

**adsteam  
marine**

**ADSTEAM'S RESPONSE TO THE  
PRODUCTIVITY COMMISSION'S  
POSITION PAPER - Part 2**

David Ryan - Managing Director  
15 July 2002

# Adsteam's Approach

- As noted, Adsteam's approach is to assist the Commission to review:
  - ➔ Whether there is a problem in need of a regulatory solution
  - ➔ The costs associated with its Preliminary Recommendations
  - ➔ The likelihood that anticipated benefits would not be fully realised
  - ➔ Why the non-renewal of declaration and continued open-market competition is likely to be the most efficient outcome



# Australian Towage in Perspective – Industry size

- ⑩ Estimated \$170 million gross national revenue
- ⑩ Less than one-fifth the container volume of Singapore
- ⑩ 0.1% of total value of goods shipped
- ⑩ 2 – 6% of total port-related charges



# Australian Towage in Perspective – Towage Prices

## Brisbane

GRT range	1994	1996	1998	2000	2001	Variance %	New cost
5,001 to 10,000	\$5,400	\$4,861	\$3,719	\$3,380	\$2,814	- 47.9%	\$3,143
10,001 to 15,000	\$6,866	\$5,876	\$5,744	\$5,963	\$5,392	- 21.5%	\$6,023
15,001 to 20,000	\$9,264	\$6,884	\$7,119	\$7,098	\$8,115	- 12.4%	\$9,064
20,001 to 30,000	\$7,957	\$8,292	\$8,796	\$8,326	\$7,390	- 7.1%	\$8,255
30,001 to 40,000	\$9,606	\$9,070	\$9,237	\$8,843	\$9,168	- 4.6%	\$10,241
40,001 to 50,000	\$14,400	\$15,705	\$10,470	\$7,937	\$9,517	- 33.9%	\$10,630
50,001 to 60,000	\$18,450	\$17,220	\$12,300	\$10,890	\$13,035	- 29.3%	\$14,560



# Australian Towage in Perspective – Towage Prices

## Port Jackson

GRT range	1990	1992	1994	1996	1998	2000	2001	Variance %	New Cost
10,000 to 12,499	\$6,443	\$5,772	-	-	\$6,636	-	\$3,775	- 41.4%	\$4,764
12,500 to 14,999	\$4,470	\$4,695	\$3,130	\$3,443	\$3,991	\$4,320	\$3,674	- 17.8%	\$4,637
15,000 to 17,499	\$5,235	\$4,533	\$4,373	\$4,443	\$7,982	\$4,197	-	- 19.8%	\$5,297
17,500 to 19,999	\$5,960	\$6,752	\$5,739	\$5,064	\$5,738	\$5,047	\$3,786	- 36.5%	\$4,778
20,000 to 24,999	\$6,197	\$6,623	-	\$4,517	\$6,855	\$6,093	-	- 1.7%	\$7,689
25,000 to 29,999	\$10,980	-	-	-	-	\$8,840	\$5,172	- 52.9%	\$6,527



# Australian Towage in Perspective – Towage Prices

## Port Botany

GRT range	1990	1992	1994	1996	1998	2000	2001	Variance %	New cost
5,000 to 14,999	\$7,398	\$6,054	\$6,504	\$5,732	\$5,734	\$5,711	\$5,282	- 28.6%	\$5,974
15,000 to 29,999	\$10,271	\$9,721	\$9,989	\$8,798	\$7,960	\$7,368	\$7,164	- 30.3%	\$8,102
30,000 to 39,999	\$12,501	\$10,675	\$8,168	\$10,279	\$9,781	\$8,613	\$9,258	- 25.9%	\$10,471
40,000 to 49,999	\$14,034	\$14,549	\$14,734	\$14,904	\$14,734	\$10,801	\$11,269	- 19.7%	\$12,745
50,000 to 59,999	-	-	-	\$15,338	\$15,338	\$11,300	\$11,838	- 22.8%	\$13,389



# Australian Towage in Perspective – Towage Prices

## Melbourne

GRT range	1990	1992	1994	1996	1998	2000	2001	Variance %	New cost
5,001 to 7,500	\$5,812	\$3,658	\$3,658	\$3,951	\$3,658	\$4,030	-	- 30.7%	
7,500 to 10,000	\$5,017	\$6,553	\$7,800	\$6,825	\$3,413	\$3,249	\$2,276	- 54.6 %	\$2,809
10,001 to 12,500	\$6,643	\$5,283	\$6,887	\$4,891	\$3,981	\$4,702	\$2,306	- 65.3 %	\$2,846
12,501 to 15,000	\$7,652	\$6,607	\$5,918	\$4,352	\$4,595	\$6,547	\$4,863	- 36.4%	\$6,001
15,001 to 17,500	\$8,058	\$6,695	\$6,932	\$6,123	\$5,364	\$5,965	\$6,023	- 25.3%	\$7,432
17,501 to 20,000	\$8,735	\$10,020	\$7,538	\$6,283	\$5,782	\$2,787	\$4,100	- 53.1%	\$5,059
20,001 to 30,000	\$10,478	\$9,145	\$8,511	\$9,045	\$6,435	\$6,539	\$6,332	- 39.6%	\$7,814
30,001 to 40,000	\$9,340	\$9,928	\$9,065	\$9,821	\$7,789	\$6,678	\$6,990	- 25.2%	\$8,626
40,001 to 50,000	\$10,124	\$9,554	\$10,740	\$12,274	\$8,055	\$7,194	\$7,801	- 22.9%	\$9,626



# Australian Towage in Perspective – Towage Prices

## Adelaide

GRT range	1990	1992	1994	1996	1998	2000	2001	Variance %	New cost
12,000 to 15,999	\$12,525	\$9,366	\$9,573	\$8,433	\$8,505	\$11,340	-	- 9.5%	
16,000 to 19,999	-	-	\$11,519	\$11,339	\$9,027	\$7,688	\$3,983	- 65.4%	\$4,612
20,000 to 24,999	\$14,227	\$11,680	\$16,550	\$14,711	\$12,688	\$16,520	\$3,866	- 72.8%	\$4,477
25,000 to 29,999	\$15,161	\$15,950	\$19,347	\$10,576	\$12,760	\$12,278	\$10,140	- 33.1%	\$11,742
30,000 to 34,999	\$12,581	\$9,840	-	\$16,740	\$12,485	\$11,700	\$11,167	- 11.2%	\$12,931
35,000 to 39,999	\$17,364	\$17,920	\$19,800	\$15,840	\$15,840	\$11,880	\$14,322	- 17.5%	\$16,585
40,000 and over	\$24,302	\$18,200	\$22,155	\$20,820	\$20,821	\$15,938	\$14,396	- 40.8%	\$16,671





# Australian Towage in Perspective – Towage Prices

Port	Ship	Invoiced cost in 1993	Invoiced cost in 2001	Published price change	Actual cost change
Brisbane	<i>Ariaka</i>	\$9,840	\$6,112	down 6.2%	down 37.9%
Port Botany	<i>New Zealand Pacific</i>	\$14,734	\$10,692	steady	down 27.4%
Melbourne	<i>Arafira</i>	\$11,790	\$5,052	up 10.0%	down 57.2%
Adelaide	<i>New Zealand Pacific</i>	\$16,520	\$12,033	steady	down 27.2%



# Australian Towage in Perspective – Towage Prices

## Containership on 3 Port Rotation

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

- Note:**
1. Price increase calculated inclusive of GST
  2. Increase calculated in cost per full teu
  3. Based on a vessel with 1728 teus total capacity

## Commodity Value per teu A\$

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



# Australian Towage in Perspective – Towage Prices

## Adsteam implemented price increases in March 2002

Port	Date of last increase	March 2002 price increase	Per annum increase since 1992
Brisbane	1987	11.7%	0.8%
Port Jackson	1998	26.2%	4.1%
Port Botany	1990	13.1%	1.1%
Melbourne	1999	23.4%	3.3%
Adelaide	1992	15.8%	1.6%



# Australian Towage in Perspective – Towage Prices

- Adsteam implemented price increases in March 2002
  - ➔ Regulatory intervention leading to price bunching
  - ➔ Inability to gradually move prices in line with all other participants
  - ➔ Declining vessel calls and tugs per vessel



# Is there a need for Intervention? - Key Terms of Reference

- ⑩ “... measures that could be taken to increase the level of competition in harbour towage and related services, **where desirable.**”
- ⑩ “whether there is a continuing need for prices oversight of certain harbour towage services and, if so, the most effective forms of price oversight.”



# Is There a Need for Intervention? - Key Preliminary Findings

- ⑩ “Available evidence suggests that these barriers [to entry into towage markets], while not insignificant, are **not large.**” Preliminary Finding 6.2
- ⑩ “Available evidence indicates that towage prices in **some Australian ports** have been above efficient levels but the **margin has not been large.**” Preliminary Finding 6.5
- ⑩ “These costs [of prices declaration under the PSA] are not insignificant and would seem to **exceed the benefits.**” Preliminary Finding 8.4.



# Is There a Need for Intervention? - Importance of a Net Benefit Case

- Key questions:

- ➔ What are the perceived benefits, how significant (and real) are they, to whom do they accrue and to what extent are they likely to be realised?
- ➔ What are the costs to society of the proposed arrangements, including direct financial costs and broader economic/welfare costs?
- ➔ What are the more efficient alternatives, eg an open-market solution



# Volume Rebates – The Issues

- It is sometimes argued that volume rebates, offered by incumbent towage providers, constitute an entry barrier.
- This argument can really only take two conceivable forms:
  - that volume rebates are due to economies of scale and these economies of scale constitute the barrier to entry;
  - that such rebates lie below cost.
- The PC itself proposes pro-efficiency reasons for volume rebates.





# Volume Rebates – Economies of Scale

- Economies of scale alone cannot be a barrier to entry.
- Any firm that enters at sufficient scale can claim such economies, and any firm that does not, suffers from being inefficient rather than being disadvantaged by an entry barrier.
- One caveat to this argument is that capital market imperfections may create a barrier to entry, making it difficult for small operators to fund entry ***at the efficient scale.***
- However, in practice some potential entrants are sufficiently large on their own that the ability to enter on a large scale is not likely to be a problem.
- For example many potential entrants are vertically integrated into many aspects of shipping and port services e.g. Hong Kong Salvage & Towage, Smit International.



# Volume Rebates – Alternative Views

- Volume rebates are not likely to be large enough to hinder entry
- Other explanations have been proposed for the introduction of rebates, based primarily on market-based and efficiency reasons:
  - the countervailing power of towage users, particularly the larger shipping lines
  - lower unit costs of servicing large volume customers
- Rebates were called for in the mid 1990's by the users and Adsteam responded



# Exclusive Licences - Overview

## ⑩ Cautionary findings

→ “... the Commission stresses that it does not consider that exclusive licensing by port authorities in practice will always deliver superior outcomes to non-exclusive licences or, indeed, other options including no licences.”

## ⑩ Industry Commission (1993) and Productivity Commission (1998) – Noted preference for and benefits of non-exclusive licensing



# Exclusive Licences – Industry Reaction

- *“Towage in Australian ports should switch to a system of exclusive licences issued by a competitive tender process in order to increase competition and reduce prices, according to a draft recommendation by the government agency known as the Productivity Commission.”*

*Lloyd’s List 6 June 2002*



# Exclusive Licences – Industry Reaction

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*Lloyd’s List 6 June 2002*

- *“National Farmers' Federation president Peter Corish said the commission has accepted the NFF's position that ... competitive tendering for exclusive licences is the most efficient way to regulate the industry.”*

*Lloyd’s List 7 June 2002*



# Exclusive Licences – Licence Duration Example

- Licence duration recognised as a critical and complex issue
  - ➔ IC (1993) - If exclusive, should be short term (3 years) through public tender
  - ➔ Interested parties argue for 7 years or more (existing licences 5 to 7 years)
  - ➔ What will licence issuer decide - and on what basis?



# Exclusive Licences – ACCC Concerns

“Competitive tendering for the right to supply towage services may be a problematic solution to the natural monopoly structure of harbour towage. Similarly, it is not clear which alternative type of towage contract, non-exclusive or exclusive, is superior in terms of its potential effects on economic welfare.”

**ACCC, May 2002**

- “... the ACCC is concerned that the potential costs and risks” are examined
- Who designs the tenders and what are the problems?
- Careful examination of terms of the towage licence
- Inconsistent regulatory framework imposing greater transacting costs
- Lack of incentive to make provision for salvage capability



# Exclusive Licences – Transaction Costs

“The transaction costs of tendering include the cost of preparing tender documents, running the tender, evaluating the bids and monitoring compliance with the conditions of the licences. The potential towage operators also incur costs when participating in the tender process.”

Position Paper p.141.

- Precisely what are these costs and how significant are they?





# Exclusive Licences – Transaction Costs

- ACIL report on the *direct* costs of implementing Preliminary Recommendation 2
  - ➔ Costs to port authorities – Setup, cost/benefit analysis, draft contract, tender management, probity audit, contract management
  - ➔ Costs to tenderers – Local study, demand study, securing tugs, preparation of bid, termination and handover, contract management and renegotiation during contract
  - ➔ Total transaction costs are very significant and not generally scaleable
  - ➔ Estimated \$1 million plus uncertain items for a 5 tenderer competition – more if more tenderers, legal issues arise and/or if TPA issues need to be addressed



# Exclusive Licences – Transaction Costs

## ACIL – Port Authority Costs

Setup Costs	\$20,000	Tender Management	\$100-150,000
Cost Benefit	\$50,000	Probity Audit	\$20–30,000
Draft Contract	\$25,000	Contract Management	Uncertain

**TOTAL \$215 - \$275,000 + uncertain costs  
Per Tender**



# Exclusive Licences – Transactions Costs

## ACIL – Bidder Costs

Local Study	\$20,000	Quality Accreditation	\$10,000
Demand Study	\$30,000	Termination and handover	\$20,000
Secure Tugs	Uncertain	Contract Management	\$10,000
Travel	\$5-10,000	Renegotiation during contract	Uncertain
Preparation of Bid	\$75-100,000		

**TOTAL \$170 - \$200,000 + uncertain costs  
Per Bidder**



# Exclusive Licences

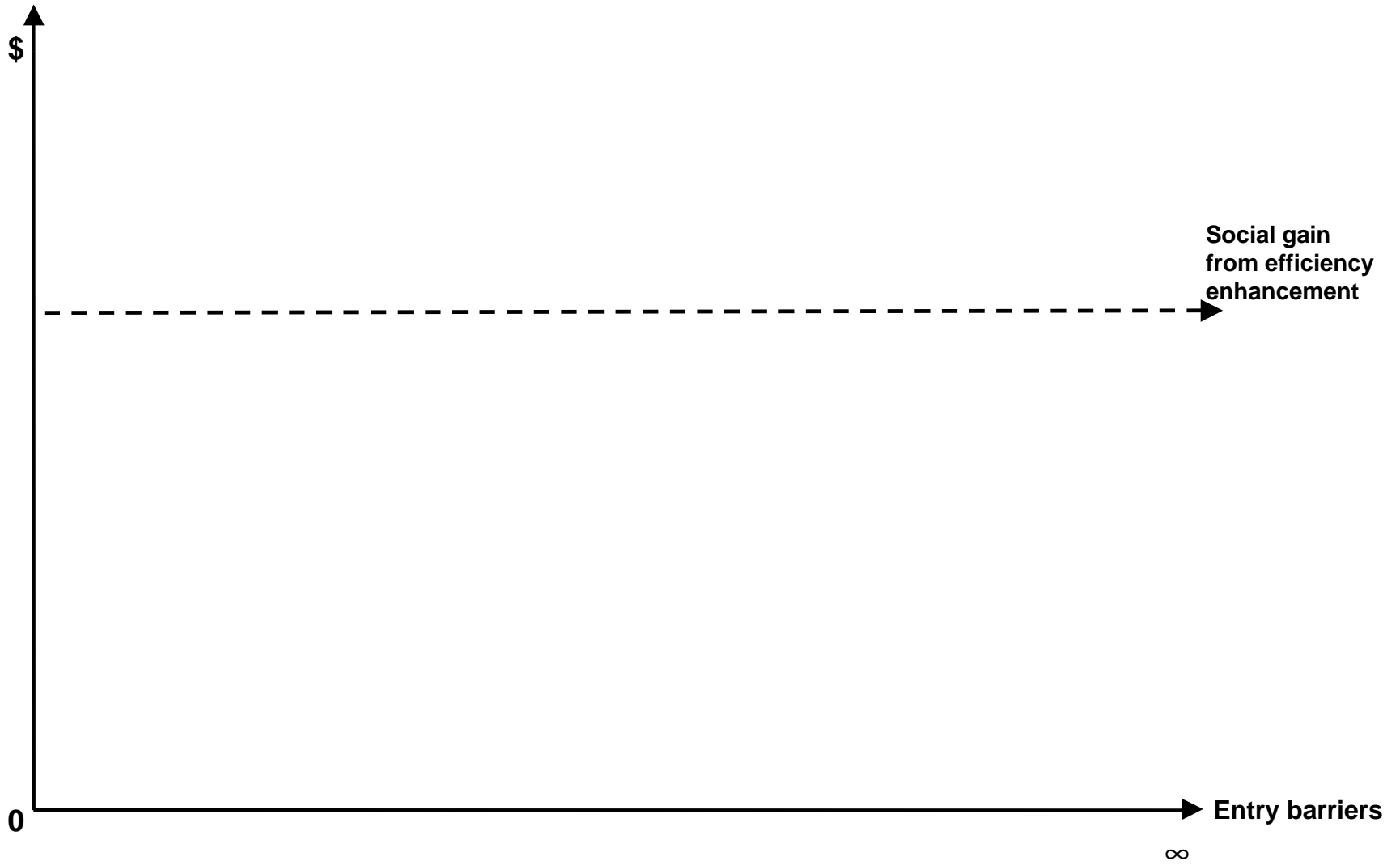
## - Broader Economic Costs (NECG summary)

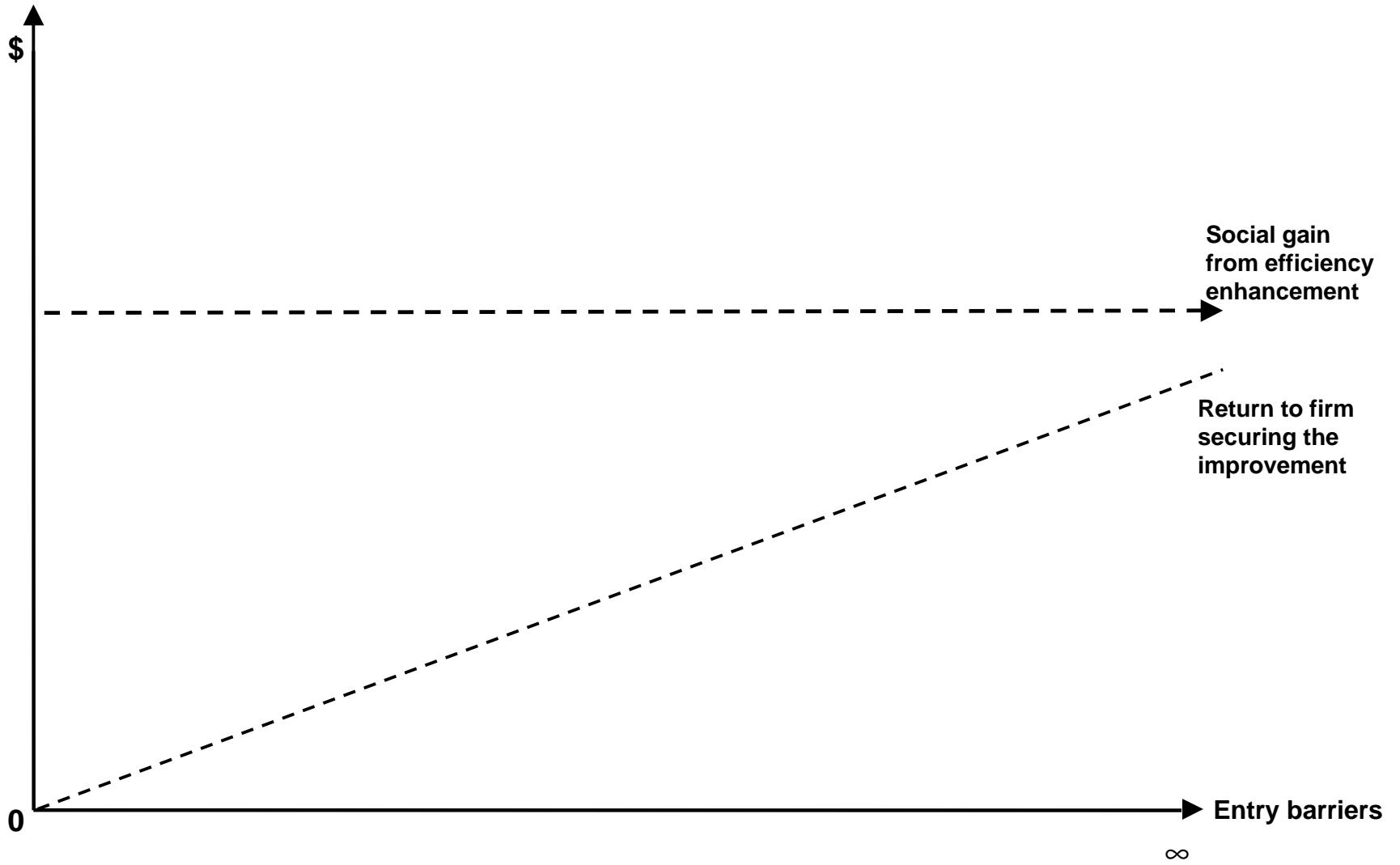
- Port authorities face a conflict of interest in administering exclusive licensing for towage contracts.
- A broader adoption of exclusive licensing would expose towage providers to expropriation of their investments in cost reducing innovations.
- This would not be in the long run interests of towage users as it would reduce incentives for future investments in cost reduction.
- In addition **even if** the conflict of interest problem could be resolved, there are various costs inherent in the exclusive licensing process that would tend to reduce efficiencies and increase costs.
- These are contractual design and enforcement costs; adverse effects on dynamic efficiency through effects on the timing of investments; bidding parity problems.

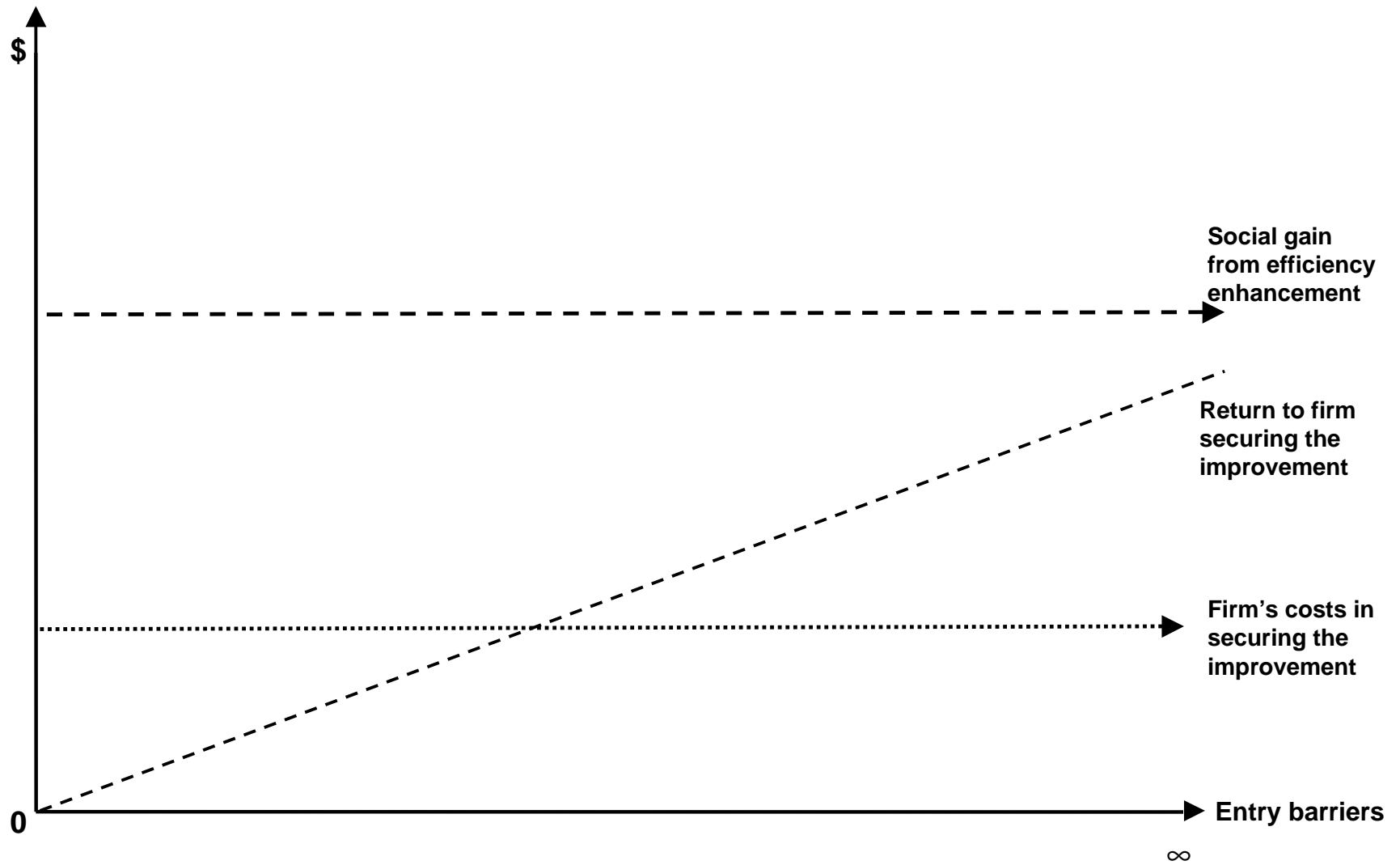


# Comparing the situation before licensing and the situation after

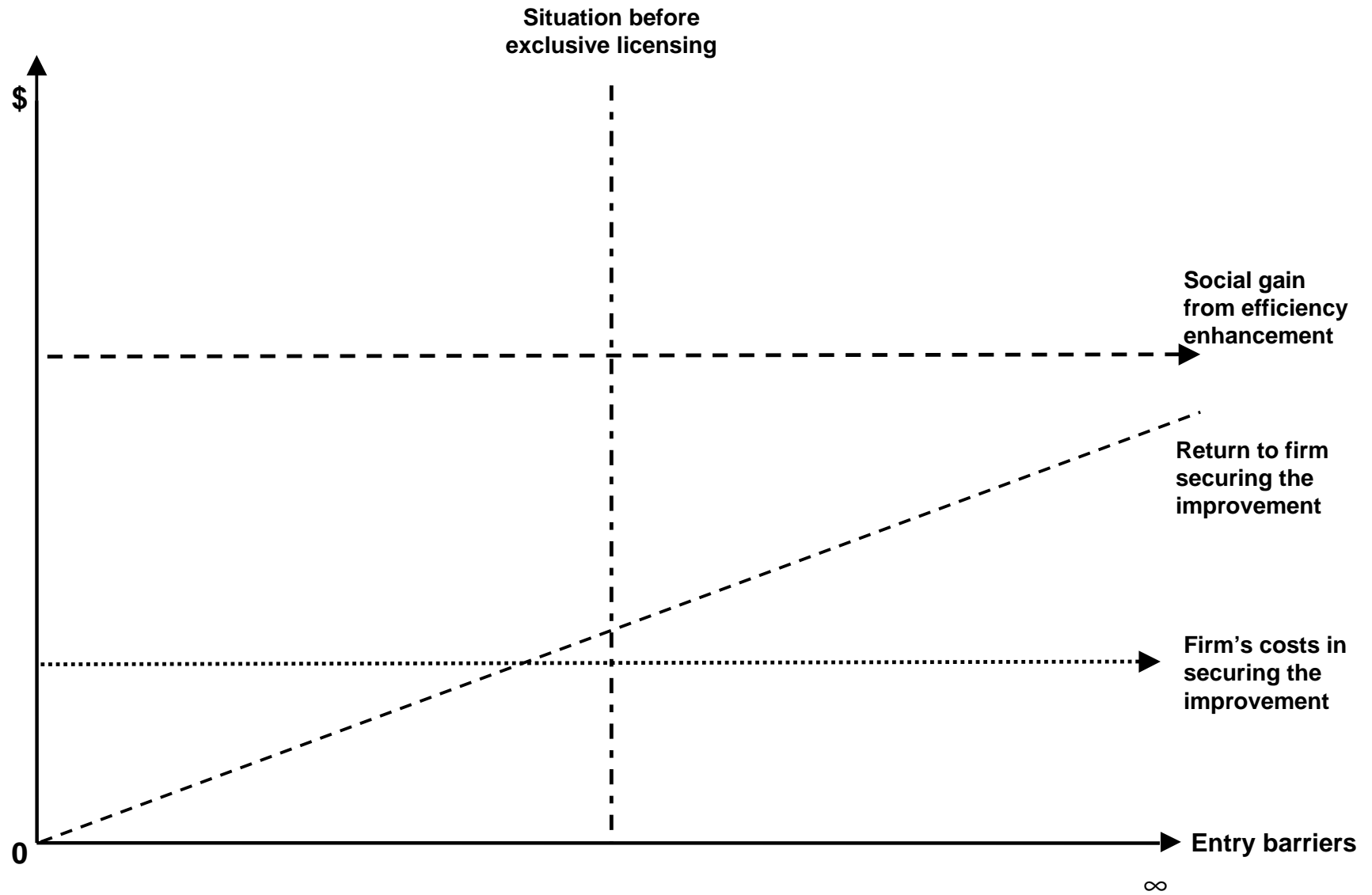


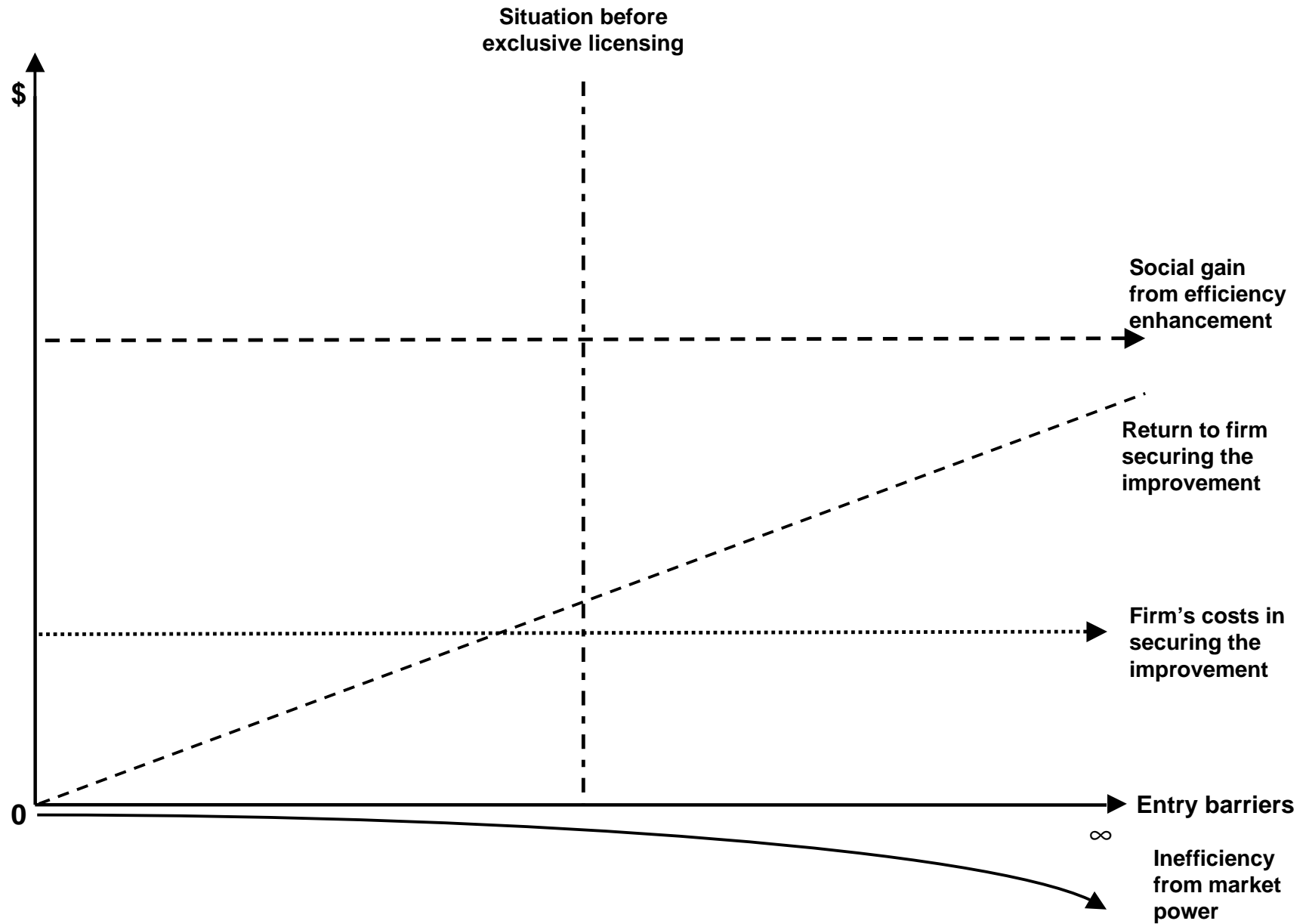


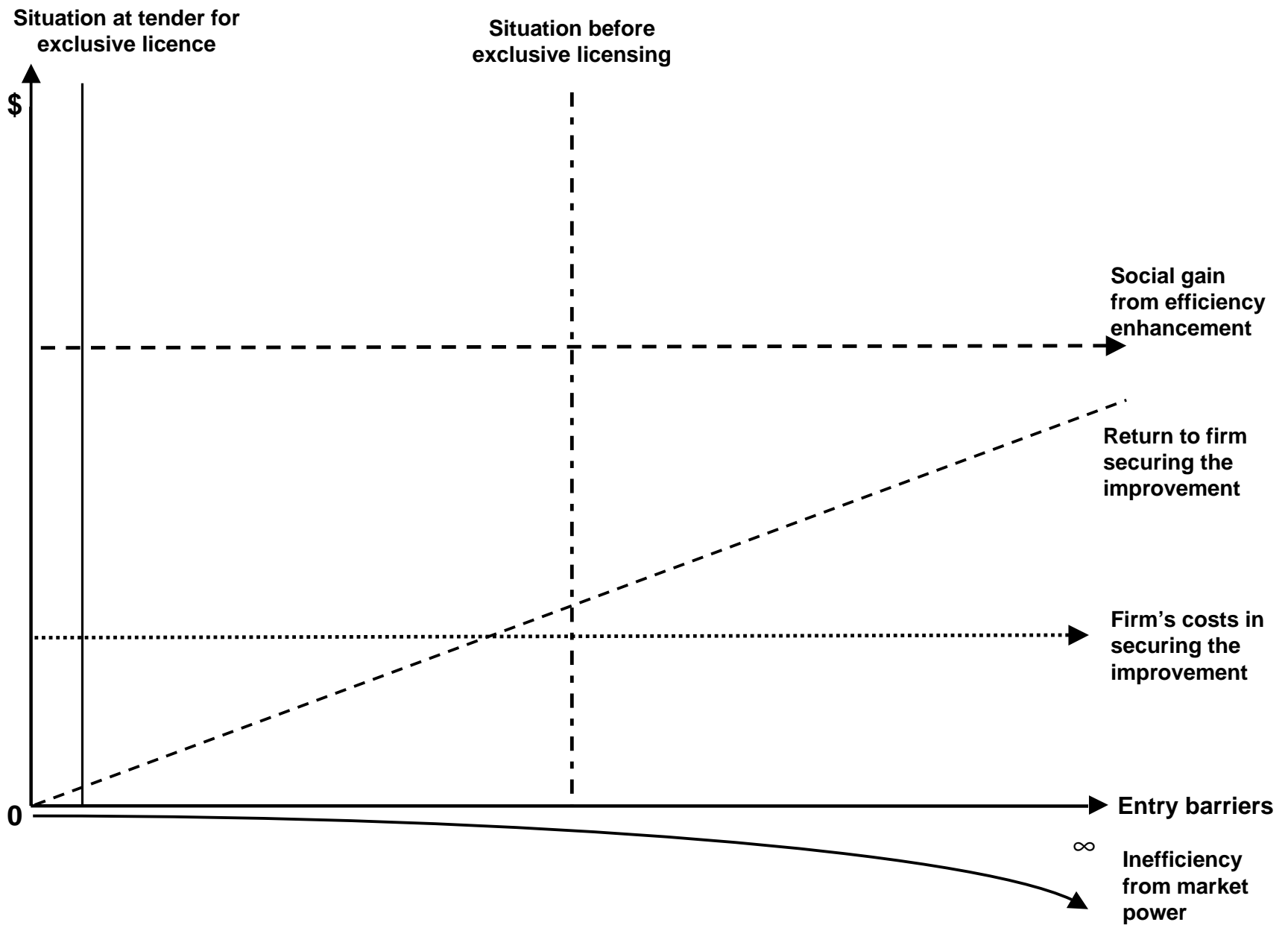


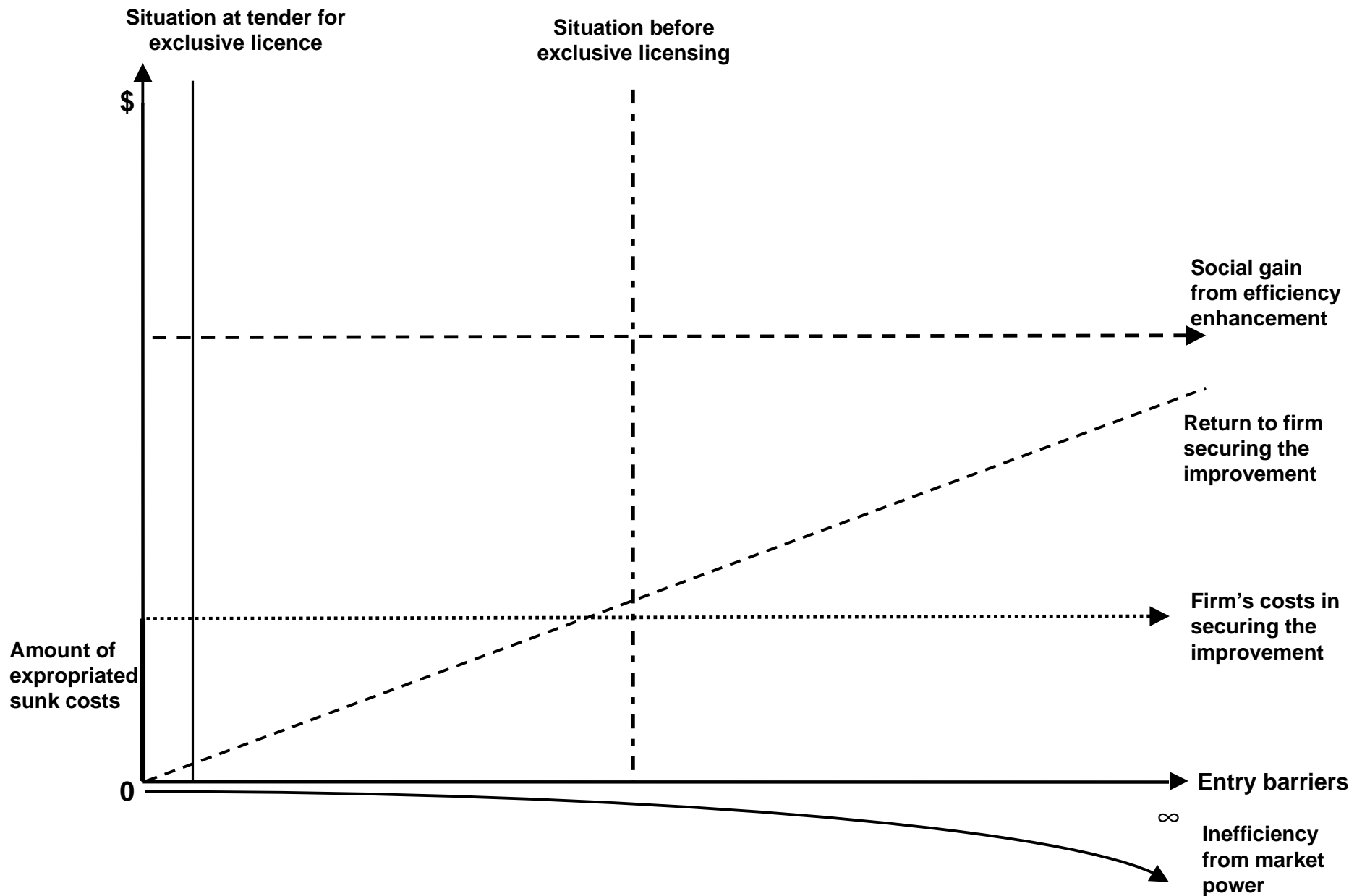


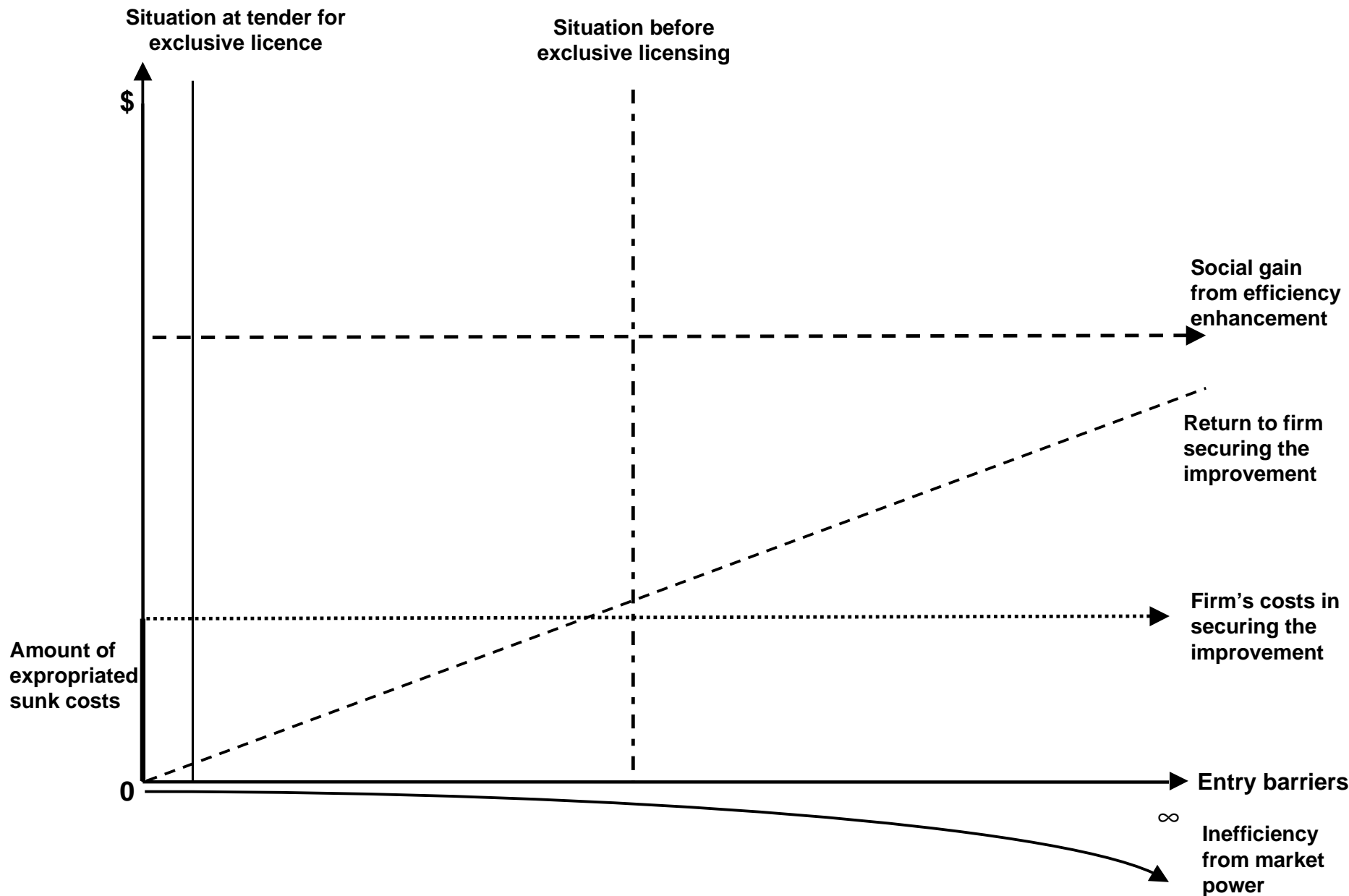












# Exclusive Licences

## - Broader Economic Costs (NECG conclusions)

- There are circumstances in which the costs of exclusive licensing are worth bearing
- This is most notably the case when the alternative is entrenched monopoly **and** other forms of regulation – e.g. classic rate of return controls – are themselves inefficient
- Here, however, it is common ground that the market is subject to competitive disciplines
- In these circumstances, exclusive licensing will impose costs but create few durable benefits



# Exclusive Licences – Broader Economic Costs

- Costs of exclusive licences are widespread - Charles River Associates
  - ➔ *Towage licence establishment costs* – Policy development, stakeholder consultation, legislative change, co-ordination and consistency, procedural safeguards
  - ➔ *Port authority costs* – Running the tender process, ongoing costs of monitoring and compliance, transition costs
  - ➔ *Towage providers (actual and potential) costs* – participating in the tender process, costs of uncertainty and “lock-in”, ongoing compliance costs, transition costs
  - ➔ *Towage users costs* – the principal-agent problem, impact on quality and innovation, loss of alternative welfare-enhancing competitive arrangements



# Exclusive Licences - Costs to Salvage Capability

***“Where ports or users put their towage requirement to tender they normally would specify tugs that met the needs of the port. The contracts or licences also presumably would stipulate conditions under which tugs could be called away for any salvage work. While this would ensure efficient salvage capacity for the port, an issue remains about the optimal national salvage capability in ocean waters, and its location. Though well beyond the scope of the inquiry, this issue (and how salvage capacity should be paid for) may warrant further examination.”***

***Position Paper, p.XXXVI***





# Exclusive Licences - Costs to Salvage Capability

***“Salvage operations do not relate to the operation of any particular port and so there is no incentive for port authorities to allow for salvage tugs if they believe that another port authority will do it for them.***

***This leads to a free rider problem in that if all port authorities adopt the same stance with the result that no towage company provides salvage capability in any port leading to a serious weakening of Australia’s capacity to respond to marine accidents ...***

***Some port authorities notably the Port of Bunbury have recently displayed a reticence to include provision for salvage capable tugs in their respective ports and therefore bidders that offer salvage capability at higher capital cost automatically lose.”***

ACCC, May 2002



# Exclusive Licences - Costs to Salvage Capability

- Australia requires a comprehensive, large-scale salvage capability
  - ➔ 36,000 kilometres of coastline
  - ➔ Sensitive reef areas and critical shipping-routes
  - ➔ International obligations and industry expectations
  - ➔ Specialised and strategically positioned tugs the back-bone of this salvage capability



# Exclusive Licences - Costs to Salvage Capability

- Australia's salvage requirements are currently met by privately-funded salvage operations
  - ➔ Purpose built tugs - Deep-sea towing winches and associated hardware, fire-fighting capabilities, comprehensive navigational aids and communications equipment
  - ➔ Highly-trained, professional salvage crews and shore-based teams, capable of working in all conditions and assisting all types of emergencies
  - ➔ Efficiently and seamlessly "integrated" into existing harbour towage fleets
  - ➔ 27 casualties assisted in the last 3 years



# Exclusive Licences - Costs to Salvage Capability

- An efficient “users pays” model
  - ➔ Governed by industry contracts and agreements
  - ➔ Independent Arbitrator under LOF
  - ➔ Reward proportional to salvage commitment and maintenance of capability and capacity to respond
  - ➔ Purely “user pays” – No taxpayer or third-party contributions to ensuring maintenance of Australia’s national salvage capability



# Exclusive Licences - Costs to Salvage Capability

- The alternative “government funded” model – The UK
  - ➔ 4 dedicated Emergency Towing Vessels
  - ➔ 8 year Contract
  - ➔ Year round coverage of a 1,700 km coastline
  - ➔ £75 million (A\$205 million contract)

*Lloyds List.com*

*30 August 2001*



# Exclusive Licences - Conclusions

- The strongest case for exclusive licensing is that it may reduce a perceived price margin (not large) – but at what cost?
- The transaction and broader economic costs of exclusive licences are potentially very significant – but have never been quantified
- Real danger that port authorities and users will proceed with exclusive licences without undertaking a proper cost benefit analysis – as already evident in statements in the industry



# Exclusive Licences – Summary

- Are exclusive towage licences “desirable” and where does the onus lay?
- Commission’s assessment is, at best, cautionary
- Open-market forces and non-exclusive licences are effective and should not be underestimated or subject to inappropriate comparisons
- The bunching effect of PSA regulation makes a compelling case for less not more regulation



# Price Declaration and Monitoring - Overview

- ***“Costs arise for both the regulated entity and the regulator in relation to the price notification system for harbour towage under the Prices Surveillance Act 1983. These costs are not insignificant and would seem to exceed the benefits.” Preliminary Finding 8.4***
- ***“Price monitoring, if undertaken through clearly specified and focussed indicators, may have a role during a period of transition to a more competitive environment.” Preliminary Finding 8.3***





# Price Declaration and Monitoring - Costs

- PSA declaration and PSA monitoring involve high regulatory costs
- The more intrusive and onerous price regulation is, the more costly – Principles of “light handed” approach should apply



# Price Declaration and Monitoring - Costs

- Heavy-handed monitoring of Prices, Costs and Profits will significantly damage Adsteam's 24,500 Australian shareholders – as well as:
  - ➔ Exceed the level of disclosure under accounting standards
  - ➔ Exceed the level of disclosure under the Stock Exchange continuous disclosure regulations
  - ➔ Provide a level of transparency not required of any other participant in the transport chain that has not received government assistance



# Price Declaration and Monitoring - Benefits

- What is the problem? Or what is hoped to be gained from price monitoring?
- No gain to Adsteam – potential deterrent to a new entrant
- Possible gain is a competitive advantage for new entrants, but is this justified?
- Adsteam would not support provision of Profit and Loss information – but if price transparency is the issue then a less intrusive arrangement may be workable.



# Price Declaration and Monitoring - Conclusions

- Formal price declaration should not be renewed – intrusive price monitoring should not be imposed
- No clear objective and significant costs for anything other than the most “light handed” of approaches where a need is identified



# Regulatory Harmonisation

- Adsteam fully supports Preliminary Recommendations to harmonise state based regulations
- Outstanding issues – How to make it happen? What are the mechanisms, objectives, timelines?
- Who will “champion” this process – momentum exists today because of this Productivity Commission Inquiry and needs to be acted upon



# Summary

- Regulation of towage in Australia – needs to be put in perspective, alleged size of the problem vs the cost of regulation
- What is so unique about this small part of the transport chain that needs such scrutiny – are there bigger problems to deal with?
- Open-market competition provides the constraints and incentives (without regulatory costs) to enable efficient investment, quality service and effective pricing – can every other industry player make the same claims?
- The building blocks for removing and preventing “undesirable” regulatory arrangements are contained in the Commission’s Position Paper

