its own product, apparently as a direct response to congestion in the port and has no intention of entering the storage market as a third party provider. Other transport operators operate bonded facilities, but can ‘piggy back’ on PNGPCL’s storage charges, thereby creating a situation of tacit price collusion.

Furthermore, PNGPCL has not addressed the delay in provision of gate passes, which are claimed by users to almost completely neutralise the ‘storage free’ days. The perverse incentive for such behaviour by PNGPCL, to maximise storage revenue, has been mentioned in the Commission’s draft report.

PNGPCL has strenuously argued, in the context of possible location of Customs scanning facilities near Motukea that the additional transport and handling costs would create a competitive economic advantage for that port. Yet, in the context of storage facilities, it dismisses such costs as part of the charge for the overall logistics service. Indeed, the delays in gate passes which require port storage beyond the period that should be necessary, combined with transport operators storage charges, effectively constitute a ‘double whammy’ for users. Put colloquially, PNGPCL ‘can’t have it both ways’.

Storage within the port precincts is clearly uncontestable in an economic sense, therefore the definition of storage as a contestable service in the Regulatory Contract is misleading and inaccurate because clearly storage within the customs controlled area of the port is confined to PNG Ports. The physical constraints do not enable others parties to have storage facilities within the PNGPCL wharf areas.

The Commission’s final view on storage is that the market for storage services within the port precincts is a separate market from outside bonded facilities due to barriers to substitution of such storage services by those outside the ports, particularly, but not exclusively, for customers that require customs clearance. Therefore, it is a monopoly service of PNG Ports. Whilst PNG Ports may argue that outside bonded facilities indicate that competition is working, the fact is outside bonded houses are for long term storage and there are clearly additional costs barriers associated with using outside bonded houses. Also according to the Riback submission, it is clear that outside bonded houses are for long term storage and not cargoes requiring immediate Customs and quarantine clearance. A minimum charge of K700 per TEU is understood to apply to the use of such facilities provided by an operator, with escalation beyond the duration to which the minimum charge applies. This clearly demonstrates the ‘switching’ costs involved.

The Commission is, therefore also of the view that port storage is not contestable because it
constitutes a different market to outside storage facilities due to the various barriers outlined above. There are no effective substitutes for the customs controlled areas of the ports for the overwhelming preponderance of cargo-shippers and consignees. Other practical barriers apply to coastal cargo, outlined earlier. This finding disproves the definition in the regulatory contract that storage service is a contestable service.

FINDING

The Commission’s finding is that the definition of contestable services is inaccurate and misleading because storage within the port is not contestable. Therefore storage services should be a regulated service under the relevant provisions of the ICCC Act or the Price Regulation Act.

6.2 PILOTAGE

As mentioned above, marine pilotage is an ancillary service to berthing and is an essential service provided to ships maneuvering within port limits and coastal waters declared as pilotage areas.

In 2011, the Commission noted that the provision of Pilotage services was limited to pilots employed by PNGPCL hence; there was in effect a PNGPCL marine pilotage monopoly within these declared ports.

The National Maritime Safety Authority (NMSA) is the mandated “Pilotage Authority” under the Merchant Shipping Act (MS Act), empowered to declare areas that are to require marine pilots and to licence such pilots. Pursuant to Section 197 of the MS Act, NMSA is authorized to delegate the power of appointing a person or entity to be a “Pilotage authority” in respect of a declared Pilotage area. Pursuant to Section 197 of MS Act, NMSA previously delegated PNGPCL to be the Pilotage authority at the following declared ports in Papua New Guinea.

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<td>Jomard Entrance</td>
<td>Madang</td>
<td>Wewak</td>
<td>Port Moresby</td>
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15 PNG Ports Corporation Ltd Website

16 There is a statutory difference between the “Pilotage Authority” being NMSA alone, and a “Pilotage authority” (with a lower case ‘authority’) which is the delegated entity, exercising powers delegated by NMSA, which is the ‘Pilotage Authority’ (upper case ‘Authority’).
Of considerable significance, the power capable of being delegated to the Pilotage authority (in this case, PNGPCL) was to licence pilots. The instrument of delegation by NMSA is understood to have purported to have delegated the power of licensing pilotage providers. If so, that delegation appears to have been ultra vires and the exercise of the purported delegated powers by PNGPCL, unauthorised and beyond power.

Of greater significance, in a competition context, in keeping with the ‘reality and commercial common sense’ stricture in the Act, PNGPCL did not authorize any pilotage providers, despite approaches from potential providers, nor did it licence any pilots not employed by itself. PNG Ports, however, exclusively provided pilotage services itself and licenced its own pilots exclusively; and those circumstances prevail currently, and for the medium-term future. These circumstances strongly suggested an anti-competitive purpose in a monopoly market, to foreclose competition.

The Commission could, of course, consider instituting proceedings for past alleged breaches of Section 58, cited earlier.

6.2.1 Market for Pilotage Services

During the 2011 Review of Domestic Shipping Rates, which was commissioned by the Department of Transport, the Final Report highlighted a significant increase in pilotage charges through a change in the charging regime for pilotage services. In particular, the Report noted that effective from January 2006, PNG Ports adjusted the charge for pilotage from a vessel length overall (LOA) rate to a Gross Registered Tonnage rate (GRT). This had the impact of increasing charges by up to 380%, as Table 4 shows for a typical vessel.

<table>
<thead>
<tr>
<th>Basis</th>
<th>Rate</th>
<th>K / Hour</th>
<th>Increase/Hour</th>
<th>Increase %</th>
</tr>
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<tbody>
<tr>
<td>LOA 102.5</td>
<td>0.96</td>
<td>98.4</td>
<td>~</td>
<td>~</td>
</tr>
<tr>
<td>GRT 4292</td>
<td>0.11092</td>
<td>476.07</td>
<td>377.67</td>
<td>383%</td>
</tr>
</tbody>
</table>

Source: Review of Domestic Shipping Rates-Final Report

The extent of the increase in pilotage charges clearly indicates the exercise of monopoly market power in the industry. Without an analysis of the costs of provision of pilotage services, it is difficult to say if the new charges are cost-reflective, but, in general terms, if pilotage were open to competition, such a large increase in pilot charges, would appear to be unlikely because of the risk

17 Department of Transport Review of the Domestic Shipping Rates-Final Report, p.43-44
of losing market share to competitors, if the previous charges reflected costs and approximated levels that would have prevailed in a competitive market.

6.2.2 Commission’s intervention

In its draft report, the Commission said that it was very concerned that a monopoly service provider in the market was empowered to licence pilots for its competitors – a situation which may have created incentives for the taking advantage of market power, which is prohibited by Section 58 of the Independent Consumer and Competition Commission Act 2002.

PNGPCL offered various reasons for continuation of the conduct of having exclusive delegation powers for licensing shipping pilots such as safety and the need for cross-subsidisation of loss-making ports and pilot activities. However the ICCC maintained that while the law supports the safety issues it did not provide for conduct which excluded competition in the provision of pilotage services in order to support loss-making activities, and there is no provision for its authorisation under the relevant legislation.

Safety is an important concern, but the Commission concluded that safety considerations do not preclude competition and the necessary safety standards could be met in a competitive market. Authorities responsible for safety need to ensure that safety criteria are observed by all licensed pilots, whatever the source.

Following correspondence and meetings between the ICCC, PNGPCL and NMSA, the matter appeared to have been resolved by NMSA resuming the function of licensing pilots. NMSA revoked PNG Ports’ pilotage authority delegation. The revocation was published in the National Gazette on 08th March 2012 (Gazette No. 92).

In its draft report, the Commission said that the problem had not been resolved. NMSA has not licenced any additional pilots for the claimed reasons that:

- A board meeting necessary to formalise licensing for pilots could not be called because the recent appointments of NMSA members has not been gazetted.

- The workload of NMSA, which is involved in the Commission of Inquiry into the sinking of the Rabaul Queen, has placed such a demand on staff resources that licensing of pilots could not be prioritised for immediate implementation.

This course of events raised serious concerns for the Commission as a competition regulator and merits urgent attention by the Government and NMSA.

Although NMSA informed the Commission on 15 June 2012 that the relevant requirements and standards had been approved by the NMSA Board during its meeting on 12 June 2012 and persons intending to carry out marine pilotage services could apply directly to NMSA, and if they satisfy the relevant the requirements, a licence would be issued, it is not known whether those who previously expressed interest in the provision of marine pilotage services have been informed of these developments. As of this date, no pilots have been licensed that are not employed by PNGPCL.
Until it is evident that the process for licensing marine pilots is open, based on clear, objective and relevant criteria, seen to be so and actually working, the Commission considers that an effective monopoly exists in that market and, therefore, it should be regulated.

More generally, this matter highlights the risks and costs of inappropriate regulation which results in anti-competitive conduct or structures in shipping and port markets, in turn leading to inefficiencies and increased costs which are passed through the transport chain to consumers.

Of particular concern in the context of the regulatory contract, as mentioned earlier, the definition of ‘Contestable services’ includes pilotage.

In attempting to introduce competition into the marine pilotage market, the Commission itself pointed out to the definition of contestable services in correspondence with PNGPCL, querying the basis of its constructive refusal to licence pilots of competing providers. In putting forward arguments supporting the continuation of its monopoly provision of marine pilotage,

PNGPCL responded as follows:

‘........I wish to put foward to the Commission some of the practical and anecdotal evidence from the industry in response to your assertion in the letter that “pilotage is a contestable service”.’ (emphasis added).

The clear implication in that response was that pilotage was not a contestable service (copy of letter attached as Annexure – confidentiality request rejected).

Those comments provide an insight into the approach of PNGPCL to competition regulation in general and to the provision of accurate information in particular. On the one hand, the monopoly over marine pilotage is staunchly defended on various grounds, while, on the other, the regulatory contract, required to be drawn up by PNGPCL and submitted to the Commission for review, purports to classify the service as contestable. Clearly, pilotage cannot be both, a contestable service for the purposes of the contract; and a monopoly service when PNGPCL is required to allow competitors to enter the market.

These facts strongly suggest that PNGPCL is prepared to use information asymmetry and those contract provisions that provide it with economic advantage, as instruments and strategies to resist regulation and competition, even when it is not entitled to do so, and interpret provisions as convenient to its commercial interests at particular times, even if they are inconsistent with its own interpretations at other times.

It is generally accepted that the information asymmetry that exists between competition regulators and regulated entities works to the advantage of the latter and that ‘gaming’ is not unknown in regulation. This example illustrates the need for care in the design and implementation of regulation.

PNGPCL informed the Commission that pilotage charges are
“...set and approved by the Minister responsible for Transportation matters through a notice in the National Gazette.”

It is not known on what basis charges are calculated; whether the process is transparent; based on industry and public consultation; or whether the criteria used are laid down by legislation or arbitrarily set.

The regulation of pilotage charges merits urgent review, given the level of recent increases identified in another part of this report.

The discussion of pilotage charges, as in the case of storage charges, is to flag the possibility of the Commission invoking its declaration powers under section 33 (1) (b), although further consideration needs to be given to the issue on the following points:

(a) Whether the current Ministerial price-regulation power takes precedence over the Commission’s declaratory powers; and

(b) Whether NMSA is able to organize itself quickly to licence competing marine pilots.

Once the question of primacy of price-regulation powers is settled, the Commission will give serious consideration to declaration of marine pilotage as a ‘regulated service’, given that its efforts in introducing competition have been frustrated for a considerable period of time.

The nation’s economic progress cannot be hampered by bureaucratic inefficiency; and ‘buck-passing’ of responsibility to frustrate the application of the competition law for their organisational benefit, at the expense of the nation.

PNGPCL was invited to provide details of revenues from pilotage fees and the proportion of total revenues they represent but it never did, primarily because it considers that this issue is outside the scope of this review.

SUBMISSIONS ON PILOTAGE SERVICES DRAFT DETERMINATION

PNGPCL Response Submissions

In its response submission, PNG Ports concurred with the ICCC that it is currently the only provider of pilotage services in PNG but it is of the view that this fact itself is not sufficient to conclude that PNG Ports has substantial degree of power in the market for pilotage services. There are no barriers to entry that currently prohibit any other pilot from seeking a licence from NMSA. There are also a number of pilot licensing exemptions which have been issue by the NMSA. Both facts are against the contention that PNGPCL has substantial degree of power in the market for pilotage services. Furthermore, PNGPCL argues that it is far from clear whether the price increases demonstrate an exercise of monopoly power. Furthermore since 2006 there has been only one additional change in
prices, which involved a change in the calculation of the charge from hourly rate to a fee per ship. PNGPCL claimed that apart from this change prices have remained constant in nominal terms and thus have decreased in real terms taking into account inflation. PNGPCL argues that it is far from clear whether it holds a substantial degree of market power, since the price increases in 2006 is of little to no relevance given the changes in price (or lack thereof) since that time.

PNGPCL considers that this issue would only be relevant to the extent that the current licensing framework posed a significant enough barrier to entry such that it could be concluded that as a result PNGPCL holds substantial degree of market power.

**IPBC Submission**

IPBC submitted that these functions have been transferred back to NMSA and PNGPCL is working closely with the team to ensure a smooth transition on this process with the secondment of officers to assist. Its Chairman is (also Chairman of NMSA) aware of progress been made to ensure that there is an independent licensing and supervisory role that NMSA will play in the operation of the pilotage service.

IPBC also suggested that rather than further price regulation which is what the ICCC is proposing, a better approach would be to allow the proper independent licensing and supervisory functions to be instituted and operated. IPBC is off the view that this is more likely to encourage new entry and competition rather than an approach which effectively locks in the incumbent service provider by using PNG Ports' cost base as the guide for setting pilotage price.

IPBC further highlighted that the Commission has already agreed to an interim arrangement for licensing and technical regulation of electricity service providers hence, a pilotage solution along this lines would be consistent and in the long term interest of the Nation.

**DISCUSSION ON PILOTAGE SERVICES**

PNGPCL clearly is a monopoly provider of pilotage services and this fact disproves that definition in the regulatory Contract that pilotage is a contestable service. This is because it has never issued pilotage licences nor actively encouraged competition in the industry whilst it was the delegated pilotage authority over the last 10 years due to its purported 'safety concerns'. As mentioned in the draft report, even a cursory examination of the delegation by NMSA strongly suggests that that delegation, insofar as it purports to delegate a power of licensing providers, has been ultra vires.

The changes to the charging regime by PNGPCL also indicate that it has substantial market power in pilotage services. This is because the changes in the charging regime had the potential to greatly increase pilotage revenue imposed on vessels. Had PNGPCL provided information about the revenue generated by pilotage services as requested by the Commission, the magnitude of the increase in revenue associated with pilotage services and the changes in its charging regime would have been clearly demonstrated.
The Commission acknowledged in its draft report that it was possible that the new charges were cost-reflective, as it had no evidence of costs, but invited submissions on costs. PNGPCL declined to provide such information.

Furthermore, PNG Ports argues that with the current changes to the pilotage regulatory framework, there are no barriers to getting a licence from NMSA. However to date, the Commission notes that NMSA has not issued any licence to interested parties nor has NMSA advised the public of the latest changes to the regulatory framework and the fact the pilotage services is now open to competition. This is despite the fact that NMSA revoked PNG Ports’ pilotage delegation back in March 2012—some 6 months ago (March 2012). Six month is a sufficient timeframe to put in measures to facilitate competition in the market. It is clear to the Commission that the licensing process is clearly not working properly hence, the need for price regulation given the fact that PNGPCL is the monopoly provider of pilotage services in the market hence, it has monopoly power.

Clearly the process of opening up the market to competition will drag on for a considerable period of time therefore the Commission’s final view is that price regulation is needed to ensure that PNGPCL charges are reasonable and not over the top. Furthermore with regulation, an appropriate charging regime can be determined for the industry and it can be benchmarked with other pilotage jurisdictions.

In Contrast to the IPBC’s view on using PNGPCL’s costs base in setting pilotage, the Commission has not received any submissions from PNGPCL on that point.

Furthermore, it is disappointing that the Department of Transport, which is said to have carriage of setting marine pilotage charges, has not made a submission to this review, despite invitation to do so.

Whilst the IPBC pointed out that a pilotage solution similar to the ICCC’s interim arrangement for licensing and technical regulation of electricity service providers, the ICCC contends that such a rationale by the IPBC is similar to a case where “apples are being compared to oranges”. This is because clearly these are two separate issues and scenarios. IPBC was right to point out that the ICCC’s technical regulatory functions for the electricity industry were delegated to PNG Power Ltd due to capacity constraints within the Commission. However, unlike PNGPCL when it was delegated with pilotage authority, PNG Power consistently issues licences to qualified electrical contractors that meet its requirements set for the industry. PNG Power continues to undertake this regulatory function at a significant cost to its business due to its genuine concerns about safety of the people of PNG and not trying to use safety as the reason to maximise profits at the expense of the people.

Unlike PNG Power when it was delegated pilotage authority, PNGPCL never issued a licence to pilots outside of its organisation hence it was a likely contravention of the ICCC Act. It was also clear that PNGPCL had a perverse incentive to do so because by licensing its competitors (as a player also in the pilotage market) it would lose revenue to its competitors.
Hence, the conclusion is difficult to escape that, contrary to the implicit argument in the submission by IPBC, the comparison appears irrelevant, as there is no evidence that PNG Power has taken advantage of its market power for a purpose proscribed by Section 58. In the case of PNG Ports, the evidence strongly supports an allegation that it has. The Commission will give further consideration to this issue.

PNGPCL submits that the consideration of the provision of marine pilotage as a possible monopoly service is ‘extraneous to the Mid-term review of competition’, without providing any supporting argument. There is no obvious bar to consideration of such services in this review, which is concerned with ‘competition’, not necessarily only with competition in those services the subject of PNGPCL’s review request. This point was made in the Commission’s Draft Report, but, apart from the sweeping assertion above, has not been addressed in any meaningful sense by PNGPCL.

PNGPCL concurs in the Commission’s view that it is the only provider of pilotage services, but denies that it has market power, on the claimed basis that there are no barriers to entry. The facts, however, show otherwise.

For a long period during its purported delegated power from the National Maritime Safety Authority of licensing of pilotage providers, section 197 of the Merchant Shipping Act does not and has not conferred on NMSA the power to delegate the power to licence pilotage providers, but only license pilots. PNGPCL arrogated to itself the right to provide pilotage services on claimed safety grounds by refusing to license pilots other than those employed by itself. That itself, in the Commission’s view, constituted a breach of section 58 of the ICCC Act.

PNGPCL now claims that “there are no barriers that currently prohibit any other pilot from seeking a licence from NMSA”. PNGPCL says that the Commission has not provided statistics about prospective entrants. It is not necessary for the Commission to do so; suffice it to say that the Commission has received complaints that new entry has been frustrated by PNGPCL in the past and is now being frustrated by the inability of NMSA to put in place standards and procedures for licensing new pilots. The Commission is concerned about the fact that NMSA has not licensed other pilots and there is little evidence that such licences for entry by new pilots is likely in the near future, despite applicants notifying it that they seek licences. Whether a licence can legally be granted is only part of the circumstances relating to entry barriers. The theoretical possibility of entry contrasts starkly with the practice on the ground, which indicates that no pilotage provider, other than PNGPCL, operates in the market, is a very relevant consideration and does demonstrate a practical barrier to entry. Put simply, if competitive entry and licensing were possible, it would have happened, given the interest in the market among potential entrants. Whether because of the inability of NMSA to fulfil its statutory functions, or for other reasons, the reality is that no new entry has occurred.

The Commission, in its draft report, pointed out, as PNGPCL emphasises, that there is no information to indicate whether the price increase for pilotage is cost-reflective. It asserts that ‘...it is far from clear whether the increase in prices in 2006 indicates an exercise of ‘monopoly market power’. Generally accepted industrial organisation practice is to assess whether, if a supplier
increases prices by between 5% and 10%, there is, or is likely to be, a switch to another supplier or product in volume proportionately greater than the price increase. Clearly, no such demand or supply response occurred. That is a clear indication of substantial market power. Moreover, PNGPCL does not indicate whether that price increase was cost-reflective or not. Clearly, it is within PNGPCL’s knowledge and ability to provide cost information to settle the issue. That it has chosen not to do so, is, in itself, significant. If the pilotage charges are cost-reflective, PNGPCL should have no concern about the regulation of those charges and, furthermore, would have said so.

As for there being no applications before NMSA, the Commission is aware of a number of interested persons wishing to apply, but because of the failure of NMSA to put in place appropriate arrangements, such as application forms, guidelines etc for a considerable period of time, there can be no confidence that competition will be initiated in the near future.

PNGPCL’s view that competition in pilotage is imminent, or that there are no barriers to entry into that market is in stark contrast to its entrenched opposition to licensing pilots of alternative providers, which led to the Commission’s intervention and public notice on the subject [attach copy of notice].

In the Commission’s experience a number of sections of the PNG bureaucracy apply regulation in a way that appears to be aimed at restricting entry and it is necessary to address such regulatory barriers as and when they are identified.

**FINDING ON PILOTAGE**

Pilotage is a monopoly service provided by PNGPCL by not licensing other pilots outside of its organisation to provide this service. The current Regulatory Framework whereby NMSA has taken back its licensing functions in accordance with the Merchant Shipping Act is not working therefore pilotage should be subject to price regulation in accordance with section 33 (2) b of the ICCC Act or other legislation empowering the Commission to do so.

The Department of Transport should inform the Commission of its role in regulating marine pilotage service charges and facilitate a smooth transition of the regulatory responsibility to the Commission.
6.3 PRICING STRUCTURES GENERALLY

In its draft report, the Commission said:

“The current pricing regime applied by PNGPCL is as follows:

- berth reservation charges based on a ‘per-booking’ amount;
- berthage charges based on berth occupation time and overall length of vessel;
- wharfage charges based on per unit rates for:
  - container size/break-bulk tonnes;
  - passengers;
  - head of livestock (with different rates for different livestock)

From an economic view point, pricing by PNGPCL should seek to:

- recover the total costs associated with the provision of services by the particular asset or group of assets;
- recover the total costs, including a reasonable return on the incremental investment in relevant assets, from all infrastructure port services provided by PNGPCL
- encourage efficiency by creating incentives for productivity in the use of its facilities.

The Commission has no difficulty with berthage charges based on berth occupation time and overall length of vessel. Such a charge sends the right signals for minimization of occupation time for the use of scarce facilities and fits well with the above principles.

The wharfage charges, however, are highly inefficient in sending the right signals to improve productivity and competition in stevedoring. They essentially amount to a ‘tax’ by charging per unit, thereby failing to encourage maximisation of the number of units loaded/unloaded.

PNGPCL has repeatedly mentioned its objective of improving stevedoring efficiency.

What better way to improve efficiency than by creating the right incentives? If a time-based charge is used to recover costs from ‘landside’ assets, thereby encouraging stevedores to maximize throughput to minimize unit costs, that best achieves the objectives of efficient pricing.

For example, a shift-based charge; or a charge per day, would encourage stevedores to maximize the economic benefit from usage of the facilities by maximizing throughput and thereby minimizing unit costs related to use of the facilities.
In discussions with the ICCC at various times, PNGPCL indicated that various complex incentive structures for pricing were being considered e.g. discounts for productivity beyond certain ‘base’ levels. In the Commission’s view, such pricing structures are difficult to monitor and have only limited efficiency-enhancing features, because once the ‘base’ measure has been passed, no further incentive exists for the quantum of the ‘above base’ throughput, which, albeit, is charged at the reduced rate, which constitutes a limited incentive.

The simplest and most effective efficiency-enhancing pricing structure in the Commission’s view is a time-based charge, corresponding to the charge for berthing.

Such a ‘landside’ charge would do much more to reduce vessel congestion and berthing waiting times than the current hybrid berthing and wharfage charges. This charging approach would achieve another professed goal of PNGPCL – reducing cargo dwell times at its port precincts. Stevedores would have a strong incentive to enhance throughput and, to do that, they would ‘pull out all stops’ to facilitate clearance of cargo – they do not currently have an incentive to do on a ‘competitive’ basis i.e. for ship-owners other than those who have ownership interests in the particular stevedoring company; and for the cargo-shippers/consignees who are the customers of those ship-operators.

A consequence of the proposed charging structure, therefore, is that stevedores would have a far greater incentive for handling cargo effectively to create space for additional throughput. Stevedoring efficiency would also become a consideration of ship-operators who could divert their business to those stevedores who provide the most efficient service and turn-around times for their vessels.

Stevedoring competition, of course, is a complex issue and pricing incentives are only one of a range of factors which include market structure and the conduct of competitors, which influence competition and, thereby, efficiency. While those issues need to be examined, port pricing structures are a necessary condition and a key starting point, though not, of itself, a sufficient condition for stevedoring efficiency.

Of course, the issue of Customs/NAQIA clearance times and gate pass processing times would need to improve to keep pace with the increased cargo handling efficiency and throughput, else the bottleneck merely shifts to another point in the transport chain.

Such pricing changes require the agreement of PNGPCL in the current regulatory framework. In the Commission’s recent experience, PNGPCL has not shown itself amenable to efficiency-enhancing improvements.

In practice, the ‘approved tariff’ is the operative price regulatory instrument. The tariff elements documented in the contract could be argued to be conclusive of regulated services and, for the duration of the current contract, a strict application of the law and regulatory contract would brook no change to the tariff elements, thus probably ruling out the inclusion of pilotage and storage services within ‘regulated services’.
The economic cost to the nation, however, is so significant that failure to institute efficiency-enhancing changes would hold back the nation’s economic progress and the improvement in the living standards of its people.

Hence, the Commission is exploring the possibility of using its powers to declare cargo storage services at ports and marine pilotage services to be ‘declared services’ under paragraph 33 (2) (b) of the ICCC Act”.

Trukai Industries Submission

TIL submitted that it would strongly support a change in port charges that encourages efficiency by creating incentives for productivity. TIL currently pays per metric tonne of product and/or FCL moved. This does not encourage productivity as the stevedore will get paid regardless of how many units are moved per hour.

TIL agrees that stevedores require a further review to increase efficiency and reduce costs. Also its current view is that PNGPCL should operate as a landlord, not a quasi-port operator.

6.3.1 New Services

PNGPCL has acquired a number of rubber tyred gantries for its Port Moresby and Lae ports, but has not provided any indication as to whether the services they are to be used to provide are to be directly provided by PNGPCL to ship-operators or stevedores, or whether the equipment is to be made available to stevedores for use in their stevedoring and handling businesses on the basis of hire.

Two issues arise.

First, if the RTGs are to be used to provide services directly to ship-operators, to the exclusion of the use of other equipment which provide a similar service, whether owned by stevedores or third parties, for the provision of relevant services, the charges for the RTG services need to be regulated, on the basis that the services would be provided on a monopoly basis.

If the equipment is to be used to provide services to stevedores, on a compulsory basis (that stevedores must use the equipment in cargo handling work), then again the charges need to be regulated.

If the equipment is to be used to provide services to stevedores, but on a voluntary basis (that stevedores may, if they wish, use the equipment in cargo handling work, but are not bound to do so), then the charges need not be regulated.

In either case, PNGPCL would need to employ drivers for the equipment and the lack of accountability of such labour to stevedores creates an impediment to efficiency.

If the equipment is to be hired to stevedores, regulation of hire charges would, again, depend on whether use is compulsory or voluntary.
In the two cases of voluntary acquisition of services by stevedores from PNGPCL (i.e. either purchase of services or hire of equipment), issues arise about the likely rate of usage, productivity and prudence of investment.

There is also the question whether the RTGs have been purchased from PNGPCL’s own resources or have been provided by budgetary subvention. It is not clear at this stage whether the National Government provided the funding for the RTGs. The national budget papers for 2011-2012 show an allocation of K30 million to PNGPCL for the acquisition of mobile harbour cranes. Whether they are the RTGs needs to be established, although, normally, cranes and gantries are not the same. The relevance of budgetary funding is that in any price determination for the provision of services utilizing assets funded by the Government, the value of those assets need to be excluded as ‘gifted’ assets.

PNGPCL was invited to provide further information about the use of the RTGs but it did not do so.

6.4 DEFICIENCIES IN THE REGULATORY CONTRACT

6.4.1 Incentive regulation
The regulatory contract is said to be based on incentive regulation principles. However, the only incentives appear to encourage investment. Where investment is prudent, that is laudable. The regulated entity is rewarded (the carrot) with more revenue and higher prices to earn that revenue in order to facilitate further investment. In fact, there is no incentive for PNGPCL to reduce costs. If investment is prudent, then that should translate into efficiency gains (lower costs) and, therefore, in theory, lower prices. The consumer and the economy at large benefits. If fall in costs are higher than the fall in prices then PNGPCL should earn higher profits. However, incentives for investment alone, without more, could lead to unnecessary or inappropriate investment.

There is a role for Commission assessment of the quality of investment, but, because of unrealistic time-frames in the Contract, there is little scope, in practice, for the Commission to make an effective evaluation of investment decisions, priority and sequencing of asset acquisition, and the efficiency of the acquisition process in terms of value for money.

Price cap/Revenue cap/Rate of Return
PNGPCL argues that the Commission's Draft Report is erroneous in describing the contract as incorporating a regulatory regime based on a revenue cap, claiming that the ‘weighted average price cap’ or ‘tariff basket approach’ reflects an incentive-based price regulatory approach, with PNGPCL bearing the volume risk. Elsewhere, in its final submission, it refers to ‘rebalancing control’; ‘overall price control’. Furthermore, the Contract itself provides for price regulation based on a weighted average cost of capital; estimates of throughput, upon which the ‘tariff basket approach’ is based; overall revenue assessments; a regulated asset base as a starting point for calculating allowable revenue; CPI adjustments and other features which characterise rate of return regulation rather than incentive regulation. The fact that the contract advocates incentive regulation, of itself, is not probative of the actual type of regulation it specifies. The regulatory principles under schedule 5 clause 2 of the Contract states that PNG Ports must be regulated using an incentive regulation.
approach. In that sense, there is an inherent contradiction within the contract itself. PNGPCL itself describes the price cap form of price regulation as “restricting annual price movements for the business usually measured as annual revenue divided by annual volume throughput”. This is indistinguishable, in a practical sense, from a revenue cap approach, on which it is based, both of which form ‘rate of return regulation’, characterised by fixing of an annual revenue cap, calculated to allow a return based on the WACC on the allowed regulatory asset base, but converted into a tariff schedule.

Of course, under the price cap basket, PNGPCL does bear the risk of volume variations, but in an economy which is growing, that is hardly a risk, given the absence of inter-port or inter-modal competition due to lack of, or the poor condition of, roads. That situation is unlikely to change as demonstrated by the demand data from PNGPCL for the last three years (2009-2011).

<table>
<thead>
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<th>2011</th>
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<td>Cargo throughput (revenue tonnes)</td>
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<td>vessels calls</td>
<td>6,177</td>
<td>6,985</td>
<td>7,675</td>
<td>24.3%</td>
</tr>
</tbody>
</table>

Source: PNG Ports Schedule 6 Regulatory Reports

While the regulatory contract expresses the intention of incentive regulation, the use of a WACC, applied to a regulated asset base, even though that is fictional, being derived from a revenue allocation formula; a revenue cap; derivation of a tariff schedule based thereon; all constitute ‘rate of return’ regulation. The fact that the formula uses an ‘X’, is deceptive, being an inflator for the two categories of ports, rather than representing an efficiency factor, in true incentive regulation. Thus, the contract appears to attempt to give the impression of incentive regulation, through ‘form’ and use of an ‘X’ factor, which is not what it seems, while, in fact and substance, constituting ‘rate of return’ regulation.

The Commission’s proposal, initially agreed to by PNGPCL, but subsequently abrogated by it, which was to review the entire pricing structure to introduce incentive-enhancing methods of pricing, rather than efficiency-stultifying structure now in place for cargo-related charging, would have avoided such classification issues, the practical application of which have far-reaching consequences for efficiency losses.

Incentive regulation, used in much of the western economies, largely applies to operators which are privately owned, rather than State-owned enterprises. The latter have little, if any, incentive to increase efficiency and deliver lower prices; rather the incentive is to enjoy the ‘easy life’ through higher staff numbers; higher salaries; better perquisites of office and generally, benefit employees and management, who reap economic rents at the expense of customers or the shareholder, being the State.
Operating expenditure.

In its final submission, PNGPCL claimed that the system of regulation is ‘incentive regulation’ and that implies that regulation of operational costs and other proposals by the Commission in its draft report, amounts to ‘rate of return’ regulation. A number of points need to be made about this and the discussion below explores this issue, together with PNGPCL’s claims that it has an incentive to limit operating expenditure below the benchmarks identified in the contract. For three reasons, those claims are invalid. First, although the operating expense is one of the building blocks in the calculation of the price path, very little or no attention is paid to it. The primary focus is on capital expenditure, where the WACC is applied to the regulated asset base (RAB) to determine the return on capital. This forms the basis of calculation of regulated revenue and the charges for specific services with no regard to operational expenditure even though operational expenditure is included as one of the building blocks. The positive X factors generated by the building block WACC model are not the true X factors and tend to favour PNGPCL. When capital expenditure is found to be prudent, then PNGPCL is rewarded with more revenue through higher prices. Prudent investment is supposed to, at some point, translate into efficiency gains and lower prices and should also benefit PNGPCL in terms of higher profits. It is PNGPCL that benefits from this type of regulation and not the consumer and the economy at large. This is not true incentive based regulation. Secondly, the lack of regulation of charges for such services as marine pilotage and storage, which, as analysed in the Commission’s draft report, constitute services by a provider with substantial market power, means that (a) revenue from those services could offset blow-outs in operating expenditure in regulated services; and (b) operating expenditure, unless properly allocated among various service provision heads, under generally accepted costing principles, allows ‘fudging’ and transfers as between services. Finally, the lack of incentive for staff and management of state-owned enterprises to deliver returns to the shareholder, while maximising their own benefits, has been alluded to above and limits the incentive to reduce costs in the delivery of regulated services.

Whilst this is the Commission’s current position, the Commission takes note of PNGPCL’s letter of 31st July 2012, that over the next six (6) months this issue, among others, will be further discussed prior to the re-set of the next regulatory Contract, which is still two and half years away.

6.4.2 Unrealistic time frames for Commission assessment and determination

The mid-term capex review specifies the latest possible date for provision of information by PNGPCL as 31st August 2012. The Commission is required to make its determination by 31st October. A period of ten days is provided for the Commission to notify a need for an international consultant to conduct the capex review, at the cost of PNGPCL, following receipt of information from it. There is no time limit for PNGPCL to agree to that proposal. Even if the Commission notifies PNGPCL in advance, as it has done, PNGPCL is under no obligation to expedite the process and, in fact, it has refused to do so. At the maximum, the Commission has two calendar months to assess complex information and conduct verification work, including inspections, to satisfy itself as to the fact of, and prudence of, investment. Given the limited financial and staff resources provided
to the Commission and its wide range of responsibilities, there are serious issues in managing the workload under such tight time pressures.

Similarly, the time frame for completion of this competition review is two months. Given the limited resources of the Commission, the extent of investigation and depth of analysis is necessary limited.

The contract needs to provide realistic time-tables for effective regulation.

### 6.5 CONFLICT OF PNGPCL’S REGULATORY POWERS WITH COMPETITION

From an economic perspective, the key policy basis for regulation, PNGPCL’s regulatory functions, which cover services such harbour towage, stevedoring and pilotage, also affect the market for port services within Fairfax Harbour in terms of the ability of other potential service providers to compete broadly and effectively in the market, so that overall costs in the shipping and land transport chain are as low as they could possibly be, to maximize efficiency and national economic performance. Each of the above services and the competition implications of each are discussed separately below.

#### 6.5.1 Harbour Towage

In its draft report, the Commission raised certain matters relating to the harbour towage markets as follows:

PNG Ports is vested with harbour regulatory functions through delegation from the Department of Transport. As part of its regulatory functions, PNG Ports also regulates towages services.

PNGPCL’s market power in markets not subject to regulation by the Commission is significantly driven by its harbour regulatory functions.

The Commission noted from the 2010 non-regulated tariffs schedule that PNG Ports licenses tugboats as follows:

<table>
<thead>
<tr>
<th>SERVICES</th>
<th>Kina Ex GST</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>License – Berthing Tug – New or Renewal</td>
<td>5,000.00</td>
<td>Year x No. of Tugs x Rate</td>
</tr>
</tbody>
</table>

There are some aspects of towage regulation which give the Commission considerable cause for concern.

It is not clear whether the requirement for a tug, and if so, the technical requirements (e.g. bollard pull; engine power; or capability of navigational movements per minute) are specified by the ship's Master, Pilot or PNGPCL. The marine pilotage market itself is a monopoly market in the hands of
PNGPCL and the specification right for provision of towage may well be relevant to the structure of the towage markets in PNG.

The Commission sought information from PNGPCL as to the regulation it applies to towage and tugboats, having established from NMSA that the latter does not regulate the provision of towage services.

In response, PNG Ports stated

“......to comply with Section 39 of the Ports (Management and Safety) Regulation 2010, we have in draft form a tug policy to manage the tug services in the ports for berthing and towage. The table above provides the latest update of the tug positions owned by Pactow at the ports for which Permits have been issued upon payment of the required fees.

“At this stage, there is no updated information on any other tug providers however this information will become available when companies put in applications to also provide tug and mooring services at our declared ports. Companies like Islands Shipping of Rabaul and Bismark Maritime Ltd of Lae do own tugs but these are used for towing services at the outer ports and for salvage operations.

“In the draft policy, all tug operators within a declared port will be issued a permit to operate by the PNG Harbour management Services. This permit will impose regulatory requirements which the operators must satisfy before a permit is issued to ensure the continued safety and security of tug services. Also, note this policy is in draft format however much of the content will remain.”

While the response states that permits have been issued upon payment of the required fees, no answer was provided to specific questions as to whether any licensing requirements apply to the provision of towage services; and whether technical specifications currently apply to tugboats. In the absence of specific criteria for licensing, the inference is available to be drawn that the permits issued to the one incumbent have been issued arbitrarily.

The response provided raises more questions than it answers. It does not indicate, for example

• whether new entrants have tried to enter the market and, if so, the response(s) provided to them;
• for what period of time the draft policy has been in preparation;
• the contents of the draft policy;
• whether the draft will be released for public consultation;
• when the policy is likely to be finalized; and
• whether the policy is likely to allow competitive provision of towage services.

PNGPCL is subject to the prohibitions in the ICCC Act against anti-competitive conduct and taking advantage of market power, under the market conduct rules. If the evidence supports the
likelihood of a breach of the ICCC Act, the Commission will, of course, explore enforcement options, including litigation.

6.6 PNGPCL’S APPROACH TO COMPLIANCE WITH ITS LEGAL OBLIGATIONS

Below are examples of the approach by PNGPCL to compliance with its legal obligations.

6.6.1 Stevedoring Services

PNGPCL licenses stevedores under delegation from the Department of Transport. Licence fees are charged for such licensing. It is not clear whether the fees are limited to recovering costs or recover more than the costs incurred in the function. Hence, the charges for licensing stevedores merits scrutiny.

In discussions with ICCC staff, PNGPCL indicated that it would not licence additional stevedores for fear of objections from landowner groups.

While PNGPCL does not compete in the stevedoring markets, it is inappropriate for an entity exercising regulatory functions to subordinate the public interest to private landowner interests. Such anti-competitive regulation constitutes a substantial detriment to the public interest by stifling efficiency; maintaining charges at higher levels than they would otherwise be; and seriously hampering national economic development and efficient resource allocation and reducing living standards by ‘knock-on’ effects on prices throughout the economy.

SUBMISSION RECEIVED IN RELATION TO STEVEDORING

The Commission received a number of submissions on this Competition Review which highlights some issues of concern regarding the current state of stevedoring services in operation.

NAQIA Submission

NAQIA as a bio-security organisation responsible for safe guarding the bio-security status of PNG aims in ensuring that the country is well protected from pests and diseases by permitting and screening all incoming and outgoing goods of biological nature. In addition to inspections at any port of entry, NAQIA also undertakes pests and disease surveillance activities throughout PNG often in collaboration with other PNG national agencies.

NAQIA has argued that in many cases, NAQIA has been blamed for the prolonged delays and storage cost charges that the shipping companies, business houses pay when in fact these delays are caused by the Customs Clearing Agents themselves or other agencies involved in the clearing process. It is often fashionable to blame any government agencies such as NAQIA or Customs when agencies fail to play their roles effectively, resulting in their clients pointing fingers to either NAQIA or Customs.

NAQIA also noted that due to the limited space available at the wharf, it is encouraging customs clearing agents to have their own bonded yards so that inspection of cargoes can be done at their
own time and convenience. This greatly would reduce the overcrowding at the seaports of Port Moresby and Lae.

**Riback Stevedoring Submission**

Riback Stevedoring has argued that, although PNG Ports in December 2011 had publicly informed the stevedoring companies, shipping lines and general public that it has opened a bonded storage facility, called the Wacuk Storage area to be used as a ‘timeout facility’ where cargoes stored for more than 14-28 days were required to move, it has never eventuated. Instead the area is now being leased to a private operator (TransWonderland or TWL). It was also noted that the contract for provision of transport and forklifts services was given to East West Transport without a public tender.

**Trukai Industries Submission**

Trukai Industries Ltd has stated that the stevedoring operation currently in PNG requires further and thorough review to increase efficiency and reduce costs. Trukai’s view is that PNGPCL should operate as a landlord, and not as a quasi-port operator.

**Commission’s Views**

The Commission notes and acknowledges some of the issues raised in the submissions concerning the stevedoring services which involves and not limited to;

- Delays in moving cargoes for quarantine inspections are partly caused by Stevedoring Companies, not being effective in its operations,
- Limited number of forklifts by stevedoring companies causing delays at Port Moresby Wharf with forklifts drivers giving preferential to certain clients, and
- Stevedoring operations needs to be reviewed for possible anti-competition, cost reduction and efficiency in service delivery
- Failure of PNG Ports to deliver on the ‘time-out’ yard storage services;
- Failure of PNG Ports to conduct tenders for supply of stevedoring equipment.

**FINDING**

Stevedoring services could constitute a significant part of the inefficiencies and high storage requirement and cost problem for most of the shipping lines and companies and other users. In order to alleviate possible anti-competitive behaviour and to increase efficiencies in its service delivery, a further review into stevedoring operations as well as its licence issuance needs to be conducted. Most of these problems could be obviated by an incentive –based charging methodology by PNG Ports for the use of its facilities for cargo handling, rather than the current ‘tax’ based wharfage pricing structure.
6.6.2 Information provision and contractual obligations

PNGPCL is required under the regulatory contract to provide information by a certain date, including the tariffs proposed for the forthcoming year. Such information forms the basis of the Commission's monitoring of performance by PNGPCL and, is intended to form the basis for the Commission to verify the data submitted in support of the tariffs proposed, where appropriate. Where the submission is made by the stipulated date, the Commission is bound to either approve the tariffs or, where justified, make a determination substituting its own tariffs, by a nominated deadline. Where the submission is not made by the stipulated date, the Commission is not bound to either approve the proposed tariffs or to determine the tariffs that should apply for the next year, by any deadline.

In the actual circumstances outlined below, where PNGPCL failed to meet its contractual obligation stipulated above, a consequence of such withholding of approval or determination of charges is that PNGPCL would have been unable to impose any charges for regulated services once the new year began. So, leaving aside the issue of higher charges and revenue arising from the ability of PNGPCL to impose the charges proposed by it to the Commission, its existing revenue for regulated services would have been nil. Such an outcome would have been catastrophic for PNGPCL's business.

PNGPCL did not make its submission by the stipulated date in 2011, for tariffs to apply in 2012. When the submission was made, there were some errors, which were subsequently corrected. The regulatory contract requires the provision of full and accurate information specified in it. The Commission did not consider the time available for verification of all data and assessment of the proposed tariffs or the determination of appropriate substitute tariffs to be sufficient. To avoid undue disruption to PNGPCL’s business, however, which, as outlined above, would follow from its inability to make any charge for regulated services from 1\textsuperscript{st} January 2012, if the Commission did not make a tariff determination before that date, it met with PNGPCL Officers, including its CEO, and, in the interest of protecting PNGPCL from the catastrophic consequences of strict observance of the letter of the contract, proposed that the Commission approve the proposed 2012 tariffs on the condition that a review of the regulatory contract be undertaken in 2012 to address the following key issues:

1. Review of the existing pricing structure to enhance efficiency of stevedoring;
2. Review cost allocation methodology;
3. Review operating expenditure to enhance efficiency;
4. Revisit and review the definitions of regulated and non-regulated services; and
5. Commence work in relation to the mid-term capital expenditure review before the scheduled date;

PNGPCL, including its CEO, agreed at that meeting to the review proposed by the Commission as a condition of approving the 2012 tariffs proposed by PNGPCL. A letter outlining the offer invited
PNGPCL agreed in writing and suggested an expanded review and, on that basis, the 2012 tariffs proposed by it, was approved by the Commission.

At a meeting to discuss the modalities of conducting the agreed review, however, the Commission was informed by PNGPCL that it had decided not to proceed with the agreed review. That position was confirmed in writing in the following terms:

“I refer to the correspondence between ICC and the former CEO of PNG Ports Corporation Limited (“PNGPCL”) dated 09 January 2012 on the reopening of the Regulatory Contract.

“I further advise that after careful consideration of section 9 of the current regulatory contract the board and management have since decided that the position taken by the former CEO is contrary to the spirit and intentions of the current ICCC Regulatory Contract and the ICCC Act.

“As such PNG PCL hereby confirms that the previous decision is not in the best interests of the company. Therefore we cannot agree to a reopening of the existing PNGPCL Regulatory Contract. This letter hereby formerly [sic] conveys our decision to withdraw the previous undertaking for a reopening of the current Regulatory Contract”

Serious issues arise from the behaviour of PNGPCL, which may have implications for the whole gamut of regulation of SoEs, for which the Commission is responsible.

Regulatory contracts are binding on both parties. Failure to make submissions on time, or to make accurate accounting returns, constitute breaches of the contract, both of which characterized PNGPCL’s submission in 2011.

Having agreed, both orally and in writing, to certain conditions of tariff approval, PNGPCL secured the Commission's approval, but then reneged on its agreement, after the tariff approval was granted.

Quite apart from the regulatory contract, an agreement by both parties for valuable consideration is enforceable under common law contractual rights.

Without the agreement, the Commission could easily have withheld its price determination indefinitely, thereby putting at risk the entire regulated business components of PNGPCL’s revenue. As a responsible regulatory authority, however, the Commission put forward a proposal in the national interest and, without coercion; PNGPCL accepted it, thus constituting a binding contract under common law, to amend the regulatory contract.

As a responsible regulator, the Commission informed PNGPCL’s shareholder, the Independent Public Business Corporation (IPBC); the relevant Ministers responsible for PNGPCL’s activities; the heads of departments and agencies reporting to those Ministers; and the boards of directors of both
enterprises; as stakeholders with a real and legitimate interest in the matter, of PNGPCL’s behaviour.

In response, however, among other things, IPBC replied as follows:

“...the ICCC has taken no action to enforce the regulatory contract under section 38 of the ICCC Act despite having formed the view that Ports is contravening or is likely to contravene its regulatory contract – the words used in section 38 (1).”

Section 38 (1) however is merely a notice provision, intended to bring to the attention of a regulated entity, a breach or likely breach of the contract, with the clear objective of remedying or avoiding an actual or potential breach. In the circumstances under consideration, PNGPCL was well aware of the breach, hence any notice would have been otiose. Further, it had agreed to a process proposed by the Commission as a way to avoid a catastrophic destruction of PNGPCL’s business, both orally, and in writing, and then blatantly proceeded to renege on its commitment.

While litigation by a Government regulatory authority against another Government instrumentality is generally undesirable, special circumstances may justify such action such as a significant public interest in securing compliance with regulation aimed at improving national economic performance. The Commission has been in the position of defending legal action brought by Telikom in the past, but not in the position of initiating action against a State-owned enterprise and is considering the issues carefully. It certainly has not eschewed its rights to take legal action in this matter.

In light of the above background, the Commission considers that the request for a competition review and pricing change needs to be examined more broadly than the limited scope of the issues contained in the request by PNGPCL.

No submission was provided by PNG Ports on the issues above outlined in the Commission’s draft report.

**SUBMISSIONS**

**PNG Ports Response Submission**

PNG Ports Corporation Ltd (PNGPCL) is of the view that it should be entitled to offer price and non-price terms and conditions of service to particular customers or customer groups in order to compete for demand when certain conditions are met.

PNGPCL further noted that there is lack of clarity in the current PNG Ports Regulatory Contract (Contract) as to the ability of PNGPCL to diverge from tariff and conditions of service in the Schedule and any circumstances under which this would be appropriate. There needs to be flexibility or a mechanism in place that would allow a re-opening of the Contract or appropriate adjustment to the regulatory settings as and when there is direct competition by Curtain Brothers
or when the Deed of Agreement between these two players (PNGPCL and Curtain Bros) are terminated or varied.

6.6.3 Reasonable regulatory process

PNPCL expresses concern about ‘reasonable regulatory process’ in the Commission’s intention to enlarge the scope of issues under the mid-term review of competition, indicating concern about regulatory uncertainty and pointing to processes available under the contract to do so.

A number of points are relevant here. First, any amendment of the regulatory contract requires both parties to agree to it. This avowed allegiance to the sanctity of the contract sits uncomfortably with PNGPCL’s own failure to comply with its requirements, as outlined in the Commission’s draft report. Furthermore, having agreed to its amendment to secure price increases that it otherwise would not have been entitled to, it has reneged on its undertaking to review certain key aspects of the contract. Such behaviour gives the Commission little confidence that the mutually agreed amendment process, which requires good faith on both sides, offers any realistic prospect of amendment in the public interest.

In addition to any agreed amendments or variations to the Contract, the regulator must at least within 40 days prior to the agreed amendment taking place, publish a public notice and National Gazette to the general public, inviting submissions regarding the proposed variation, not less than 20 Business Days after the date of publication of that notice. A written notice will have to be provided to the Minister responsible for the Harbours Act also and that the regulator must ensure that copies of the precise form of variation be made available for either inspection or purchase by the general public. No variation will be made to the Contract unless the regulator has considered any submissions to the proposed variation as it receives.

6.6.4 Regulated Services under ICC Act; Regulatory Contract; and Prices Regulation Act

Without regurgitating PNGPCL’s lengthy submissions on these matters, essentially it is arguing that services regulated under a regulated contract cannot also be regulated under the PRA; nor can they also be declared under the ICC Act.

PNGPCL is right in that assertion. What it fails to understand, or concede, is that the services regulated under the regulatory contract, on its own submission and argument does not include marine pilotage and storage services. Hence, since they are not regulated under the regulatory contract, there appears to be nothing in law to prevent them being (a) declared for the purposes of regulation under the ICC Act, or, (b) if necessary, under another regulatory contract; nor (c) regulated under the PRA.

One of the arguments by PNGPCL regarding appropriate regulatory process is that inquiries preceding decision-making by the regulator under the ICC Act, or the Minister, under the PRA, are usually lengthy, often taking a year's time. The relevance of that argument is difficult to see. If a process can be undertaken more efficiently and quickly in the public interest, it is perplexing that
an argument should be raised that a more time-consuming process should be adopted because it is regarded as being, somehow, better in ‘regulatory process’ terms.

**IPBC Submission**

From its submission, the Independent Public Business Corporation (IPBC) has fully supported PNGPCL response to the Draft Report. IPBC’s main concern was the legality of the actions proposed by the Commission in the Draft Report for the next regulatory period. A precautionary measure is needed if ICCC is to maintain its current high profile as there are appeals provisions and Ministerial discretion issues that some of the options being proposed would bring into play. However, IPBC did not specify the nature of any illegality in the Commission’s proposed actions.

**Commission’s Views**

The Commission notes and understands the roles and powers it has under the *ICCC Act 2002* that is required to effectively perform its duties. After consideration on the decision on the submissions received, the Commission is of the view that there is a need to examine the current basis of regulation more broadly than what has been discussed.

As a responsible regulatory authority, the Commission is also mindful of the legitimate business interests of PNGPCL going forward and if need be re-open or amend the current Contract to allow flexibility or include a mechanism in the Contract to ensure that there is direct competition for demand for the Essential Port Services.

### FINDING

The Commission determines that the issues highlighted by PNGPCL needs to be examined and analysed more broadly and that a mechanism or clause inserted in the Contract to allow flexibility for re-opening of the Contract to ensure that there are regulatory safeguards for users of all essential port services.

#### 6.6.5 PNGPCL’s objectives and role in the national economy

As has been observed in relation to PNGPCL’s request for approval of discriminatory pricing; its resistance to the introduction of competition in the provision of marine pilotage services; its opposition to the inclusion of storage services in the regulation framework; its reluctance to introduce efficiency-enhancing pricing structures (discussed below); and its abrogation of its agreement to have certain aspects of the regulatory contract reviewed, in consideration of the Commission allowing the price increases for 2012, despite PNGPCL failing to fulfill its obligations to lodge information it was required to lodge by the contractual due date, there is a serious issue about PNGPCL’s perception of its objectives and the role it is expected to play in the national economy.
PNGPCL’s attempts to vary its pricing regime to maximize profits and position itself to prevent competition, and eliminate any possible incipiency of competition; maintain its monopoly on marine pilotage; avoid the inclusion of storage services in the regulatory regime; and resist efficiency-enhancing pricing regimes; strongly suggest a profit maximization objective.

The regulatory regime, on the other hand, is intended to curb the ability of ‘enabling’ infrastructure industries to exploit their market power to increase prices and profits above and beyond reasonable costs, including an appropriate return, at the expense of the national economy.

The endowment of ‘legacy’ assets at no charge to PNGPCL at its formation and subsequent budgetary subventions clearly indicate a public policy designed to reduce infrastructure charges so as to contribute to achieving the goals of national development. While taking advantage of such benefits, PNGPCL resists efforts to scrutinize its operational efficiency and areas of monopoly power to contain prices and enhance efficiency.

The above suggests a need to examine PNGPCL’s objectives, priorities and record of efficiency.

6.7 OPERATING COSTS

Effective regulation requires incentives for operational efficiency as well. Currently, no incentives for operational efficiency exist in the contract. Again, any amendment would require PNGPCL’s agreement unless the National Government, through the Independent Public Business Corporation, the designated shareholder of PNGPCL, initiates a process for including operational efficiency in the regulatory framework for effective supervision of PNGPCL. In commercial enterprises, the disciplines of the capital markets perform the function of monitoring efficiency by valuing the shares of the enterprise appropriately. Such disciplines are not available in the case of State-owned enterprises.

SUBMISSIONS ON OPERATING COSTS

PNG Ports Corporation Limited Response Submission

There were no comments received by PNG Ports regarding possible incentives for operational expenditure in the regulatory framework.

Trukai Industries Limited Submission

Trukai Industries Ltd argued that there should be a change in the port operating model and strongly supports a change in the port charges that encourages efficiency by creating incentives for productivity.

Commission’s Views

The Commission is of the view that the regulatory framework for State Owned Entities must capture any incentives for operational efficiencies, being mindful also of the impact that it will have on the different players in the market. This envisages the entity concerned to having its operational
efficiency monitored, thus enabling the Commission to assess the entities performance appropriately to avoid unnecessary costs to end users.

**Significance of price increases by PNGPCL**

PNGPCL mounted an argument that individual past price increases had a miniscule on the end price of a 1 kg pack of rice. This is curious for an SoE, the objectives of which include enabling’ the efficiency of downstream users and end customers’ by reducing their costs for national economic benefit.

Some key issues need to be considered in relation to the argument by PNGPCL:

- Pricing of services delivered by SoEs is relevant not only for PNG Ports, but others such as PNG Power, PNG Water, Eda Ranu, MVIL, and PNG Post. Efficiency forgone in a cumulative sense, over a significant period of time, is significant.

- Prices ‘increases’ are not only relevant, but the counterfactual of having an efficient operator – availability of the lowest possible prices across the board, not only on one product.

- In that sense, the minuscule effect argued by PNG Ports is not minuscule, but actually substantial when the counterfactual is taken into account in one SoE and magnified in SoEs collectively.

- For citizens, the welfare of whom is identified in ICCC Act objectives as a key consideration, a large number of imported products are affected, with cumulative effect on living costs.

- Allocative inefficiency in the form of consumers being prevented from spending surplus that would otherwise be available on other products and services, is significant.

- Above also stifles economic activity that would be generated from spending/saving of such consumer surplus.

- For industry, the long-term interests of which are also included in ICCC objectives, input costs would be reduced.

- The value of, and welfare effects of, alternative investment possibilities from such costs saved by industry, is also a consideration.

- For national economic growth, not only ‘first round’ effects, but ‘second round’ and ‘third round’ effects which would otherwise enhance national economic performance, are forgone.

- The argument by PNGPCL ignores fundamental aspects of regulation and competition that:
  
  o (a) regulation, while a second-best surrogate for competition, should attempt to secure the efficiencies that workable competition does;
(b) The competitive process is a never-ending one, the dynamics of which bear down continuously on costs and prices, thus enhancing public welfare; and

(c) a ‘snapshot’ view of the effect of a price increase in one year, on 1 kg of rice, is an inappropriate approach to measuring efficiency.

Thus, price increases, over a prolonged period, affecting all cargoes crossing PNGPCL’s wharves, when compared to the prices that would have been applied by an efficient operator, with efficient costs, are not as insignificant as suggested by PNGPCL’s submission which exemplified by the effect of one year's increase on a 1 kg pack of rice.

If SoEs are not conscious of such implications for their efficiency or lack thereof, it is a matter for national concern, not just for their regulator.

**FINDING**

The regulation of PNGPCL should include the evaluation of its operational expenditures to ensure that the operational costs are assessed appropriately and be taken into account in price-setting.

### 6.8 HOLISTIC ACCOUNTING REVIEW

For effective regulation, not only must all relevant services provided through ‘essential facilities’ be subject to regulation, but the assets, costs, revenues, and other relevant information concerning them should be reconciled to the overall statutory accounts of the enterprise, to ensure proper cost allocation and consistency of data. Such a system does not prevail at the present time and it is desirable to introduce such effective accounting safeguards. The position is exacerbated by the delay in the auditing of SoE accounts by the Auditor-General and the accounts remain opaque to the public for unacceptably long periods.

### 6.9 ONE-PARTY ENTITLEMENT TO REVIEW

The contract provides for PNGPCL to initiate reviews of (a) competition, as it has done; (b) pricing arrangements, to seek the Commission's approval to amendment or introduction of new charges, as it has done; but does not provide for Commission-initiated reviews of a particular or general nature. It is understandable that a relatively high degree of certainty is necessary to plan and manage long term investment and business strategies; however, the trade-off is that information provision and co-operation with the regulator to ensure that essential information is not withheld; information returns are accurate and provided within the time-frames of the contract; and any agreements made are honoured, not only by the regulator, but also by the regulated entity.
The one-sided nature of such entitlements act against the public interest by fettering the Commission in exercising effective regulation.

While the Commission can invoke its powers of declaring services under Section 33 of the ICCC Act, it is far more preferable for mutually agreed review processes to be undertaken rather than for coercive statutory processes to be invoked.

6.10 COMMISSION RESOURCES
It could be argued that such deficiencies could and should have been recognized by the Commission during the process of settling the contract. As mentioned above, information asymmetry is a serious problem in regulation. In addition, the Commission’s resources have been severely constrained, although it engages professional external consultants to assist in such work. Nevertheless, the overall workload does limit the Commission’s ability to critically assess all aspects of such contracts and going forward, this issue needs to be addressed so that effective regulation is implemented to maximize the public interest in the efficiency of regulated entities.

In an effort to ensure proper scrutiny of regulated entities, the Commission, as mentioned in its last annual report to the Parliament, has initiated discussions with governing body of the AusAID funded Economic and Public Sector Programme, to fund the engagement of embedded advisers on a long-term basis so that adequate expertise can be brought to bear on this important issue. Embedded expertise is preferred to ad hoc consultancies as on-going knowledge transfer is facilitated with a view to building a core of expertise for long-term regulatory efficiency.

This review work, unlike the Mid-term Capex Review, despite conferring a right on PNGPCL, has not been funded by it. Nor has it been funded by Government under the National Budget. Hence, the meager resources of the Commission have been further eroded by this work, which, obviously, involved considerable cost to the Commission in staff and Commissioners’ time and consultancy costs.

In future, any such entitlement by the SoE will not be agreed under relevant regulatory contracts unless also funded by it or funded by the Government in advance.

6.11 CUSTOMS/NAQIA
It was widely reported in the past that one of the contributing factors to clearance delays was lack of PNG Customs manpower. Like all Government institutions PNG Customs also only operate from 8am-4 pm on weekdays and closes for business during weekends, resulting in costs for weekend storage as well. However, it has been claimed that often the ‘receiving counter’ at Customs is only open for half a day.

Cargo-shippers and consignees claim that they have difficulty meeting the requirements of the National Agriculture Quarantine & Inspection Authority (NAQIA) as they say they have difficulty having containers fumigated and washed due to inadequate physical facilities at PNGPCL ports and, hence, experience delays in fulfilling those requirements to enable them to clear cargo promptly at the PNGPCL wharf in Port Moresby. That has the potential to greatly increase the costs of exporting
and importing in PNG ports. While storage rates currently applied by PNGPCL create the incentive on consignees to clear their cargoes, often they are unable to avoid the significant storage charges as a result of clearance delays said to be caused by Customs and meeting NAQIA requirements.

If there are, in fact, significant inefficiencies in meeting the Customs and NAQIA clearance processes, the additional costs for storage are significant and ultimately borne by consumers below the supply chain, which is a major concern of the Commission.

SUBMISSIONS ON NAQIA AND CUSTOMS

NAQIA Submission

From NAQIA’s point of view, it acknowledges that inefficiencies do exists however; these inefficiencies are attributed to other players as well.

Most of the cargoes clearance delays results in consignees or customs agents not following NAQIA’s requirement or other third parties such as stevedore/fumigation companies not doing their part. It is unfair when NAQIA is singled out and blamed because one or two clients have had clearing problems and had to pay storage fees.

However, NAQIA has taken the following measures to ensure that some of the inefficiencies in the port clearance can be resolved;

- Shipping companies and customs clearing agents to register with their own Quarantine Bonded yards where NAQIA release containers or cargoes from the Port Moresby seaport precinct under quarantine bond and inspect these containers outside the main wharf at their own time and convenience,

- If everyone requiring NAQIA’s services make prior appointments to be served, there will be minimal delays or frustration, and

- NAQIA is in the process of increasing its operational staff numbers throughout PNG so hopefully its inefficiencies due to man power will be resolved or addressed in time.

Riback Stevedores Submission

Riback noted that in 2011, there was wharf congestion in Lae due to factors such as slow customs clearance, slow NAQIA clearance, lack of trucks, and increase in cargo volumes. There was a need for additional off wharf storage.

Trukai Industries Submission

Trukai Industries Ltd stated that since PNGPCL operates 24/7, NAQIA/Customs should follow the same principle and operate 24/7. This will ensure that the importers do not arrange for officers from NAQIA/Customs whilst footing for their overtime allowances as well. This would significantly increase the number of containers cleared per day, thus reduce wharf congestion.
Commission’s Views

The Commission acknowledges the above comments put forward and further notes that there are a number of players in the importation and exportation clearing process at the wharves. Most of the inefficiencies that exist are attributed to other key players not playing their part in the clearing process and limited space availability at the main seaports. In order to avoid delays and high costs in storage fees, clearing agents must all comply with the requirements set by NAQIA or the Health Department.

6.12 NEED FOR WIDE-RANGING INQUIRY

The range of significant matters relating to the regulation of PNGPCL gives the Commission considerable cause for concern and, in these circumstances; there is a strong argument for a wide-ranging inquiry into PNGPCL’s operations, including its objectives; regulatory compliance record; overall efficiency, including operational efficiency.

Trukai Industries Submission

Trukai Industries Ltd is of the view that transparency of port productivity can be greatly improved. Different stakeholders all have their own independent opinion on how PNGPCL is performing since there is no standard benchmark to measure its overall performance. Trukai Industries Ltd further stated that PNGPCL should be benched marked on a monthly performance against a globally recognised standard of productivity. This will provide the facts about ‘perceptions’ of port performance as well as identify which ports are falling behind in their plans to improve productivity.

COMMISSION’S VIEWS

The Commission is of the view that there is a need for a wide inquiry into PNGPCL operations, its main stakeholders and regulatory bodies involved in the sector so that a range of reforms can be developed to assist PNGPCL and the market players fulfil the role of providing port services whilst contributing to the national economy.

FINDING

The Commission to assess the waterfront sector inclusive of all regulatory stakeholders involved to establish reforms and potential measures necessary to increase efficiencies across all players in the sector at the same time increasing productivity in the national economy.
7. **FINAL DETERMINATION**

The Commission has considered the two requests by PNGPCL and, based on its analysis herein, the findings and determinations in relation to the request by PNGPCL for a competition review and tariff variation are that:

(c) Competition in Port Moresby for the provision of infrastructure port services is insufficient to constrain the market power of PNGPCL; and

(d) The request to vary the pricing structure is denied.

In addition, the Commission has formed a view that it should declare the provision of marine pilotage services in relevant ports as ‘declared services’ under the provisions of paragraph 33 (1) (b) of the ICCC Act.

Alternatively, if the provisions of the ICCC Act are incapable of introducing such changes, the Commission will explore the possibility of utilizing the provisions of the Prices Regulation Act (Chapter 320) to introduce the changes proposed.

The Commission also considers that:

- The markets in relevant geographic locations for in-port cargo storage services should be further investigated with a view to establishing whether they should be declared either under the ICCC Act or under the Prices Regulation Act (Chapter 320).

- the regulatory framework for PNGPCL should be reformed to:
  - change the structure of charges, as distinct from the level of particular charges and the total revenue cap, including in the latter, cargo storage charges and marine pilotage charges;
  - include regulation of operational expenditure;
  - ensure the integrity of the system by adopting an holistic approach which includes cost allocation requirements across the enterprise and reconciliation of the accounts for regulated services with the statutory accounts of the enterprise, in accordance with generally accepted accounting principles.

- the Customs/NAQIA procedures, which are seriously deficient and impose significant and unnecessary costs on users, which detrimentally affect national economic progress and living standards of all citizens, is in urgent need of substantial reform;

- Shipping agents also contribute to clearance delays which imposes unnecessary costs on users when they don’t submit manifests on a timely manner.

- licensing of stevedoring service providers should be examined for anti-competitive consequences;
The problems of the waterfront sector merit a wide-ranging inquiry, particularly of the plethora of regulatory bodies involved in various elements of the sector, to establish the range of reforms necessary to allow it to fulfill its part in contributing to national economic growth.

Special Acknowledgement

The Commission would also like to acknowledge Mr. Winston Rodrigues, Principal of Reform Strategies Pty Ltd, for his significant contribution to this midterm competition review of the ports industry in PNG, but of course, the report is issued by the Commission and it takes responsibility for the contents.

Associate Prof. Billy Manoka, PhD
Commissioner & CEO

29th August 2012