

SUBMISSION TO  
THE MINISTRY OF ECONOMIC DEVELOPMENT

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# Review of Regulatory Control Provisions under the Commerce Act

6 July 2007

On behalf of the Chief Executives of 15 **Port Companies**

## SUBMISSION ON REVIEW OF REGULATORY CONTROL PROVISIONS UNDER THE COMMERCE ACT

### Introduction

- 1 This submission is made on behalf of 15 Port Company Chief Executives<sup>1</sup> who work together on public policy issues, in response to the discussion document entitled *Review of Regulatory Control Provisions of the Commerce Act* released by the Ministry of Economic Development (MED) in April 2007 (the *Discussion Document*).

### Summary

- 2 In summary, the port industry's views on the issues traversed in the Discussion Document are as follows:
  - 2.1 ***Regulatory purpose statement should focus on economic efficiency.*** A specific purpose statement for Part 4 may be helpful. It should promote efficient outcomes in priority to the pursuit of short-term distributional objectives. A distributional agenda will dramatically dampen investment incentives.
  - 2.2 ***The decision to regulate should not be taken lightly.*** Efficiency must be the primary objective underpinning any decision to regulate and detailed qualitative and quantitative analysis must be undertaken to support any regulatory intervention on these grounds.
  - 2.3 ***The Minister should decide whether to regulate, having considered analysis undertaken by the Commission.*** The Minister must make the decision to regulate, especially if any residual discretion is to remain regarding the pursuit of distributional objectives. However, the Minister should act only having secured and tested detailed analysis – both qualitative and quantitative – from the Commission.
  - 2.4 ***“Lighter handed” tools should be approached warily.*** Lighter handed tools such as “negotiate/arbitrate” and, to a lesser extent, information disclosure are more fraught than MED suggests in its Discussion Document. They are not costless and their pitfalls should be properly acknowledged and assessed. This analysis must be undertaken and only then, if these devices are still thought to be valuable, they should only be deployed only once their full impact is understood using both qualitative and quantitative analysis.

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<sup>1</sup> The Port Companies are: Northport Limited, Ports of Auckland Limited, Port of Tauranga Limited, Eastland Port Limited, Port of Napier Limited, CentrePort Limited, Port Taranaki, Port Nelson Limited, Port Marlborough NZ Limited, Lyttelton Port of Christchurch Limited, PrimePort Timaru Limited, Port Otago Limited, South Port New Zealand Limited, Port of Greymouth and Buller Port Services (Westport).

- 2.5 **Merits review is clearly appropriate.** Regulatory error is a major risk and merits review is a fundamental check and balance against that risk. It would clearly be inappropriate if any such error were to impact in a materially adverse manner on a regulated business without there being some ability to address the error.
- 2.6 **The likelihood of pass through occurring is relevant.** Ports provide a useful illustration of the relevance of pass through because customers are invariably shipping lines, and not shippers themselves. In the port industry, our sense is that price cuts enjoyed by shipping lines are rarely shared with shippers. In that case, there would be little point in regulating price reductions in ports without requiring the *benefit* to be passed through. Ironically though, if regulated prices were set in the port sector at a level allowing port companies to recover WACC (as surely they would), this would likely involve mandated price *increases*. In that case, a question would arise as to who would end up bearing the *burden* of the regulatory imposition.

**Objectives of the review are pitched in positive terms**

- 3 At a glance, the high level objectives cited by the MED in the Discussion Document have a ring of reasonableness about them. Most notably, MED says it is looking to provide for *better quality regulation*. The quality of economic regulation is primarily an issue for those who happen to be subject to regulation. In New Zealand, happily, that is a relatively small group, namely:
- 3.1 electricity lines companies (with their “thresholds” regime);
- 3.2 the gas distribution businesses of Powerco and Vector (subject to price control under Part 4); and
- 3.3 Telecom (subject to a specific regime under the Telecommunications Act).
- 4 For regulated firms, and their customers, it is desirable that the applicable regulatory regimes operate optimally. Apparently, this has not been the case. For example, we understand that many regulated companies have particular concerns relating to:
- 4.1 uncertainty as to the policy objectives underpinning the regulatory intervention;
- 4.2 a lack of clarity relating to key input methodologies with significant value implications;

- 4.3 the regulator acting as an enforcer, punishing regulated entities for perceived “transgressions”; and
- 4.4 the lack of accountability for regulatory decision-making and in particular the lack of scope for merit review.
- 5 The port companies have no direct experience of most of these issues, except to say that, on the face of it, these concerns appear legitimate, and we support the objectives of the review in so far as it aims at dealing with these issues. For example, it seems self-evident that a merit review process should be available to those businesses adversely affected by regulatory error. Regulatory errors can have a profoundly negative effect on regulated businesses, including on their ability to invest in key infrastructure. It is critical then that regulated businesses have the opportunity to have regulatory errors corrected. The discipline of merits review should also of itself stimulate better decision making on regulatory matters.
- 6 In addition, we note in terms of the purpose statement debate, it seems sensible that one be developed in the specific context of Part 4 of the where clearly the “promotion of competition” is problematic. However, the underlying themes of the existing section 1A purpose statement remain relevant. The Commerce Act current seeks to promote competition for the *long-term* benefit of New Zealand consumers. This is in effect an efficiency standard as only a regime that generates efficient outcomes can benefit consumers in the long-term. So, any co-existing regulatory purpose statement should similarly seek to promote efficient outcomes in priority over the pursuit of short-term distributional objectives which dramatically dampen investment incentives to the ultimate detriment of New Zealand consumers.

#### **Our concerns**

- 7 The port companies acknowledge that the stated underlying intention of the Discussion Document is to make improvements to the regulatory framework in response to legitimate concerns expressed by regulated businesses. The issue is that, in seeking to address these concerns, the MED may be inadvertently opening the door to an undesirable increase in the level of intervention in industries that currently, for good reason, are not regulated. The risk is that the “improvements” are susceptible to being hi-jacked at a future point in time by over-zealous regulators seeking to expand their influence across the New Zealand business environment. This could be materially adverse to the economy overall.
- 8 Accordingly, it is essential that the threshold for regulatory intervention remains high. All regulatory regimes are flawed and expensive. This is the

case no matter how honourable the intentions (either stated or actual) of the designers of a regulatory regime, or those tasked with implementing it. Yet the MED seems to consider that once it has tidied up the handful of problems exposed in the regulation of the industries identified above, it will have a blueprint for regulation which can be rolled out with great confidence to a range of currently unregulated businesses. This could be a dangerous assumption.

***Lighter handed solutions still problematic***

- 9 The introduction of generic lighter handed devices is problematic because it effectively lowers the threshold at which regulatory intervention can be justified. It would do this in two ways. First, the devices are cheaper and therefore the compliance burden less – this reduces incrementally the negative efficiency impacts relative to heavier handed solutions. Second, and more worryingly, it has been suggested that less rigour is potentially required in deciding to whether to impose these measures, presumably because these measures are considered to be fundamentally benign.
- 10 The port companies are not satisfied that these lighter hand models are in fact benign. Accordingly, some vague “qualitative assessment” is simply not a sufficiently robust basis upon which to justify a decision to regulate.
- 11 The “negotiate/arbitrate” model has already been investigated (and rejected) in a variety of cases, including very recently by the Productivity Commission in Australia on the grounds that it inappropriately altered the incentive to engage properly in the commercial negotiation process. A variation has also been tried in the telecommunications sphere with the experience being an overwhelming tendency for parties to have the matter arbitrated. It seems to be a model that is only appropriate in a business to business context anyway. From a ports perspective in particular, there is nothing to be gained by delivering shipping companies yet another avenue for applying commercial pressure.
- 12 Similarly, price monitoring and information disclosure can be problematic. The MED itself recommended (see MED’s Review of Port Companies’ Market Power dated 5 November 2002, paras 39 to 44) against introducing an information disclosure requirement for ports, not only because of compliance costs but also because of the “distortionary effects” created by non-captive customers (i.e. those with a genuine choice as to which port to use) being able to access information disclosed to with the intention of assisting those customers that are genuinely captive.
- 13 Perhaps the over-riding concern is that there will be a tendency to underestimate the adverse consequences of regulating in this way. The tone of MED’s Discussion Document – and even the light-handed label itself

– betrays an indifference to the very real risks associated with any kind of regulation.

***Lowering the thresholds for regulation***

- 14 It is not clear what additional problem the MED is looking to solve – or what unregulated industry it is looking to “fix” – by lowering the applicable thresholds at which regulation can be justified. Certainly the port industry should not be a target.
- 15 In April 2002, CRA concluded in a comprehensive report (commissioned by MED) that there was no case for the regulation of ports. Since that time, there has been significant consolidation in the shipping industry to the point where, more than ever before, the more powerful shipping companies substantially dictate commercial terms to ports. In this environment it is inconceivable that the Government would need to intervene to control the extraction of “monopoly rents” by port companies.

***Port sector already has low rates of return***

- 16 On the contrary, of much greater concern from a policy perspective is the fact that port companies invariably are unable to make what the industry considers to be an appropriate return on WACC. This means that port companies cannot make the investment decisions necessary to optimise port infrastructure for the long-term benefit of consumers in New Zealand – at least not without substantial subsidies from ratepayers via uneconomic contributions from local Government shareholders. This situation is unacceptable for a country for which geographical remoteness is clearly its most significant trading disadvantage.
- 17 It is this commercial context that is currently foremost in the minds of port companies and has lead major players in the industry to investigate their own options to consolidate into a form so as to be able to meet the commercial demands of shipping companies in a sustainable manner. In a more consolidated environment, it is conceivable that a case could be made for some degree of regulatory oversight within the industry. For example, there could be a case in particular circumstances for the imposition of information disclosure requirements to facilitate commercial discussions by providing for a degree of transparency and accountability.
- 18 Whatever the form of any particular intervention though, ports would be want to know that the particular nature of the port industry was accounted for. It would not be ideal if “best regulatory practice” was simply imported from another industry where the issues may be quite different. Similarly it would be critical to recognise the very particular issues faced by different ports of wide-ranging scale operating across the commercial spectrum.

***Efficiency goals vs. distributional goals***

- 19 Another fundamental issue is the treatment of producer/consumer transfers and the assessment of the overall impact on efficiency. MED's discussion of the policy objectives underlying regulation. The Discussion Document contemplates there being a certain tolerance of net efficiency losses. From a port company perspective, efficiency considerations are paramount in looking to support the sustainable development of key infrastructure assets in our economy. To over-emphasise the "net acquirer" standard would be to mandate destruction of significant value in the New Zealand economy. For a country looking to manage a known infrastructure deficit, and encourage investment, this is a luxury we cannot afford.
- 20 It follows then that, to the extent that investment incentives have to date been ignored – or in any way de-emphasised – in deciding whether, and if so how, to regulate, any explicit promotion of the importance of this fundamental dynamic will be an improvement on the status quo.
- 21 The question however is whether the status quo is itself legitimate. As we understand it, there is some doubt as to whether there has ever been scope in the legislative scheme under the Commerce Act for regulators to pursue a distributional agenda as between producers and consumers. The courts have certainly insisted that "wealth transfers" are not relevant to the granting of an authorisation on public benefit grounds – in particular, such transfers do not serve to promote the long term interests of consumers in New Zealand.

***Investment incentives***

- 22 In any case, at a general level, the port companies support the promotion of incentives to invest in infrastructure. That is because the central challenge for ports in the next 50 years is going to be funding appropriate levels of investment – particularly given the difficulties faced by ports in securing appropriate commercial rates from shipping companies to facilitate this investment. We also accept that the "promotion of competition" may be a non-sensical objective when regulating a genuine monopoly. Accordingly, we encourage the development of a specific purpose statement that appropriately elevates investment incentives. This is of course consistent with the wider scheme of the Commerce Act in that it demonstrably furthers the long-term interests of consumers in New Zealand.

***Decision to regulate should be made by the Minister***

- 23 As for the question of who regulates, the ports clearly favour the decision being a Ministerial one, especially if the decision to regulate is based at least in part on distributional considerations. There must be political accountability for pursuing these objectives. In addition, there is a

significant risk that a regulator may from time to time look to grow its own sphere of influence. That is not to say that the Minister should not be able to commission a report from the Commerce Commission to inform his or her decision.

***Pass through***

- 24 The issue of pass-through is worth considering briefly. The Discussion Document queries whether the prospects of pass through should be relevant to any decision whether to regulate.
- 25 We understand this has been at issue previously in the context of electricity lines, airports, gas pipelines and telecommunications (in particular, in the context of mobile termination rates). As we understand it, the concern is essentially:
- 25.1 the extent to which the benefit of lower (regulated) prices charged by the provider of an “input” service (such as the line charge component of the electricity retailer’s bill to consumers) is likely to be passed through to the ultimate purchaser of the aggregate service; and
- 25.2 if pass-through is unlikely, whether it should be compelled.
- 26 At a commercial level, the port companies have no reason to believe that the price accommodation periodically demanded by shipping companies – and often granted by ports – is passed through to shippers (i.e. importers and exporters) to any material extent (although it may occur for exceptionally large customers, such as Fonterra, with volumes sufficient to generate a plausible bargaining position as against the shipping companies). In that case, there would be no point regulating ports to reduce prices without in turn requiring shipping companies to pass those reductions through to shippers. Otherwise, the Government would simply be mandating a straight value transfer to offshore shipping company interests.
- 27 Ironically, in the present commercial environment, if regulated prices were set in the port sector at a level allowing port companies to recover WACC, this would more often than not involve price *increases*. Conversely then, it would be expected that shipping companies would inevitably look to pass through the entirety of this *burden* to shippers. Ultimately, the critical regulatory design question would revolve around deciding who should pay for the development, maintenance and operation of port infrastructure to service New Zealand’s export and import requirements on a sustainable long-term basis.

**Further information available**

28 For further elaboration or additional information on any of the submissions above, please contact either of the following:

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