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**Comments on the submission by Adsteam Marine to the Productivity
Commission inquiry into the economic regulation of harbour towage
and related services**

Executive Summary

1. A central theme of the Adsteam submission is a questioning of Port Authorities' involvement in the provision of towage services in a port especially from a commercial perspective.

A key role of a Port Authority is to facilitate trade through the port. This is achieved by ensuring that all services required, including land areas, meet stakeholder requirements.

The reforms undertaken by ports in the 1990s were based on a landlord model whereby ports retained only the core functions that they were required to perform, with all activities such as stevedoring, some maintenance etc., being undertaken by private sector providers.

The ongoing development in ports in order to meet market needs and to ensure that long term planning was carried out in relation to both land and sea access, led to the emergence of a strategic management approach by Port Authorities as a natural extension of their landlord role. We understand that this approach has been received well by industry in view of the complexities of the land and sea interfaces in ports and the need for a single body working with the broader port community to champion necessary infrastructure and other developments including services provision.

We therefore contend that the role that some ports have taken up in connection with towage ie., licensing or contracting with the towage provider, is compatible with this strategic management role.

Furthermore, Port Authorities, under their enabling legislation, are required to implement many of the marine safety regulations developed by State Governments.

In specific relation to towage Port Authorities see their role as ensuring that a towage service will always be available in the port, that the standards of service and tug vessels remain adequate and meet ship operators' requirements in terms of acceptable delays, minimal number of tugs per ship etc., and that prices charged to the ship operators, as users of the towage service, are reasonable.

2. The tendering of towage services by some ports in recent years, largely as a result of stakeholder suggestions, has demonstrated that price reductions are available in connection with improvements to service levels. Adsteam has participated in all recent tenders.
3. Adsteam operates as the dominant towage provider in Australian ports and, as such, could be said to have a national coverage. This gives them a powerful position as an incumbent towage service provider in any one port.

We contend that this results in significant barriers to entry of new service providers.

Furthermore, Adsteam have adopted a policy of not sharing their tugs with other actual or potential competitive service providers. In addition, they have an established practice of rebates for large volume users on a national basis which makes it difficult for a new entrant to compete on a price basis. These are also barriers to market entry.

4. Port Authorities are required to manage safety and environmental regulations under their enabling legislation. They also have to manage overall risk issues within the port in the interests of facilitation of trade. This covers damage to property, ships, personnel, the environment, channel blockages etc.

In this regard, ports' involvement in the provision of towage services is through the combined operational assessments and judgements of the pilots, who are expert ship handlers and navigators, and the harbour masters, who are not only also experienced ship handlers in the port, but also have the responsibility for and knowledge of overall safety relating to all harbour conditions. Their joint involvement is seen as a primary form of risk management for the port.

It is considered that the disciplined management of these matters in the interests of the whole port community is of far greater consequence than the commercial aspirations of a towage company providing one service function in the port, albeit a most important function. The management of these risk parameters cannot be left to commercial organisations alone as that would produce an inherent conflict of interest. Furthermore, the towage industry has neither the legal power nor the operational ability to manage the risks in relation to vessel handling in port waters.

5. Most ports are owned by State Governments and are accountable to Governments for their performance in line with their appropriate legislation and charters. There is no conflict in their implementation of regulatory functions with commercial considerations. However, ports are required to operate ports and manage port assets in a commercial manner.

Comments on the submission by Adsteam Marine to the Productivity Commission inquiry into the economic regulation of harbour towage and related services

This submission comments on statements made in Adsteam Marine's submission dated April 2002. We have addressed their submission in the same order that it has been provided to the Productivity Commission and wherever possible we have related our comments to the individual segments of their submission. As a result there is inevitably some repetition of argument but we consider that this will help the Commission's understanding of the important issues in relation to towage.

1. Industry Overview

1.1.2 Towage Charges

Port Authorities are prepared to consider different methods of charging for towage services under any licensing arrangements that they have in place. Obviously, the charging regime must be agreeable to the shipping companies as purchasers of the towage service.

Port Corporations would be pleased, as part of their overall strategic port management function, to assist in these consultations. No doubt the shipping industry will have its own views on this matter.

Pricing models will probably vary from port to port depending on the types of vessels, different trades, acceptable delays, etc. and there is no one model that can be seen as common to all ports.

Rebate Arrangements

The issuing of rebates or volume discounts is an accepted commercial practice especially in highly competitive industries.

Whilst there could well be justification by Adsteam's major customers that they were under-pinning the fixed cost of towage to the benefit of less frequent callers to Australian ports, the real issue, from our point of view, is that the use of the rebate system on a national basis constitutes a very significant barrier to entry of a new towage provider in any one or more of the ports.

Whilst it is denied that these rebates are international, ie. go beyond Australia, it is conceivable that these rebates could extend to those shipping lines that use Adsteam's UK towage services and thus heighten the barrier.

Furthermore, the rebates are in the main given to those companies engaged in container services as these companies manage and operate a large number of ships under their own name. This contrasts with

ships engaged in the bulk trades where, in general, each ship is a company in its own right and there are few companies that operate a number of vessels such that they could attract a rebate. The bulk trades are therefore disadvantaged by not gaining access to the rebates which results in bulk trades not gaining some additional, much needed, competitive advantage in terms of their export markets.

Lastly, someone has to bear the cost of the rebates. Any commercial organisation has to earn a return on its investment (and this has been stressed repeatedly by Adsteam in their submission). It is unlikely that they will reduce their revenue by means of the rebate and so deny themselves the opportunity of meeting their required return. Therefore, the cost of the rebate must be borne by those companies who are not able to gain the rebate. We consider that in a monopoly market such as towage, the granting of rebates is inequitable as, contrary to Adsteam's claims about the freedom of access by competitors to ports, competitive entry to ports is extremely difficult with a national incumbent in place as we have mentioned in our earlier public statement.

1.2.1 Lines and Mooring Services

The cost of lines and mooring services in Sydney is approximately three times the cost of those in Brisbane and Melbourne . (There are two competitors in Melbourne.) These services are provided by Adsteam and associated companies in Sydney. It is considered that there could be opportunities for cost reduction if there were a greater sharing of resources and equipment between the Adsteam companies operating towage and lines services. The comments by Adsteam that industrial constraints have prevented any improvement in efficiency or pricing change in Sydney are correct

1.2.2 Ocean Marine Salvage

The rewards from salvage can be quite significant and therefore salvage operations are a fairly competitive business - in some ways akin to tow truck operations for cars involved in accidents. Adsteam, through United Salvage, is a significant supplier of salvage services as it has the towage capacity with salvage capability strategically located around Australian ports. Other salvage providers are mainly those involved in off-shore oil and gas supply operations and some smaller groups which focus on recreational vessels, repair work etc.

Adsteam have publicly stated that they do not pass on the cost of salvage capacity in harbour towage charges. As a commercial operation it is difficult for us to accept that this is the case in view of the infrequency of salvage operations and the variability of the reward. We suggest that the Commission may wish to discuss this matter with Adsteam.

1.3.1 Ship Operations

Adsteam say that “the size of their (‘their’ being regular callers to Australian ports) contribution to a towage provider’s bottom line is a significant source of bargaining power”. We consider that an individual shipping line would have little bargaining power in towage but if a number of lines were to collectively support an alternative towage provider that may provide adequate support for entry at least in the short term.

However, this has not occurred and we have yet to see where competitive providers of towage services have successfully attempted to enter the market in a non-exclusive manner probably because they recognise the power that Adsteam has in relation to the smallness of the individual port towage markets. It is interesting that the towage operations of large ship operators such as Maersk and NYK, who are regular callers to a large number of liner service ports in Australia, have not attempted to enter the Australian towage market.

1.3.2 Pilots

The comment that “Adsteam successfully removed two tugs from Newcastle allowing its acquisition of Hunter Towage” must be taken in context. When Newcastle licensed two towage operators they required each of them to have four tugs. This provided an overcapacity of towage in Newcastle but as Adsteam was not prepared to hire their tugs to the other company when they were needed so that there could be the required number of tugs in the port, each company had to maintain a full complement of four. Therefore, the “rationalisation” achieved by Adsteam through its acquisition of Hunter Towage should be seen as simply returning the market to what it should have been.

1.3.3 Port Authorities

The primary role of Port Authorities is to facilitate trade, a role that has been confirmed in legislation establishing Port Corporations/Authorities in the 1990s following from the significant reforms of Port Authorities undertaken by State Governments. This role requires ports to be responsible for the management and development of port assets and also to be effectively strategic port managers ensuring that all services are provided efficiently and effectively so that trade through the ports can be enhanced. Port Authorities also have a role to ensure that the risk to property, channels, the environment, ships and service providers (as appropriate) is managed in the collective interests of the port. In carrying out this role Port Authorities implement a number of safety regulations on behalf of the State regulatory authority.

It is true that Port Authority charges are not always totally transparent in relation to the actual cost of providing facilities. A large proportion

of a Port Authority's costs are incurred in the strategic management of the Port which includes ensuring the provision of a range of service activities that are required for the ongoing facilitation and growth of trade.

It is quite incorrect to say that "Port Authority charges are often allocated to meet the dividend requirements of State Governments". Port Authorities are required as corporatised entities to pay a dividend to their State Government shareholders. This is normal commercial practice. Dividend policies do vary from State to State and in recent years in one State there has been a significant review of debt/equity ratios in some ports which has led to the payment of special dividends to shareholders. In addition, over the past ten or so years since corporatisation, some State Governments have required special dividends resulting from the sale of surplus assets by Port Corporations.

It is also true that a Port Authority's interest in towage "is related to their interests in making their ports safe and attractive to ship operators" but, as well, that there is an efficient and cost effective service provided to enable shipments to move in and out of the ports. Obviously, as trade facilitators ports do wish to increase the desirability of their port so that shippers from the regions surrounding the port are able to engage in trade in the most cost effective manner possible.

To say that a Port Authority's "underlying driver" (in relation to towage) is competition (with other ports) is fundamentally incorrect. Competition between ports is in most instances marginal, largely because of the relatively high cost of land transport in Australia and the large distances between ports.

The cost of towage in the overall transport chain equation is relatively small in relation to other service costs. The underlying driver for a port in relation to towage is to ensure that their shipping and trade stakeholders' needs are met and that port risk profiles are not exceeded. Adsteam seem to confirm this point in a subsequent paragraph in which they discuss the development of towage guidelines to ensure the risk of damage to the port environment is minimised.

Adsteam state that Port Authorities are compensated "more on cargo volumes" which gives port operators "a significant interest in cargo throughput and less of an interest in ship size". This is also fundamentally incorrect. Obviously Port Authorities are interested in cargo volumes as this is a direct reflection of their responsibility for trade facilitation. However, they are vitally interested in ship size as increases in ship sizes sometimes require quite significant changes in port infrastructure to accommodate such larger ships, for example, wider and deeper channels, deeper turning circles and access to berths and on some occasions, different means of, or enhanced levels of, land

access to the berth.

Adsteam further comment on “the derived competitive constraint on towage providers” from Port Authorities. In this regard they state that “Port Authorities are extremely attentive to ship operator demands for high quality and lower cost port services including towage services”. Also “Port Authorities actively encourage and sometimes direct” towage operators to increase their efficiency and standards of service.

As facilitators of trade and in their strategic port management role, ports are required to listen to the requirements of their stakeholders (in this case shipping operators) and so it is difficult to understand why Adsteam are making such an implied criticism of Port Authorities becoming involved in towage supply. If there were no “third party” between the towage operators and shipping operators then the needs of the trading community relying on a particular port may not be met.

The requirement of one port as compared to another relating to service charters, and exclusive, or non-exclusive contracts in relation to towage operators, is largely a function of other stakeholders’ concerns (or otherwise) in relation to towage services as well as a perception (mainly from stakeholder comment) by Port Authorities on the level of cost and quality of services provided by the incumbent towage operator.

There are no instances where there are differential standards and criteria set out in service charges and contracts applying to different towage operators in the one port – for one reason, all Australian ports effectively have a single operator and ports are bound by regulation to set safety standards to which Adsteam do not seem to object.

It is a Port Authority’s judgment, with input from stakeholders, as to whether the market for towage in a specific Port can provide for more than one service provider. The last example of two service providers in the one port was in Newcastle. As the Commission is aware, this failed as the market was simply not large enough to meet two operators given the size of the vessels and therefore the required tug fleet capacity in what is a very large Australian port. It appears to us that Adsteam are stating that a Port Authority has no right to make a judgment or even take a perception on what stakeholders’ require or what is good for the specific port.

Some Port Authorities do charge towage operators a licence fee. In the main these fees are quite small and are certainly not designed “to extend their control beyond safety issues and increase their own profitability”. Where towage operators use berth and land facilities in a port area, we cannot see why a Port Authority should not charge for the use of these facilities at rentals related to alternate market uses, as these facilities are essential to the towage operator’s business activity and income earning capacity. Why, for example, should a towage

operator be treated any differently to a container terminal operator or a container depot or any other service provider using Port Authority land or other facilities? Port Authorities are required as commercial operators to maximise the use of the land under their control, just as any public/private company would do. In fact, State Governments have taken back from ports “surplus” or unused port land in recent years.

1.5.1 Labour Reforms

We are aware of, and commend Howard Smith and Adsteam for the staged reduction in crew numbers on tugs from eight to three in just over ten years and in particular the reduction from four to three in recent years in those ports and on those vessels that have the facilities that can safely allow a three man crew. However, despite Adsteam’s public comments at the time of the most recent crew reduction that this would allow them to reduce prices, this has not occurred in any port.

1.5.2 Industry Concentration

We support the achievement of greater economies of scale where this can yield lower prices for users of the service. However, the market dominance achieved by Adsteam in Australia through the acquisition of Howard Smith in both the UK, together with the subsequent acquisition of another UK company which makes Adsteam the sole towage provider in another major UK port, does concentrate a lot of power in relation to towage provision in Adsteam’s hands.

The fact that a large number of the container lines regularly visiting Australia’s container ports also use UK ports gives, in our view, Adsteam very considerable market dominance through the use of the rebate arrangements and potentially other arrangements, such that these can be used as significant barriers to entry into individual port towage markets in Australia and even perhaps the UK.

We do not accept Adsteam’s contention that “where a towage operator becomes more efficient through an acquisition its ability to constrain its own prices and service levels increases” as “the threat of new entry remains”. We believe that the reverse can also be true as the power of the incumbent can be a very significant barrier to entry unless potential entrants are able to gain a guaranteed market share such that their entry and operating costs can be met within a time frame that is acceptable to them.

In this regard Adsteam is also vertically integrating its overall business through the acquisition of ships agency businesses. These could be used to enhance their towage market dominance by directing ship operators to Adsteam tugs. Furthermore, the recent joint acquisition of ports in South Australia allows them to control towage in South Australia.

1.5.5 Towage Regulation

Adsteam acknowledge in this section that towage guidelines are necessary for proper risk management within the port, however, they criticise the conservative attitude of key market participants – pilots and Port Authorities. They then go on to say that “this conservative attitude constitutes a form of regulation that prevents towage operators achieving the efficiencies – and potential costs of savings to ship operators - that tug fleet reductions would allow”.

The issue here is that there can be occasions when fewer tugs may be necessary on ships because they have technological aids and/or weather conditions are very favourable to reducing the number of tugs used. In a number of ports there is a flexible approach to tugs needed on vessels on a day by day and ship by ship basis. However, there are times when the guidelines need to be adhered to such as in periods of bad weather or where vessels do not have advanced technological aids. This requires a certain complement of tugs as otherwise ships will be delayed in entering or departing a port until weather conditions are more favourable or another tug is brought in from another port. These delays are unacceptable to most, if not all, ship owners and are a subject that is discussed between ship owners and Port Authorities from time to time. The costs of these delays over time to a ship owner can be more than the cost of meeting “extra” towage requirements in a port.

Furthermore, a Port Authority has to meet the needs of all shipping companies trading into a port and not just a select few. In addition, the Port Authority has to ensure that all risks relating to the movements of ships within ports are minimised as the cost to the port, to shipping companies, to port service providers, and shippers (exporters and importers) from an accident that, say, may result in a blockage of a channel or significant damage to a wharf, may be far greater than a reduction in the number of tugs servicing the port and the effect of that reduction.

It seems to us that Adsteam, in arguing for a more commercial management approach to towage with commercial considerations being the sole driver, is taking a self interest view at the expense of its customers, the ship owners, and to other significant stakeholders in the port. This contradicts recognition by them elsewhere in their submission that pilots and ports have risk considerations that they have to manage.

Adsteam then states in Box 1.5 “recent examples where **pressure** has been placed on Adsteam to make decisions about the fleet’s specification ...”. In other words, Adsteam are implying that the Port Authority has no right to enter into discussions with its shipping company stakeholders regarding towage requirements that will be

required to service the future needs of the port and minimise the attendant risk factors and that the towage operator is best placed to make the decision on the best combination of tugs applicable to that port for his commercial benefit. Surely the Port Authority is fundamentally assisting the meeting of market needs by signalling this information and by making an informed judgement on what will be required in terms of towage for these changed requirements. Why is this **pressure** on the towage operator as surely the operator accepts that there will be changing circumstances that may require long term changes to tug configuration in a port from time to time? Our comments on Adsteam's examples of **pressure** follow:

- In the case of Geraldton, the expansion of the port requires a different channel configuration and therefore it has been judged by the Harbour Master after extensive simulation and other trials that larger tugs will be required not only to meet the larger size of vessels, but to meet some of the effects of the new channel, weather conditions etc. This is a significant and long term change in this port which benefits Geraldton port users considerably.
- Mackay indicated in 1998 that it expected that larger sized (panamax) vessels would be required in the future and advised all service providers accordingly. This was fully supported by the Port Advisory Committee which is the representative group for the port's user community. Potential towage providers were advised of this at the time and also that Mackay did not wish to be involved in a situation where they needed to engage an additional tug at high cost from the adjacent Port of Hay Point. Whilst a licence invitation process had to be abandoned at the request of the State Government, Adsteam on its own volition and without consultation, upgraded the tugs in Mackay in February 2001, possibly earlier than really necessary.

It is felt that this action was clearly taken as a pre-emptive measure to reinforce their position as the incumbent. Adsteam did not seek any increase in the pre-existing towage charges at the time but indicated earlier this year that a major price rise (of around 60%) was pending. However they have now deferred this increase until the report from the Productivity Commission has been considered.

- The comment in relation to Newcastle is quite incorrect. The Harbour Master has never criticised the occasional use of smaller tugs to replace the larger omni-directional tugs, nor has their use ever been refused. However, they do criticise the power capability of one of the Adsteam tugs which is often used in Newcastle.
- The introduction of a new trade in wood chips in Albany has led to the commissioning of a dedicated woodchip vessel. The port advised the single towage provider that a larger tug would be necessary for this new trade. This is a normal request for a port to

make in relation to their consideration of the risks and it is hard to accept that this is “**pressure**” on Adsteam as they would have been aware, for quite some time, about the wood chip trade in Albany.

Ports object to the use of the term “**threat**” of regulation by Adsteam. In the role of a trade facilitator it is incumbent upon ports to represent the interests of their stakeholders. If in any situation there is a perception that one or more of the service providers in a port, whether they be towage, pilotage, stevedoring or others, are being inefficient or not maintaining a requested level of quality and service then Port Authorities have an obligation to discuss this with the service provider. All Port Authorities have a Port User Group which comprises members from all groups that are involved in port activities, including towage, and it is through these fora that service qualities can be discussed and are often raised. Adsteam’s argument in relation to this issue appears to us to imply that they have, as the incumbent, the perpetual right to provide towage services in each port in which they currently operate under their terms.

We are not aware of any instance where new entrants, as implied by Adsteam, have sought to damage the incumbent operators to win the right to provide towage in a port and then proceed to renegotiate the contract during its tenure. As far as the recalculation of the contract terms in Bunbury is concerned, we understand that as GST arrangements had not been fully agreed at the time of the tender, GST was not included in any of the tender responses which included one from Adsteam. Adsteam suggest that a new entrant who won an exclusive contract could proceed to renegotiate the contract during its tenure. This is possible even in the case of a non exclusive contract however, legally the provider could be forced to perform the contract that it had entered into or otherwise it would be a breach of the contract. We suggest that the Commission may seek to discuss this directly with Bunbury.

Adsteam are correct in that a licensed or a non-licensed incumbent could always threaten to leave a port at short notice and, if this were to be the case, then the Port Authority and its stakeholders would be severely disadvantaged. In fact, this is a level of power that an incumbent in a port has over the Port Authority and its stakeholders and could be used by the incumbent as a “**threat**” to maintain their position. For this reason it is important that Port Authorities, if they are entering into licensing arrangements, have in place transitional arrangements to ensure that towage services are maintained at all times.

Adsteam are correct in saying that there are only a few arrangements for towage in a port that incorporate pricing arrangements that recognise an agreed return on the towage operator’s investment. Adsteam imply that Port Authorities should always consider this and presumably one could extend this implication to say that Port

Authorities should negotiate an arrangement with towage companies that gives a guaranteed return on investment. If Adsteam feel strongly about this then there is no reason why they could not have discussed this with Port Authorities and shipping operators and appropriate arrangements entered into.

In this regard Adsteam also are critical of the examples of where a rate of return is used in setting price levels that such rates do not allow for any revenue enhancements for the towage operator from traffic growth in that port. This seems an extraordinary argument to us, as traffic growth over time allows the benefits of economies of scale which are a reward in themselves.

Furthermore, such growth does not deny Adsteam the ability to reduce their costs or discuss changes in arrangements which could lead to greater efficiencies for them and for their customers. In fact, over the last ten years or so when there has been substantial traffic growth through most ports there are no examples of Adsteam reducing its prices to share some of the benefits from that growth in trade with its customers other than reductions in real terms. Their argument that because of reduced traffic volumes now they are entitled to increase their prices substantially is therefore somewhat one-sided in our opinion.

We sympathise with Adsteam over the variability between States in the classification and qualification requirements of tug crews. The variability in classification and qualification requirements and many other regulatory issues is a very serious deficiency in our Federal system but it is being addressed, albeit very slowly, through the work of the National Maritime Safety Committee which is a sub group of the Australian Maritime Group which, in turn, is a group formed under the Australian Transport Council. The slowness of achieving uniformity in regulations, classifications etc is largely due to individual States being unwilling to move from their entrenched positions. We feel that the Commission could refer to this as an example of where towage efficiency is being hindered.

1.5.6 New Entrants

Adsteam are correct in saying that when towage has been licensed or expressions of interest sought, there have been a large number of towage operators indicating their interest and indeed tendering for the supply of towage services. However, most of these prospective service providers have required exclusive access arrangements. Furthermore, many do not provide complying tenders or do not offer the level of service required to meet stakeholders' interests or the safety and risk management profiles required by Port Authorities.

As previously mentioned, the entrant of a second supplier in Newcastle was not successful over time and the new entrant sold its operations to

Adsteam.

Invariably new entrants require an exclusive arrangement because of the smallness of the individual (port) markets and also because of the power of a national incumbent if that incumbent continues to provide towage operations in that port. This power comes from rebate arrangements with large users (which are primarily only applicable in the large container ports) and also the ability of the incumbent to move tugs from port to port, thus lowering the cost structure in a particular port which may be subject to competition (subject of course to Port Authority requirements). This power also comes from the ability to operate in one Port at a loss or lower margin so that the new entrant, who will always have higher initial costs, is effectively priced out of the market.

It is interesting to note that the potential new entrant in Melbourne is not seeking to provide services at the same time in another or other ports.

Adsteam also talks about the strong second hand market for tugs. Whilst this is undoubtedly correct, it is interesting to note that with the purchase of their six new tugs they have not, to our knowledge, sold any of their older tugs into the second hand market but have sent one tug to their UK operations. One can only suspect that they have not done so because of the possibility of a potential new entrant picking them up in Australia, thus saving the cost of positioning tugs in Australian ports to challenge Adsteam's market dominance.

It should be noted in this section that at no time has any Port Authority sought an exclusive towage arrangement that did not have a time limit attached to it. Port Authorities wish to have contestable towage arrangements, however, given the high cost of entry into the market it must be recognised that at least the initial new entrant under an exclusive licence should be given an adequate time to recoup their capital investment so that they can offer attractive prices to ship operators. There are many views on the length of time that is required but generally speaking we see a time period as being between five and seven years. Once one or more new entrants have established themselves in Australia we believe that there is a far more contestable market as such operators will find it much easier to expand into other ports. It is possible that after the first entrant future licence arrangements could be for shorter periods.

2. **Towage Economics**

2.1.1 **Adsteam's Cost Reduction Initiatives**

Adsteam discuss at length the fixed cost problem that they have through the need to have a large variety of different tugs. However, there is no mention of the consequences of the purchase of six new

building tugs vis-à-vis the old tugs that must inevitably be replaced by these new tugs. As mentioned previously it is understood that only one tug has been sent from Australia to Adsteam's UK operations which means that there must be a number of tugs still on the Australian coast that are surplus to their requirements. This in turn must increase their "fixed cost problem".

Adsteam also comment on "Port Authorities, harbour masters and pilots insisting on tugs that are capable of assisting the largest and most cumbersome ship that is likely to arrive in their Port even if such ships arrive only infrequently". This is partially correct as otherwise it would put the Port Authority in the position of denying entry to a (trading) ship to the port because of the lack of availability of suitable tugs.

The alternative would be to bring a suitable tug from another port if one were available without causing delays at that port which could be quite costly in terms of the positioning costs and also the time for the vessel to wait for the specific tug. Whilst this could be a viable solution in some cases, the distance between most ports in Australia makes this relatively impractical.

Furthermore, there are issues in relation to risk management requiring a composition of tugs to meet a range of access requirements throughout the year. In addition, the level of service required is largely dictated by shipping companies and not ports.

If a port were to indicate that it was not prepared to accept certain types of vessels it would be failing in its primary responsibility of facilitating trade. Such a decision could only be taken after much consideration within the port community and invariably there could be a political input.

Adsteam also raise the cost of consultants and other direct costs in relation to compliance with the Prices Surveillance Act procedures and also, presumably, submissions to the Productivity Commission. This is an issue that we all face and from a Port Authority perspective we could also argue that we incur significant costs because of the need to meet a range of Government requirements that are not required from genuine private sector companies. We would argue that if there were general contestability in the market then Adsteam would not be in the main required to respond to the PSA or other control measures.

However, we would caution that we do see a role for a form of prices regulation in some ports where it may not be possible to develop some form of contestable competition. In such situations we would suggest that the level of price and other reporting be simplified as far as possible.

2.2.1 The Nature of Demand for Towage

Elements of this section appear to be contradictory. On the one hand Adsteam state that they “recognise that Port Authorities and Pilots have a role to play” yet at the same time they are more or less advocating a completely open and unregulated market. Furthermore, there are no restrictions on the ability of ship operators to contract directly with the towage operator of their choice. If a new towage operator wished to enter a port it is unlikely that, unless the towage operator did not meet regulatory requirements, a Port Authority would deny its entry. We do not accept that the market can be completely open and unregulated – Australian ports are required by regulation to ensure that the port is operated in a safe manner and this in turn requires regulations to be set by Port Authorities which are in fact implementing State Government regulations. It is most unlikely that any State Government would seek to remove safety and other relevant regulations.

Adsteam also state that market contestability should be customer driven. We have no problem with this as long as new operators meet the standards of safety required in the Port. These regulations do require some expertise in their application and we contend that this expertise is best provided by pilots and Port Authorities rather than the towage operators themselves who would effectively have a conflict of interest between imposing safety regulations and the “commercial” provision of tugs.

Furthermore, a towage operator could, if he were a regulator as well, create barriers to entry of other operators.

2.2.2 Tug Usage

It is not easy to compare towage statistics at selected ports. At best they can only be seen as a very rough guide. This is because all ports are unique – there is no model port and each port will have differences in terms of weather conditions, tidal flows, distances the tug has to travel to pick up or leave a vessel, ship sizes, sophistication of ships in terms of technological capability in berthing and unberthing, types of channels, angles of access and egress, etc.

Adsteam also imply that the drive for efficiency by ship operators is giving the opportunity for “others” to potentially increase their charges. Presumably this implication is directed at Port Authorities. If so, this is completely incorrect. Port Authorities will continue to work with ship operators to ensure that the most efficient towage service is available within accepted safety regulations. However, shipping operators also demand a level of service and are prepared to pay for it, and this level of service will be a significant determinant of the composition of a tug fleet in a Port.

Meeting the regulatory requirements as well as the level of service required by a shipping operator is a commercial decision by the towage operator. There is nothing to stop the towage operator from entering into discussions with shipping operators and Port Authorities on better means to manage their fleet if they see that they have too many tugs in a particular port or if they can see that a reduction in the fleet could create certain changes to the level of service, and ascertain whether shipping operators are prepared to accept this. It is accepted that the result of such discussions is often a compromise, however, surely this can be accepted as part of the cost of doing business in that port. Furthermore, the seeming reluctance of Adsteam to sell surplus tugs, despite what they say is a strong market for second hand tugs, must also be looked at in this context.

It is also the right of Adsteam to discuss with their customers different pricing arrangements. In general, the Port Authority would not be a party to these discussions.

2.3.1. Towage Cost and the Broader Supply Chain

We agree that the indicative cost of towage is small in relation to the costs of the overall transport chain. However this does not justify that towage costs could be ignored, as all costs in any chain are important in terms of the ultimate competitiveness of the supplier of goods. Ignoring individual components could be giving an opportunity to a service provider of a particular component to exert monopoly power.

Furthermore, the cost/price margin of many of our dry bulk products is very low and even if towage costs were themselves low as a percentage of cargo value, increases in these costs can have a far greater level of significance in terms of competitiveness of these products given Australia's relative distance from most of its trading partners and continuing downward pressure on the selling price of these goods. Coal is a particular case in point where producers in Australia are now limiting production of thermal coal because of an over supply – it is contended that any increase in costs relating to the shipment of thermal coal make it that much more difficult to secure a profitable export sale.

2.5 Risk

Towage companies are aware of all risks and if they were not prepared to accept these risks they would not be in the towage business. We therefore believe that Adsteam's comments in this area, whilst correct, are not really relevant to their argument. In this regard it is interesting to note that Adsteam are opposed to the introduction of the UK Standard Conditions for Towing and Other Services (revised 1986) to the Australian towage business although it is used by them in the UK because of the requirement for the towage operator to assume some

liability prior to and after completion of the towage job. Reliance on a 1974 Standard limits incentives to perform.

Furthermore, the matter of offering credit to ship operators is no different to credit being provided to any industry.

Adsteam talk about the natural monopoly characteristics of most ports in Australia and point out that Adsteam would have a lot to lose should a new entrant succeed in establishing themselves. Nearly all industries have to learn to live with competition and it seems to us from these statements by Adsteam that they simply do not accept that they should be in a competitive situation. This is a most unreasonable argument and tends to highlight the perception of Adsteam's monopolist attitude to the towage business in particular in Australia by its customers and other groups such as Port Authorities.

3. Competition Issues

3.2.3 Market Power Held by Towage Operators

We consider that much of Adsteam's comment in this section is arguable. Any business that wishes to meet customer demand has to keep up to date and meet its customers' needs. If it doesn't another competitor will enter the market but, in the case of towage, this is seen as far more difficult than perhaps in other industries because of the nature of the industry and the strength of a national supplier.

Adsteam say that "ship operators have secured rebates and maintain continuing pressure on towage operators". We contend that rebates have just as much benefit to Adsteam as rebates are an effective barrier to competition as was demonstrated in the Fremantle towage tender. Furthermore we understand that rebates were offered to container lines by Adsteam rather than being sought by container lines.

We have discussed the "threat" imposed by Port Authorities elsewhere in this submission. Whilst Adsteam may have retained its role as sole towage provider in a number of ports over the last few years, this was done on a non-exclusive contract basis and we would contend that if exclusive contracts had been available then, there would not only have been lower prices achieved through the tender process but there may have been one or more other towage providers currently in the market.

In the case of Melbourne where "an unassisted" new entrant is establishing itself in the market, we suggest that a judgment should not be taken now, rather we wait for twelve months or less to see whether the new entrant has a sustainable business. The actual evidence in Newcastle demonstrated that the new entrant, BHP, which did have some level of command of the market, did not achieve its required rates of return and furthermore that Adsteam ran large losses while they had competition in the port.

The issue of market power has been raised by Adsteam and they contend that the market power of Port Authorities (and pilots) on the pricing and supply discretion of towage operators generally, and Adsteam in particular, is of greater concern than any market power that Adsteam may have. Any market power that a Port Authority may have is not used for the benefit of the Port Authority, rather it is used for the benefit of the port community as part of the Port Authority's role as the facilitator of trade. Decisions taken by the Port Authority are made in consultation with relevant industry stakeholders and as Adsteam have mentioned on a number of occasions in their submission, Port Authorities do discuss towage and a range of other issues with shipping operators and other stakeholders.

Decisions on safety in the Port are made between pilots and the Port Authority. Both groups are free of commercial pressures in the main. This is not the case with Adsteam and shipping operators. There is no advantage gained by a Port Authority in using the market power that is attributed to them by Adsteam, and issues of dividends etc have been raised in earlier sections in this submission.

Port Authorities are established by Act of State Parliament. As such they are under very considerable surveillance by their Ministers. Certainly ports are "constrained" by inter-port competition. As previously mentioned, this is basically competition at the margin and whilst there may be many views within the trading and transport industries regarding Port Authority prices, access arrangements etc., in general we believe that following the reforms of Port Authorities in the 1990s resulting in the provision of most services by the private sector, Port Authorities themselves do not exercise undue influence by virtue of their monopoly status. Port Authorities are quite different to towage operators in terms of their "monopoly" power and it is in our view quite incorrect to compare them. In most cases Port Authorities openly tender for all services to be provided in ports.

The issue of pilots is one that is being considered by several Port Authorities at the present time. There are two methods of pilot service delivery in Australia: pilots being employees of Port Authorities, or specific pilot owned companies tendering to supply pilotage services to a specific port. Queensland is planning to return pilots to Government employment with their newly formed marine safety authority. Apart from the private company operating pilots in Port Hedland which also provides pilots in Wyndham and Cockatoo Island there is no example of a pilot company providing services in more than one port. In the northern ports in Tasmania, pilots are employees of the Port Corporations but are licensed to carry out pilotage in other ports. By agreement between the Port Corporations there is some filling in by pilots from another port from time to time.

It is relevant to point out in this section that Adsteam itself is vertically

integrated and this in itself gives additional bargaining power if there were to be competition in towage in a particular port. For example, Adsteam operates a nationwide ship agency business and could therefore be influential in directing ships using its agency to Adsteam tugs. Adsteam also owns 50% of the management company for Flinders Ports in South Australia which has recently been privatised and sold to a group in which Adsteam is a shareholder.

Furthermore, Adsteam provides the pilot in Bundaberg as well as the towage but this is likely to change shortly as Queensland port pilots are being taken back as employees of a newly formed Marine Safety Queensland group.

In addition Adsteam has towage operations in the UK and elsewhere and as mentioned previously, the combined UK and Australian operations could be used again as a means of influencing choice of towage provider in Australia.

3.3 Is Towage a Natural Monopoly?

We believe that towage is a natural monopoly in Australian Ports. This is due to the relatively small size of Australian ports and the distances between ports which make it uneconomic to move tugs from one Port to another on a regular basis.

As Adsteam has pointed out, technology is changing and there is now pressure for fewer tugs to be used on vessels and this trend is expected to continue. The fact that fewer tugs will be required in some Ports actually strengthens an incumbent's position in view of its economies of scale. This is enhanced by having a national coverage which enables tugs to be moved from port to port, for costs to be spread between ports, especially if there is a new entrant into a port, and for the development of other barriers to entry such as volume rebates.

3.2.4 Is There a Competition Problem?

It is arguable whether the lack of competition, or threatened competition, leads to Adsteam really addressing its performance and passing on to its customers efficiency-related cost savings. In several ports it is considered that there is a surplus of tug capacity. In others Adsteam has unilaterally put in higher capacity tugs than is deemed necessary, whilst in others, there is some concern that Adsteam may not be addressing with the shipping industry more efficient ways of managing call out times, cancellations, etc. Examples of these can really only be gained by direct contact with ports and shipping companies. However, one example could be the fact that a large Melbourne tug was able to attend a salvage operation in New Zealand earlier this year and tow the salvaged vessel to Asia which resulted an absence from the port of approximately one month. This tug is regarded as a harbour tug and therefore its costs are included in the

overall port tug charges. One may well question whether this does reflect a surplus capacity of tugs in that port.

In conclusion in this section, Port Authorities would argue strongly that the towage industry is not over regulated and that some regulation is essential for safety reasons as mentioned earlier in this submission. Furthermore, it is understood that the shipping industry itself wishes to have some element of regulation so that its desired service standards can be met. Further regulation, such as the granting of licences, or forms of price control, is seen as desirable in some ports because of the market perception that Adsteam are acting as a monopoly service provider and thus may not be providing the most cost effective and efficient service and are maintaining significant barriers to entry in most ports in which they operate.

4. **Regulatory Options**

4.1.1 **Has Prices Surveillance Been Affective?**

We understand that Shipping Australia Limited has addressed in some detail the reasonableness or otherwise of Adsteam's price notifications. Port Authorities are not privy to this data.

We would contend that Adsteam's record in respect of the ACCC advice on notified price increases demonstrates that it puts its own position well ahead of that of its customers. This thwarting of the Prices Surveillance Act certainly demonstrates that prices surveillance has been ineffective and whilst the current Act continues in its present form, it would seem that Adsteam would continue to ignore recommendations made under the Act.

4.1.2 **What Has Been the True Cost of Declaration?**

The process adopted by Adsteam in its recent price notification to the ACCC demonstrated to the industry generally that Adsteam had no respect for the industry or their customers, as the timing of the notification gave both the ACCC and their customers minimal time to argue the case. We believe that this was a deliberate act by Adsteam. If Adsteam genuinely believed that its proposed price increases were completely justified and were realistic then they should not have had to fear giving the ACCC and its customers the maximum time available to study their notification rather than effectively minimising it.

4.2 **Exclusive Towage Licences**

Notwithstanding comments made by the Industry Commission in 1993 and again in 1998, it is now felt by a large number of Port Authorities and, we understand, by many in the shipping industry, that exclusive licenses are an acceptable means of developing contestable competition in towage in Australia. Furthermore, the judgment of French J in the

Bunbury exclusive licensing case supported exclusive licences as the best means of encouraging competition. This judgment was upheld on appeal. This court case was rigorously prosecuted and defended with many expert witnesses and so we consider that a strong precedent has been set in this regard.

We consider that it is essential in entering into any exclusive licensing arrangement that the tender documents should set out all terms and conditions, types and capacities of tugs required, risk management profiles, as well as service delivery requirements. Such documents should be developed with shipping operators and pilots. Furthermore, as these licenses will last for several years there should be incentives built in to the arrangements to ensure that the towage operator continues to improve efficiency to the extent that it can within the port and in line with expectations of both the Port Authority and shipping operators.

Again Adsteam is critical of the role of Port Authorities in these tenders. Whilst it is recognised that Port Authorities probably need to learn more about the towage industry so that they can manage these tenders better, Adsteam do not offer another party to act as a conduit between the towage company and shipping operators to ensure that maximum efficiencies are achieved in the port in line with safety regulations. Surely it must be seen that the Port Authority is best placed to undertake this role especially as it has to implement statutory safety regulations.

Furthermore, we do not accept Adsteam's contention that a Port Authority's role in such licences is a substantial conflict of interest. We also do not accept that Port Authorities will abuse this position by way of gaining a greater share of the port visit revenue – it certainly would not have “a commercial obligation to capitalise on – the situation”. Shareholding Ministers of Port Authorities would be, we expect, highly critical of a situation where a Port Authority was abusing its power in this way.

4.3 The Need for Reform

Adsteam appear to base their case on the need for reform on the distortions in the towage market caused by the interference of third parties – Port Authorities. Much of their argument in this regard is backed up by the research by CoRE Research which states that harbour towage “is subject to price and service quality pressure from Port Authorities who have the power to exclude towage operators in their respective ports”. We consider that this statement is made without a real and practical understanding of the issues related to safety and risk management in connection with the supply of towage services in ports. We argue that Adsteam's assertion that the distortions caused by the interference of third parties which “are nothing more than commercial

opportunism, or reflect a lack of coordinated regulatory administration” is quite incorrect.

As has previously been discussed in this submission, actions by Port Authorities (third parties) to correct market failures are largely at the request of shipping operators. We would be interested to hear from Adsteam on where there is “a lack of coordinated regulatory administration” as the safety regulations set by State Governments and implemented by Port Authorities are very clear and are certainly coordinated.

The free market approach to the regulatory frame work encouraged by Adsteam may well be appropriate in Europe and the US but many of the ports in both continents are a lot larger than the largest Australian ports and there is also competition between these ports because of their proximity.

We would be interested to learn whether in the UK there are examples of new towage entrants into an established market where there is a national or multi-port towage service provider as an incumbent.

It is not always possible for pricing and other commercial issues to be left to negotiation between towage operators and their customers as the towage operators in Australia are single service providers which are dealing with a number of customers of varying sizes and market dominance. The comments by the shipping operators through SAL indicate that they are not happy that commercial issues are left to negotiation between the towage operator and themselves.

We support compensation for services such as salvage and emergency services provided by towage operators which should not be subsidised by harbour towage. We agree that there should be an adequate commercial return for “the provision of public good” services such as salvage and emergency services and believe that this issue needs to be discussed at length in Australia. In this regard AAPMA and AMSA arranged a workshop on salvage and places of refuge in February in order to commence a dialogue on these issues. The Australian Marine Group has also arranged a study on salvage capacity around the Australian coastline.

Lastly, we strongly support Adsteam in their request for greater uniformity in State and Federal regulations applying to towage operators, particularly in relation to manning levels and qualifications, occupational health and safety and the regulation of the interstate deployment of tugs.

27 May 2002