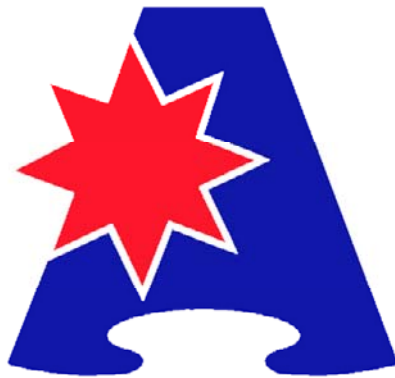


**ADSTEAM MARINE LIMITED**

Submission to the

**Productivity Commission  
Inquiry Into The Economic Regulation Of  
Harbour Towage and Related Services**



**adsteam  
marine**

**PART C – RESPONSE TO INITIAL SUBMISSIONS**

**May 2002**

**Adsteam Marine Limited**  
submission to the  
**Productivity Commission**  
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## INTRODUCTION

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The Commission has received a number of initial submissions concerning the future regulation of the harbour towage industry. Some submissions have argued against regulation,<sup>1</sup> while others argue that further regulation is warranted.<sup>2</sup> There is general consensus that the Commission should not recommend the continuation of the current prices surveillance arrangements under the PS Act – although some interested parties recommend price regulation through the use of exclusive towage licences.<sup>3</sup>

The ACCC believes there is a *prima facie* case for “some form” of regulation of the towage industry, but it offers few positive suggestions. It argues that the current prices surveillance regulation of towage charges has been ineffective<sup>4</sup> (it does not appear to recommend directly a reapplication of that regulation) and warns of the dangers of using exclusive and non-exclusive licensing as a “... panacea to the problem of natural monopoly markets with weak contestability...”<sup>5</sup>

Disappointingly, apart from Adsteam few interested parties have considered reform options beyond price regulation and the use of exclusive towage licences.

As stated in its earlier submission, Adsteam does not believe that price regulation or exclusive towage licences are needed in any towage market. This is principally because of the demonstrable contestability of those markets and because there exists the opportunity to increase reliance on market forces to facilitate greater economic efficiency. The costs associated with various forms of regulation also need to be taken into account.

It is equally clear, however, that a number of interested parties would stand to benefit from increased regulation, even where the ultimate outcome would be sub-optimal from an overall economic perspective.

In this submission, Adsteam focuses on a limited number of issues raised by third parties in their initial submissions. This should not be taken to imply that Adsteam is only concerned about the issues discussed below. Adsteam’s initial submission lodged on 26 April 2002 dealt with a variety of complex, interrelated issues that it maintains are all relevant to the present inquiry.

The issues discussed in this submission are:

- Exclusive towage licences;
- Market contestability;
- The impact of towage on international competitiveness and trade;
- Service quality and reliability; and
- Profit margins.

All queries and correspondence regarding this submission should be directed to Peter Macmillan by telephone on (03) 9504 5888 or 0417 239 115 or via e-mail at [pmacmillan@adsteam.com.au](mailto:pmacmillan@adsteam.com.au)

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<sup>1</sup> For instance, see generally Adsteam, submission lodged 26 April 2002 (including the report by CoRE Research in Part B of Adsteam’s submission) and TC Boxall, submission lodged 16 April 2002. The AIMPE submission lodged 24 April 2002 at page 12 also recommends that “... economic regulation should be lighter; the new phase of competition should be permitted to demonstrate its effectiveness in meeting the needs of the users.”

<sup>2</sup> AAPMA, submission lodged 19 April 2002, p.26 and the ACCC, submission lodged 14 May 2002, where at page 26 “some form of economic regulation” is recommended on a *prima facie* basis, but no specific suggestions are offered.

<sup>3</sup> For example, see SAL, submission lodged 19 April 2002, p.ii and NFF, submission lodged 22 April 2002, p.7.

<sup>4</sup> ACCC, submission lodged 14 May 2002, p.ii.

<sup>5</sup> ACCC, submission lodged 14 May 2002, p.25.

# 1 EXCLUSIVE TOWAGE LICENCES

Exclusive towage licences are considered by some interested parties to be necessary to regulate how towage operators run their businesses. Others argue that such licences have shortcomings that have not been fully explored. Adsteam maintains its view that regulation of this or any other kind is not necessary. Moreover, it contends that the implementation of exclusive towage licences where not justified will lead to sustained economic detriment.

Adsteam opposes any attempts by its competitors (or potential competitors), other port service providers and its customers to implement any regulatory arrangements intended to override the operation of market forces. Rather, Adsteam supports deregulation and the facilitation of competitive outcomes without third party interference.<sup>6</sup>

Adsteam is not surprised that port authorities are among the strongest supporters of exclusive towage licences, as are other interested parties who see such licences as an opportunity to regulate prices, "... safety and salvage capability, when/how tugs can be released for emergency purposes, training, repairs and maintenance, and so on."<sup>7</sup> For these parties, the prospect of being able to regulate the elements of a towage operators business may provide significant commercial rewards.

Port authorities can use exclusive towage licences to undergird their largely self-appointed role as the entities responsible for ensuring the operational efficiency of towage operators, the passing-on of efficiency gains to towage users, and protection from the fear of towage service providers abusing their natural monopoly power.<sup>8</sup> It is expressly recognised that in the absence of such license arrangements, port authorities have limited effective involvement in pressuring towage operators to behave in particular ways.<sup>9</sup>

The Ports Corporation of Queensland's concern over its lack of control over towage services (and the advantages that an exclusive licence would provide in this regard) has led it to state:

"The Corporation's only ability to control towage providers is through the ownership of facilities for berthing tugs, and indirectly via port rules. Regulation of harbour towage and related services is, consequently, a significant issue for the Corporation."<sup>10</sup>

The key benefits of exclusive towage licences are argued to be an increase in market contestability (and the protection of market entrants from price wars),<sup>11</sup> reduced towage charges (supposedly to increase Australia's international competitiveness and the trade in goods between Australia and elsewhere – ostensibly because ship operators will be able to lower their prices/improve their margins)<sup>12</sup> and increased service quality and reliability.<sup>13</sup>

The Ports Corporation of Queensland's submission indicates that exclusive towage licences would:<sup>14</sup>

- Significantly reduce towage operators' discretion over price, quality, safety and availability of towage (such matters would otherwise be subject to negotiation between the towage operator and ship operators);

<sup>6</sup> Adsteam, submission lodged 26 April 2002, pp.57-67.

<sup>7</sup> SAL, submission lodged 19 April 2002, p.ii.

<sup>8</sup> AAPMA, submission lodged 19 April 2002, p.8.

<sup>9</sup> AAPMA, submission lodged 19 April 2002, pp.18-19.

<sup>10</sup> Ports Corporation Queensland, submission lodged 29 April 2002, p.1.

<sup>11</sup> Fremantle Port, submission lodged 8 April 2002, p.2.

<sup>12</sup> Sea Freight Council of Western Australia, submission lodged 19 April 2002, p.5.

<sup>13</sup> Fremantle Port, submission lodged 8 April 2002, p.2.

<sup>14</sup> Ports Corporation Queensland, submission lodged 29 April 2002, p.2.

- Guard against towage becoming so expensive that a port becomes uncompetitive (presumably because ship operators will go to other ports although no evidence is provided in this regard); and
- Provide a control mechanism so that "... firefighting and salvage can be locked away into the towage arrangement," notwithstanding these services are almost universally provided without resort to exclusive towage licences (and commonly at prices well below cost).<sup>15</sup>

The ACCC is less enthusiastic about the use of towage licences, although its concerns appear to be still largely undeveloped in an analytical sense. As noted in the introduction to this submission, the ACCC cautions against the use of licensing as a "general panacea" to perceived natural monopoly problems<sup>16</sup> and identifies regulatory "limitations" to the competitive tendering approach favoured by some port authorities.<sup>17</sup>

In this latter regard, the ACCC highlights the complexities involved in designing an effective and efficient auction process (and provides a detailed account of the relevant economic theories). It also expresses concern over the potential for competitive licensing to "... increase opportunities for tacit collusion between bidders"<sup>18</sup> and facilitate "... predatory behaviour in bidding by a strong bidder."<sup>19</sup>

A further area of concern discussed by the ACCC is the potential costs of the regulatory solutions to be implemented and "... the [problematic] incentives of the respective parties involved"<sup>20</sup> – which appears to reinforce the concerns previously raised by Adsteam in relation to the role of port authorities in the licensing process.<sup>21</sup> More generally, the ACCC warns that:

"The resulting regulatory framework may be inconsistent on a national basis and impose greater costs than the current regime due to greater transacting and it may not be able to deal with potential free rider problems that may emerge."<sup>22</sup>

In Adsteam's view, the perceived benefits of exclusive towage licences as identified by the port authorities and others above are either limited to benefits direct to the issuing port authority or simply illusory. As such, these benefits are not sufficient (or even relevant) to recommend an exclusive licence regime. The "problems" that they imply are not contestability problems but rather problems faced by port authorities and other interested parties that crave greater control over other port service providers.

Adsteam makes these comments as seemingly one of very few interested parties that has investigated the potential adverse impact of exclusive licences on competition and economic efficiency in the towage industry.

Further, any legitimate concerns in the above areas could be adequately addressed through the use of non-exclusive towage licences and service charters. The experience in Fremantle is one example where in relation to towage prices it is reported that "... the issue of non-exclusive licences nonetheless resulted in an average reduction of around 15 per cent in towage charges from previous levels ..., "<sup>23</sup> in addition to service quality improvements.

<sup>15</sup> See Adsteam, submission lodged 26 April 2002, pp.9 and 10.

<sup>16</sup> ACCC, submission lodged 14 May 2002, p.25.

<sup>17</sup> ACCC, submission lodged 14 May 2002, p.24.

<sup>18</sup> ACCC, submission lodged 14 May 2002, pp.24 and 25.

<sup>19</sup> ACCC, submission lodged 14 May 2002, p.25.

<sup>20</sup> ACCC, submission lodged 14 May 2002, p.25.

<sup>21</sup> Adsteam, submission lodged 26 April 2002, pp.61-63.

<sup>22</sup> ACCC, submission lodged 14 May 2002, p.25.

<sup>23</sup> Fremantle Port, submission lodged 8 April 2002, p.2.

The utility of these less restrictive mechanisms may explain, at least in part, why so few port authorities in Australia have been willing (or permitted by their respective state governments) to adopt exclusive towage licensing in their ports, and why such licences are a rarity overseas.

At this stage, Adsteam does not intend to add to its previous discussion on the detrimental effects of exclusive contracts. In its view, the first order issue of there being a problem has not been established. Without putting forward reasoned argument supported by facts, no amount of commercial convenience or opportunism can satisfy the fundamental requirement that there must exist a problem in need of a solution.

It is also emphasised that the effect of attempting to regulate a small element in the total port service supply chain (whether by exclusive towage licences or statutory regulation) can be seriously counterproductive, especially when the costs of regulation are also taken into account. Moreover, any decision to regulate a single service element should only be contemplated after reviewing all other elements, some of them far more significant in an overall cost and efficiency sense.

These issues were discussed in some detail in the CoRE Research report provided to the Commission in Part B of Adsteam's initial submission. While noting that "... the case that there is a particular competitive problem in harbour towage is yet to be proven,"<sup>24</sup> CoRE Research goes on to conclude that:

"... approaches to regulation that consider a single element [in the chain of port production] are unlikely to be effective in improving the efficiency of shipping through Australian ports. For example, price regulation in towage should not be considered in an independent manner to price regulation of all other port services. Piecemeal reform is likely to be either ineffective or potentially harmful. If there are real competitive problems in ports they should be addressed at an industry level rather than on a single dimension."<sup>25</sup>

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<sup>24</sup> CoRE Research, *Harbour Towage in Australia: Competitive Analysis and Regulatory Options*, April 2002, p.24.

<sup>25</sup> CoRE Research, *Harbour Towage in Australia: Competitive Analysis and Regulatory Options*, April 2002, p.24.

## 2 MARKET CONTESTABILITY

Market contestability is likely to prove to be a key issue for the Commission. It is an issue that is central to determining whether or not an economic or competition problem exists in the towage industry, and thus whether or not an imposed regulatory solution is required.

In its initial submission to the Commission, Adsteam cited both empirical and analytical support for its contentions that towage markets in Australia are contestable.<sup>26</sup> These contentions are consistent with those of other interested parties, such as the AIMPE, that have gone to some length to explain how “Entry and exit of operators from the Australian Towage Industry has been quite common over the last decade or more.”<sup>27</sup> Adsteam agrees with the AIMPE’s observation that:

“The impending start-up of this new operation [Australian Maritime Services] in several of the major metropolitan ports give the lie to the notion that there are insuperable barriers to entry in the Australian towage industry.”<sup>28</sup>

At the same time, the AAPMA claim that “It is well recognised that entry into any single port is very difficult given the economies of scale, high sunk costs etc (Bunbury case, various ACCC and other inquiries) and, as a result, is unlikely without some regulatory/commercial arrangements in place.”<sup>29</sup> Adsteam questions the accuracy of such observations in light of other information provided to the Commission.

The ACCC cites its own previous studies and information given to previous reviews of harbour towage to establish the “considerable” transaction costs of transporting tugs from overseas markets to Australia. In this regard, it estimates that “re-positioning” costs can be as high as \$400,000 for a single tug, with upgrading costs to meet Australian standards being “up to \$500,000.”<sup>30</sup>

These figures contrast with Adsteam’s own experience in bringing five new 60-tonne bollard pull Z-peller tugs from Singapore in 2000. The relevant “re-positioning” costs as set out in the following table are actual costs inclusive of crew wages, fuel, air travel and victualling.

**Table 2.1 – Actual cost of bringing tugs from Singapore, 2000**

Port Destination	Travelling Time	Total Delivery Costs*
Adelaide	16 days	\$114,000
Sydney	21 days	\$139,000
Brisbane	18 days	\$134,000
Fremantle	11 days	\$ 82,000

\* As note above, costs are actual “per tug” costs paid by Adsteam for delivery of new tugs from Singapore to the above ports in 2000 and cover crew wages, fuel, air travel and victualling.

It should also be borne in mind that the use of foreign and non-union crews can significantly reduce the cost of importing tugs from overseas markets. This and an understanding of other cost variables are arguably more relevant to an economic analysis of market contestability than the “maximum” figures quoted in other contexts.

<sup>26</sup> Adsteam, submission lodged 26 April 2002, pp.28-32, 55 and 57. See also Part B of Adsteam’s submission and in particular the report *Harbour Towage in Australia: Competitive Analysis and Regulatory Options*, prepared by CoRE Research, April 2002.

<sup>27</sup> AIMPE, submission lodged 24 April 2002, p.5.

<sup>28</sup> AIMPE, submission lodged 24 April 2002, p.7.

<sup>29</sup> AAPMA, submission lodged 19 April 2002, p.17.

<sup>30</sup> ACCC, submission lodged 24 May 2002, p.6.

Another relevant factor is the ability of tug manufacturers/dealers to tailor very favourable lease and buy-back arrangements requiring very little up-front cash from existing and prospective towage operators. For instance, during the recent call for tenders at Fremantle, Dutch tug manufacturer Damen offered a number of tenderers very attractive lease and buy-back arrangements inclusive of the delivery costs noted in Table 2.1.<sup>31</sup>

Adsteam supports the ACCC's suggestion that the Commission inquire as to the delivery costs incurred by Australian Maritime Services in bringing its tugs to Melbourne from Hong Kong last month.

As to the cost of modifying foreign tugs for use in Australian ports, modern tugs from Asia and elsewhere generally compare favourably with those built specifically for Australian conditions and can enter service here with minimal, if any, modification. It is understood that Australian Maritime Services needed only to increase the bulwark height of its 1995 Japanese-built tugs imported from Hong Kong.

Adsteam understands that the three Dutch-built tugs imported by BHP from Malta to Newcastle in 1993, required no more modification than a name change.

It should also be noted that the economic value of tugs does not diminish quickly. Due to relatively low volumes of tug calls in Australian ports and hence low running hours, as well as other factors inherent in modern tug design, tugs in Australia hold their value well. By way of illustration, Adsteam believes that the last tugs it had built in 1999/2000 would still command a sale price very close to their price when new.

Tugs prepared for use in Australia are readily deployed in almost any overseas port.

Further to its discussion of market contestability and the need for regulation, the ACCC refers to a paper prepared by Henry Ergas in relation to the Federal Court decision on the use of exclusive towage licences in the Port of Bunbury. The ACCC cites the Ergas paper to highlight the significance of sunk costs when assessing whether potential behavioural responses by an incumbent towage operator towards new entrants.<sup>32</sup>

The Ergas paper goes on to demonstrate how market contestability in harbour towage could be a more significant constraint on incumbent behaviour than has been recognised in previous studies and court cases. The paper also raises serious questions about the use of exclusive towage licences and the need for the economic regulation of towage services more generally.

Like the ACCC, Adsteam supports the use of the Ergas paper by the Commission.

Also relevant are the comments of the Victorian Department of Infrastructure, which while recognising potential short term difficulties for market entrants, concludes in its submission that:

“... in the long term, technical substitutes such as bow and stern thrusters will become cheaper relative to towage. Thus, both technological change and contestability will erode any form of market power that might exist in the short term.”<sup>33</sup>

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<sup>31</sup> Damen Shipyards of Holland is one of the largest tug builders in the world and has offered (and is ostensibly still offering) brand new 45 to 60 tonne bollard pull tugs to any interested party in Australia under a range of flexible financing options. One of the options that has been offered is a 7-year lease arrangement with a guaranteed buy-back. Under these arrangements, a deposit of 20% of the build price is required which covers the tugs being built to Australian standards (either 2 or 3 man crew) and delivered to the wharf in any port in Australia.

<sup>32</sup> ACCC, submission lodged 14 May 2002, p.6.

<sup>33</sup> DOI, submission lodged 26 April 2002, p.2.



It remains Adsteam's contention that market contestability in the towage industry is impeded more by the existence of exclusive towage licences than almost any other factor. Rather than aid contestability as their supporters argue, such regulation imposes a "second best" solution to a problem that is more perceived than real.<sup>34</sup>

In sum, Adsteam does not believe that there is sustainable evidence that there exists a problem with contestability in any of the markets in which it operates (apart from the small number of ports where it holds exclusive service supply rights), or at least no problem significant enough to favour economic regulation over a free-market approach.

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<sup>34</sup> Adsteam, submission lodged 26 April 2002, pp.61-63.

### 3 THE IMPACT OF TOWAGE ON INTERNATIONAL COMPETITIVENESS AND TRADE

Adsteam believes that it is misleading to state, as some interested parties have, that lower towage charges will appreciably improve Australia's international trade position. Such statements overstate the significance of towage in the context of international trade, wrongly presume that towage price reductions would be passed on to end users, and wrongly imply that towage prices are presently too high.

In addition to these concerns, Adsteam believes that a focus on towage charges in this or any other context demotes the importance of towage service quality and reliability, factors that are arguably more important than towage prices to the efficiency of international trade.

Interested parties are divided on the significance of towage charges as a cost input in freighting goods to and from Australia by ship. Consistent with Adsteam's own analysis,<sup>35</sup> CSR Shipping has calculated that towage charges can be (and for the most part are) less than 1% of costs.<sup>36</sup> On the other hand, SAL calculates that "Towage costs in Australia account for around a third of the ship-based costs of entering Australian ports ..." <sup>37</sup> and according to the Sea Freight Council of Western Australia:

"Because towage services represent a significant component of total port call costs they, potentially, can impinge on the capability to maintain that international competitiveness."<sup>38</sup>

These statements are made to the Commission without any evidence that a reduction in towage charges would be passed on to consumers - and with an element of "statistic shopping" whereby the significance of harbour towage as a cost impost can be increased or decreased depending on the desired effect. Thus, at the extremes the cost of harbour towage is 100% of the cost of harbour towage while at the same time total towage charges in Australia last year represented less than 0.1% of the total value of goods traded by ship to and from Australia.<sup>39</sup>

One way that Adsteam has attempted to add an appropriate perspective to the cost of its services, and particularly in relation to the recent increases in towage charges, is by assessing the impact of towage cost on a TEU basis for an actual ship visiting three sample ports in which prices have increased. The following table provides the relevant data for one such assessment.

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<sup>35</sup> Adsteam, submission lodged 26 April 2002, pp.42 and 43.

<sup>36</sup> CSR Shipping, submission lodged 19 April 2002, p.1.

<sup>37</sup> SAL, submission lodged 19 April 2002, p.1.

<sup>38</sup> Sea Freight Council of Western Australia, submission lodged 19 April 2002, p.5.

<sup>39</sup> Based on Australian Bureau of Statistics, International Accounts and Trade, Merchandise Exports and Imports by Mode of Transport for Year Ended 30 June 2001.

**Table 3.1 – Per TEU cost impact of towage price increases  
– Containership on 3-port rotation**

Port	No. of Tugs	Total Cost of Tugs A\$	Notified Price Increase %	Increase in A\$	Average TEUs Load/ Discharge	Cost Increase per TEU A\$
Brisbane	2	\$5,509	11.70%	\$645	336	0.95
Port Botany	3	\$8,158	13.10%	\$1,069	476	1.12
Melbourne	1	\$3,075	23.40%	\$719	598	0.60

**NOTES**

1. Price increase calculated inclusive of GST
2. Increase calculated in cost per full TEU
3. Based on an actual ship with 1728 TEUs total capacity
4. Commodity value per TEU A\$
 

Grapes	\$20-25,000
Whiskey	\$30-80,000
Wool	\$40-50,000
Cotton	\$70-75,000
Chilled meat	\$70,000
Wine	\$100,000
Waste paper	\$1,250-2,500

It can be seen from Table 3.1 that towage both as an absolute cost and in terms of the recently notified price increases is insignificant in an applied sense as a percentage of the total value of commodities shipped in by TEU. This analysis, which can also be adapted to bulk cargoes, is consistent with the assessment of CSR above and tends to discount the relevance of the statistics quoted by other interested parties.

One possible explanation for the concern expressed by SAL, among others, over towage prices is the fact that container box rates (which are determined more by the forces of supply and demand than any other factors) are presently low with margins suffering as a result. In these circumstances, calls for lower towage charges are as predictable as the likelihood that none of the resultant cost savings would be passed on to shippers or consumers.

In these regards, the Commission's attention is also drawn to the concern expressed by the SAL that "Increased towage costs will exacerbate ..." the "... unrealistically low [liner freight rates that] threaten the health of some carriers."<sup>40</sup> It is difficult to see how reduced towage charges would not be quickly absorbed by ship operators in these circumstances.

Further discussion of these issues is provided in the Howe Robinson report provided in Part B of Adsteam's previous submission.

A related issue is the concern expressed or implied by some interested parties that towage charges can adversely affect the competitiveness of individual ports.<sup>41</sup> Leaving aside the question as to the degree to which competition exists between ports within Australia, Adsteam does not accept on the basis of existing evidence that towage prices have any significance in this context (although it does acknowledge that the perception of competition at this level can have a very real constraining influence on towage operators' business decisions.)

A related misapprehension is the number of physical tug jobs that occur in ports. The overstating of tug jobs can lead to a perception that towage is more significant as a cost to international trade than is actually the case. For instance, Sydney Ports appears to have miscalculated tug calls in Port Jackson and Port Botany by equating them to ship movements.<sup>42</sup> Of the 4,884 vessel movements recorded across both ports, the number of

<sup>40</sup> SAL, submission lodged 19 April 2002, p.1.

<sup>41</sup> See for example, Ports Corporation Queensland, submission lodged 29 April 2002, p.2.

<sup>42</sup> Sydney Ports, submission lodged 8 May 2002, p.3.

ship calls using tugs was 1,994 (total in/out movements being 3,992) resulting in 6,648 tug jobs, which is far fewer tug jobs than implied by Sydney Ports' figures.

This correction highlights a common mistake made by port authorities and others when assessing towage operations. It also shows that the critical issue is not so much the total number of ships through a port but rather the number of ships that use tugs.

In sum, Adsteam does not believe that towage charges are as critical to international trade (or even to the ultimate cost of goods) as is being argued by third parties. Moreover, it would seem that the concern expressed has more to do with self interest than community mindedness (or even objective analysis).

In Adsteam's view, there is yet to be shown a problem with towage prices in Australia such that regulatory intervention is required. To the contrary, there is evidence of opportunities to increase competition (and potentially to reduce towage costs) through fewer pricing controls.<sup>43</sup>

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<sup>43</sup> Of interest in this regard are the comments of the Victorian Department of Infrastructure that, "It is critical that the price [of towage] be allowed to adjust to the point where it entices new entrants or technological change." DOI, submission lodged 26 April 2002, p.2.

## 4 SERVICE QUALITY AND RELIABILITY

The focus on towage prices by ship operators and other interested parties underscores the high quality of services provided by towage operators in Australia. If service levels were low, much more would be said of it than of price. This is because it is much more important to have high quality towage services than cheaper towage services. As it is, price complaints remain the only substantive form of criticism (and this is to be expected even in the most efficient of industries).

In this context, it is of interest to note the comments of the Victorian Department of Infrastructure, where in its submission it contended "... that any decision to regulate towage should be based on the failure of the market to provide adequate safety, not harbour towage operators exercising market power."<sup>44</sup> While Adsteam does not necessarily concede any misuse of its market power, it agrees with the DOI's concern for safety over pricing.

Some interested parties believe that, "harbour towage reliability is extremely high in Australian ports."<sup>45</sup> Others have acknowledged "... that considerable improvement has been achieved in the efficiency of harbour towage," although they also believe that further improvements are possible.<sup>46</sup> Still others state that they are "... reasonably satisfied with the levels of service provided by towage operators."<sup>47</sup>

Adsteam interprets these statements as positive endorsements of its operations during an inquiry where the temptation for interested parties to be overly critical is strong.

Adsteam has identified a number of sources, including data gathered by the BTRE, to establish the exceptional reliability of its services.<sup>48</sup> Regardless, some interested parties have been critical of various aspects of those same services. Some have even used this criticism to justify the introduction of towage licences. Fremantle Port for instance has stated that:

"Before licensing was introduced, Fremantle Ports had been greatly concerned that towage services were not meeting customer expectations in terms of reliability and prices."<sup>49</sup>

The survey results collated by Fremantle Ports as reproduced as Table 2.4 in Adsteam's previous submission, do not, however, support the above contention. This is because the survey in question pre-dates any towage licences in Fremantle and clearly shows a high degree of towage customer satisfaction relative to almost every other port service provider.

In any event, the licensing arrangement referred to by Fremantle Port is non-exclusive licensing of a kind that Adsteam does not oppose.

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<sup>44</sup> DOI, submission lodged 26 April 2002, p.2.

<sup>45</sup> AIMPE, submission lodged 24 April 2002, p.9.

<sup>46</sup> AAPMA, submission lodged 19 April 2002, p.9.

<sup>47</sup> SAL, submission lodged 19 April 2002, p.2.

<sup>48</sup> Adsteam, submission lodged 26 April 2002, pp.6-8 and 43 and 44.

<sup>49</sup> Fremantle Port, submission lodged 8 April 2002, p.2.

## 5 PROFIT MARGINS

Notwithstanding the Commission's stated preference to focus on other issues,<sup>50</sup> interested parties have expressed a good deal of interest in Adsteam's profitability and justification of its recent price increases. Much of this interest (and the criticisms levelled at Adsteam in this area) arises directly from the comments and assessments made by the ACCC during the recent price notification process. For instance, SAL states rather indirectly:

"Guided by the ACCC conclusion in its recent investigation of the notification under the Prices Surveillance Act, one would have to agree that excess profits are apparently now being earned by Adsteam in the ports that were the subject of that inquiry."<sup>51</sup>

Other interested parties, such as the National Bulk Commodities Group, agree with the Commission that such comments are not central to the present inquiry.<sup>52</sup> Others go as far as to provide support for Adsteam's contentions as put (generally unsuccessfully) to the ACCC, that "... it can be argued that in view of the high fixed cost and relatively stable or declining revenue base, [Adsteam's] profit margins have remained relatively stable if not declined."<sup>53</sup>

In its present submission, the ACCC maintains its view that Adsteam's desire to earn better than average returns is somehow reprehensible and evidence of excessive market power (a review of the "better than average" results of other Australian listed companies will demonstrate the flaws in the ACCC's reasoning in these regards – or possibly identify many new industries in need of regulation). The ACCC also offers a "re-run" of recent price notifications and cites its own conclusions as evidence of there being a problem in this area.<sup>54</sup>

In relation to the ACCC's recording of the magnitude of cumulative increases in towage rates as set out in Table 3.3 on page 19 of its submission, Adsteam is concerned both with the integrity of the underlying mathematics and the fact that these figures would appear to include price notifications associated solely with the passing-through of the GST (and may therefore mislead the Commission as to the total amount of increases "driven" by the declared businesses). Unfortunately, Adsteam has been unable to reconcile the figures quoted by the ACCC and up to the date of writing has been refused an explanation by the ACCC as to its approach.

While unable to comment further on the veracity of the statistics quoted by the ACCC (or the text accompanying it), Adsteam requests that the Commission be especially circumspect in relation to this data.

The Commission should also be cautious in its acceptance of the timeliness statistics provided by the ACCC in Table 3.2 of its submission. These statistics purport to demonstrate how the ACCC has dealt efficiently with previous price notifications, something that Adsteam strongly disputes based on its experience of the same events.

In relation to the first two noted price notifications involving Waratah Towage, these notifications essentially relate to the same price increases and therefore the times noted should be combined rather than be considered separately. Moreover, the actual time taken amounted to several months (not the combined 62 days) as Adsteam was persuaded by the ACCC to undertake an extended draft notification process notwithstanding that such a process is not recognised in (and is arguably contrary to) the PS Act.

<sup>50</sup> Productivity Commission, Issues Paper March 2002, p.5.

<sup>51</sup> SAL, submission lodged 19 April 2002, p.8.

<sup>52</sup> See NBCG, submission lodged 22 April 2002.

<sup>53</sup> DOI, submission lodged 26 April 2002, p.8.

<sup>54</sup> See generally ACCC, submission lodged 14 May 2002, pp 9 to 23.

Adsteam understands from Howard Smith records that a similar “draft notification” process was undertaken in relation to the third noted price notification. In relation to suggestions by the ACCC that the “stopping and starting” of the notification within the formal processes of the PS Act were as a result of Howard Smith decisions, these suggestions are ostensibly incorrect. As in Adsteam’s experiences, it is typically the ACCC that engages in stopping and starting the statutory “clock” in ways that best suit its objectives.

In Adsteam’s view, the invention of the draft notification process is a prime instance of the ACCC seeking to bend statutory rules to suit itself, even where the resulting processes can be incredibly resource intensive for the regulated entities.

The fourth and fifth noted price notifications are nothing more than the passing through of the GST, appropriately adjusted. These notifications required no analysis on the part of the ACCC and are therefore not a basis on which to assess regulatory timeliness or efficiency.

In these areas, Adsteam rejects the ACCC’s contentions that it has maintained an exemplary regulatory record for conducting itself within the strictures of the relevant regulations – or for having regard to the openness and transparency one would expect from light-handed regulation. The failure of the ACCC to “come clean” on these issues has frustrated Adsteam during the price notification processes it has endured to date, and threatens to frustrate the Commission’s task of objectively assessing the efficacy of current regulatory arrangements.

More generally, Adsteam does not agree with the ACCC’s assessments regarding price regulation and nor does it see the relevance in much of the information it has provided to the Commission. In the event that weight is to be given to these matters, the Commission’s attention is directed to the recent profit downgrade lodged by Adsteam with the Australian Stock Exchange on 2 May 2002. This downgrade, which is in the order of around 15 per cent, is based on a range of factors not usually associated with a business enjoying substantial market power and an ability to reap “excessive” margins.<sup>55</sup>

Having made clear its views on these issues over the last few months, Adsteam does not consider it necessary or appropriate to comment again on these issues. Rather, it believes that the focus of the inquiry should not be distracted from the fundamental economic issues of market failure, contestability and efficiency – and a discussion of options for reform rather than increased regulation.

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<sup>55</sup> Included in the list of relevant factors noted by Adsteam are “They entry of a new competitor this month to the Port of Melbourne market” and “A continued sluggishness into the June quarter of vessel calls and tug jobs in Australia, which in the nine months to 30 March, 2002 were down by 1.1% and 2.8% respectively. This continued the trend outlined by Adsteam at its annual general meeting late last year and at its first half year results presentation in February this year.”