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Republic of Palau: Facility for Economic and Infrastructure Management

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Strategic Options for Private Sector Participation in Port Services

Working Paper 6

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ACRONYMS

FEIM – Facility for Economic and Infrastructure Management
GOP – Government of Palau

Executive Summary

1. This Working Paper addresses key issues relating to the provision of port services in Palau.

2. The current concession agreement has expired, and is being renewed on a month by month basis. Any long-term renewal must be made in the light of the possible development of additional, or alternative, port facilities at Peleliu or Ngardamu – the latter is associated with creation of a Free Trade Zone.

3. The development of a new port facility is likely to have significant economic and financial impacts. Whether it threatens the financial viability of the existing port (or whether it can operate profitably if it is in competition with Malakal port) will require careful examination, as will the logistic issues such as internal transportation. Projected return on investment for future port operators also requires evaluation.

4. One scenario is that a new port replaces the Malakal port, with land then being freed up for tourism development. This has other implications in terms of land zoning. Any options for port development require detailed feasibility studies that evaluate all such issues.

5. Regardless of these considerations, the present time appears appropriate to reconsider the status of the existing concession, including tariff structures and cost recovery for Koror State government and the national government.

6. Traffic volumes are reported to have fallen, but this is no reason to defer formal renewal of the concession for say 3 – 5 years, until other policy decisions on long-term future ports have been evaluated. If the extension of the concession is for a limited time frame only then it is more pragmatic not to enter into competitive bidding, since developing competitive operating proposals for the short-term only is unlikely to be attractive to private sector port operators and investors. It makes sense, therefore, to seek a negotiated settlement with the existing operator.

7. It is suggested that any extension of the existing concession should incorporate additional essential changes, to enable some cost recovery by the national government for indirect costs such as security. This implies that the national government becomes a party to the short term extension of the concession, and that it can exercise basic regulatory oversight of the port, as the major strategic asset for international trade.

8. A longer term concession will need to incorporate features such as regulatory controls; full cost recovery; and performance monitoring. Alternative ownership models are discussed in the report, but the present "landlord port" model has many benefits, provided it incorporates protection against abuse of monopoly power. A longer term concession should be subject to competitive bidding.

I. Introduction

9. This Working Paper provides a brief overview of the current situation relating to sea ports in Palau. It has been based on relatively short discussions with: (i) the Minister of Commerce and Trade; (ii) the Chief, Division of Transportation and Communications; (iii) Chairperson, Koror State Public Lands Authority, and (iv) the Director, Koror State Public Lands Authority. All participants are thanked for their assistance.

10. The focus of discussions and the approach to the consulting assignment has been to ascertain the adequacy of safeguards for the nation as a whole, and for the State of Koror. These have included the terms of the agreement and safeguards built into the arrangement for the concession. Opportunities for the private sector to improve performance do not fall within this scope of work. No discussions have therefore taken place with the port operator.

11. At the time of finalizing this Working Paper the Concession Contract was not available, and detailed contractual terms and rights and obligations were unclear.

II. Existing Situation

A. Overview

12. The main seaport for Palau is at Malakal port, but ancillary ports are designated at Peleliu and Ngardamu. The latter has also been established as Free Trade Zone. However, in general discussions the impression has been gained that development of the port at Peleliu is a higher probability. At present only Koror port has significant capacity.

13. Malakal port is operated by a single concessionaire who holds a contract with Koror State Government to provide stevedoring services. In effect, the arrangement is one variant of what is popularly termed a “landlord port”. Appendix 1 provides information on the more common form of port ownership. Without sighting the detailed concession agreement, but based on verbal feedback, it appears that the concession lacks the focus and clear definition of responsibilities one expects to see in a well structured concession contract. Appendix 2 identifies items that would normally be included in a lease agreement.

14. The port at present is an unregulated monopoly. This is an undesirable situation for the both the National and State governments, because of long-term risks if the operator changes.

15. For its part, Koror State is also to a large extent a monopoly provider of land for the port, since no competitive port is currently in existence for the country. There is not, therefore, the competitive balance that ensures no excessive land lease charges are applied to the port facilities.

16. There is a lack of awareness of rights and responsibilities for monitoring performance and throughput of the concessionaire.

B. National Government Responsibilities

17. Under the Compact of Free Association, there are some obligations on the Government of Palau relating to the provision and availability of port facilities at Malakal.

18. In common with international conventions, the national Government is responsible for port security, covering both international and coastal vessel movements and cargo. It does not receive any portion of revenue for this activity. Security services and responsibilities are effectively provided free of cost.

19. **It is recommended** that any short-term review of the Concession includes provision for some cost recovery for the national government, to offset costs of providing this service.

20. The national government has no other control of the port, and no ability to influence tariffs. The question must be asked as to whether this is desirable.

21. The national government, through its membership of the Micronesian Shipping Commission, does have some ability to influence sea freight tariffs and the issue of licenses to shipping companies operating in the region. Bidding for licenses occurs every five years. This also forms the basis for tariffs, with provision for escalation based on increased fuel costs. The basis of such tariffs goes back some years. There is a fuel cost escalation clause.

22. There has been some discussion on the need for a Port Authority, but no decision has been made. There is also a proposal for a more detailed study into infrastructure limitations and future requirements, with the possibility of a Commission being formed to examine future requirements in greater depth.

23. A Committee established to consider future requirements is not active at present. Development of any new port is likely to have significant financial and economic impacts, and result in dilution of traffic volumes crossing Malakal port wharf, with financial implications in terms of cost recovery, and changed distribution and transportation of shipments to end users. Scenarios to be considered include the establishment of an additional port(s) or the replacement of the Malakal port, with existing port land being freed up for other activities. Any decisions in this area will require a detailed feasibility study.

24. There is also proposed legislation before Congress relating to formation of a new port. There is insufficient time available within this Technical Assistance to review the proposed legislation.

C. State Government Responsibilities

25. Koror State owns the land, and is responsible for land zoning. Koror State does not own the infrastructure. Buildings previously occupying the site have been demolished, so there is no maintenance requirement in this area.

26. Oversight of port operations appears at best limited. Koror State does not maintain statistics of vessel calls or traffic volumes. Anecdotally, these have declined recently, so that there is surplus capacity to absorb growth. However, there is no a single source of information on traffic volumes in either the national or State government units

responsible for oversight of port operations. This reduces the ability to undertake quantitative based forward planning.

27. Ancillary operational issues relate to safety of the fuel facilities, and to land zoning.

D. Concessionaire Responsibilities

28. The concessionaire is responsible for plant and equipment, and its maintenance. It is suggested that there are considerable sunk costs in the provision of this infrastructure.

29. The consultant has received some indications of shareholder dissatisfaction within the port operating company, but this is an internal issue that does not affect operation of the concession unless it threatens its viability.

E. Tariffs

30. A Water Use tax applies, and is collected by Customs. A Navigational Aid tax is received by Koror State, but navigation aids are maintained by the national government. Koror State also receive wharfage, dockage, and port entry fees. It is not clear from discussions who is responsible for reviewing tariffs and authorizing increased rates, or the basis on which they should be increased.

31. The above charges paid to Koror State have been held constant for some time. It is understood that payments are significantly in arrears. Neither the National or State government appear to have any involvement in the stevedoring charges set by the port operator.

32. A 2006 review proposed tariff increases in order to provide new equipment. In the absence of the opportunity to examine the concession agreement, it is not totally clear who is responsible for provision of all equipment.

33. It is also noted that the approach channel requires dredging to avoid vessels grounding at low water. It is not clear what cost recovery mechanisms are included in the tariff to cover this cost, or where responsibility lies.

34. It is reasonable for Koror State to expect to receive at least the same rental value for land used for port operations as it receives for other commercial land, and adequate recompense for the provision of infrastructure which the State has provided and is required to maintain (wharves etc.). It is also reasonable for the national government to recover the cost of safety and security services which it provides.

35. There is, therefore, scope for a review of the fundamental cost structures underpinning the present tariffs.

F. Concession Term

36. The concession expired some years ago, and is being renewed on a month by month basis. There is therefore an opportunity at any time to renegotiate the terms of the agreement. Any extension of the concession can incorporate additional safeguards required by both national and state governments, and by the concessionaire.

III. Conclusions

37. Any port must be considered a national asset, and an appropriate oversight framework needs to be considered.

38. If traffic volumes at Malakal port are declining, then there is no immediate need to plan for additional port facilities in the short-term. When more detailed planning takes place, then wider economic and financial factors must be considered in the evaluation, including the port hinterland, associated logistics and transportation costs, and the financial impact on profitability of existing operations.

39. A monthly rollover of the lease on present terms does not provide the operating company with any certainty, and therefore discourages investment. A long-term lease, especially one which offers guarantees to the operator, requires more careful development.

40. Given that no alternative port is likely to be in service for some years, and that the concession has expired, this is a convenient time to formalize a medium-term (3 – 5 years) extension of the concession, and to consider revised tariffs that reflect the need for government to recover a contribution to costs, and for Koror State to receive something close to market value for land used by the stevedoring company. This allows adequate time for decision making on the creation of any alternative port locations. Tariff escalation clauses can also be incorporated into the extension.

41. Reaching agreement on a medium-term extension of the concession can proceed in the near future. If the extension of the concession is for the medium-term only then it is more pragmatic not to enter into competitive bidding, but to seek a negotiated settlement with the existing operator. Developing competitive operating proposals for the short term only is unlikely to be attractive to private sector investors. However, the attitude to longer term concessions is likely to be different.

42. **It is recommended** that any extension of the existing concession should incorporate additional essential charges, to enable some cost recovery by the national government for indirect costs such as security. This implies that the national government becomes a party to the short-term extension of the concession, and that it can exercise basic regulatory oversight of the port, as the major strategic asset for international trade.

43. A longer term concession will need to incorporate features such as regulatory controls; full cost recovery; and performance monitoring. Alternative ownership models are discussed in the report, but the present “landlord port” model has many benefits, provided it incorporates protection against abuse of monopoly power. A longer term concession should be subject to competitive bidding.

Appendix 1 Alternative Ownership Structures

44. There are five major models for port ownership:

i) Service Port – under which there is no 3rd party involvement. All assets and operations rest with one institution. All risks rest with that organization;

ii) Resource Port – an arrangement whereby land, assets, and infrastructure rest with one organization, which meets all financial liabilities and carries the risk. Port work itself is handled on contract, but usually with fixed payment terms for the contractor;

iii) Management Contract – whereby an experienced port manager is engaged to provide the necessary management expertise. Although management contracts are common with many utilities, they are not common in port management

iv) Joint Venture Operating Company – a form of public private partnership, usually with some shared risk, and always with an independent Board of Directors representing the interests of the respective shareholders

v) "Landlord" port Concession – an increasingly common form of ownership, under which exclusive use is guaranteed to the concessionaire, often with basic infrastructure also provided, but with supplementary infrastructure provided by the concessionaire at his own expense. Payment is normally based on a combination of a guaranteed minimum income, plus a variable component that reflects traffic volumes. The concessionaire would normally arrange for all maintenance up to a standard specified in the agreement, and to contract work required at his own expense. The concessionaire would be expected to replace plant and equipment at the end of its working life, as well as upgrade any computer hardware and software used in operations. All loan or debt servicing remains the responsibility of the landlord, who also retains the right to carry out periodic inspections to ensure adequate standards of maintenance and safety.

Appendix 2 Typical lease conditions

As a general guide, any lease document should include reference to the following clauses:

- Appointment of the Lessee;
- Duration of the Agreement
- Commencement of Operations
- Procedure at the End of the Lease
- Performance Guarantee
- Peaceful Enjoyment
- Definition of Area
- Transfer of Installations and Assets on the Effective Date
- Preferential Use
- Land and Equipment Ownership
- Access to Land
- Acquisition and Disposal of Assets During the Lease
- Conditions as to Utilities
- Description of Services
- Lease Assignment and Sub-Contracting
- Labour
- Maintenance of Installations and Equipment
- Insurance
- Tariffs
- Payments to the Lessor
- Emergency Measures
- Records and Reports
- Taxes and Financing
- Supervision by Lessor and Regulator
- Circumstances for Termination of Lease
- Procedure for Termination
- Dispute Settlement
- Arbitration
- Force Majeure
- Insolvency of Lessee
- Penalties
- Notice and Communications