ADSTEAM MARINE LIMITED

Submission to the

Productivity Commission
Inquiry Into The Economic Regulation of Harbour Towage And Related Services

adsteam marine

PART D – RESPONSE TO POSITION PAPER

July 2002

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INTRODUCTION

Adsteam commends the Commission for the way in which it has sought to identify those aspects of the Australian towage industry in need of reform. Towage is both a remarkably simple service as well as a complex commercial, social and even political activity. That this has been clearly recognised in the Commission's Position Paper is an achievement, particularly given the timeframe in which the Inquiry has had to be conducted.

Many of the preliminary findings in the Position Paper are consistent with Adsteam's assessment of the industry at present, and its own performance within it. Most notable among these findings are the Commission's views on the relatively low barriers to entry into towage markets and the limited degree to which towage prices have diverged from efficient levels. Adsteam also notes the widely held view that the quality of its towage services is of the highest standard.

At the same time, some of the Commission's findings appear to have underestimated critical aspects of the towage industry, including its minor significance as a cost impost within the greater transport chain and the degree to which open-market competitive forces discipline incumbent operators. The belief that exclusive licensing can create enduring benefits for towage users is, in Adsteam's view, misplaced in most if not all contexts.

A number of ironies have become evident during the Inquiry. Some of them are worthy of note. Many of the interested parties who have argued that towage prices are too high, are themselves at risk of criticism for monopoly pricing or retention of cost savings at the expense of end-users. Another irony is that towage rebates are seen by some (customers in particular) as pro-competitive price reductions – while others (port authorities and lobby groups) contend that they are purposely anti-competitive.

It is important to note that no actual consumer of towage services has raised any complaint about Adsteam's discount arrangements.

The issue of Australia's national salvage and coastal protection capability is another important area of debate. The present system is widely recognised as effective and efficient, yet some interested parties seem willing to risk this system on the wishful thought that exclusive licensing can cater for this and a range of other needs with consummate ease. Adsteam does not consider that such an experiment is worth pursuing, particularly when alternative salvage and coastal protection models are likely to be more complex, costly (for users and for governments) and difficult to co-ordinate given Australia's extensive coastline and federal system of government.

Ultimately, the Commission must form a view on the advantages and disadvantages of a range of alternative regulatory and non-regulatory arrangements. Some of these arrangements rely on the ongoing forces of free market competition. Others depend on the decisions of individuals and entities whose judgement and agenda restrict their view of what is an appropriate towage service, an appropriate towage price and ultimately an appropriate towage operator – a particular cause for concern when landlord ports with little understanding of user needs are made the responsible regulators.

Adsteam has sought to raise the level of discussion during this inquiry above mere assertion and self-interested commentary. It has invested in independent research on issues that have never been researched as thoroughly before. It has also argued at length from its position as an experienced and successful towage operator, the only one that has so far publicly contributed to the Inquiry.

As both an incumbent operator and a hopeful entrant in new markets, Adsteam believes that free and open-markets are the best way of generating efficient outcomes, in harbour towage and related markets. This is because these markets have been shown to operate impartially through pricing mechanisms and service quality requirements communicated directly between users and providers. The result is workable competition without excessive regulatory costs.

In Adsteam's view, the current declaration of it services under the PSA should not be renewed. Neither should exclusive licences be imposed where there is no justification. Any observable imperfections in the competitiveness of the Australian towage industry should be seen as indicators of workable competition – not as problems requiring a regulatory response.

STRUCTURE OF THIS SUBMISSION

This submission draws together information and analysis from previous Adsteam submissions and presentations. It also offers new information in areas where it is believed the Commission may benefit from a more complete understanding of certain aspects of the towage industry.

Section 1 confirms Adsteam's agreement with the Commission's Preliminary Recommendation 1, with the rider that a program for translating the Commission's views into action is needed as a matter of some urgency.

Section 2 provides a summary of Adsteam's continued opposition to the imposition of exclusive towage licences in Australian ports. It looks at the problems of contracting and the costs and benefits of exclusive license regimes, including the potentially adverse effects on Australia's national salvage and coastal protection capability.

Section 3 provides support for the Commission's preliminary recommendation that the current declarations under the PSA not be renewed. It also questions the need for any further price regulation, including "light handed" price monitoring.

Attached to this submission are the following reports, some of which have previously been forwarded to the Commission:

- ACIL Consulting, *Exclusive Licensing of Port Towage Services – A Report to Adsteam Marine*, July 2002
- Charles River Associates, *Exclusive Licensing of Harbour Towage Services in Australian Ports: An Analysis of the Potential Costs*, July 2002
- NECG, *Response to the Productivity Commission's Position Paper on Harbour Towage*, July 2002
- Thompson Clarke Shipping, *Report – Conference & Workshop Safe Havens & Salvage: Australian Maritime Safety Authority, Association of Australian Ports and Marine Authorities*, February 2002.

1. COST MINIMISATION AND REGULATORY HARMONISATION

The Commission has recognised the need for towage guidelines to be used to minimise towage costs (to the towage operator and other parties) without sacrificing safety levels. This is consistent with the view that regulations that prescribe tug utilisation levels should not unnecessarily distort the cost-base for towage operators, for instance by requiring them to maintain a larger fleet of tugs in a port than is strictly necessary.

The Commission has also recommended that minimum crew qualifications and standards in different jurisdictions should be harmonised so as to not create barriers to the free movement of crews and tugs between Australian ports. Again, this is consistent with ensuring that unnecessary regulations – or regulatory disparities – are removed and avoided in the future.

An important aspect of such an initiative will be the elimination of prescriptive crew qualifications that do not reflect the requirements of the towage industry. For instance, it should not be necessary for a tug crew member to have qualifications for open-ocean work where this is clearly "overkill" in terms of the duties they actually need to perform as part of a harbour towage service.

Adsteam fully supports the Commission's recommendations in these areas. However, it is concerned that the momentum that exists today because of the Inquiry will not be acted upon unless a program is established to ensure that changes occur. A key element of such a program will be a "champion" to push for the needed reforms in a timely and effective manner.

A possible suggestion in this regard is the Bureau of Transport & Regional Economics which has a good understanding of the overall transport industry. Such a role would also appear consistent with its general mission and interest in efficiency initiatives of these kinds.

There is a range of issues that need to be addressed. What are the appropriate mechanisms through which change will occur? What are the timelines that should be put in place? What are the ultimate objectives of the reform process – and how will they be measured?

Adsteam encourages the Commission's further recommendations in these areas to ensure that impediments to increased competition at this level of the towage industry are removed as soon as possible.

2. EXCLUSIVE AND NON-EXCLUSIVE LICENSING

The Commission has recommended that port authorities be given the power to determine whether, when and in what form to issue exclusive and non-exclusive towage licences - subject to them also observing certain procedural guidelines. In this section, Adsteam sets out the basis for its continued opposition to exclusive licensing. This discussion builds on its previous submissions and presentations during the Commission's Public Hearings.

Adsteam seriously questions whether the practical outworking of this recommendation will lead to enhanced efficiency outcomes. Based on its own analysis, which has been presented to the Commission in written submissions and oral presentations, Adsteam believes that the practical effect of the Commission's recommendation will be inefficient intervention into markets that are demonstrably contestable.

Adsteam reiterates the words of Dr Ergas, who appeared at the Public Hearings and presented the case against the use of exclusive towage licensing on the grounds of economic inefficiency. Central to Dr Ergas' analysis is the need to focus on the appropriate counter-factual when assessing the likely costs and benefits of intervention. To quote from the transcript of Dr Ergas' presentation on 11 July 2002:

> "What's at issue here is not a comparison between an imperfect world as we have it and a perfect world where contract enforcement would be costless and contract execution flawless. The relevant comparison is between a world where there is some, and we believe significant, discipline that comes from potential entry and a world where the entire burden of assuring service quality and price competitiveness rests on a regulatory mechanism."[1]

The rigour of the Commission's analysis in this area is critical if an efficient result is to eventuate from this inquiry. Adsteam is concerned that there has been a multiplicity of vested interests arguing for exclusive licences, but they have not sought to base their claims on anything more than supposition, unsupported assertion and wishful thinking.

In Adsteam's view, it is critical to test the assertions of all interested parties, and for the Commission to undertake an economic analysis that correctly identifies the issues that need to be assessed. It is then necessary to determine the costs and benefits of possible regulatory options, while at the same time observing the ways in which open-market forces can themselves lead to efficient outcomes.

It is important to ensure that such analysis also recognises the regulatory distortions that presently exist in the harbour towage industry, mainly in the form of prices regulation under the PSA. The "bunching" of price increases under this regulation has led many industry participants to conclude that Adsteam's prices reflect a misuse of market power. In reality, the annualised effect of those price increases are arguably less significant than the price increases of other industry participants over the same period.[2]

It is within this environment that the Commission has deliberated over the use of exclusive licences. It does not, however, appear to have had the benefit of detailed analyses of the likely consequences of its preliminary recommendations. This may explain the cautionary nature of its preliminary recommendations in this area. Adsteam now urges the Commission to consider further the impact of regulatory intervention at this level.

1 Transcript of the Public Hearing on 11 July 2002 in Sydney.

2 It is relevant to note in this regard the recent, significant increases in berthage charges by some port authorities and the recent announcement by companies grouped under the Asia Australian Discussion Agreement (AADA) that they will increase their rates by $200 per TEU from Taiwan, China and Hong Kong to Australia from 1 July 2002 (if achieved, this would represent a price increase of over 50% in some instances). This follows earlier increases of $100 per TEU for movements between Asia and the Middle East. It is expected that freight rates for Asia/Europe will go up by $250 per TEU during July 2002. See for instance Lloyd's Register – Fairplay web links, 11 June 2002.

In this section, Adsteam restates many of the propositions put forward during its presentations at the Public Hearings. It also refers to further written material by economic and industry experts which explains the basis for many of its contentions.

Ultimately, Adsteam does not believe that exclusive licences will increase the efficiency of any aspect of towage services in Australian ports over and above what can already be achieved, at less cost, through open-market competition. Indeed, it believes that the detriment of this form of regulation could be very significant, especially when the economic costs of licensing are fully assessed.

2.1 Industry response

Notwithstanding the qualifications in its preliminary recommendation regarding exclusive and non-exclusive towage licences, the industry response to this recommendation has been disturbing, particularly given the importance placed by the Commission on a structured and rigorous process for determining when such licences should and should not be used.

In our view, the PC should give careful consideration to how exclusive licenses would be imposed and administered in the post-inquiry world. Expressing the need for caution and constraint is not enough. The PC needs to consider whether these conditional aspects will be ignored in practice as the proponents seize on a perceived simple outcome that "exclusive licences are authorised". Adsteam is firmly of the view, based on reaction to date, that proponents of exclusive licences would do exactly that.

In Adsteam's view, the proponents of exclusive licences are by and large motivated more by self interest than a concern over social welfare. Some of them are driven by a desire to add to their already extensive regulatory powers. Others see exclusive licences as a device to force reductions in the cost of towage, despite the fact that no submission that has been open to public scrutiny has demonstrated excessive costs at present.

It is also noted that these interested parties have not sought to measure the costs associated with their proposals, but rather have seen only the "bright side" of their plans.

During its presentation at the public hearing on 15 July 2002, Adsteam noted examples of industry responses noted in industry media. The essence of those examples was an unexplained eagerness by industry participants to implement exclusive towage licences in many if not all ports around Australia, even though such an approach would seem inconsistent with the Commission's detailed analysis.

In its most recent submission to the Inquiry, the National Farmers Federation for instance encourages the Commission to state more strongly the utility of increasing the use of exclusive towage licences in Australian ports. In this regard, it enthuses:

> "There may also be value in emphasising the appropriateness of exclusive contracts as the most efficient means of regulating towage."[3]

Putting to one side the issues of costs and benefits discussed further below, the Commission will now be aware how easily its careful and informed deliberations over the complexities of towage licensing, can be overlooked at an individual port level – particularly where port authorities are predisposed to the implementation of further industry regulation.

The Commission will also note how exclusive licences are seen by some port authorities as a means of regulating greater financial contributions from towage operators. The Port of

[3] National Farmers Federation, submission dated 9 July 2002.

Bunbury, for instance, demonstrated the importance it placed on licence fees over service criteria in its 2000 tender, with the relative criteria weighting as follows:

Table 2.1 – Port of Bunbury tender criteria weighting

Criteria	Weighting
Prices charged for harbour towage services	50%
Continuity of towage service ("no-strike" guarantee)	20%
Amount of licence fee payable to the port authority	10%
The provision of towage services 24 hours per day 365 days per year	10%
Provision of substitute tug	5%
Relevant experience and corporation capacity	5%

As noted in the Charles River Associates report, "… the license fee payable by the successful bidder to the port authority was attributed a significant 10% weighting in the overall selection criteria, while the prices charged for towage services (presumably a key focus of the exclusive licensing regime) were attributed a 50% weighting." It may be argued that where a port is able to specify and weight criteria on this basis, support for exclusive licensing by port authorities is to be expected.

2.2 Costs

During its oral presentations at the Public Hearings, Adsteam explored the costs of implementing some of the Commission's preliminary recommendations. In relation to exclusive licensing, Adsteam referred to work undertaken by ACIL Consulting, Charles River Associates and NECG. This work provides a comprehensive account of the likely transaction and broader economic costs of setting up and managing a licensing regime in a port.

While Adsteam commissioned each of these expert organisations to prepare their reports, there was no consultation between them, nor any suggestion that their views are not truly independent. As with the other reports provided by Adsteam during the Inquiry, these documents are provided to assist the Commission rigorously consider the issues raised by interested parties, including Adsteam.

The direct costs of licensing to port authorities and tenderers are estimated in the ACIL report. While some costs are acknowledged as uncertain in that analysis, the bottom line is that a 5-tenderer competition is likely to cost over $1 million, with significant additional costs if authorisation under the TPA is required or if unforeseen contract management issues arise requiring further negotiation and possibly litigation.

A broader range of economic costs, not just direct transaction costs, are considered in the Charles River Associates report. This report makes no attempt to quantify relevant costs. However, there is detailed conceptual discussion of towage licence establishment costs, port authority costs, towage provider costs and towage user costs which are likely to be incurred if the Commission's Preliminary Recommendation 2 were to be implemented.

A key point from this report is the so-called Principal-Agent problem, which highlights the difficulties that a port authority faces when acting on behalf of users while also pursuing its own corporate objectives. Some of these problems were noted during the public hearings where it was unclear exactly how a tenderer selection committee would be constituted (the issue of whether it should be constituted with or without user representatives was an issue of considerable uncertainty) and how decisions could avoid a less than efficient "one size fits all" result.

Additional information relevant to the Commission's consideration of these issues is provided in the Confidential Addendum to this submission.

The report by NECG considers many of the areas noted in the other reports, but in addition focuses on the inefficiencies created by exclusive licences that on their face appear to result in more efficient pricing than open-market competition. This analysis demonstrates how the expropriation of the incumbent's sunk costs and the bunching of future investment under an exclusive licence regime are likely to lead to inefficient outcomes.

The main thrust of the NECG paper is summarised in the following extract from the introduction to that document:

> "In a range of contexts, the PC has recently argued that where there is a risk of regulation discouraging efficient investment, then that risk needs to be given substantial weight in consideration of appropriate policies. We believe that the analysis we have set out highlights just how serious these risks to efficient investment are when ports, exercising their regulatory powers, enforce a policy of exclusive licensing. We believe that the PC needs to recognise these risks and in line with sound economic analysis, strongly recommend against the use of exclusive licensing in the services being examined in this review."

Lastly, it is noted that the development of legal principles under the Workplace Relations Act could impact substantially on the exclusive licensing process, making it less attractive to bidders and potentially port authorities as well.

In this regard, the recent decision of the Federal Court in *Health Services Union of Australia v Gribbles Radiology Pty Ltd* [2002] FCA 856 highlights the risk that a port authority would be viewed as engaging in the transmission of business (from the incumbent to the winning tenderer) such that the new operator could be bound by the Awards and Enterprise Agreements which bound the incumbent – and may be obligated to meet the redundancy costs of the incumbent's former employees if it decides not to employ them itself.

The effect of this ruling could be to discourage prospective entrants from tendering for an exclusive licence, and place port authorities in a potentially parlous position regarding their obligations. In any event, the case demonstrates that not only can a winning tenderer expropriate the sunk cost investments of the incumbent (assuming the incumbent did invest knowing that expropriation was a possibility) but that the obligations of the incumbent under workplace relations legislation may also be acquired in the process.

For further information about this case and its possible implications in the towage industry, a copy of a generic newsletter from law firm Corrs Chambers Westgarth dated 16 July 2002 is provided in Appendix A.

These issues do not arise under a non-exclusive licensing regime or an open-market model, where the port authority is not "transmitting a business" between competing operators and thus triggering the WR Act. Accordingly, industrial reforms in a non-exclusive environment will be much more likely than under the exclusive alternative, where there would be relatively little incentive to undertake labour market reform by any incumbent or prospective operator.

2.3 Benefits

The Commission's Preliminary Finding 6.5 states:

> "Available evidence indicates that towage prices in some Australian ports have been above efficient levels but the margin has not been large."

While not wanting to necessarily dispute this finding, Adsteam believes that the ports in which this finding may be true are likely to be small in number and that the margin above efficient prices in these ports is probably much less than might be inferred from the evidence that has been made available to the Commission to date.

The proponents of exclusive licences claim that lower prices are their main objective. This reflects, at least in part, the general view that service levels, particularly the service levels achieved by Adsteam and its subsidiaries, are of the highest level. It also recognises, at least implicitly, that if prices fall then quality levels may also decrease. Possibly for this reason, attempted price control invariably creates quality control issues as well.

The presentations by Dr Ergas discussed the pricing effects of licensing and in particularly whether prices are likely to be more efficient before or after an exclusive licence regime is established. Dr Ergas' analysis, which is set out in the attached NECG report, describes in some detail the potential pricing inefficiencies of such a regime.

To the extent that price reductions may be considered to be a benefit of exclusive licensing, they must also be seen as having negative side effects – or costs – when assessed in a broader economic framework. Any observed short-term price benefits need to be discounted to take into account these costs.

Where there are other benefits ascribed to exclusive licensing, these too need to be assessed in light of the inefficiencies in the tendering process. Even where a potential benefit may exist, securing that benefit will not be costless and numerous inefficiencies along the way can reduce the size of the anticipated reward.

In relation to service quality, which is an element of the towage industry that is commonly overlooked because it is generally at high levels, it is unlikely that any substantive gains can be achieved in this area from exclusive licensing. Indeed, there are reasons to believe that exclusive licensing could lead to a deterioration of service levels as licensees seek to increase their margins under price regulation.

This service deterioration has at least two aspects. The first is the direct consequence of a service provider subject to price regulation cutting costs to increase profits. The second relates to the expropriation of sunk costs, which is facilitated through exclusive licensing. Service quality improvements and efficiency enhancements will not be pursued by the incumbent operator where it cannot expect to recoup its investment in these areas.

The current high levels of service quality in the Australian towage industry are a reflection of the competitive pressures on incumbent providers. In addition to the Commission's preliminary findings regarding the limited degree to which towage prices diverge from efficient levels, the same forces of market contestability and countervailing power have maintained service levels without resort to a centralised licensing system.

Adsteam maintains that open-market forces can effectively constrain all elements of the incumbent's service, even though this influence may be more subtle and less easily observed than some interested parties may prefer.

2.4 Non-exclusive licences

Many of the envisaged benefits of exclusive licences can be achieved through non-exclusive means. Assurances as to service quality levels, commitment to providing a full and continuous service to port users, setting pricing parameters and payment of a licence fee to the port authority, can all be achieved through non-exclusive towage licences which preserve continuous, open-market pressures.

One obvious advantage is that the vexed problem of licence duration is avoided. As noted during public hearings, previous work by the Industry Commission and the Commission favoured non-exclusive licences wherever possible. Where exclusive licences could be justified, the recommendation was that they be for no more than 3 years. This contrasts with calls by interested parties for exclusive licence terms of 5, 7 and more years.

It may be suggested that there will be less competition for a non-exclusive licence than for an exclusive one. This may be true. But it is not competition for competition's sake that is important. Rather it is the ultimate quality and pricing of the service – not necessarily the intensity of the process involved – that should be the focus of regulatory intervention.

Adsteam notes that prospective market entrants invariably desire an exclusive licence over the alternative of open-market competition. This is because they can be assured of the entire market without having to prove their entitlement on the basis of actual price and service competitiveness. In this sense, exclusive licences provide an unwarranted degree of protection for potentially ineffectual competitors wanting dispensation from normal competitive forces.

Such operators will invariably choose exclusive licences over non-exclusive licences even in demonstrably competitive markets, regardless of the consequences for users and the society more generally.

Notwithstanding this self-interested preference for exclusivity, the potential benefits of non-exclusive licences are evident in the experience of ports such as Fremantle for instance where price reductions and purported quality improvements have resulted from non-exclusive tenders. They are also implied in the formulation of the Commission's Preliminary Recommendation 2, which does not distinguish between exclusive and non-exclusive licences at a broad policy level.

What is of concern, however, is the ease with which many participants in the Inquiry process have focussed solely on exclusive licensing as the main if not the only alternative to open-market competition. This is unfortunate where non-exclusive licences can potentially be implemented with less cost than their exclusive alternatives. This is particularly the case in a broad economic sense where towage markets may not be natural monopolies, such as in the larger container ports.[4]

Even in natural monopoly situations, open-market contestability can provide sufficient constraint on incumbents. In these situations, there is a risk that an exclusive licence could eliminate that constraint as an ongoing pressure and replace it with serial competition which may prove no more effective yet much more costly. Again, non-exclusive licensing has the potential to deliver both the control over prices and service quality that some market participants desire - without abandoning the free market in favour of a regulated monopoly.

Central to these issues – and to the Commission's other findings – is the view that barriers to entry into harbour towage are not large. While the Commission has arrived at this conclusion

[4] It is noted that the Port of Brisbane suggested during its presentation at the Public Hearing on 10 July 2002 that an exclusive licence could create a monopoly situation in that port, even though it is far from clear that two operators could not compete long term in that port. Similar comments were made in relation to Sydney and Melbourne, the latter presently experiencing on the water competition between Adsteam and Australian and Australian Maritime Services.

itself, more recent comments by port authorities and others about the relative ease with which they or some other competitor could enter a towage market confirm this conclusion.[5]

A possible line of further inquiry is to document the different types of non-exclusive licence that exist or could be used in Australian ports, with a view to establishing the most efficient form of such licences. This should include the same kinds of cost/benefit analysis undertaken with respect to exclusive licences during the course of the Inquiry.

Another way of approaching this issue is to encourage the use of non-exclusive licensing (following the procedural guidelines noted by the Commission previously), with the onus on the proponents of exclusive licences to establish the relative advantages (in terms of both costs and benefits) of exclusivity over non-exclusivity. Procedures need to be put in place to ensure that this assessment is not undertaken in a perfunctory manner.

In this context, it is noted that port authorities and their shareholder governments have an ability to circumvent the checks and balances that should be in place to ensure optimal outcomes. In the Port of Bunbury, for instance, Ministerial approval was needed to issue an exclusive licence. However, there is no evidence that any public benefit test was ever conducted and certainly no public benefit assessment was ever released.

2.5 Salvage and coastal protection

Salvage and coastal protection operations in Australia exist within a complex social, commercial and political framework. The importance of an effective, national salvage and coastal protection capability in Australia has not been questioned by any party involved in the Inquiry. Nor has anyone criticised the effectiveness of Australia's current salvage and coastal protection arrangements, which have worked efficiently and effectively for many years.

Attached is a copy of a report by Thompson Clarke Shipping concerning a conference and workshop on safe havens and salvage held by the Australian Maritime Safety Authority and the Association of Australian Ports and Marine Authorities on 19 and 20 February 2002. This report details some of the issues facing the Australian salvage and coastal protection industry at present.

As noted in Adsteam's previous submissions to the Inquiry,[6] the essential characteristics of Australia's current salvage and coastal protection capability are its "user pays" compensation arrangements (governed largely by internationally accepted conventions and agreements) and its efficient integration within harbour towage fleets in strategic locations around the Australian coastline.

It has been argued that exclusive towage licences can significantly increase the complexity of salvage and coastal protection arrangements in Australia, imposing greater cost and co-ordination responsibilities on a range of entities. There is general consensus that such effects would not be easy to address if the use of exclusive towage licences becomes widespread.

In addition to Adsteam and some other parties, the ACCC has made clear its concerns in this area. It is worthwhile restating the essence of the ACCC's position on the apparent incompatibility of efficient salvage and coastal protection operations and exclusive licence regimes in individual ports:

[5] See for instance the comments of the Port of Brisbane during the public hearing on 10 July 2002. These comments, which describe the port authorities abiding interest in exploring the possibility of setting up in competition with the incumbent towage provider, are also set out in the policy paper provided to the Commission by the Port of Brisbane.

[6] In particular, Adsteam refers to its submission to the Commission dated 24 June 2002 which provides detailed background information regarding Australia's towage operations.

> "Salvage operations do not relate to the operation of any particular port and so there is not 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."[7]

The Commission itself has also noted that further work may need to be done to understand these issues better – and to develop a way of dealing with the risk that exclusive towage licences could undermine existing, efficient arrangements.[8]

The comparison between the existing towage arrangements in Australia and those in other countries, particularly the UK, is instructive. The UK model is based on a Government-funded fleet of 4 dedicated Emergency Towage Vessels. These ETVs provide protection around the UK's 1,700 kilometre coastline at a cost of A$205 million for an 8-year contract.

Another model is the payment of a levy by ship operators. Adsteam does not support this approach for several reasons, including concerns over the mechanics of who pays what to whom and how much. There are also issues regarding the basis on which levy revenue is distributed and the cost of administering such a system relative to the anticipated benefits (and alternative models such as the current Australian system).

While there are potentially a range of alternative salvage and coastal protection models, there are strong grounds for asserting that the efficiency of the Australian model is, at least in terms of direct cost to the taxpayer, superior to all other alternatives.
The issue of cross-subsidisation of Adsteam's fleet of 14 frontline salvage tugs has arisen in written submissions and during public hearings. In addition to Adsteam's assertions that no such subsidisation occurs – and that in fact it is the shareholder base of Adsteam and previously Howard Smith that subsidised these vessels when required – the fact that the tugs in question were acquired well before any price rises in relevant ports supports the view that they do not impose a cost burden on port users beyond that of a tug with no salvage capability.

If the Commission requires further data to access these issues, Adsteam would be pleased to attempt to provide it.

Any deleterious effect on existing salvage and coastal protection arrangements resulting from the Commission's recommendations, could very well require both Commonwealth and state planning and funding on a major scale. Whether unintended or not, this is a potential consequence that increased use of exclusive licensing could create.

It has been suggested that exclusive licensing models can incorporate an adequate national salvage and coastal protection capability. However, this conclusion is not obvious. Moreover, such an assumption may well underestimate the effect of the focus of individual port authorities on their own port requirements at the expense of national salvage and coastal protection capabilities.

In these regards, the following extract from the Public Hearing transcript in relation to the presentation by the Port of Bunbury is particularly apposite:

[7] ACCC, submission to the Inquiry dated May 2002.
[8] Position Paper, p.XXXVI.

> "The extent of salvage is so diverse that we just focused on the port itself and first and foremost we really have to recognise the needs of the port because again, as an example, say, we have a storm event in Bunbury and there is a salvage event off Bunbury, my prime focus is to go to make sure that the vessels in Bunbury are safe. We have had an instance just in the past week where I've had to call the tugs out to actually assist a vessel because of the strong winds. So in that instance my focus has to be the Bunbury port and my priority will be the Bunbury port."

In Adsteam's view, these issues must weigh on the cost side of exclusive licensing – even if a solution to the problems of federal planning, co-ordination and funding can be found. If nothing else, they should lead to a more highly qualified recommendation by the Commission as to the suitability of exclusive towage licensing in individual ports.

2.6 Which ports?

The Commission has observed that the conditions under which exclusive licences are most likely to be effective are when users are unable to efficiently exercise their countervailing power (the problem of too many disparate users to co-ordinate themselves effectively) and where the port authority has a clear incentive and capability to at all times act in the best interests of towage users.

The Commission's Preliminary Recommendation 2 would also seem directed at ports that do not already have the power to issue towage licences. It should, however, be inferred that those ports with such a power should be subject to the procedural guidelines noted by the Commission, including an obligation to undertake a cost benefit analysis and formally consult port users.

Further, where a port authority has considered commencing its own towage operation in competition with the incumbent provider, it is unlikely that market contestability would be a problem sufficient to warrant exclusive licensing in the first place. It is also doubtful that such a port authority would conduct a licence tender fairly and at 'arm's length' given its own vested interest in competing, or potentially competing, in the port.

Lastly, there are the larger ports that may not be natural monopolies. In these ports, granting an exclusive monopoly to a single towage provider would be significantly less efficient than the open-market solution – which even in contestable natural monopoly markets provides a substantial and ongoing constraint on incumbent behaviour.

Working within these parameters, there are arguably very few ports that fall within the focus of the Commission's recommendations.

Out of the 51 ports in Australia that require a towage service, 15 already have an apparent licensing power; 4 of these have also indicated an interest in becoming towage operators themselves, as have 6 other port authorities; there are 8 ports which can be considered shipper-dominated ports with evidence of significant countervailing power; a further 5 ports are shipper-controlled ports in a similar position; and yet another 12 ports are privately owned and therefore not bound by a lack of legislative power to licence port service providers.

Based on these calculations, this leaves 8 ports where Preliminary Recommendation 2 would seem to have prima facie application. Whether a net benefit case can be established to support licensing in these ports is another question.

Appendix B sets out in tabular form the above listing of ports and their relevant status. It also describes in greater detail the meaning of the port descriptions noted above, eg what constitutes shipper-dominated and shipper-controlled ports.

Separate from the above analysis, there are also those ports that are so small as to preclude the possibility of a licensing regime on the basis that the costs of setting-up, selecting a successful tenderer and managing the contract are likely to be prohibitive. In some ports, a complete passing on of those costs to users would more than match any hoped for reduction in towage prices.

Using the analysis set out in the attached ACIL report, ports with annual towage revenue of between $1 to $2 million offering a 7 year licence would incur a cost of, $1.5 million.[9] Even if the ACIL estimate is out by 90%, a cost imposition of $150,000 in a port of $1 to $2 million would be very significant and arguably out of proportion to any perceived benefit.

When a broader perspective of costs is taken covering the efficiency factors noted in the Charles River Associates and NECG reports, further social welfare costs would need to be added to this assessment.

The following table that shows the number of ports in Australia grouped according to their annual towage revenue base.

Table 2.2 – Port Revenues[10]

Towage revenue range	Number of ports in range (Ports currently with exclusive licensing powers)	Percentage of all towage ports
$0 – 2 million	20 (2)	40%
$2 – 4 million	10 (5)	20%
$4 – 6 million	5 (1)	10%
$6 – 8 million	2 (1)	4%
$8 – 10 million	4 (2)	8%
> $10 million	9 (0)	18%

Of course, the figures set out in the ACIL report are approximations only. Adsteam encourages other interested parties to submit their estimates. It is noted that the Port of Bunbury claims to have implemented an exclusive licence regime for towage for around $10,000, which is difficult to accept and should be investigated further.

In Adsteam's view, the information presented above and in the attached reports suggests that exclusive licensing is not, contrary to the remarks of some industry participants, something that should be subject to wholesale adoption in Australian ports. Adsteam believes that such a proposition is inconsistent with the Commission's analysis and would inevitably lead to sub-optimal outcomes.

[9] There is a range of different scenarios that could be considered here, each with different numbers of tenderers and licence duration. By doubling the number of tenderers direct costs could easily exceed $2.5 million per tender, which figure could be expanded even further if, as noted, broader economic costs were to be quantified.

[10] These data are based on actual and estimated towage revenues at 50 ports around Australia.

3. PRICE DECLARATION AND PRICE MONITORING

3.1 Price declaration

The Commission's decision not to recommend the renewal or extension of the current declaration of towage services under the PSA, is largely based on its finding that:

> "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."[11]

Notwithstanding calls from some interested parties to continue prices surveillance, and suggestions by others that the regulatory framework is sound even though the ACCC's recent behaviour may be open to criticism, the Commission has maintained its view that declaration should not continue. This view is consistent with the Commission's previous consideration of the PSA itself, which it recommended should be revoked.

3.2 Price monitoring

The key Preliminary Finding underlying the Commission's recommendation that Adsteam's prices in the currently declared ports be subject to price monitoring, is Preliminary Finding 8.3. This finding states: "Price monitoring, if undertaken through clearly specified and focussed indicators, may have a role during a period of transition to a more competitive environment."

The main point of distinction between the two forms of regulation appears to be that prices under the proposed price monitoring arrangements would be notified at regular intervals rather than only at times of price increases as is currently the case.

In Adsteam's view, the need for price monitoring as recommended by the Commission is not adequately explained. Neither is it clear that the perceived benefits of such monitoring are likely to outweigh the costs. While such an analysis has been undertaken with respect to price declaration, the Commission does not appear to have submitted any concrete price monitoring proposal to a similar test.

The kinds of information that would be monitored under the Commission's proposal are not precisely stated. On the one hand, there is emphasis on "price" monitoring and the apparent desire to avoid "onerous and intrusive" reporting requirements. This suggests that the publishing of publicly available towage price lists would be sufficient.

On the other hand, the Commission's definition of price monitoring could extend to the provision of "price, cost, profit and other data", in which case such arrangements could be at least as onerous as the present system – but to what end?

Adsteam queries why this information is required if not to provide its competitors with information about its operations and thereby provide them with a competitive advantage. Having concluded that Adsteam's margins are not large, and at the same time acknowledging that the current price declarations are ineffective, it is unclear why the Commission considers that there exists a "transition period" in which special precautions are needed.

Repeatedly during the public hearings, the Commissioner asked proponents of price monitoring to explain the objectives behind their proposals. In almost every case, the response was essentially "Well, it would seem like a good idea." This is hardly a foundation on which to base a policy decision in favour of price regulation of any kind, let alone regulation that could significantly disadvantage an Australian public company that already must comply with a range of financial reporting and transparency measures.

[11] Preliminary Finding 8.4.

It is also relevant to ask what effect such a regime may have on potential market entrants, who would presumably also have to provide such information to the monitoring entity.

Adsteam has described in detail the costs it has incurred in complying with the current prices surveillance declaration. These costs are much more than the direct costs of preparing, lodging and defending notified price increases, although those costs are not insignificant. There are other costs associated with the commercial damage of adverse and potentially inaccurate analysis by the regulator, as well as instances where confidential information has been divulged to third parties.

If the Commission considers that price monitoring is a necessary part of its recommended reforms, then Adsteam strongly believes that a cost/benefit analysis of this recommendation must be undertaken. Moreover, Adsteam would strongly resist any suggestion that the ACCC be the relevant regulator or that anything other than mere public prices be monitored.

Reference by some interested parties to the applicability of the price monitoring regime currently applied to stevedores is also inappropriate. That regime is linked to the payment of some $260 million of Government funding for a specific purpose. If Adsteam were also to be assisted in this manner, there may be justification for intrusive monitoring arrangements. As it is, Adsteam has never benefited from such governmental funding. Its recent major redundancy programme was entirely self-funded, in stark contrast to that of the Stevedoring Industry. Therefore, like any other business acting independently and in the best interests of its shareholders, it should not be subject to more intrusive regulation than that required by the general law, eg stock exchange rules and accountancy regulations.

If necessary, Adsteam would not oppose a proposal that it supply its public price lists to a body such as the Bureau of Transport and Regional Economics, which already undertakes a price monitoring role in relation to other parts of the Australian transport sector. Such a proposal would also avoid having to use any aspect of the PSA regime, which would be consistent with the Commission's previous recommendations that this legislation be revoked.

CONCLUSION

This submission has provided an overview of issues that Adsteam considers to be important to the Commission's deliberations as it settles it report. Combined with Adsteam's previous submissions, this material constitutes a substantial contribution to the discussion of key issues and is relevant to each of the Commission's key findings and preliminary recommendations,

Adsteam has not only stated its views as to how it believes the Australian towage industry should or should not be reformed. It has also explained at length the reasoning behind its views – and where necessary sought the assistance of a range of industry, economic and legal experts to test and explore contentious and novel issues.

The end result of this approach is Adsteam's deeply held belief that:

- Continued prices declaration (or intrusive price monitoring) is not justified and, if not addressed, could create significant marketplace inefficiencies and further damage Adsteam's business as well as deter new entrants;

- The harmonisation of regulatory standards between jurisdictions and the need to eliminate the commercial distortionary effects of towage guidelines are priorities that must be pursued with a practical plan; and

- Exclusive towage licensing is a costly form of regulatory intervention, which, in the final analysis, can only ever be a second best solution to existing open-market competition.

Adsteam maintains that it has yet to be established that there exists a problem with towage prices and service levels in any port such that regulatory intervention is warranted. The reality is that towage operators are constrained by a range of competitive and non-competitive forces, and that this is reflected in many of Commission's findings.

It is also arguable that any preceived imperfections in towage markets are inconsequential when compared with inefficiencies in other aspects of the broader transport chain - and in terms of their significance to international trade.