



15 May 2002

Ms Lisa Gropp  
Assistant Commissioner  
Productivity Commission  
Harbour Towage Inquiry  
LB2 Collins Street East  
MELBOURNE VIC 8003

Dear Ms Gropp,

**Submission by Adsteam Marine Ltd to the Productivity Commission Inquiry into the Economic Regulation of Harbour Towage and Related Services.**

I refer to the above submission and would like to make the following comments in relation to various issues raised in that submission.

Turning to the Executive Summary, we would comment as follows:

Prices Surveillance

Reference is made to the reduction in the invoice price of towage over the last 10 years in both declared and non-declared ports because of reduced tug usage and the introduction of volume discounts and other factors, but the real benchmark is whether an effective, safe and reliable service can be mounted in competition with Adsteam at significantly reduced towage prices when compared to current prices. Furthermore, the reduction in tug usage has been certainly more evident with container vessels compared to bulk or specialised vessels.

Exclusive Towage Licences

Adsteam claim that exclusive licenses put marketplace decisions into the hands of centralised service providers, whose commercial interests conflict with the interests of other service providers and service users. SAL Members do not believe that this would necessarily be the case with exclusive towage contracts, but what it does emphasise is the need for serious and comprehensive negotiations between the port authorities and towage operators in developing the content of the license, and, importantly, the users of those services should have an input at the appropriate time, i.e. before it is finalised.

Importantly, Members do not believe the towage service market in Australia is contestable and there are high barriers to entry and, in fact, sunk costs, primarily because of the cost of positioning or building tugs for the Australian market and, if they were to

be repositioned, the costs of repositioning them from Australia is also a significant sunk cost. Please refer to the attached letter we have received from our consultant, Mr Dale Cole, regarding the issue of sunk costs.

The entry of a competitor into Melbourne is most welcome, but it is very early days and there is a question mark over whether such competition will be sustained in the face of Adsteam's reaction in the marketplace, and, more importantly, the effect on rebate arrangements, generally enjoyed by container ship operators, would require in terms of competition, and in the absence of licenses, the presence of a competitor in at least three of the major container ports in Australia.

It is understood that there are plans to expand, but such expansion may well encounter much stronger opposition from Adsteam than a 2-tug operation in Melbourne is likely to attract, simply because of the minimum number of movements that could be handled compared to the 5 tugs operated by Adsteam Marine. Whilst some operators may be able to use the competitor without affecting their rebate arrangements, others may not be able to use the competitor for fear of dropping below threshold levels to attract the rebate.

It is also mentioned that exclusive contracts limit competition in the sense that not all potential market entrants will be in a position to tender at the same time, but this did not appear to be the situation that prevailed in Fremantle in recent years, and further elaboration of this comment is required.

It is also suggested that such contracts remove choice from ship operators and constitute a "one size fits all" product, but on a per port basis this simply emphasises the need to involve ship operators in the content of the license and ensure their requirements are met in all respects, along with those of the safety regulators, etc.

It is also claimed that such licenses are inconsistent with the "landlord" philosophy of most Australian ports, and we are sure AAPMA will take issue with that as being a general philosophy of most Australian ports today rather than the strategic manager model, which certainly prevails in many of the major ports. We are happy to elaborate further on that issue during the public hearings.

It is also suggested that port authorities have an incentive to force down towage prices at the expense of towage operators' potential port users, but this is something that would be welcomed by the users, consistent again with the required levels of service being provided, and our Members do not see why that cannot be outlined in an exclusive contract.

Reference is made to Sections 45, 46 and 47 of the Trade Practices Act, 1974, but Adsteam do not elaborate on what these issues would be, given that ports are a State responsibility and in many cases are covered by State legislation, and we would be happy to respond in more detail if provided by Adsteam.

### Need for Reform

Most of these issues listed by Adsteam are covered in the SAL submissions, including the comments on salvage and emergency services capabilities, but we do support greater uniformity in State and Federal regulations applying to tug operators in relation to tug manning levels, crew and qualifications, and other relevant issues.

Turning to the submission itself, we would like to make the following comments.

In the middle of page 5 of the submission there is the comment that Adsteam's approach is based on historical pricing methods which have, with some modification in terms of volume rebates, continued to find acceptance among ship operators but, given the recent proposed increases, ship operators do not accept current prices.

Mention is made on page 9 that industrial constraints have, to-date, prevented any improvement in efficiency or pricing changes in the ports of Newcastle, Port Botany, Port Jackson and Port Kembla, and we would request that Adsteam to elaborate upon that point.

On page 12, Adsteam state that for regular callers to Australian ports, the size of their contribution to a towage provider's bottom-line is a significant source of bargaining power. An individual shipping Line has very little bargaining power when faced by a monopoly towage provider in a port. Collectively, this could be different, but would again depend upon barriers to entry and the fact that it is a weak contestable market. By the time the public hearings are held, more information will be available regarding Australian Maritime Services foray into the Melbourne towage market, which will be relevant in the discussion of this issue regarding contestability.

In box 1.9 on page 16, in the penultimate paragraph, Adsteam refers to port authorities possibly obtaining license fees out of all proportion to any supervisory function performed by the authority. This emphasises again the absolute importance of close and comprehensive consultation with potential users of towage services to ensure the required level of transparency that would reduce the possibility of that becoming a reality.

On page 17, port interface costs out of 'Waterline' are mentioned but, as stated in the SAL submission, towage costs account approximately for 30 percent of the shipowners' costs of calling at a port in Australia, i.e. excluding stevedoring, road transport, etc.

At the top of page 22, Adsteam claim that they have consistently passed on benefits to their customers, but we would question that proposition in relation to prices in many of the declared ports, for example.

In the penultimate paragraph on page 26, Adsteam suggest that a new entrant who won an exclusive contract could proceed to renegotiate the contract during its tenure, but presumably legally it could be forced to perform the contract that it had entered into if it would wish to avoid a breach of that contract.

On the bottom of page 28, reference is again made to the fact that towage is not a high sunk cost industry, and we would concede that there could be debate on the meaning of “high”, but there are definitely sunk costs if, for example, an exclusive contract was not renewed as far as an incumbent was considered (refer attached letter).

At the bottom of page 31, the comment is made by Adsteam that “Many of the Asian operations noted could easily bring their tugs to any of the above ports in a matter of days.” This was certainly not the case with the Fremantle/Kwinana experience, when it was understood that a new entrant would require a minimum of a month to position tugs into Fremantle and to gear them up for service.

Surprisingly, we do not believe towage markets are demonstrably contestable, as concluded at the bottom of page 32.

In box 2.2 on page 37, mention is made of the Federal Maritime Commission taking action against exclusionary towage contracts. What is not clear from that example was whether it was the result of the tender or simply private terminal operators choosing their preferred tug operator, which is a procedure we would not support as there has to be a fully open tender prior to an exclusive contract being granted.

At the bottom of page 39, the comment is made that the trend to larger ships fuels the demand by harbour pilots for larger, more powerful, and inevitably more expensive tugs, but there are tugs designed with, for example, a 60 tonne bollard pull that are cheaper than many of the tugs that are presently employed by Adsteam.

On the top of page 41, Adsteam claim that, in economic terms, ship operators are engaging in a form of free-riding. They are reducing their costs by not paying for the costs borne for them by the towage operators. This is simply not the case, and can be debated further at the public hearings. However, if this is the case, how can competitors provide the same level as Adsteam at a considerably cheaper tariff in return for an exclusive contract?

It is interesting that in the second paragraph on page 45, Adsteam notes the natural monopoly characteristics of most ports in Australia and that it is not really possible for two operators to exist for very long unless “a joint venture can be devised in a way that preserves the operator’s viability while also complying with the law”. The alternative is an exclusive contract.

In the third and second last paragraphs on page 49, Adsteam considers the use of exclusive towage contracts to fall within this category of exclusionary and detrimental regulation, but our Members would say the opposite in that it can provide a positive and important system of regulation to improve towage services and prices in Australia. Reference is also made by Adsteam to the already highly regulated industry, yet in the declared ports there are some 45.6 percent of all tug jobs using the data set out in Appendix A to the submission, and for most of these ports there is no regulation at all, other than those relating to safety, etc.

In the second paragraph on page 51, Adsteam claim that ship operators have secured rebates and maintained continuing pressure on towage operators through their influence over port authorities and pilots. Ship operators do not have a lot of influence over port authorities and pilots, and rebates were the subject of an approach by Adsteam. Clearly, with the application of recent price increases in selected declared ports, it is obvious that ship operators have no influence on Adsteam. We would have a similar comment in relation to the last two paragraphs on page 52.

On page 54, reference is made to a natural monopoly referring to technology, not market structure, and we would be interested in the PC reaction to that proposition.

On page 59, reference is made to price “stickiness” because of the presence of price regulation (fourth last paragraph), but this would appear to indicate the pricing practices of a monopolist.

On the top of page 61, reference is made to the support shown by the shipping Lines to the fact that customers should be choosing their towage providers, but SAL Members are strongly supportive of exclusive licenses on the basis that they are closely consulted on the content of such licenses, as mentioned previously.

Under Section 4.2.1, there is a list of so-called negatives regarding exclusive licenses, and we would like to respond as follows:

- Whilst there is an initial barrier to entry, there is a level of serial competition.
- Time limits when responding to tenders is an issue that affects all companies responding to tenders.
- It is a fair point regarding volume changes and technical innovation, etc. and exclusive licenses should cater for changes in that respect.
- The comment by the NSW Coal Association to the Commission’s 1993 study that exclusive licensing agreements has tended to result in excessively high charges and restrictive work practices, could well refer to arrangements that were quite different from what we have in mind.
- We have previously commented on the issue of the “landlord” philosophy suggested by Adsteam as being adopted by Australia’s major ports, and we do not believe that to be the case.
- The raising of issues under the TPA need to be explored further if Adsteam wish to pursue that point.
- Adsteam suggest that with exclusive licenses there could be an incentive to build into towage charges a risk premium that may not exist without exclusive contracts, but this was simply not the case, for example, with Fremantle’s recent experience, and we are not aware of any evidence to support that proposition.

In the second paragraph on top of page 63, it was suggested that in a sense, a port authority is a competitor with the towage operator for a share of the port visit revenue, and we are sure that AAPMA will respond to that point as we do not see it as being a valid point at all. Maintenance of service levels, in our experience, is an extremely important objective of port authorities.

14 May 2002

The Chief Executive Officer  
Shipping Australia Limited  
Level 6, 131 York Street  
Sydney NSW 2000

Dear Sir

## **Re: Sunk Costs**

I refer to the Executive Summary and Chapter 2.2.2 of CoRE Research's Paper. This Paper was included in Part B of Adsteam's submission to the Productivity Commission.

The sections referred to above state, that in the author's view, a new entrant's sunk costs are low,

Dale Cole & Associates does not support this view and suggests the following calculations reflect the reality faced by a new entrant who is forced to exit the industry within three years of arrival.

### ***Administration Costs***

Sunk Costs in computer hardware and software, office furniture, communication equipment, stationery, training, entry preparation and motor vehicles would exceed \$A200,000.

### ***Tug Crews***

Sunk costs in training, operation manuals, information technology and quality assurance would exceed \$A150,000.

### ***Tugs Purchased from Overseas***

**With the exception of Newcastle, a new credible entrant entering an Australian declared port will require at least three tugs (five in Newcastle).**

Tugs generally hold their price and, provided the depreciation regime is appropriate, the written down value should be indicative of their market value.

The Sale and Purchase (S&P) market for second hand tugs will most likely be the Far East (Singapore/Hong Kong). A new entrant will have to source tugs from this market and, if the company becomes a distressed seller, sell the tugs back into this market. Delivery costs to Port Botany from Singapore using competitive non-Australian crews would exceed \$A110,000 per tug.

As the second hand tug market in Australia is almost non-existent, a subsequent sale would attract a redelivery cost of the same magnitude. In the case of a distressed seller the delivery cost would either be deducted off the purchase price or become the responsibility of the seller.

Any owner purchasing an overseas second hand tug for the Australian market will be faced with additional sunk costs preparing the tugs for Australian conditions. This cost will vary with each tug, but a prudent buyer/charterer would allow \$A50,000 per tug in their budget to cover modification costs.

### ***Tugs Built in Australia***

Delivery costs should not exceed \$A30,000 per tug, however sunk costs relating to overseas sale(s) would exceed \$A110,000 per tug.

### ***Charter Tugs from Overseas***

The charter rate for tugs suitable for the Australian market is \$A4,600 (\$US2,500) per day per tug.

A new entrant would charter tugs from an owner "point of delivery to point of redelivery" (say Singapore). The sunk costs in this case would be \$A170,000 (\$US92,000) per tug for delivery and the same amount for redelivery.

In addition the tugs would have to be inspected by representatives of the maritime unions in the delivery port. The cost of this inspection, in terms of delay and travel costs for union officials, would exceed \$A30,000 per tug.

The question of a penalty payment in the event the tugs were redelivered prior to the expiry of the charter period will vary with each contract. However a 30-day (\$US75,000) penalty (for each tug) would not be unusual.

### ***Charter Tugs from an Australian Owner(s)***

This is not an option, because there are no suitable tugs available in Australia.

### ***Redundancy Costs***

A new entrant exiting the market would be required to pay crew redundancy costs. Using current award rates and conditions (Melbourne) and three years as the "life" span of the new entrant, redundancy costs for five crews would total \$A470,000.

### **Sunk Costs Summary Table – For Each Port Entered**

<b>Cost Centre</b>	<b>Second Hand Tugs Purchased Overseas</b>	<b>New Tugs Built in Australia</b>	<b>Second Hand Tugs Chartered from Overseas</b>
Administration	200,000	200,000	200,000
Crew Training	150,000	150,000	150,000
Delivery Costs	330,000	90,000	600,000
Modification Costs	150,000		150,000
Redelivery Costs	330,000	330,000	510,000
Redundancy Costs	470,000	470,000	470,000
Penalty Payment			417,000
<b>Total</b>	<b>\$A1,630,000</b>	<b>\$A1,240,000</b>	<b>\$A2,497,000</b>

Yours faithfully  
For Dale Cole & Associates Pty Ltd



Dale Cole  
Director