

Silver Fern Shipping Limited  
Sovereign Assurance House  
142 Lambton Quay  
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Wellington

14 August 2001

The Chairman  
Commerce Commission  
PO Box 2351  
Wellington

Dear Sir

Submission on Draft Report – Price Control Study of Airfield Activities.

Silver Fern Shipping Ltd [formerly Coastal Tankers Ltd] (“SFSL”) is an interested person in relation to the Commission’s inquiry and draft Report to the Minister of Commerce.

SFSL wishes to make submissions in relation to the pricing principles and asset valuation methodology adopted by the Commission in its draft Report.

By way of introduction, SFSL first puts these submissions in context. While SFSL’s submissions are directed to the subject matter under inquiry (whether airfield activities should be subject to price control), the issues confronted by SFSL in relation to seaports are directly applicable.

SFSL has been grappling with increasing sea port charges since the corporatisation of port companies under the Ports Act 1988. This Act requires port companies to act “as successful businesses” but does not subject port companies to any form of light handed regulation.

SFSL faces issues in relation to asset valuation, rates of return, allocation of overhead and utilisation. These have occurred particularly at ports at Westgate [New Plymouth], Mount Maunganui and Wellington, and date back as far as 1993. Shippers generally operate in a low margin, high volume commodity based market place, so it is important to get the methodologies for these issues “right”. Some shippers who are “captive” to a particular port, are vulnerable to increased port charges; they are the non-competitive “filler” used by port companies to meet pre-set rates of return, either after charges to non-captive users have been struck, or after any downturn in that sector.

In relation to the pricing principles addressed by the Commission in its draft Report, SFSL submits:

1. SFSL shares the Commission’s view that the positive characteristics of a competitive market are those which must be the benchmark against which outcomes in other types of markets must be compared.

2. Consequently, SFSL supports the Commission's preliminary view as to appropriate general pricing principles, namely:
  - Prices should be commensurate with the desired level of service quality and based on appropriate costs (productively and dynamically efficient costs) which encourage efficient use of the supplier's facilities and avoid cross subsidisation. In SFSL's view, the avoidance of cross subsidisation between contestable and non contestable activities is a major objective and must be confronted head on by the general pricing principles.
  - Prices should permit normal returns based on an appropriately determined asset base and rate of return.
  - Prices should cover efficient operating costs.
  - Prices should send appropriate signals for determining whether new investment (or divestment) is efficient. One way of ensuring that appropriate signals are sent to infrastructure users, is to ensure that only those users who seek the new investment bear the cost of the same (so that they can make their own assessment of the cost/benefit of the new investment).
3. In relation to asset valuation methodology:
  - SFSL agrees that the asset base is best determined (where relevant) by reference to opportunity costs.
  - In this regard the distinction between land and specialised airfield assets chosen by the Commission in the draft Report is appropriate.
  - It is appropriate to value airfield land by reference to the opportunity cost determined by the highest alternative use value of that land.
  - It is agreed that specialised airfield assets (runways, taxiways and aprons) (similar to wharves and other assets dedicated to port users that have no alternative use) have zero opportunity costs and, therefore, should be included in the asset base at historic cost depreciated and optimised as appropriate.
  - It is agreed that only those assets that are currently "used and useful" should be included in the asset base on which a rate of return is calculated and that all other assets should be optimised out. However, the test of "used and useful" needs more definition so that it is, first, readily applicable to airport infrastructure assets, and secondly, to infrastructure assets generally (so that the application of the test to infrastructure assets generally can be more readily debated).
4. The Commission's preliminary view that pre-financing of new investment is generally inappropriate is correct i.e., only "used and useful" assets should be included in the asset base so as to encourage airports to only undertake new investment that will be "used and useful". An alternative approach, which encourages investors to finance new investment only when new investment is efficient, is to develop a means whereby the infrastructure owner only undertakes new investment when those users who benefit from the new investment are willing to pay the cost of financing the new investment – enabling the users to make their own assessment of the cost/benefit of the new investment. This

ensures that new investment in infrastructure assets will only occur when those users who will benefit from the new investment agree that the benefit of the new investment will outweigh the cost.

SFSL is appreciative of the work done by the Commission in its draft report in dealing with asset valuation and rates of return bases which have the potential to lower charges to current captive users of those assets, with benefit to both exporters and importers. It is possible that non-captive users could also benefit from the reduced pressure to maintain charges. It is SFSL's contention that the draft review of airfield activities should encourage a similar review of ports – for similar reasons.

SFSL's concern is to ensure that there are clear rules and guidelines in relation to pricing principles and asset valuation methodology to ensure fair and reasonable charges.

SFSL seeks an opportunity to present cross submissions on 31 August 2001 and an opportunity to speak at the conference on 4 – 7, 10 and 12 – 14 September 2001.

SFSL thanks the Commission for the opportunity to make these submissions.

Yours faithfully

F. D. Wall.

General Manager