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12 August 2002

Productivity Commission
Harbour Towage Inquiry
LB2 Collins St East
Melbourne Vic 8003

(email – harbourtowage@pc.gov.au)

Dear Sirs

ECONOMIC REGULATION OF HARBOUR TOWAGE AND RELATED SERVICES

I refer to submissions made to the Commission by ACIL Consulting, Charles River Associates (Asia Pacific Pty Ltd) and the Network Economics Consulting Group. These consultants were appointed by Adsteam Marine Ltd to prepare submissions on the cost of exclusive licensing. Fremantle Ports would like to respond to these submissions, drawing on its recent experience in tendering for the licensing of towage at Fremantle.

ACIL Consulting prepared estimates of costs incurred by Port Authorities (Table 1 in the submission) and bidders (Table 2) in the bidding process. ACIL's figures in Table 1 show that port authorities are likely to incur between $215,000 and $275,000 (plus uncertain items) to introduce exclusive licensing. Fremantle Ports has assessed that its own actual costs were well below the range suggested. Our records indicate that actual disbursements were less than $50,000. Other internal costs such as salaries and overheads are fixed costs that could be expected to be incurred in the normal course of business, but even if they are allocated on a time basis to the various tasks performed, the amount apportioned to tendering for towage licensing plus follow up would still be of the order of $100,000, making total costs $150,000. We believe that the figures in Table 2 are similarly overstated.

While Fremantle Ports takes issue with the type and magnitude of costs identified in all of the three submissions, perhaps the most significant point that needs to be made is that all these costs need to be considered against the benefits. In our first submission to the Productivity Commission we indicated that exclusive licences would have resulted in the greatest cost reductions in the short term, but even so, non-exclusive licences nonetheless resulted in an average reduction of around 15 per cent in towage charges from previous levels in both the Inner Harbour at Fremantle and the Outer Harbour at Kwinana/Cockburn Sound. In addition, the scale of charges in the Outer Harbour was simplified with penalty rates and surcharges for out of ordinary hours work being completely removed. When one compares 15% of the industry revenue to the types of costs mentioned in the submissions, it is very clear that the benefits of licensing have outweighed the costs. It must also be remembered that the benefits are ongoing, whereas the costs, even if they were of the order identified in Tables 1 and 2 of the ACIL submission, are not.

The CRA submission seeks to identify wider costs associated with exclusive licensing and concludes that there are some costs impacting on the dynamic aspects of harbour towage e.g. customer choice, innovation and efficiency. However, the experience at Fremantle is that the reverse is likely to be true. The interest from alternative service providers in the Request For Proposals (RFP) process at Fremantle was primarily for exclusive licences, and customers were widely consulted on their preferences, so that they exercised customer choice where they had none before. Furthermore, the process attracted many submissions, some of which were greatly innovative. Finally, the process resulted in significant savings to customers which were achieved through innovation in work practices and better efficiencies. It is clear from this experience that without competitive tendering for licences, there would be less interest from alternative providers and less incentive for change that would benefit customers.

The NECG submission argues that the lowering of prices, such as that achieved through exclusive licensing, reduces incentives for towage providers to make future investments in innovation and is likely to reduce long run efficiency. Fremantle Ports does not agree with this. The RFP process attracted much interest that would not otherwise have been there and the prospect of exclusive licences was an incentive that attracted alternative service providers. Some of the proposals received were very innovative. With regard to incumbent service providers, the threat of losing exclusive licences provides an effective incentive for them to invest in innovation and ongoing improvements. On the issue of profitability and business sustainability, there is no evidence to suggest that even with the price reductions achieved under exclusive licensing, profit margins are insufficient to ensure long term business sustainability.

The NECG submission makes reference to "port authority conflict of interest" and "extensive regulatory powers that ... they can use to ends which may be very poorly aligned with economic efficiency". Fremantle Ports does not agree with these statements. The AAPMA submissions have drawn attention to the role of ports which include facilitating trade and being responsible for the safe and efficient operation of the port. Ensuring that all port services are provided efficiently and effectively is certainly part of this role and is aligned to economic efficiency. We note that in the NECG submission no empirical evidence has been offered to support the assertions presented. Our observations are that the reverse is true.

Appendix A in the NECG submission makes reference to volume discounts and economies of scale and concludes that these are not barriers to entry. The experience at Fremantle shows the opposite. For example, customers were widely consulted in the RFP process and our view is that, for a number, their choice of service providers was very much influenced by the ramifications of the outcome on their national rebate schemes. The RFP process also clearly demonstrated that economies of scale are very real. For example, tenders submitted show that the issue of two exclusive licences (one for Fremantle and one for Kwinana) would have resulted in higher prices than would be achieved under one exclusive licence covering both Fremantle and Kwinana. This is because there would be sharing of resources under the one licence that could not be achieved under two licences and led us to conclude that economies of scale were greater than we had assumed.

Finally, we note that Appendix B of the NECG submission lists some of Adsteam's "competitors" at selected ports. It is interesting that, given the economies of scale we understand to exist and the advantages an incumbent operator with national contracts would have, the only way we can see that they could be real "competitors" would be under circumstances where there was regular competitive tendering for exclusive licences, which the contrary of what is being implied.

I would be happy to elaborate on any of these points if required.

Yours faithfully

Kerry Sanderson
CHIEF EXECUTIVE OFFICER