

# **Australian Competition and Consumer Commission**

Submission by Adsteam Marine Limited on towage prices in  
Brisbane, Port Jackson, Port Botany, Melbourne & Adelaide



**January, 2002**

# Australian Competition and Consumer Commission

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### **Note:**

This submission contains confidential financial and other information which Adsteam Marine regards as being market sensitive.

Where such market sensitive information occurs, it has been deleted from this public document. Deletions are marked ■.

The market sensitive information, however, has been supplied to the Australian Competition and Consumer Commission on a confidential basis.

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### SECTION 1

#### EXECUTIVE SUMMARY

Harbour towage has been a declared service under the Prices Surveillance Act 1983 since 1991. Towage operators are currently declared in the ports of Brisbane, Newcastle, Port Jackson, Port Botany, Melbourne, Adelaide, and Fremantle.

The last price increases in these ports occurred in

Brisbane	1987
Newcastle	1989
Port Jackson	1998
Port Botany	1990
Melbourne	1999
Adelaide	1992
Fremantle	1992

Since these last increases, there have been cumulative published price decreases in Brisbane (minus 8.5%), in Newcastle (minus 10.0%), and in Fremantle (minus 25.1%). In all declared ports, there has been a further real reduction in the cost of towage to shipping companies over the last five years<sup>1</sup>. This has been brought about by the reduction in the use of tugs on a wide range of ships, the introduction of rebates benefiting the major users, the elimination of ancillary charges, and the increase in ship size not matched by a higher requirement for tugs.

In practical terms, these reductions are even greater when it is realised that the majority of ship costs, and almost all freight revenues, are in U.S. dollars, while towage prices are in Australian dollars. The effect is that Australian towage, in real terms, is a significantly lower part of overall ship costs than it was five years ago.

On the other hand, costs to Adsteam have risen in every port that is the subject of this submission, averaging plus 54.0% since the last price increases, and average margins have eroded to a current 0.7%, which is clearly unsustainable.

A case for the following published price schedule increases is made for certain ports.

Brisbane	+ 11.7 %
Port Jackson	+ 26.2 %
Port Botany	+ 13.1 %
Melbourne	+ 23.4 %
Adelaide	+ 15.8 %

These proposed increases have been calculated to achieve a margin on costs of 18%, which we suggest is reasonable for the towage industry, and is, we believe, justified in the body of this submission.

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<sup>1</sup> See Section 6.

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It should be noted that the net increases will be lower than these figures, because a number of towage users have stand-still pricing agreements that can have up to two years to run.

In no instance do these proposed price increases exceed, or in most cases even approach, the real reduction in the cost of towage over the last five years.

No case is submitted for either Newcastle (a port standstill agreement does not expire until June 2002) and Fremantle (where a standstill pricing contract agreement extends to December 2003).

## **SECTION 2**

### **EXPLANATORY SUMMARY 1 - WHAT IS AUSTRALIAN TOWAGE?**

The overwhelming majority of ships entering Australian ports are large, ocean-going vessels. They are designed for long sea voyages, carrying anything up to 250,000 tonnes of bulk cargoes or up to 4000 containers.

When they are within a port, these ships are big, clumsy objects which, if not carefully helped to their berths, are capable of immense damage to wharves, shore equipment, and the environment. With few exceptions, they are simply unable to manoeuvre themselves with the precision required when approaching a wharf. Likewise, they need assistance to leave a berth safely and transit port navigational channels before embarking on their next ocean voyage.

Harbour tugs are essential for the safe berthing and departure of most ocean-going vessels. These tugs are extremely powerful, manoeuvrable vessels packed with sophisticated technology controlling their propulsion and steering systems. Engines delivering up to 4,800 horsepower are now typical. The tugs combine brute force with the most delicate of touch. Understandably, they have a high capital cost; the most common tugs in Australia's capital city ports now have a build cost of over \$10 million each.

Depending upon the size of the ships coming into port, and their design, anything up to four tugs are necessary to provide safe assistance. The oil tankers coming into Sydney Harbour, for example, require four of these monster tugs. Dedicated car carrier ships, with great slab sides that catch the wind, will need at least two tugs, and more if the weather is inclement. Container ships typically need between two and three tugs. The number of tugs needed in each case is determined by strict guidelines issued by the port authorities.

Australia's ports must have enough tugs of sufficient power to handle all shipping requirements. This means that each port tug fleet must be at least of a size to assist the largest and most cumbersome ship that is likely to arrive. And because these ships can cost their owners around \$60,000 a day, and carry cargo loads with an estimated value of up to \$100,000,000, they cannot afford to wait while another ship is moved. Concurrent ship movements occur frequently, and the port must have the tugs to allow this to happen.

Adsteam Marine has 22 front-line tugs in the ports of Brisbane, Port Jackson, Port Botany, Melbourne and Adelaide. Trade through every one of the ports is totally dependent upon these tugs.

\* \* \* \* \*

One of the problems for Australian towage is that, in comparison with the main ports overseas, our ports experience much lower ship call numbers. Brisbane, Port Jackson, Port Botany, Melbourne and Adelaide together have less than a quarter of the ship calls that Singapore has. And also well below the totals for ports like Rotterdam, Hamburg, Los Angeles, Yokohama, and Hong Kong. Melbourne, Australia's largest container port, ranks 42nd in the world order. Adelaide is 178th.

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Yet despite this, each of Australia's port tug fleets must gear up to handle ships similar to those calling at the majority of other world ports. This results in abysmal utilisation of the Australian fleet by world standards, and a significantly higher cost per tug job.

## **SECTION 3**

### **EXPLANATORY SUMMARY 2 - THE PRICING OF TOWAGE IN AUSTRALIA**

The pricing structures employed in the towage industry reflect the characteristics of the business described in the preceding section. It is a high fixed cost, on-demand industry with a critically important service standard component. Capital and labour costs are easily the most important two elements.

Capital costs are driven by the increasing size of ships and the need to continually improve towage capability to handle them. This is largely determined by port authorities and harbour pilots. The issue is exacerbated by port authority demand to have surplus capacity to meet every eventuality. A good example is the recent insistence by the Fremantle Port Authority to have a high power new technology tug essentially for back-up purposes, even though it would be rarely used.

Labour spends much of its time on stand-by. In this respect, towage is akin to a fire brigade service. People and equipment have to be available for immediate response, around the clock, even if for much of the time both are under-utilised. And the high fixed cost must be met by the users, who must meet the inbuilt surplus capacity and under-utilisation as well as the direct cost of a specific single service.

Despite these difficulties, the real cost of towage for shipping companies in Australia has fallen significantly in recent years. This is explained in detail in Section 6.

#### **The “published” price schedule**

The pricing of towage is usually on a “per tug used” basis, with the price of each tug rising in positive correlation with the size of the ship being handled.

In this way, cost is directly related to usage (the more tugs used, the higher the cost). Conversely, if fewer tugs are used, the cost of towage comes down even if the “price per tug” remains the same. Pricing also reflects the fact that it is the larger ships that give rise to the demand for more expensive tugs.

A typical towage price schedule looks something like this:

<b>VESSEL GRT</b>	<b>Price excluding GST</b>	<b>10% GST</b>	<b>GST inclusive price</b>
Under 5,000 tonnes	\$1,000	\$100	\$1,100
5,001 and under 10,000	\$1,900	\$190	\$2,090
10,001 and under 15,000	\$2,460	\$246	\$2,706
15,001 and under 20,000	\$2,730	\$273	\$3,003
20,001 and under 25,000	\$3,440	\$344	\$3,784
25,001 and under 30,000	\$3,750	\$375	\$4,125
30,001 and under 40,000	\$4,040	\$404	\$4,444
40,001 and under 50,000	\$4,340	\$434	\$4,774
50,001 and over	\$4,620	\$462	\$5,082

GRT stands for Gross Registered Tonnage, and is the internationally accepted standard to define the size of a ship.

Pricing schedules like these are, of course, the published prices. Increasingly, the introduction of rebate agreements have eroded their relevance and mask the true, lower cost of towage.



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### Rebate arrangements

Up until about five years ago, towage prices were the same for all shipping companies, irrespective of their usage of towage services. This structure met with significant criticism from major users of towage services, who with some justification claimed that they were underpinning the fixed cost of towage to the benefit of casual callers at Australian ports.

After reviewing policy, it was decided to introduce rebates which would reduce the cost of towage for the major users of the services. This new policy has been implemented progressively since 1996, and has met with overwhelming support from those benefiting under the new arrangements. By meeting major customer demands, the policy also improves the competitive edge sought by Adsteam. The net effect, however, is a reduction in group revenue (or, looked at another way, a reduction in the cost of towage) that is now in the vicinity of ■ million annually Australia-wide, and over ■ million in the ports that are the subject of this submission.

### Elimination of ancillary charges

Traditionally, providers of towage services (including Adsteam) had included all manner of ancillary charges in their pricing policies. The provision of tow lines<sup>2</sup> to ships which lacked the necessary standard of gear was charged for. If an ordered service was cancelled, a cancellation charge was made. If orders were changed, a charge was made. The movement of a ship from one wharf to another within a port was charged for at the full rate.

These charges were widespread, and were significant irritants to ship operators who were quite often not responsible for the order changes or cancellations. The cost of wharf-to-wharf movements tended to inhibit the optimum running of the ports. Line charges became almost routine as ship operators neglected or eliminated their own ships' gear.

Adsteam has been in the forefront of reforming towage charge policies in the ports under discussion.

Where there was scope to reduce prices, most of these charges were removed. On no occasion were these charges "rolled into" the normal price for towage. The cost of towage for shipping companies, as a consequence, has been reduced even though it is not always apparent from the headline "tug job price" in the pricing schedules.

A decade ago, these ancillary charges earned revenue of ■ annually for Adsteam's current operations throughout Australia. Today, the annual figure is ■.

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<sup>2</sup> The ropes that link the tug to the ship, and are used to tow the ship into position.

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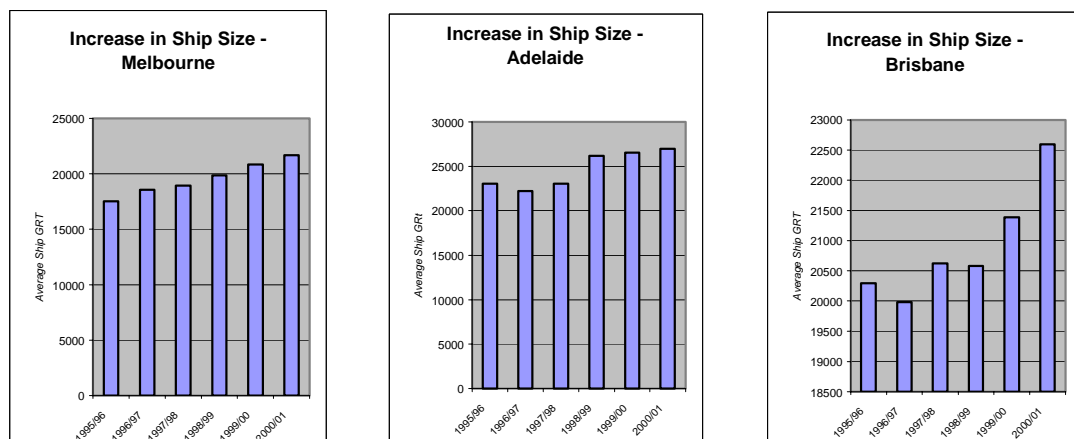
### SECTION 4

#### CHANGES IN THE AUSTRALIAN TOWAGE INDUSTRY

##### INCREASING VESSEL SIZES

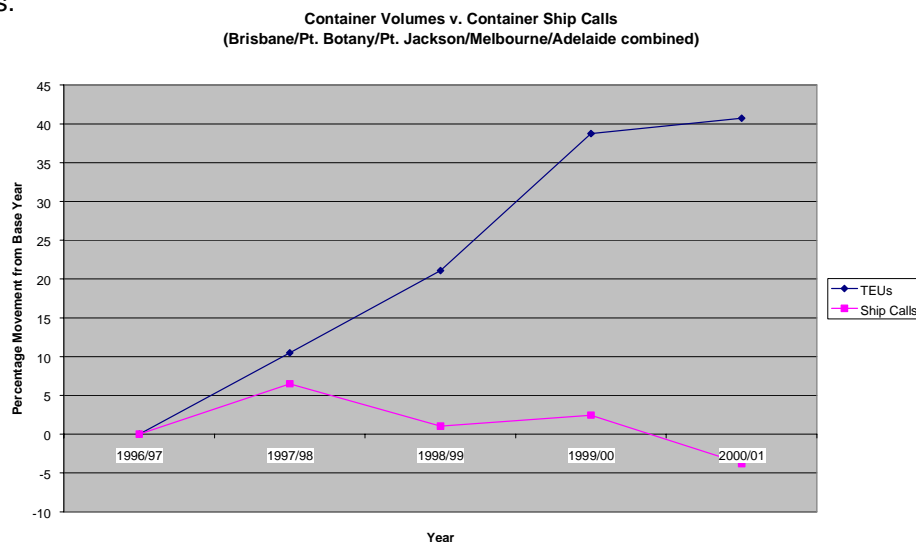
The international trend to increasing ship sizes impacts adversely on Adsteam's towage business.

The following graphs show how ships have become bigger in several of the ports which collate such data.



The most obvious effect of this trend is that there are fewer ships calling at Australian ports for the same amount of cargo. Even when trade figures suggest growth, this does not translate into a commensurate increase in ship calls.

The following graphs illustrate the diverging trend lines between cargo growth and ship call numbers.



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These trends have several important implications for Adsteam's towage business.

1. Adsteam earns revenue from tug jobs, and when ship calls are static or decline, so do tug jobs.
2. The requirement to station a tug fleet capable of servicing these ships remains. There is no scope for Adsteam to reduce its tug fleet in any port simply because there are fewer ships calling.
3. In fact, the trend to larger ships fuels the demand by harbour pilots for larger, more powerful, and inevitably more expensive tugs.
4. The marginal improvement in tug job price (bracket creep as the price per tug job increases when the ship is bigger) fails to compensate for the loss of tug jobs.

What this means is that the revenue base inevitably diminishes, while the cost base remains constant or even increases. It is Adsteam's contention that while the shipping industry quite rightly pursues these developments for its own efficiencies, it must also accept that one of the downsides is the higher price per ship that it must pay to maintain the towage service being demanded.

\* \* \* \* \*

The effects listed above are often overlooked by regulatory bodies such as port authorities, who earn revenue principally from cargo throughput, not ship calls. They tend to assume that because trade (that is, cargo throughput) is increasing, then towage must be benefiting. This is not the case.

Perversely, the trend to larger ships increases the pressure on Adsteam to reduce towage prices. Shipping companies, particularly container shipping companies, are engaged in a headlong race to build ever bigger ships. The goal is lower unit cost per container carried. The reality is too much empty container capacity, and falling freight rates in an overcrowded market.

As this self-inflicted pain on the container lines increases, so the demand increases for service providers such as Adsteam to bear some of the pain. The clamour often finds sympathy within port authorities, who find it difficult to ignore the demands of *their* customers (the shipping companies). When this is coupled with undoubted regulatory power, it is an enormous temptation to satisfy the shipping companies at the expense of a towage company for which, of course, they have no commercial responsibility.

Prime evidence of this was the introduction of the port authority controlled exclusive towage licence in Bunbury, the threat of such licensing in Fremantle (which saw towage prices fall by over 16%), the introduction of licensing in Gladstone (which saw towage prices fall by 18%), and various licensing or price control mechanisms in a wide variety of Australian ports.

The flaw in this process is that while there is an unrelenting pressure to reduce prices, there is no commensurate readiness to accept a reduction in the service levels that is the other side of the coin. Adsteam, for example, cannot lay-up tugs (as the shipping companies will lay up a

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ship if trade declines), or utilise smaller vessels, or change the number of port calls or even withdraw temporarily from a trade route, or any of the strategies common within the shipping industry.

The reality faced by Adsteam is a continuing demand for better service (which we agree with and strive to deliver), more powerful tugs, and reduced utilisation of the tugs.

The shipping companies are not slow to bring their own direct pressure to bear, either. It is no coincidence that it is the powerful container lines who have been the main beneficiaries of the Adsteam rebate system.

## REDUCTION IN TUG USAGE

Reference has already been made to the decline in tug utilisation brought about by the increasing size of ships. There is, however, an even more damaging trend which erodes tug utilisation, but, again, brings with it no scope for reducing the tug fleet.

We refer to changing towage guidelines, or the readiness of harbour pilots to manoeuvre ships with fewer tugs than previously.

Now, we have raised no argument about these developments. The port authorities are simply responding to the demands of the shipping companies who want to reduce costs. And the pilots, similarly, are under pressure to deliver savings to those shipping companies. They use professional judgement on safety margins, and routinely call for more powerful tugs to compensate. The objective is, undoubtedly, efficiency.

Unfortunately, it is efficiency on one side of the supply / demand balance only.

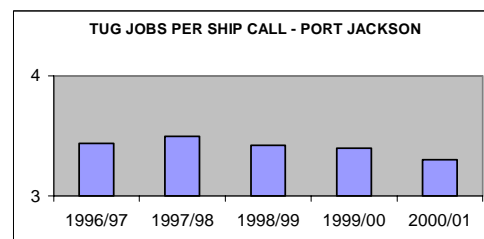
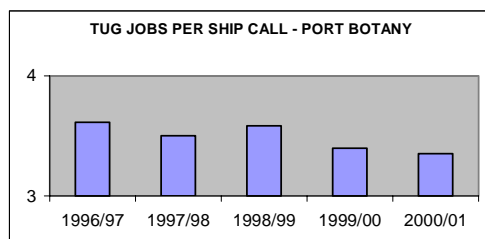
The shipping companies achieve a short-term reduction in towage costs, because tug pricing is on a "per tug used" basis, and if one tug can be eliminated then the cost to the shipping company falls. These benefits can be substantial. Adsteam estimates that lost revenue as a direct result from this "towage efficiency" is currently running at around ■ million per annum Australia-wide<sup>3</sup>, and around ■ million per annum in the ports that are the subject of this submission.

Quite often, these "efficiencies" are weather related. When benign weather conditions prevail, a pilot will be encouraged to drop a tug. They can do this, secure in the knowledge that the dropped tug can still be called up if the weather deteriorates.

Herein lies the problem. The same tug fleet in each port, with the same availability of labour, must be maintained by Adsteam. The same fixed cost base is incurred, irrespective of actual tug usage. There is almost no scope for reducing costs to compensate for the lost revenue.

The economic reality is that the shipping companies are no longer paying for the service that they and the port authorities demand. As they become "more efficient", they create an inescapable loss of efficiency (through eroded tug utilisation) on the part of Adsteam.

"Efficiency" that benefits only one side of the supply / demand balance is not efficiency at all. The full cost of the towage service being demanded by the shipping companies and the port authorities remains, and it is Adsteam's contention that those who are demanding the service should still be required to pay for it.



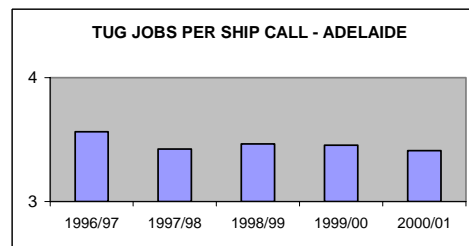
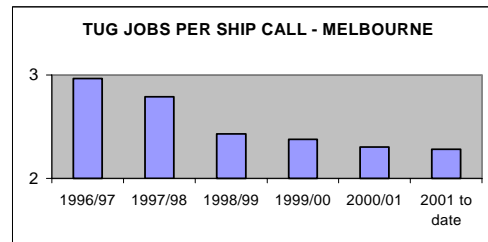
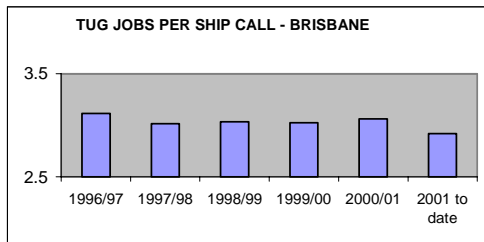
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<sup>3</sup> Tug usage rates now, compared to five years ago.

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## **INCREASED REGULATION BY PORT AUTHORITIES**

Towage has often been referred to as a *natural monopoly*. Increasingly, it is a highly regulated monopoly.

Towage has been licensed for many years in Cairns, Townsville, Mackay, Gladstone, Esperance, Albany, Bunbury, and Geraldton. Apart from standards of service requirements, the type and number of tugs required, and back-up provisions, all of these licences have significant price control mechanisms.

In 1999, the WA parliament passed an Act which allows port authorities to issue exclusive licences. An exclusive licence has been issued in Bunbury, which deprived the right of the incumbent (Adsteam) to operate in the port, even on a competitive basis. More recently, the Fremantle Port Authority invited proposals for either exclusive or non-exclusive licences to be issued in Fremantle and Kwinana. All three of these ports now impose very stringent price restraint controls.

The Queensland government, after a recent enquiry, extended the right to issue licences to all ports in the State. It is known that the NSW government is also considering similar legislation. In Victoria, the Office of the Regulator General conducted an enquiry in 2000 to examine whether price control licensing should be introduced.

In the private ports of Portland, Geelong and Westernport, there is a Service Agreement which imposes significant operational obligations on the towage providers.

Even in ports where there is no legislative power to issue licences, such as Port Kembla and Newcastle, there are Service Agreements which address such issues as the size, power, and number of tugs required, the provision of (free) fire fighting services, the need to obtain approval before the removal of tugs from the port, the obligation to upgrade as the port requires it, the guarantee of back-up tugs in the event of break-down, and service standards such as response time and availability of tugs.

Several important messages can be gained from this regulated environment:

- ☐ The towage companies are severely constrained in what they must do, and what they cannot do;
- ☐ Where these constraints do not currently exist, there is a readiness to introduce them should the port authority become dissatisfied with either the service or the pricing behaviour of the towage company;
- ☐ These constraints can, and do, extend to the destruction of the business of a towage company (for example, in Bunbury);
- ☐ The port authorities are not the customers of the towage services, nor do they possess any direct knowledge of the economics of towage;
- ☐ Except in the case of Gladstone<sup>4</sup>, in no licence or agreement is there any consideration of commercial viability for the towage company, nor interest in the cost effect of the demands that are imposed.

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<sup>4</sup> The Gladstone licence provides for a fixed return on investment.

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Perhaps the most disturbing aspect of all of this is that the port authorities see their primary role as in reducing costs for the shipping companies. In a sense, they are surrogate agents of the shipping companies. Furthermore, there is a readiness to use regulatory power, either directly or in reserve, to hold down towage prices irrespective of the effect on the commercial position of the towage company.

This, together with the real threat of competition<sup>5</sup>, has resulted in the unprecedented history of price restraint that has been experienced in the towage industry over the last decade.

Unfortunately, such price restraint over such an extended period carries an ultimate penalty. Either the commercial viability of the towage company is seriously threatened, or the price rise (when it comes) is of a magnitude that inevitably elicits strong and loud opposition.

Adsteam finds itself in this position. Our margins have been eroded to such a dramatic extent over the last few years that it would be commercially irrational not to seek the price increases that are being proposed in this submission.

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<sup>5</sup> See next heading.



## **INCREASED COMPETITION**

It is interesting to look at competition in the Australian towage industry.

For many years there has been the view that only one towage operation in each port is sustainable. There is clear evidence of this.

First, there has been the long history of consolidation in the industry that culminated in the position of Adsteam and Howard Smith as the two major players in the sector. More recently, there has been the decision by Brambles to exit the business in NSW, and P&O in Western Australia, and, most dramatically, the sell-out by BHP in Newcastle.

This has led to the contention that towage in Australia is a *natural monopoly*.

Now, monopolies almost by definition are drawn inevitably to abuse their market positions and increase prices to the detriment of their customers. But, as will be seen in Section 6, this has not been the case in Australia. Towage costs for shipping companies have actually fallen significantly. The evidence all points to anything but a classic monopoly in operation.

One reason that is often given for such circumstances is *contestability*. In other words, there are potential competitors “out there” who could enter the market if they so chose. Adsteam, it has to be acknowledged, has advanced this notion in the past because it has a very clear sense of competitive pressure.

The problem with *contestability* is that it is somewhat esoteric and difficult to prove in practice.

No, we think that the situation in Australia is brought about not by the single fact of there being competitors “out there”, but by two factors working together to create an environment where prices are constrained or reduced, and service standards improved.

These two factors are:

- ☐ Competitors able and willing to enter the market; and
- ☐ Port authorities anxious to create the environment for this to happen.

The latter has been dealt with in the previous section. The Fremantle Port Authority, for example, wrote to a large number of international towage operators as well as domestic providers inviting them to submit proposals. Many did. Despite stringent performance and pricing controls that the FPA has imposed on Adsteam, the port authority continues to hold discussions with major international towage companies encouraging them to enter the market.

The environment is created by the port authorities, and is characterised by their obvious desire to attract and encourage competing towage companies. It seems to matter little whether an exclusive licence, or a non-exclusive licence, either or neither, is on offer. The mere fact of encouraging entry is sufficient to attract competition.

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Recent examples of licences being offered, and the competitors, by their responses<sup>6</sup> who have indicated a willingness to enter the market, are:

Port	NEWCASTLE	ALBANY	GERALDTON	GLADSTONE	BUNBURY	FREMANTLE KWINANA
Year	1994	1996	1997	1999	2000	2001
Licence	non-exclusive	non-exclusive	non-exclusive	exclusive	exclusive	optional
Competitors	Waratah <sup>7</sup> Brambles BHP NYK Line <sup>8</sup> Navix Line <sup>8</sup> Daiichi CK <sup>8</sup> K-Line <sup>8</sup>	FTO <sup>7</sup> MacKenzie FLT <sup>9</sup> Sunlap <sup>10</sup> HK Shipping <sup>11</sup> Westug <sup>12</sup>	SHS <sup>7</sup> Brambles Westug <sup>12</sup> GTO <sup>13</sup>	GTS <sup>7</sup> Brambles Sembawang <sup>14</sup> THS <sup>15</sup> POAL <sup>16</sup>	SHS <sup>7</sup> Brambles MacKenzie Riverwijs <sup>17</sup> THS <sup>15</sup>	SHS <sup>7</sup> Brambles THS <sup>15</sup> POAL <sup>16</sup> Southern <sup>18</sup> Westug <sup>12</sup> Smit <sup>19</sup> Riverwijs <sup>17</sup> Kotug <sup>20</sup> PSA <sup>21</sup> HKST <sup>22</sup> Sabre <sup>23</sup>

<sup>6</sup> Port Authorities typically do not publish respondents. These are our best estimates, based on market intelligence, of competitors making a substantive response to invitations. Port authorities could no doubt confirm to the ACCC in confidence.

<sup>7</sup> Adsteam and Howard Smith joint venture.

<sup>8</sup> A major Japanese shipping line in consortium with BHP.

<sup>9</sup> Fremantle Launch and Tug Company - a Fremantle based tug company.

<sup>10</sup> New Plymouth, New Zealand.

<sup>11</sup> Hetherington Kingsbury, a major Australian representative of international shipping companies.

<sup>12</sup> Non-union operator providing towage services to Robe River.

<sup>13</sup> Geraldton Tug Operators, a local consortium.

<sup>14</sup> Sembawang, a large Singaporean maritime conglomerate owned by the Singapore government.

<sup>15</sup> Total Harbour Services, a WA based group with strong overseas backing.

<sup>16</sup> Port of Auckland Limited, a towage service provider with a protected domestic market.

<sup>17</sup> Riverwijs, a joint venture between Riverside (a non-union Qld group) and Wijsmuller, second only to Smit in size and capability

<sup>18</sup> Australian group with widespread towage interests.

<sup>19</sup> The largest Dutch towage operator.

<sup>20</sup> Major Dutch towage operator from Rotterdam, Hamburg, and Bremen.

<sup>21</sup> Port of Singapore Authority, one of the largest single towage operators in the world, owned by the Singapore government.

<sup>22</sup> Hong Kong Salvage and Towage, a joint venture between Hutchison Whampoa and the Swire Group.

<sup>23</sup> A U.S. group, details unknown.

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The competitive response revealed above underlines the “transportability” of competitive action, particularly from international operators. Tugs can be relocated from overseas locations, or chartered, with relative ease.

The underlying message of the foregoing is that Adsteam has been unable to move prices as if it was a monopoly. The combination of port authorities ever ready to invite a competitor in, and the readiness of competitors to respond, ensures that this is the case.

In fact, the reverse is true. Adsteam has been reluctant to move prices because of our awareness of the permanent presence of competitors who are waiting for the opportunity to enter the markets we serve.

In other words, the towage market has been strongly affected by the sense of competition, contrary to all accepted theory. The end result has been the overwhelming constraint on pricing, irrespective of what academic theory might imagine. And, now, the corrective price adjustments that are being sought are as a matter of imperative necessity.

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### REBATE PRICING

Australian towage pricing has traditionally been based on a common schedule, in each port, for all customers. This is quite different to the model that applies in most overseas markets.

In international markets, towage is very much aligned to the size and importance of individual customers, with prices structured accordingly.

Their experience elsewhere has resulted in sustained pressure from the major shipping companies to introduce differential pricing, recognising the importance of the main customers in underpinning the provision of towage services for all users.

The rationale advanced by these major customers was recognised by Adsteam in the introduction of a rebate structure to reduce the cost of towage for those with high volume usage. The “standard” price schedule, however, was retained. The reduction in pricing at the high volume end of the market, therefore, has not been matched by an increase at the lower volume end.

The introduction of rebates was undoubtedly a competitive decision. We don’t see that as a negative. What it does prove is the sense of competitive threat in the thinking behind our pricing, and our service levels. No-one who is complacent in his market would seriously contemplate returning ■ million in revenue annually to its customers, without reason. Concern about competitive threat is our reason.

The effect in overall terms, of course, is a reduction in the cost of towage. It is a reduction that is not readily apparent from a look at the published price schedule. The “rebate return” has grown steadily over the years, as follows:

Year	Australia - wide	Subject ports <sup>24</sup>
1996	■	■
1997	■	■
1998	■	■
1999	■	■
2000	■	■
2001	■	■

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<sup>24</sup> That is, those ports which are the subject of this submission.

## **SECTION 5**

### **ADSTEAM COST MOVEMENTS 1996 TO 2001**

#### **LABOUR COSTS**

Prior to 1995, tug crews were paid according to the Tugboat Industry Award. The Award was negotiated at meetings between the maritime unions<sup>25</sup> and an industry representative body, the Tug Operators Committee. Adsteam was represented on the Tug Operators Committee, as were most of the other major towage companies.

Dissatisfied with the effectiveness of this approach to industrial negotiations, Adsteam was the first to break away from the Tug Operators Committee. We initiated direct company to union negotiations in 1995 with the objective of replacing the Award structure with an Adsteam Enterprise Based Agreement. The objective was achieved with the initial three EBAs in 1996, one with each of the three maritime unions.

There were two key objectives in the negotiation of the 1996 and successive EBAs.

- ☐ dampening wage expectations below those prevailing previously, and holding wage increases to no more than, or below, general industry benchmarks;
- ☐ achieving substantial changes to work practices that would allow more flexibility in the delivery of towage services and pave the way for broad labour efficiencies.

Significant achievements have been made in both of these areas.

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<sup>25</sup> Australian Maritime Officers Union (AMOU) representing tug masters;  
Australian Institute of Power and Marine Engineers (AIMPE) representing tug engineers;  
Maritime Union of Australia (MUA) representing deckhands.

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### Wage increases

The following table illustrates wage agreements implemented under successive EBAs with each of the three maritime unions.

Year	MUA	AIMPE	AMOU
1994	Tugboat Industry Award	Tugboat Industry Award	Tugboat Industry Award
1995	Tugboat Industry Award	Tugboat Industry Award	Tugboat Industry Award
1996	5.5 % <small>see note 1</small>	5.5 % <small>see note 1</small>	5.5 % <small>see note 1</small>
1997	6.5 %	6.5 %	6.5 %
1998	nil <small>see note 2</small>	nil <small>see note 2</small>	nil <small>see note 2</small>
1999	2.0 % <small>see note 3</small>	2.0 % <small>see note 3</small>	2.0 % <small>see note 3</small>
2000	4.0 % <small>see note 4</small>	2.5 % <small>see note 3</small>	2.5 % <small>see note 3</small>
2001	2.5 % <small>see note 3</small>	nil <small>see note 5</small>	3.0 % <small>see note 3</small>

Note 1 The increase agreed for 1996 and 1997 followed approximately 18 months of a wage freeze between the expiry of the Award agreement and the commencement of the EBA.

Note 2 1998 marked the first year of the “recalculation of the aggregate wage” (see information panel). This resulted in a wage freeze for all employees during 1998. Subsequently, approximately 50% of crew experienced a continuing wage freeze in 1999, 2000, and 2001.

Note 3 Following the recalculation of the aggregate wage in 1998, this is the increase that applied to approximately 50% of the workforce. The other 50% received no increase. The net increase across the entire workforce was therefore half of this indicated figure.

Note 4 This was a “one-off” increase that applied only in those ports where deckhands were reduced from 2 to 1, and then only to the remaining deckhand. The net result, across the entire deckhand workforce, was in reality an increase of only 1%.

Note 5 No increase has yet been agreed with the AIMPE, under the current EBA negotiations.

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Taking into account the restricted application of some of the Adsteam increases, the real average increase between 1995 and 2001 was

MUA	AIMPE	AMOU
16.0%	14.9%	16.6%

### Aggregate Wage

In 1983, the maritime industry took the step of smoothing the weekly remuneration of its crews (which included a base pay plus a wildly fluctuating overtime component) by introducing the **aggregate wage**.

The aggregate wage was quite simple in concept. It aggregated the base wage and the average overtime element (1/52 of the then prevailing overtime payment in each port) and paid this each week irrespective of the actual overtime worked in that week.

The assumption was that the average overtime component would be recalculated each year in accordance with the actual overtime worked.

In practice, the aggregate wage was never recalculated. The blame for this could lie with either the unions or the employers. It doesn't matter much. The result was that the "overtime multiple" set in 1983 remained fixed for all successive years.

In the towage industry, anomalies began to be created. In some ports the crews worked more overtime than was allowed for, while in other ports they worked less. As time went by, the aggregate wage in each port became less and less representative of the actual overtime worked. Despite this, there was a marked reluctance to revisit the calculation made in 1983.

Adsteam sought a recalculation as part of the 1996 negotiations, and was ultimately successful in obtaining union agreement to the recalculation in 1998. It was agreed that

- ☐ where crews were "underpaid" because of the obsolete aggregate wage, then those crews would receive the full benefit of any negotiated wage increase;
- ☐ where crews were "overpaid" because of the obsolete aggregate wage, then those crews would experience a wage freeze, despite any negotiated wage increase, until such time as they were no longer "overpaid".

As a consequence of these agreements to recalculate the aggregate wage in all ports, wage freezes have applied to approximately 50% of the workforce since the implementation of the agreement in 1999.

## **Work practices**

Inflexible work practices were another consequence of the industry-wide approach to industrial negotiation. Adsteam, at the time we were reviewing the usefulness of the Tug Operators Committee, came to the conclusion that “industry-wide” also meant “lowest common denominator”.

The Adsteam EBA structure allowed for more efficiencies to be introduced into the work practices.

For example,

- ❑ Ordering procedures and the availability of labour created unacceptable gaps in the service being offered to customers. A particularly unsatisfactory instance of this was the requirement to order tug services by 4.00pm Friday if they were likely to be needed at any time over the weekend. We understand that this is still a requirements in some ports not served by Adsteam.

Guaranteed labour availability, flexible rosters, and the use of company-supplied mobile phones now mean an absolute worst-case of 2 hour availability of service 24 hours a day, 7 days a week, 365 days a year. Usually, this benchmark is easily beaten.

- ❑ Workforce restrictions on transferring from one tug to another created inflexible and expensive restraints on tug availability. For example, if a crew was on site and available to crew a particular tug, but another (say, more powerful) tug was required, the on-site crew refused to transfer. As a consequence, another crew had to be called in while the first crew remained idle.

This practice was eradicated within the EBAs.

- ❑ In some ports, tug availability was scheduled on a “taxi rank” system. This meant that the tug at the head of the rank had to be used, even if it was not the tug required by the harbour pilot.

On occasions, unnecessary tugs had to be provided simply to allow the required tug (further along the rank) to be deployed. Although Adsteam did not charge for the unnecessary tug, the cost of the practice was considerable and, of course, drew incredulous criticism from ship operators who usually felt that they must be being charged for services they did not need.



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- ❑ When a tug had to be sent to another port for dry-docking<sup>26</sup>, the practice was that a “home port” crew had to take it there, even if this left the port short of operational labour and casuals had to be employed. This practice was enforced by industrial muscle despite the possible availability of a duty crew in the destination or in another port.

Adsteam now routinely uses the most economical way of relocating a tug from one port to another.

\* \* \* \* \*

Changes to work practices do not always mean reduced costs. They may be designed to improve service to customers, and could result in increased costs. The dramatic improvement in tug availability is a case in point.

Other examples of ***service improvement / cost increasing*** developments include:

- ❑ The introduction of 24-hour operations centres in Brisbane, Sydney, and Melbourne. The purpose of these centres is to provide an around-the-clock ordering service to customers. The need for tugs can arise at any time, and changed tug job timing (say, because a ship is delayed by stevedores) is commonplace.

In complex ports this means that trained tug controllers must be available around the clock, able to coordinate tugs and crews with the requirements of shipping.

In the case of Port Jackson and Port Botany, the port authority has introduced a computerised harbour control system which requires ship movements and service requirements to be communicated only via the centralised computer system. For Adsteam to be linked to this system 24 hours a day, it has become mandatory for a fully manned office to be maintained at all times.

- ❑ Because of increasingly stringent occupational health and safety concerns, extended “on duty” (not necessarily working) hours must be carefully monitored. In a number of ports (Brisbane, Newcastle, Port Kembla, Melbourne, Adelaide and Fremantle) additional crews have been employed.

These additional crews are not justified by business activity levels. It has, however, been critically important to Adsteam that fatigue regulations are complied with and safety standards not compromised.

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<sup>26</sup> Dry docking - the scheduled removal of a tug from the water for extensive maintenance and/or refurbishment.

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- ❑ Related to these issues has been the introduction of a shift system for crews in Brisbane and Melbourne. This was seen as being necessary to keep individual “on duty” hours within reasonable limits while improving the availability of crews and tugs.

The shift system actually reduces the utilisation of the workforce, particularly when ship call and tug job numbers are falling.

- ❑ A Personal Appraisal System has been introduced for crews. This reflects a policy of identifying (and rewarding) individual performance. It is designed to improve the motivation and professional pride in doing a job well and efficiently. It is a policy that has generally met with resistance from the maritime unions.

For too long, in Adsteam’s opinion, the towage industry has been damaged by a culture of “not being seen to show a workmate up” by an individual working harder or better. It is a culture supported by the maritime unions who have strongly resisted the idea of paying people according to performance standards - “all should be paid the same, irrespective of performance” - has been the maritime union policy.

Adsteam is convinced that this culture is detrimental to the company’s objective of delivering a better and more efficient service to customers. For this reason, a performance pay element was introduced through the EBAs in 1997. Part of the 6.5% wage increase in that year was in fact a Personal Performance Element.

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### MANNING NUMBERS

Until 2000, a harbour tug in Australia was typically manned by 4 crew members:

one tug master	AMOU
one tug engineer	AIMPE
two deckhands	MUA.

Adsteam took the view, in 1998, that its harbour tugs could all be safely manned by three crew members. It was decided to pay off one of the two deckhands on each tug, with the tug engineer assuming additional responsibilities during the actual towage operation.

This would halve the number of MUA deckhands throughout the Adsteam tug fleet. Predictably, it attracted a virulent response from the MUA. Bearing in mind that the Adsteam plan represented an equivalent reduction in MUA labour to that which triggered the Patrick waterfront dispute, the response was scarcely surprising.

Adsteam embarked on a carefully considered programme which included:

- ☐ An Independent Expert Risk Assessment study, which concluded that with some mitigating actions (the installation of additional alarm and safety equipment, and extensive training), safety would not be compromised;
- ☐ Investment in the identified equipment, and the development of a comprehensive training course for tug engineers in deck work;
- ☐ The appointment of an independent chairman of an evaluation team, which eventually the MUA (after failed strike action) was induced to join;
- ☐ An international evaluation tour which examined towage operations in Singapore, Europe, and the USA, principally for the benefit of the MUA contingent;
- ☐ An Australia-wide evaluation programme in which the operational environment of each tug and port was taken into account;
- ☐ The preparation of supporting argument and submissions in those States where government-appointed Manning Committees were in existence<sup>27</sup>;
- ☐ A redundancy package which was entirely funded by Adsteam (in contrast to the Federal Government MIFCO<sup>28</sup> scheme for stevedoring workers as a result of the waterfront confrontation of 1998);

The result was, we believe, an outstanding achievement in creating efficient manning. The majority of Adsteam's fleet became subject to 3-man crewing during 2000 and 2001.

The redundancy cost of \$5,870,010 was funded by Adsteam. The cost of this redundancy was not recovered from the market. The benefits accruing from 3-man crewing have been factored into the Adsteam cost base presented in this submission.

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<sup>27</sup> New South Wales and South Australia.

<sup>28</sup> MIFCO - Maritime Industry Finance Company

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**It is stated categorically that, in the absence of this major manning initiative taken by Adsteam, the price increases being sought in this submission would have been significantly higher.**

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### FUEL COSTS

Fuel is the only cost element of any significance that can be regarded as a variable cost, although it is not always within the control of Adsteam.

Usage of fuel is largely dependent upon two factors:

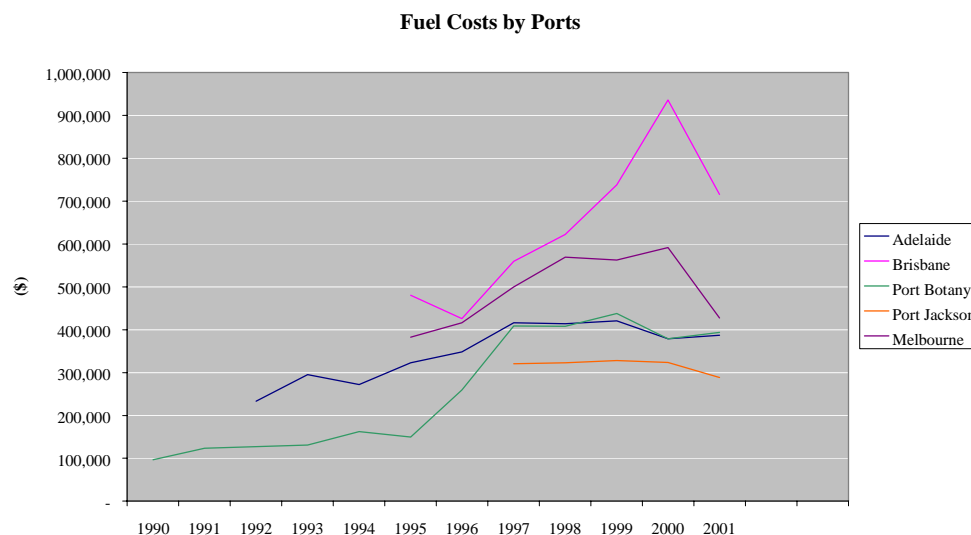
- ☐ The travelling distance between the tug base and the ship when doing a job;
- ☐ The amount of power applied during the actual tug job. This can vary. For example, if a pilot relies on one tug instead of two, he could call upon more power to be applied by the single tug. Fuel consumption rises dramatically under such circumstances.

This is a perverse cost, because not only is revenue lost (because only one tug is used) but the cost of the single tug operation rises.

Fuel costs have been controlled to the maximum extent possible by:

- ☐ Instructing all tug masters to operate at the most economical consumption rate available, except when under the instruction of the pilot;
- ☐ Implementing a National Fuel Tender, to take advantage of the Australia-wide Adsteam tug fleet. This was a competitive tender offered to the major oil suppliers. An approximate 8% overall reduction in fuel costs was achieved.

Despite these control measures, fuel costs have moved generally upwards in recent years, as illustrated by this graph:



In 2001, a Federal Government decision delivered savings to users of marine diesel fuels by way of a Diesel Fuel Rebate.

This rebate was passed on by Adsteam to our customers by way of a price reduction. The full value of the rebate was passed on in this way, a benefit that was monitored by the ACCC.

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### **TUG MAINTENANCE AND TOW LINES**

A number of initiatives have been taken by Adsteam in recent years:

- ☐ A 5-year docking programme was introduced early in the 1990's. This took advantage of Adsteam's good record with the Classification Societies, and allowed an in-water survey to be undertaken at the 2½ year mark, with the full dry-docking deferred to 5-year intervals.
- ☐ Programmed Maintenance Systems have been introduced to better control maintenance costs.
- ☐ Stainless steel fairleads and winch drums lagged with stainless steel have been fitted to all tugs to reduce wear rates on tow lines.
- ☐ New tow lines have been introduced to improve handling capabilities (and allow handling by one crewmember, not two), and to increase their service reliability life.
- ☐ A stockpile agreement has been reached with tow line suppliers, allowing Adsteam to draw from supplier-maintained stockpiles as required, thus eliminating Adsteam's inventory in tow lines.
- ☐ New paint systems have reduced lay-up time and limit paint inventory.

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### **INSURANCE - PROTECTION AND INDEMNITY**

Protection and Indemnity (P&I) insurance protects ship and tug operators against third party liability, or damage to property, people, equipment, and the environment.

P&I insurance is usually provided by mutual liability "clubs", with premiums directly linked to claims history.

Adsteam deals directly with two of the leading mutual clubs, avoiding brokerage costs. The two clubs (Shipowners of Luxembourg, and The Standard Club of London) to create competitive tension. This strategy has been successful with successive rate reductions being achieved in the last few years.

At a recent meeting with the Shipowners Club, it was confirmed that Adsteam had achieved and is maintaining the lowest premium rates for that Club of any ship or tug operator in the world.

It was also advised that, following September 11 and its impact on the world re-insurance market, premiums would rise by at least 20% in the forthcoming year.

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### **INSURANCE - HULL AND MACHINERY**

Hull and Machinery insurance covers Adsteam's own equipment.

Adsteam uses a specialised marine insurance broker, Gault Armstrong, to aggressively pursue lower rates based on the large fleet size and reputation in the market place.

Despite a hardening marine insurance market over the last few years, Adsteam has been able to keep premiums at very competitive levels.

From July 1998 to June 2001 a 3 year deal was entered into with insurers to lock in favourable rates with return premiums for favourable claims experiences. A \$50,000 return premium was received for the year ended June 2001.

The renewal process for 2001/02 was difficult and resulted in a per dollar insured value rate increase from 0.1339% to 0.1375%. This was accepted as a highly competitive rate, given that the cheapest other quote received was 0.225% and others were as high as 0.45%. As a comparison, other fleets in Australia are thought to range from 0.7% to 0.9% in coastal shipping and 1% and above in blue water shipping.

The next renewal is June 2002 and it is difficult to forecast what increases will occur. The marine insurance market will be considerably harder, given that some underwriters may be severely weakened by the events of September 11 and other incidents. Marine underwriters are often in the aviation market as well, and losses in that market are well known. Rises in the market for next year are being talked about in the 20% to 30% range, with the Adsteam position being held to 20%. War and terrorism cover has been included, but may not be available next year, or will be available but at an uneconomic premium.



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### **ADMINISTRATION**

Administration costs are principally staff costs, and relate to the operational running of the towage services.

Wage rates have overall been held at or below inflation rates for the last five years.

The major growth elements have been:

- ☐ Increasing superannuation contribution rates by Adsteam.
- ☐ The implementation of a 24-hour tug control system in Sydney to match that already existing in Brisbane and Melbourne. The background requirement to this has already been covered.

One point to note is that the previous two pricing submissions (Port Jackson 1997 and Melbourne 1999) were prepared using the assistance of outside consulting accountants and auditors. Fees associated with these submissions totalled approximately \$472,000. In preparing this submission, no such outside assistance has been used.

## **SECTION 6**

### **THE REAL COST OF TOWAGE TO SHIPPING COMPANIES**

This section takes a different perspective on towage pricing and costs.

The earlier sections dealt with the costs incurred by Adsteam in delivering its towage services, what has been done to contain them, and the restraints, both competitive and regulatory, that prevent Adsteam from increasing them excessively.

This section looks at towage costs from the perspective of the customer, the shipping companies using towage assistance in Adsteam serviced ports.

#### **Price versus Cost**

First of all, it is necessary to consider the difference between the **price** of towage and the **cost** of towage.

The **price of towage** is contained within Adsteam's pricing schedule. It is a published document, and shows the price of each tug used, which rises according to the GRT (size) of the ship being manoeuvred. It is fairly straightforward, and is usually what is seized on by, for example, port authorities, when they think about the cost of towage.

The **cost of towage** to the customer is not quite as simple. It must also take into account a number of additional factors, including:

- ☐ The number of tugs being used;
- ☐ Whether there are any other ancillary charges not immediately obvious from the published "per tug" pricing schedule;
- ☐ The applicability of discounts or rebates;
- ☐ Whether, through long-term price restraint, there has been any erosion of the real cost of towage through inflation;

and, if the customer is foreign and viewing all of his base costs in US\$, what is the currency the towage service is being charged in, and what is the exchange rate?

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This latter point is important. The overwhelming majority of shipping companies operating in Australian ports are overseas owned. Freight rates are in US\$, meaning that their revenue is almost invariably in US\$. This is the case even if it is Australian commodities that they are carrying. And almost all of their costs are either in US\$ or in their own currency of origin (if they employ nationals as crew).

When voyage accounts are prepared by these shipping line customers, they will be in a common currency, and usually US\$. Very rarely would they be in A\$. So the cost of towage, even Australian towage, will most likely be viewed in US\$, and this is how the cost of towage should be considered when looking at it from the perspective of the shipowner.

**For the purposes of this analysis, 2001 is compared to 1997. This will show the movement in real towage over the five year period.**

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### REDUCTION IN TUG USAGE

Reference was made to the reduction in tug usage in Section 4, page 10. The following tables show how the real cost of towage has declined as a result.

<b>Brisbane</b>	average tug jobs per ship call 1997	3.11
	average tug jobs per ship call 2001	3.06
	actual towage revenue 2001 <sup>29</sup>	■
	2001 towage revenue if at 1997 ratio	■
	difference caused by tug usage reduction	■
	<b>percentage difference</b>	<b>- 1.6 %</b>

<b>Pt Jackson</b>	average tug jobs per ship call 1997	3.44
	average tug jobs per ship call 2001	3.30
	actual towage revenue 2001	■
	2001 towage revenue if at 1997 ratio	■
	difference caused by tug usage reduction	■
	<b>percentage difference</b>	<b>- 4.2 %</b>

<b>Pt Botany</b>	average tug jobs per ship call 1997	3.62
	average tug jobs per ship call 2001	3.35
	actual towage revenue 2001	■
	2001 towage revenue if at 1997 ratio	■
	difference caused by tug usage reduction	■
	<b>percentage difference</b>	<b>- 8.1 %</b>

<b>Melbourne</b>	average tug jobs per ship call 1997	3.06
	average tug jobs per ship call 2001	2.35
	actual towage revenue 2001	■
	2001 towage revenue if at 1997 ratio	■
	difference caused by tug usage reduction	■
	<b>percentage difference</b>	<b>- 30.2 %</b>

<b>Adelaide</b>	average tug jobs per ship call 1997	3.56
	average tug jobs per ship call 2001	3.41
	actual towage revenue 2001	■
	2001 towage revenue if at 1997 ratio	■
	difference caused by tug usage reduction	■
	<b>percentage difference</b>	<b>- 4.4 %</b>

<sup>29</sup> Revenue from towage jobs only. Excludes ancillary charges.

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### ELIMINATION OF ANCILLARY CHARGES

Reference was made to the elimination of ancillary charges in Section 3, page 6. The following table illustrates how the elimination of ancillary charges has reduced the cost of towage to shipping companies since 1997, in the ports covered by this submission.

<b>Brisbane</b>	ancillary charge revenue 1997	■
	ancillary charge revenue 2001	■
	difference from the elimination of ancillary charges	■
	2001 total revenue (towage jobs + ancillary charges)	■
	<b>percentage cost reduction due to ancillary charge reduction</b>	<b>- 2.1 %</b>

<b>Pt Jackson</b>	ancillary charge revenue 1997	■
	ancillary charge revenue 2001	■
	difference from the elimination of ancillary charges	■
	2001 total revenue (towage jobs + ancillary charges)	■
	<b>percentage cost reduction due to ancillary charge reduction</b>	<b>- 0.1 %</b>

<b>Pt Botany</b>	ancillary charge revenue 1997	■
	ancillary charge revenue 2001	■
	difference from the elimination of ancillary charges	■
	2001 total revenue (towage jobs + ancillary charges)	■
	<b>percentage cost reduction due to ancillary charge reduction</b>	<b>- 0.0 %</b>

<b>Melbourne</b>	ancillary charge revenue 1997	■
	ancillary charge revenue 2001	■
	difference from the elimination of ancillary charges	■
	2001 total revenue (towage jobs + ancillary charges)	■
	<b>percentage cost reduction due to ancillary charge reduction</b>	<b>- 2.8 %</b>

<b>Adelaide</b>	ancillary charge revenue 1997	■
	ancillary charge revenue 2001	■
	difference from the elimination of ancillary charges	■
	2001 total revenue (towage jobs + ancillary charges)	■
	<b>percentage cost reduction due to ancillary charge reduction</b>	<b>- 0.7 %</b>

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### INTRODUCTION OF VOLUME REBATES

Reference was made to the introduction of volume rebates in Section 3, page 6 and in Section 4, page 17. The following tables show how the real cost of towage has declined as a result.

<b>Brisbane</b>	total revenue (towage + ancillary charges) 1997	■
	total rebates paid 1997	■
	rebates as a percentage of total revenue 1997	1.3%
	total revenue (towage + ancillary charges) 2001	■
	total rebates 2001	■
	rebates as a percentage of total revenue 2001	3.9%
	<b>percentage cost reduction due to increased rebates</b>	<b>2.8%</b>

<b>Pt Jackson</b>	total revenue (towage + ancillary charges) 1997	■
	total rebates paid 1997	■
	rebates as a percentage of total revenue 1997	1.0%
	total revenue (towage + ancillary charges) 2001	■
	total rebates 2001	■
	rebates as a percentage of total revenue 2001	5.8%
	<b>percentage cost reduction due to increased rebates</b>	<b>5.0%</b>

<b>Pt Botany</b>	total revenue (towage + ancillary charges) 1997	■
	total rebates paid 1997	■
	rebates as a percentage of total revenue 1997	0.3%
	total revenue (towage + ancillary charges) 2001	■
	total rebates 2001	■
	rebates as a percentage of total revenue 2001	3.0%
	<b>percentage cost reduction due to increased rebates</b>	<b>2.7%</b>

<b>Melbourne</b>	total revenue (towage + ancillary charges) 1997	■
	total rebates paid 1997	■
	rebates as a percentage of total revenue 1997	1.0%
	total revenue (towage + ancillary charges) 2001	■
	total rebates 2001	■
	rebates as a percentage of total revenue 2001	4.3%
	<b>percentage cost reduction due to increased rebates</b>	<b>3.2%</b>

<b>Adelaide</b>	total revenue (towage + ancillary charges) 1997	■
	total rebates paid 1997	■
	rebates as a percentage of total revenue 1997	1.9%
	total revenue (towage + ancillary charges) 2001	■
	total rebates 2001	■
	rebates as a percentage of total revenue 2001	3.5%
	<b>percentage cost reduction due to increased rebates</b>	<b>1.5%</b>

## Australian Competition and Consumer Commission

Submission by Adsteam Marine Limited on towage prices in Brisbane, Port Jackson, Port Botany, Melbourne, and Adelaide

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### EFFECT OF ACTUAL PRICE CHANGES

The prices on the published price schedule in Brisbane (that is, the price per tug service) were **reduced** by 3.0% in 2000.

The prices on the published price schedule in Port Jackson (that is, the price per tug service) were **increased** by 15.0% in 1998.

The prices on the published price schedule in Melbourne (that is, the price per tug service) were **increased** by 10.0% in 1999.

### DIESEL FUEL REBATE

The beneficial effect of the Diesel Fuel Rebate was passed on to shipping line customers in its entirety in 2001. It was a very transparent process. The calculated effect of this Rebate was independently monitored by the ACCC.

The result was a reduction in towage cost to the shipping line customers, as follows:

Brisbane	\$557,427
Port Jackson	\$152,498
Port Botany	\$203,331
Melbourne	\$374,685
Adelaide	\$382,524

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### REDUCTION DUE TO CURRENCY BENEFIT

As mentioned earlier, the vast majority of shipping companies earn their freight revenue in US\$. Likewise, the major part of their costs are also in US\$.

Adsteam's towage services are charged for in A\$. There has therefore been a real benefit over the last five years derived from the declining value of the Australian dollar. The magnitude of the benefit is as follows:

exchange rate 30/6/1997	0.7455
exchange rate 30/6/2001	0.5075
<b>percentage decline in value of the A\$</b>	<b>31.9%</b>



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### NET REDUCTION IN TOWAGE COST 1997 TO 2001

The following tables illustrate the reduction in the real cost (but not inflation adjusted) of towage services provided by Adsteam in each of the ports which are the subjects of this submission.

It is stressed that Adsteam does not claim to be responsible for every cost reduction element. Adsteam, of course, has been the prime mover in some of this cost reduction.

In the context of the price increases being sought by Adsteam, however, it is important to know just how towage costs have actually moved ***in the books of the shipping company customers*** over the last five years.

<b>Brisbane</b>	change due to the reduction in tug usage	- 1.63%
	change due to the elimination of ancillary charges	- 2.13%
	change due to the introduction of volume rebates	- 2.76%
	change due to actual price variations	- 3.00%
	change due to the Diesel Fuel Rebate	- 3.55%
	change due to currency variation	- 31.92%
	<b>total reduction in towage cost</b>	<b>- 44.99%</b>

<b>Pt Jackson</b>	change due to the reduction in tug usage	- 4.24%
	change due to the elimination of ancillary charges	- 0.14%
	change due to the introduction of volume rebates	- 5.02%
	change due to actual price variations	15.00%
	change due to the Diesel Fuel Rebate	- 2.10%
	change due to currency variation	- 31.92%
	<b>total reduction in towage cost</b>	<b>- 28.42%</b>

<b>Pt Botany</b>	change due to the reduction in tug usage	- 8.05%
	change due to the elimination of ancillary charges	- 0.02%
	change due to the introduction of volume rebates	- 2.66%
	change due to actual price variations	0.00%
	change due to the Diesel Fuel Rebate	- 2.05%
	change due to currency variation	- 31.92%
	<b>total reduction in towage cost</b>	<b>- 44.70%</b>

<b>Melbourne</b>	change due to the reduction in tug usage	- 30.16%
	change due to the elimination of ancillary charges	- 2.75%
	change due to the introduction of volume rebates	- 3.17%
	change due to actual price variations	10.00%
	change due to the Diesel Fuel Rebate	- 3.26%
	change due to currency variation	- 31.92%
	<b>total reduction in towage cost</b>	<b>- 61.26%</b>

<b>Adelaide</b>	change due to the reduction in tug usage	- 4.38%
	change due to the elimination of ancillary charges	- 0.67%
	change due to the introduction of volume rebates	- 1.50%
	change due to actual price variations	0.00%
	change due to the Diesel Fuel Rebate	- 4.71%
	change due to currency variation	- 31.92%
	<b>total reduction in towage cost</b>	<b>- 43.18%</b>

## **Australian Competition and Consumer Commission**

Submission by Adsteam Marine Limited on towage prices in Brisbane, Port Jackson, Port Botany, Melbourne, and Adelaide

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**These reductions in the real cost of towage are significant.**

**There is no evidence available to Adsteam that suggests that any benefit derived from these cost reductions has been passed on to Australian consumers.**

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### ADJUSTING THE TOWAGE COST REDUCTION FOR INFLATION

In many cases, the published price schedule for towage services has not been changed for a number of years. As a consequence, the real (ie inflation adjusted) cost of towage has fallen over that period in each case.

The following tables illustrate the effect of inflation *in addition to* the actual reduction in towage cost illustrated in the tables on the previous page<sup>30</sup>.

<b>Brisbane</b>	date of last increase	May 1987
	CPI effect since the date of last increase	- 38.27%
	percentage reduction in actual towage cost	- 44.99%
	<b>total reduction in towage cost (inflation adjusted)</b>	<b>- 62.22%</b>

<b>Pt Jackson</b>	date of last increase	February 1998
	CPI effect since the date of last increase	- 10.09%
	percentage reduction in actual towage cost	- 28.42%
	<b>total reduction in towage cost (inflation adjusted)</b>	<b>- 31.29%</b>

<b>Pt Botany</b>	date of last increase	October 1990
	CPI effect since the date of last increase	- 20.78%
	percentage reduction in actual towage cost	- 44.70%
	<b>total reduction in towage cost (inflation adjusted)</b>	<b>- 53.99%</b>

<b>Melbourne</b>	date of last increase	March 1999
	CPI effect since the date of last increase	- 8.97%
	percentage reduction in actual towage cost	- 61.26%
	<b>total reduction in towage cost (inflation adjusted)</b>	<b>- 66.76%</b>

<b>Adelaide</b>	date of last increase	May 1992
	CPI effect since the date of last increase	- 19.81%
	percentage reduction in actual towage cost	- 43.18%
	<b>total reduction in towage cost (inflation adjusted)</b>	<b>- 51.73%</b>

<sup>30</sup> Note that the CPI effect is taken from the date of last price increase. The "percentage reduction in actual towage cost", however, is for the period 1997 to 2001. The discrepancy is not regarded as material, as the "actual towage cost reduction" was insignificant before 1997 (except for Pt Jackson and Pt Botany, where there was a significant reduction in tug usage guidelines in 1992).

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### SECTION 7

#### MARGIN EROSION

In stark contrast to the benefits enjoyed by the shipping companies as a result of the fall in the real cost of towage, Adsteam has suffered a significant erosion of margins and profitability in the ports which are the subject of this submission.

This is despite the aggressive approach to cost containment undertaken by Adsteam and described in Section 5.

The erosion of margins is clearly illustrated in the following tables. Detailed supporting data is included in Appendix D.

<b>Brisbane</b>	total towage revenue in year of last price increase	■
	total towage costs in year of last price increase	■
	port EBIT <sup>31</sup> in year of last price increase	■
	gross margin in year of last price increase	■
	total towage revenue in 2001	■
	total towage costs in 2001	■
	port EBIT in 2001	■
	gross margin in 2001	■

<b>Port Jackson</b>	total towage revenue in year of last price increase	■
	total towage costs in year of last price increase	■
	port EBIT in year of last price increase	■
	gross margin in year of last price increase	■
	total towage revenue in 2001	■
	total towage costs in 2001	■
	port EBIT in 2001	■
	gross margin in 2001	■

<b>Port Botany</b>	total towage revenue in year of last price increase	■
	total towage costs in year of last price increase	■
	port EBIT in year of last price increase	■
	gross margin in year of last price increase	■
	total towage revenue in 2001	■
	total towage costs in 2001	■
	port EBIT in 2001	■
	gross margin in 2001	■

<sup>31</sup> EBIT: Earnings Before Interest and Tax.

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<b>Melbourne</b>	total towage revenue in year of last price increase	■
	total towage costs in year of last price increase	■
	port EBIT in year of last price increase	■
	gross margin in year of last price increase	■
	total towage revenue in 2001	■
	total towage costs in 2001	■
	port EBIT in 2001	■
	gross margin in 2001	■

<b>Adelaide</b>	total towage revenue in year of last price increase	■
	total towage costs in year of last price increase	■
	port EBIT in year of last price increase	■
	gross margin in year of last price increase	■
	total towage revenue in 2001	■
	total towage costs in 2001	■
	port EBIT in 2001	■
	gross margin in 2001	■

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### SECTION 8

#### PROPOSED INCREASES

The following tables indicate the price increases required, in each port that is the subject of this submission, to restore margins to those that are regarded as being acceptable, given the capital intensive nature of the towage business, its lack of tenure particularly in the larger ports that are the subject of this submission, and the significant time gap (in most cases) since the previous adjustments. It also needs to be taken into account that a major proportion of Adsteam's costs (tugs, fuel, lines, insurance) are subject to international currency (particularly US\$) and pricing fluctuations, while Adsteam's revenue is denominated in Australian dollars.

Under these circumstances, a benchmark margin of 18% on cost is regarded as appropriate. It should be noted that this represents an appreciable reduction against levels that applied in the more profitable ports early in the 1990s.

Adsteam acknowledges that this objective (of restoring margins) is not necessarily sustainable if the company had failed to take comprehensive and effective steps to contain costs and reduce them wherever possible.

Section 5 illustrated that aggressive and effective strategies have been implemented to contain and reduce costs. The benefits of these cost control strategies effectively pass to our shipping company customers.

port	2001 cost base	2001 revenue base	revenue base at 18% margin	revenue increase required	percentage price adjustment
Brisbane	■	■	■	■	11.7 %
Pt Jackson	■	■	■	■	26.2 %
Pt Botany	■	■	■	■	13.2 %
Melbourne	■	■	■	■	23.4 %
Adelaide	■	■	■	■	15.8 %

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In summary then, the proposed price increases are:

Brisbane	+ 11.7 %
Port Jackson	+ 26.2 %
Port Botany	+ 13.1 %
Melbourne	+ 23.4 %
Adelaide	+ 15.8 %

These proposed price increases are significantly below the levels of real towage cost reductions experienced by the shipping companies since 1997.

Brisbane	- 62.2%
Port Jackson	- 31.3 %
Port Botany	- 54.0 %
Melbourne	- 66.8 %
Adelaide	- 51.8 %

**In other words, the real cost of towage services provided by Adsteam, even after the implementation of the price increases, remains well below that which applied even five years ago.**

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### **APPENDIX A FORMAL NOTIFICATION OF PRICES UNDER THE PRICES SURVEILLANCE ACT 1983**

## **PRICES SURVEILLANCE ACT 1983**

### **Notification of prices pursuant to Section 22 (2) (a)**

Adsteam Towage Pty. Limited trading as Adsteam Harbour – Adelaide, a wholly owned subsidiary of Adsteam Marine Limited, whose address is 4 Victoria Road, Birkenhead SA 5015 (PO Box 78, Port Adelaide 5015) hereby gives notice that it proposes to supply the services described on the attached schedules at the prices and terms and conditions indicated.

### **Reason for the Proposed Prices**

Adsteam Harbour – Adelaide has incurred cost increases since its last price increase in May, 1992. The proposed prices are necessary:-

- to recover costs
- to maintain a reasonable margin
- to offset the declining volume of ship traffic/tug usage in the port.

### **Considerations having regard to Section 17(3)**

The proposed price increases should help maintain the profitability of Adsteam Harbour – Adelaide at a time when considerable investment has been necessary to maintain the level of towage service that the customers of the port demand.



## **PRICES SURVEILLANCE ACT 1983**

### **Notification of prices pursuant to Section 22 (2) (a)**

Queensland Tug & Salvage Co. Pty. Limited trading as Adsteam Harbour – Brisbane, a wholly owned subsidiary of Adsteam Marine Limited, whose address is 1 Howard Smith Drive, Whyte Island via Wynnum, Qld. 4178 (PO Box 555, Wynnum Central 4178) hereby gives notice that it proposes to supply the services described on the attached schedules at the prices and terms and conditions indicated.

### **Reason for the Proposed Prices**

Adsteam Harbour – Brisbane has incurred cost increases since its last price increase in May, 1987. The proposed prices are necessary:-

- to recover costs
- to maintain a reasonable margin
- to offset the declining volume of ship traffic/tug usage in the port.

### **Considerations having regard to Section 17(3)**

The proposed price increases should help maintain the profitability of Adsteam Harbour – Brisbane at a time when considerable investment has been necessary to maintain the level of towage service that the customers of the port demand.

## **PRICES SURVEILLANCE ACT 1983**

### **Notification of prices pursuant to Section 22 (2) (a)**

Adsteam Towage Holdings Pty. Ltd. trading as Adsteam Harbour – Melbourne, a wholly owned subsidiary of Adsteam Marine Limited, whose address is No. 30 South Wharf, 629 Lorimer Street, Port Melbourne, Vic. 3207 (PO Box 1236, South Melbourne 3205) hereby gives notice that it proposes to supply the services described on the attached schedules at the prices and terms and conditions indicated.

### **Reason for the Proposed Prices**

Adsteam Harbour – Melbourne has incurred cost increases since its last price increase in March, 1999. The proposed prices are necessary:-

- to recover costs
- to maintain a reasonable margin
- to offset the declining volume of ship traffic/tug usage in the port.

### **Considerations having regard to Section 17(3)**

The proposed price increases should help maintain the profitability of Adsteam Harbour – Melbourne at a time when considerable investment has been necessary to maintain the level of towage service that the customers of the port demand.

## **PRICES SURVEILLANCE ACT 1983**

### **Notification of prices pursuant to Section 22 (2) (a)**

Waratah Towage Pty. Limited trading as Adsteam Harbour – Sydney, a wholly owned subsidiary of Adsteam Marine Limited, whose address is Suite 2/3 Montague Street, Balmain, NSW 2041 (PO Box 176, Balmain 2041) hereby gives notice that it proposes to supply the services described on the attached schedules for the port of Port Jackson at the prices and terms and conditions indicated.

### **Reason for the Proposed Prices**

Adsteam Harbour – Sydney has incurred cost increases in the Port Jackson operations since its last price increase in February, 1998. The proposed prices are necessary:-

- to recover costs
- to maintain a reasonable margin
- to offset the declining volume of ship traffic/tug usage in the port.

### **Considerations having regard to Section 17(3)**

The proposed price increases should help maintain the profitability of Adsteam Harbour – Sydney at a time when considerable investment has been necessary to maintain the level of towage service that the customers of the port demand.

## **PRICES SURVEILLANCE ACT 1983**

### **Notification of prices pursuant to Section 22 (2) (a)**

Waratah Towage Pty. Limited trading as Adsteam Harbour – Sydney, a wholly owned subsidiary of Adsteam Marine Limited, whose address is Suite 2/3 Montague Street, Balmain, NSW 2041 (PO Box 176, Balmain 2041) hereby gives notice that it proposes to supply the services described on the attached schedules for the port of Port Botany at the prices and terms and conditions indicated.

### **Reason for the Proposed Prices**

Adsteam Harbour – Sydney has incurred cost increases in the Port Botany operations since its last price increase in October, 1990. The proposed prices are necessary:-

- to recover costs
- to maintain a reasonable margin
- to offset the declining volume of ship traffic/tug usage in the port.

### **Considerations having regard to Section 17(3)**

The proposed price increases should help maintain the profitability of Adsteam Harbour – Sydney at a time when considerable investment has been necessary to maintain the level of towage service that the customers of the port demand.

## Australian Competition and Consumer Commission

Submission by Adsteam Marine Limited on towage prices in Brisbane, Port Jackson, Port Botany, Melbourne, and Adelaide

### APPENDIX B CAPITAL EXPENDITURE PROGRAMME

Adsteam has invested a total of \$85,614,000 in new tug buildings throughout Australia over the last ten years. The tugs, their original capital costs and estimated market values, are as follows:-

TUG	BUILT	ORIGINAL COST (\$A)	ESTIMATED MARKET VALUE (\$A)	CURRENT PORT
<i>Giru</i>	1991	\$5,649,000	\$6,000,000	Townsville
<i>Karoo</i>	1991	\$5,193,000	\$6,125,000	Port Kembla
<i>Koona</i>	1991	\$5,192,000	\$6,125,000	Newcastle
<i>Wilga</i>	1991	\$6,766,000	\$6,625,000	Sydney
<i>Wyong</i>	1992	\$6,528,000	\$6,875,000	Fremantle
<i>Bunbury</i>	1999	\$7,805,300	\$10,375,000	Kwinana
<i>Tingari</i>	1999	\$8,197,000	\$10,375,000	Adelaide
<i>Beltana</i>	2000	\$7,589,600	\$10,375,000	Port Jackson
<i>Bullara</i>	2000	\$8,168,500	\$10,375,000	Port Kembla
<i>Burra</i>	2000	\$7,397,700	\$10,375,000	Fremantle
<i>Clontarf</i>	2000	\$7,192,000	\$10,375,000	Brisbane
<i>Gurrong</i>	2000	\$9,935,900	\$11,875,000	Melbourne

This capital expenditure had three objectives:-

- ☐ To maintain the fleet at the standard required in major Australian ports, and to replace ageing tugs (which in turn have been used to upgrade the tug fleet in regional ports);
- ☐ To deliver greater towage power to cope with the increasing size of ships requiring towage assistance;
- ☐ To allow for an on-going reduction in the number of tugs required. For example, one of the more powerful new tugs (*Bullara*) is currently in Port Kembla undergoing trials to reduce the number of tugs needed in the port.

In addition, Adsteam has maintained a major tug capital refurbishment programme. Between 1996 and 2001, expenditure in each of the ports which are the subject of this submission were as follows:-

Brisbane	■
Port Botany	■
Port Jackson	■
Melbourne	■
Adelaide	■

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**Note:** Appendices C to F inclusive contain confidential information.

### **APPENDIX C NOTES ON FINANCIAL STATEMENTS**

### **APPENDIX D FINANCIAL DATA - SUPPORT DETAIL**

### **APPENDIX E REBATE ARRANGEMENTS - DETAIL**

### **APPENDIX F CREDIT TERMS AND COMPLIANCE**

### **APPENDIX G CONTACT DETAILS**

For further information on any aspect of the Adsteam submission, please contact:

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