Comments on Norske Skog draft report submission

This submission addresses points raised by Noske Skog in its draft report submission. In summary:

- Many of Norske Skog's criticisms relate to the design of the TFES (median freight rate, incentive structure and market road freight benchmark).
- BITRE does not dispute the fact that shippers' real world experiences of the relative cost of its road and sea freight tasks will differ from the chosen 'market benchmark'.
- Norske Skog is a very large shipper with specialised freight requirements who clearly differs from other shippers and their freight costs cannot be used as a market freight cost benchmark.
- Norske Skog is recommending as a benchmark for the Road Freight Equivalent, the use of road freight rates that are likely to be well below market rates paid by most shippers.
- BITRE has identified some errors in the TFES benchmarking calculations provided by Aurecon. (Aurecon report for the *Freight Logistics Coordination Team Major Consultancy Support to Work Program – Supply Chains in Tasmania*, 30 August 2013), as reflected in the attached comments on the Aurecon report (Attachment B).
- Norske Skog suggests that their analysis is consistent with the industry sourced freight rate of $2.30 per tonne kilometre used by Aurecon to 'benchmark' freight costs (Table 36, Page 90). This further supports the conclusion that Aurecon's benchmark freight rate in Table 36 is not a representative market benchmark.

With respect to Norske Skog's critique of key assumptions used in BITRE Parameter Report (2013):

1. Road freight rates provided by SKM "are typical rates for large shippers, exclude backloading rates and do not allow for empty running." (Sinclair Knight Merz, *Freight Rates Update 2012-13: Final report*, 28 March 2013, page 3)
2. BITRE's based its 30 per cent 'operating empty' assumption on actual truck weigh in motion data on inter-capital routes (BITRE *Tasmanian Freight Schemes Parameter Review October 2011*, page 21).
3. The 1.5 tonne/TEU TARE is based on the TARE weights for half a standard 40 foot dry shipping container (Rockwell International Pty Ltd, Container specifications, undated).

In suggesting updated parameters BITRE has followed the TFES methodology as recommended by the TFES Review Authority. With respect to the design of the current TFES:

- The Scheme does not fully compensate all shippers for their 'sea freight disadvantage" - the TFES incentive structure phases out payments as the level of disadvantage increases to encourage shippers to seek lower freight costs.
- The use of a median sea freight rate was recommended by the TFES Review Authority (1998) to overcome what it stated was "the very heavy influence of a few very large shippers who enjoy low freight rates."
- The TFES methodology for the Road Freight Equivalent differentiates only for dry and refrigerated freight rates: it is not practical or feasible to account for higher road freight

rates for urgent or time critical freight, small shipments, and specialist freight requirements such as live animals and live fish.

Technical comments

Page 2.
"As shown in our confidential submission, there is still a significant cost disadvantage which in Norske Skog's case is 27% (net of TFES). In the case of smaller shippers, this disadvantage is most likely even greater"

"It is our experience that TFES has never fully compensated the Boyer Mill for the freight cost disadvantage and in fact the gap is increasing."

Comment:
1. BITRE does not dispute the companies' assertion with respect to its relative cost of road and sea freight tasks – however Norske Skog, as a very large shipper with specialised freight requirements, will differ from other shippers.

2. Smaller shippers are likely to face both higher road freight and higher sea freight costs, so their "sea freight disadvantage" — as defined by the Scheme — is indeterminate.

Page 3.
[Bass Strait Shipping Cost] ***is determined by BITRE by calculating the median rates****, using the TFES claims data for all Wharf to Wharf full container load shippers on the Victoria – Tasmanian routes. Although we do not have the full sequence of yearly data the last five years are shown below. The data infers that shipping costs have come down by 5% over this period of time, which has definitely not been the case.* [Emphasis added]

	All shippers
Year	*"Median Cost /TEU"*
2007/08	*$1,166*
2008/09	*$1,121*
2009/10	*$1,127*
2010/11	*$1,047*
2011/12	*$1,098*

*Page 3 "****Over this period of time, Norske Skog have experienced a 10% increase which is in line with BITRE's own shipping data which shows a 9% increase*** *and we are sure that all shippers have had at least similar increases."* [Emphasis added]

"We are obviously not privy to the underlying data but it is clear that the calculation of the "median rates" does ***not*** *reflect the real movement in shipping costs paid by Tasmanian shippers and in this case significantly understates the actual shipping rates by 15%."*

Comment:
3. The use a median freight rate, rather than an average, was recommended by the TFES Review Authority (1998). BITRE (2007) notes that:

> In establishing a 'typical' sea freight cost disadvantage as a reference point for determining assistance, the TFES Review Authority (1998) stated it had tried to balance conflicting needs:

> "On the one hand, the use of average freight rates per TEU is likely to be unsatisfactory because of the very heavy influence of a few very large shippers who enjoy low freight rates and account for a high proportion of all TEUs shipped. On the other hand, the use of 'median shipper' can also have undesirable effects. The TFES database reveals… there are a significant number of shippers who apparently ship only one or two full containers per year of non reefer freight on a wharf-to- wharf basis at high freight rates. Their inclusion… is distortive because they skew the distribution." (TFES Review Authority 1998)

4. Median freight rates are the most volatile TFES parameter, as noted by the PC (2006).

5. It is unclear what series Norske Skog is referring to as "BITRE's own shipping data". The median freight rate series for all TFES claims decreased 6.8 per cent over the five years.

Page 3-4
"*Road Freight Equivalent Costs: This is the area where Norske Skog's real world experience diverges significantly from BITRE's analysis of costs."*

6. Freight rates paid by NS are not typical of the majority of shippers.

7. BITRE has interpolated an average road freight rate that is indicative of the general level of inter-capital freight routes, it does not – and cannot – be representative of any one freight route (as cited in the specific example by Norske Skog).

8. As clearly stated in a series of SKM reports and BITRE parameter reviews, freight rates vary significantly by size of shipper, route and direction, the nature of the freight task, as well as time of week and year.

9. Norske Skog is recommending a level of road freight rate that would appear to be below market rates likely to be paid by most shippers, which Norske Skog acknowledges is based on a single temporary spot rate.

"BITRE have increased the trucking rates provided by their consultant (SKM) by a factor of 30% because they feel it would be an applicable allowance for empty running rate. Given that the information from SKM "generally reflects actual rates negotiated and paid" then wouldn't the typical industry empty allowance already be factored in the SKM rates?"

Comment:
10. SKM (2008) state that the freight rate series **"**are typical rates for large shippers, exclude backloading rates and do not allow for empty running."

11. BITRE (2008) therefore made a 30 per cent adjustment – the level of which was based on actual truck 'weigh in motion' data – to allow for an average level of under-utilisation of trucks on inter-capital routes.

"BITRE assume in their calculations that there is net payload of 11.5 tonnes per TEU.
This is based on an assumption that the tare weight of an average TEU is 1.5 tonnes. … Actual TEU's weigh between 2.2 and 2.4 tonnes (and Norske Skog's "purpose built" TEU's are 3.2 tonnes) and FEU's between 3.6 and 4.0 tonnes."

Comment:

12. To estimate the road freight benchmark hte BITRE (2008) assumed a notional b-double carrying 3 containers (with a TARE weight per TEU of 1.5 tonnes).
13. Container weights can vary significantly. BITRE's TARE of 1.5 tonne/TEU was half the standard TARE weight for a 40 foot dry container of 3.064 kilograms (source: Rockwell International Pty Ltd http://www.stockwells.com.au/userfiles/file/documents/cont.pdf)

14. BITRE is not disputing Norske Skog's own container weights – however, Norske Skog's acknowledges that its specialised containers are heavier than standard shipping containers.

Page 4

"BITRE rely on advice from SKM on the actual road rates. As noted above, they have indicated that ***a typical B-Double rate carrying 39 tonnes is 11.78 c/t/k****. This equates to a rate of $4.59 per km. It is Norske Skog's (and others) experience that this is considerably higher than we are currently able to achieve in a real world commercial environment."* [Emphasis added]

Comment:

15. SKM's (2013) rate of 11.78 c/ntk is estimated using the SKM freight cost model with 20 per cent empty running. BITRE's 13.46 c/ntk rate uses the same model with 30 per cent empty running.

16. As noted, it appears that road freight rates by Norske Skog are not typical of market levels.

Page 4

Actual Road Rates

…

"a) In 2013, Norske Skog transported newsprint on B- Doubles from the Boyer Mill to Burnie (320 kms) for a short time for a rate of $2.15 /km. ***Although we acknowledge that these were "spot" pricing rates and probably a permanent operation would have higher costs****, we firmly believe that rates of $2.50 /km would be achievable."* [Emphasis added]

"b) ***Our analysis above is consistent with the information provided in the Aurecon Report*** *completed for the FLCT that indicated that a rate of $2.30 /km would be commercially achievable."* [Emphasis added]

Comment:

17. Norske Skog's road rates cited at point (a) a spot rate that reflects marginal cost pricing for a very large shipper. This rate is not suitable for benchmarking as it is not indicative of general market rates that are available to most shippers.

18. Norske Skog points out that its spot pricing rates— for a very large, specialised shipper on a short term marginal basis –are "consistent with" (unsourced) industry rates used by Aurecon for its benchmarking analysis.

19. Norske Skog submission suggests that the 'industry sourced' freight rates underpinning Aurecon Report's "benchmarking" analysis is a low spot rate. That is not a representative 'market benchmark'.