

**The following submission to the Productivity Commission is prepared by Sydney Ports Corporation for the Commission's inquiry into economic regulation of harbour towage and related services. This follows the Commonwealth Government's request that the Productivity Commission report on whether harbour towage at major ports should continue to be a "declared" service under the Prices Surveillance Act 1983.**

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## **Executive Summary**

Sydney Ports Corporation (Sydney Ports) is making this submission to the Productivity Commission in support of one of our key roles, which is to facilitate trade through the ports of Sydney by providing competitive advantage to importers, exporters, and the port related supply chain. In connection with this role we wish to ensure that a towage service will always be available, that the standards of service and tug vessels remain adequate and that prices, charged to users of the service, are reasonable.

### **This paper canvasses five areas:**

1. It provides some background on the ports of Sydney (Port Jackson and Port Botany) and the present marine service operations in the ports.
2. It makes some observations about the efficiency of service provision in Sydney's ports.
3. It also makes some observations about increasing competition in the provision of harbour towage services.
4. It identifies some options for pricing oversight.
5. It contains some comment on the lines services provided by a wholly owned Adsteam Marine subsidiary.

### **The key matters to bring to the Productivity Commission's attention are:**

1. The recent price increases introduced by Adsteam Marine are not supported by Sydney Ports, a view consistent with our submission to the Australian Competition and Consumer Commission (ACCC). Although Adsteam Marine has suffered some erosion in its revenue base due to:

- a decrease in vessel visits and
- a reduction in the average number of tugs required per vessel,

this is balanced, to a degree, by an increase in the average vessel size (gross tonnage) which incurs a higher towage charge, increasing Adsteam Marine's revenue.

2. Adsteam Marine has implemented some operational reforms through reduced manning of the tug crews but, given the low usage of some tugs, further flexibility should be pursued which may, for example, include greater casualisation of labour.
3. Sydney Ports is, in principle, supportive of a competitive towage provider or providers establishing operations in both of its two ports. However, the geographical separation of the ports and the need to base tugs in both ports, effectively halving the shipping numbers served by those tugs, suggests that this may not be a viable option for Sydney's ports in the medium term.
4. The weakness in the present system that allows the towage company to ignore the findings of the ACCC in relation to the company's notification of proposed pricing increases needs to be addressed. This could be through either an appropriate amendment to the Prices Surveillance Act 1983 or through a licensing arrangement between the towage supplier and Sydney Ports Corporation. This approach is supported by point 3 above although, at this point in time, the Ports Corporatisation and Waterways Management Act, under which Sydney Ports Corporation operates, does not provide for an exclusive licence arrangement for towage services.
5. The lines service charges in Sydney's ports are far higher than in either Brisbane or Melbourne. Adsteam Marine, through a subsidiary, has sought operational reforms to the lines service. To date, this action has not been successful. Sydney Ports and the shipping industry continue to support any initiative which reduces lines charges or enables the introduction of competition.

## 1. Background

Sydney Ports Corporation provides port facilities at Port Jackson and Port Botany, which are geographically separated by 12 nautical miles. Port Jackson caters for general cargo vessels, motor vehicle carriers, some container vessels, oil tankers as well as passenger vessels. Port Botany handles the majority of container vessels visiting Sydney's ports, bulk liquid and gas carriers as well as oil tankers. The following table summarises vessel movements, as well as tug fleet size servicing those vessel movements, in each port.

<b>2000-01</b>			
	<b>Vessel Movements</b>	<b>Percentage</b>	<b>No. of Tugs</b>
Port Jackson	2,428	49.7	4
Port Botany	2,456	50.3	3
<b>Total</b>	<b>4,884</b>	<b>100.0</b>	<b>7</b>

Typically, a ship visiting Sydney's ports will require the following services:

- Pilotage – provided by Sydney Sea Pilots, a private operator contracted to Sydney Ports.
- Towage services – provided by Waratah Towage, a division of Adsteam Marine Limited.
- Lines services (mooring and unmooring) – provided by Stannard Bros Lines Services and Bay Star, wholly owned subsidiaries of Adsteam Marine.

In addition to providing towage services, the towage operator provides assistance to Sydney Ports for fighting fires on vessels. Sydney Ports pays a significant annual fee to the towage operator to ensure two tugs (one in Port Jackson and one in Port Botany) have appropriate fire-fighting capability. The operator also provides salvage services on an as needed cost-recovery basis. As stated above, lines services are provided by wholly owned subsidiaries of the towage operator.

There is limited sharing of resources and equipment between the parent company, Adsteam Marine, and its subsidiaries in the delivery of the towage and lines services. While both the towage and line services operate from a common depot in both ports, no other resources are shared.

## 2. Efficiency of Service Provision in Sydney's Ports

### 2.1 Competitive Environment

Due to the division created by the two-port operation, the scale of operations in each port may be insufficient to economically support competitive towage operators. The following table shows the approximate percentage usage of the individual tugs in the two ports.

<b>Port Jackson</b>		
<b>No. of Tugs</b>	<b>Day</b>	<b>Night</b>
1	26%	17%
2	17%	10%
3	6.5%	1.5%
4	3.5%	0.5%
<b>Port Botany</b>		
1	30%	19%
2	20%	13%
3	7.5%	2.5%
<p>Note: 1. The percentage stated is the average percentage per 12 hour day or 12 hour night.</p> <p>2. The tug operating times and hence percentages are approximated by vessel booking times as recorded in Sydney Ports' booking system - ShIPS - from pilot aboard to all secure. Tug operating times may therefore need some adjustment to take into account such factors as travel time to and from the tug base.</p>		

In Port Jackson, Shell tankers are the dominant users of the third and, particularly, the fourth tug and, in Botany Bay, Caltex tankers are the dominant users of the third tug (refer Section 2.6 also).

The significance of the impact of the need to maintain tugs in two ports and additional tugs principally for oil tankers is highlighted in the tug utilisation figures at Australian and selected overseas ports produced by the Productivity Commission in 1998 and subsequently republished at page 7 of the Harbour Towage Issues Paper produced by Economic Associates Pty Ltd for Queensland Transport.

We estimate that a 4-tug fleet would accommodate the current level of vessel movements in Sydney's ports if the towage operator was servicing a one-port operation only.

While Sydney Ports is supportive of a competitive environment, an additional towage operator would not be able to compete for the full range of services unless it employed an equivalent sized tug fleet. This would result in a reduction in the percentage of total time each tug is utilised, resulting in further inefficient use of resources. However, a second operator, through the use of a smaller fleet, may be able to provide a limited service to specific lines or vessels. Conversely, this could have the effect of driving up prices for vessels requiring the third and fourth tugs. It should be noted, however, that, provided that between them they had the appropriate sized tugs, there would seem to be no reason why two tug operators could not work a vessel together; however, the historical difficulties in doing this are noted in Section 3.2 below.

In addition, the rebates on offer by Adsteam Marine (addressed in Section 2.8) could be lost to a shipping company if it used another towage company's services in any other Australian port where Adsteam Marine operates.

## **2.2 Increasing Vessel Sizes / Reducing Vessel Visits**

There has been an increase in the average size of vessels, expressed as gross tonnes (G.T.), visiting Sydney's ports in recent times. However, with flat trade throughput in 2000/01 and 2001/02 this has been offset by a decrease in the number of vessels calling. This trend is expected to continue while cargo volumes remain flat and vessel sizes generally continue to increase. Generally, the newer vessels have auxiliary propulsion systems installed, such as bow and stern thrusters, and this enhances their manoeuvrability, which could, in turn, lead to a reduction in the number of tugs needed.

## **2.3 Reduction in Tug Usage**

In recent years, Sydney Ports, the pilotage company and Adsteam Marine have co-operated in reducing the number of tugs servicing appropriate vessels where circumstances permit. Any change is approved only after comprehensive "testing" is undertaken by the pilotage service, following a request from the vessel master. Safety is never compromised. As the technological capability of vessels improve, towage requirements may reduce further.

## **2.4 Reduced Manning**

Following successful negotiations with the relevant trade unions, the towage operator reduced the crewing levels for tugs from 4 to 3 personnel. This resulted in significant labour savings reported to be of the order of \$2.5 million to \$3.0

million Australia wide. Although promised to the shipping industry, the savings accrued from this reduction were not reflected in any price reduction in Port Jackson or Port Botany.

## 2.5 Pricing

Since a price increase for towage in 1990 in both of Sydney's ports, the following price increases have been implemented:

Date of Increase	Port Jackson	Port Botany
8 February 1998	15.0%	Nil
6 March 2002	26.2%	13.1%

The total increase since 1998 in Port Jackson of 41.2% (non-compounding) in particular is considered to be excessive, especially given the arrangements that are in place for the recovery of the cost of the fourth tug (covered in more detail in the next section).

Adsteam Marine's latest pricing schedule is provided in Attachment A. It is noted that the pricing structures for Port Jackson and Port Botany are different, with far more bandwidth categories in Port Jackson, than in Port Botany, which results in pricing disparities for the same vessel visiting both ports.

## 2.6 4<sup>th</sup> Tug in Port Jackson and 3<sup>rd</sup> Tug in Port Botany

While 4 tugs are currently used on oil tankers entering the Shell Australia berth in Gore Cove, Port Jackson, the 4<sup>th</sup> tug, used almost exclusively by Shell, is charged directly to Shell at \$21,031.80 (excluding GST) per use, far greater than the maximum charge of \$4,365.26 (excluding GST) for other vessels. It is understood that the previous charge to Shell of \$18,332 (excluding GST) per use achieved full cost recovery for Adsteam Marine. The need to have raised this charge by 14.7% is queried.

Similar circumstances occur in Port Botany where the 3<sup>rd</sup> tug is mainly used on oil tankers entering the Caltex Australia berth at Kurnell. The charge for each use of the 3<sup>rd</sup> tug is \$4,465.39 (excluding GST) in comparison to the normal maximum charge of \$3,801.29 (excluding GST).

## 2.7 Introduction of New Tugs

Adsteam Marine introduced two new and more powerful tugs, the *Bullara* and *Beltana*, into Sydney's ports in October 2000, with the *Bullara* subsequently transferred to Port Kembla.

While Sydney Ports is supportive of an initiative (the new tugs), which will assist with improving port safety, the cost of any such initiative, particularly if it is used to justify an increase in towage prices, must be queried. Sydney Ports is unaware of any user consultation prior to the introduction of the new tug. The pilotage service provider did not request the new tug.

## 2.8 Rebates

It is our understanding that Adsteam has in place rebate arrangements with a small number of large customers. It has been suggested that the rebate is only available if the Adsteam Marine service is used in all the main Australian container ports and, possibly, some overseas ports. If this is the case, it creates a barrier to, or restriction on, operations of a towage competitor who may operate in one port only.

It has been reported that Adsteam Marine is currently offering rebates to shipping lines with the intention to enter into long-term contracts with them. Such a move could adversely impact upon the entry of competition although it is acknowledged that a regime of published rates with rebates for volume etc. is a legitimate commercial practice.

## 2.9 Costs

The capital cost of establishing a fleet of tugs capable of servicing all current shipping movements is significant. The main operating costs of providing harbour towage services are labour and fuel, both of which are relatively fixed.

Savings in operating costs may be possible through wider use of casualisation in the workforce, particularly for the manning operations of the 3rd and 4th tugs in the ports which tugs operate sparingly.

### **3. Increasing Competition in the Provision of Harbour Towage Services**

#### **3.1 General**

Until Adsteam Marine's recent action to increase prices by substantial percentages in Port Jackson and Port Botany, Sydney Ports has not believed it necessary to introduce any operational or other controls over the towage operator. This is because the company has performed at the required standard and has priced its services at a reasonable rate and thereby met the objective in respect of towage set out in the Executive Summary of this submission.

The recent price increases have stimulated consideration of alternative arrangements through which towage services could be provided in Sydney. Consequently, Sydney Ports has examined mechanisms that might facilitate competition in a monopolistic market that is created through the relatively high entry costs brought about by the necessity to purchase and/or charter sufficient tugs to service a port and the relatively low number of vessels visiting the Australian ports.

Three different operating models are considered below – the natural monopoly and competition model, the serial competition model and the regulated service provider model.

#### **3.2 Natural Monopoly and Natural Competition**

We agree with those who have concluded (for example, the ACCC in 1995) that the fact that most Australian ports are serviced by one towage operator tends to be suggestive of natural monopoly at current traffic volumes and the levels of demand prevailing in Australian ports. (It is interesting to observe that, in the one Australian port where another tug operator recently established itself in competition with the existing service provider, there had been a suggestion that the existing tugs had not exhibited the same degree of timeliness as in other Australian ports in circumstances where the number of ship visits per tug per annum was higher than most Australian capital city ports.) However, the market power associated with single firm supply and the capacity for excessive charging (or inefficient provision of services) should not be ignored.

In the majority of ports in Australia there are no regulatory or similar constraints that may hinder the entry of a new towage service provider. However, as already noted, the monetary barriers to entry for a new entrant to the harbour towage industry are high. The costs to purchase and/or charter the required number of appropriately sized tugs to provide a complete towage service in a port are

substantial. In addition to this impediment, the new operator has to identify and establish an appropriately located base (wharf and office facilities) from which to operate. In many ports this is becoming more difficult as any excess harbour-side land has been returned to Government for alternative uses.

A new entrant may attempt to offer a limited service with a reduced number of tugs but could only offer a competitive service for the smaller sized vessels under this arrangement. It might be argued that two towage operators in a port could adopt a co-operative approach through both providing tugs to service the one vessel. In practice this does not appear to occur. An example of this occurred in 1994 in the port of Newcastle, when a new entrant, a consortia including BHP and its Japanese partners, set up in competition to the existing operator, Howard Smith. The consortia started business with three tugs when four tugs were required to service the large coal vessels. They found that they could not charter a fourth tug from Howard Smith when the need arose. Eventually the consortia acquired the fourth tug and the two companies competed for the limited work available. However, there was never sufficient work to support two fully equipped operations and in 1999 the consortia ceased operations in Newcastle.

The geographical separation of Sydney's two ports adds a further complication to a complex issue. For the reasons explained in Section 2.1 of this submission, Sydney's two port operations effectively halve the number of vessels visiting each port, making it less attractive for an additional towage operator.

### **3.3 Serial Competition**

Serial competition may be an option for consideration under the right circumstances. Serial competition would occur when a port authority invited tenders from the incumbent operator and other potential operators for the provision of towage services in its port for a nominated period and could be for an exclusive or non-exclusive operation. It would be expected that performance indicators, such as operating performance, service to clients, safety issues and pricing, would be identified in the tender documentation and included in any contract or licence documentation.

We have identified at least one difficulty that may arise in the serial competition scenario when a new operator secures the contract or licensing agreement through the tender process. The new operator is likely to need time to establish in the port and this includes securing and repositioning tugs, employing suitably qualified staff and establishing a tug base. Unless proper controls are in place, the existing operator, having lost the new contract, may immediately cease operations in the port prior to the new operator being ready, thereby creating a

major operational problem and the failure to meet one component of the towage objective set out in the Executive Summary of this submission.

### **3.4 A Regulated Service Provider**

Such a model could be introduced on a State by State basis, via each State's marine legislation, whereby the port authorities and corporations could licence (a) towage operator(s) to provide the towage service in their ports. The system could provide controls on pricing and operational performance, but would need to allow for the entry of new operators provided any new entrant is able to meet operational performance and safety standards.

Obvious difficulties with this approach include the differences that may come to exist from State to State and the consequential impact of these differences on the volume discounts or rebates currently offered to major shipping lines visiting more than one Australian port. However, in general, we think that the shipping companies are ultimately likely to be attracted to the ports offering trade rather than to towage operators offering rebates.

Due to the geographical separation of Sydney's two ports the regulated service provider model is the approach most favoured by Sydney Ports for Port Jackson and Port Botany.

## **4. Options for Pricing Oversight**

### **4.1 In a Natural Monopoly Situation**

Adsteam Marine is the only provider of harbour towage services at major ports in Australia in a monopolistic position. As a result, Adsteam Marine is a “declared” provider under the Prices Surveillance Act 1983 and is required to notify the Australian Competition and Consumer Commission (ACCC) of proposed price increases and the ACCC has 21 days to review the notification.

In March 2002, Adsteam Marine increased its prices, despite a finding by the ACCC that the price increases were not justified and that the “proposed prices would be greater than those required to meet the efficient cost of providing harbour towage”.

Sydney Ports currently believes that in a port where there is a natural monopoly there should be some form of binding price oversight.

For the declaration of the kind previously made in connection with Adsteam to be of any benefit, the Prices Surveillance Act 1983 would need to be amended to provide the ACCC with powers to ensure that its rulings on pricing for towage services are binding. There would, however, need to be appropriate appeal mechanisms in place. This would only address one of the potential issues in a natural monopoly and not the other major concern of inefficient service provision. Furthermore, we do acknowledge that there are significant policy considerations in amending the Prices Surveillance Act in this way.

Also, it is important to note that the introduction of a binding pricing regime should almost certainly cover all ports not subject to separate contractual arrangements as price control on, say, the capital city ports only, could lead to uncontrolled and unjustified price increases in other regional ports.

### **4.2 In Serial Competition or where there is a Regulated Service Provider**

For both of the models discussed in Sections 3.3 and 3.4, towage operators could be oversighted by the relevant port authority or corporation in respect of pricing and standards of service.

Significant savings to industry were recently achieved when Fremantle Port Corporation licensed towage operations. The competitive tender process was instrumental in achieving significant price reductions for users of that port which have been locked in for the period of the licence. In addition, there is regular monitoring of the standard of service in accordance with a service agreement negotiated in this process.

## **5. Lines Services**

### **5.1 The Position in Sydney**

The lines services (mooring/unmooring of vessels) in the ports of Sydney are provided by Stannard Bros Line Services, a wholly owned subsidiary of Adsteam Marine. Presently the resources used to service vessels berthing at the ports are prescribed in the New South Wales Marine Motor Drivers, Coxswain etc (State) Consolidated Award. For container vessels in Port Botany in excess of 25,000 G.T. the resources required by the Award are 10 men with 2 launches for mooring and 8 men for unmooring. The shipping industry has long complained that lines services in Sydney are significantly more expensive than in other ports in Australia for servicing the same vessel. For example, lines service costs are in the order of three (3) times more expensive in Sydney than in Melbourne. The shipping industry generally considers that this is due to the over-resourcing of the lines service to comply with the abovementioned Award. Stannard Bros has attempted unsuccessfully to address this situation in the NSW Industrial Commission.

### **5.2 Cost and Efficiency in Sydney**

In January 2000, Sydney Ports commissioned an independent review on the efficiency and cost effectiveness of the lines service operation in Sydney's ports, examining the appropriate number of linesmen, the appropriate numbers of launches (if any) and cost comparisons with Melbourne and Brisbane.

The report's recommendations/findings were:

#### *Number of Linesmen*

"Without consideration of time for completion of an individual berthing operation two men per mooring position on a continuous wharf face are required and multiples of linesmen pairs only if time is a consideration. The normal operation therefore would be to have two men at each end of the vessel and one supervisor in contact with the pilot for determining the priority of particular line positions and for positioning the vessel. A total of five persons would be used in those circumstances. A normal preference would be to land breast lines and then springs before running bow and sternlines".

#### *Number of Vessels*

"Lines launches should not be required for berthing at continuous wharf faces unless for some older Ro-Ro vessels for offside quarter lines.

Only one launch should be necessary for dolphin-equipped berths”.

Cost Comparison

“Typically for a Mark II Ro-Ro vessel without weekend penalty rates the mooring/unmooring costs including launch hire would be \$1,700.00 in Brisbane, \$1,500.00 in Melbourne and \$4,800.00 in Sydney”.

It is acknowledged that the lines company has sought operational reforms which to date have not been successful. Sydney Ports and the shipping industry continue to support any initiative, which reduce lines charges or enables the introduction of competition.