

Our reference
ECS/JC/CORR4394-9120629

ONE ONE ONE Eagle Street
111 Eagle Street Brisbane QLD 4000
GPO Box 9925 Brisbane QLD 4001
Tel +61 7 3228 9333
Fax +61 7 3228 9444
www.corrs.com.au

**CORRS
CHAMBERS
WESTGARTH**
lawyers

Sydney
Melbourne
Brisbane
Perth

12 October 2016

By email: kabita.prasad@acc.gov.au
Kabita Prasad
Assistant Director
Merger and Authorisation Review Division
Australian Competition and Consumer
Commission
GPO Box 3131
Canberra ACT 2601

Contact
James Cameron (07) 3228 9752
Email: james.cameron@corrs.com.au

Partner
Eddie Scuderi

Dear Kabita

Response to Svitzer submission – A91545

This letter responds to the Svitzer submission dated 29 September 2016 and is made on behalf of Port of Townsville Limited (**POTL**) and Far North Queensland Ports Corporation (**FNQPC**) (together, the '**Applicants**').

This letter is for the public register.

1 Response to Svitzer submission

- 1.1 The Applicants do not agree that they have relied upon any 'misconceptions' in making their application or submissions to the ACCC. We address each of the substantive misconceptions claimed by Svitzer in this letter.
- 1.2 Before we do, we wish to correct a misconception that Svitzer rely on, namely the incorrect claim that exclusive licences lead to price increases or contractual variations as a result of volume changes or other cost escalations (articulated at pages 1-2 of the Svitzer submission).
- 1.3 The pricing able to be charged by the winning towage service provider at each port will be fixed following the tender process with increases only permitted in accordance with a contractually agreed formula likely to be referenced to CPI. The exclusive licence holder will not be free to arbitrarily increase price or reduce service standards.
- 1.4 It is simply incorrect to imply that a towage operator that is granted an exclusive licence for a port by one of the Applicants under the proposed competitive tender process will be free to arbitrarily increase its rates or unilaterally apply variations to its contract.

Merger and Authorisation Review Division
Australian Competition and Consumer Commission
Response to Svitzer submission – A91545

- 1.5 One of the key outcomes of the competitive tender process will be respondent towage service operators competing with each other on (among other factors) price. Those prices will be fixed under the awarded contract subject only to a prescribed formula for increases.
- 1.6 In this regard, the Svitzer submission does not in any way address or make any mention of the important competition effects achieved through a competitive tender process that is coupled with an offer of exclusive licences. Those benefits and outcomes are considered in more detail at paragraphs 2.7 to 2.11 of this submission.
- 1.7 We now respond to each of the claimed misconceptions by reference to the paragraph numbers used in the Svitzer submission.
- Paragraph 2(a) – ‘Towage jobs are not a relevant or effective benchmark to assess the stability of port operations, efficiencies or customer outcomes’***
- 1.8 Svitzer claim that ‘considerable changes’ have occurred within the Australian towage sector since 2002 and argue that the number of towage jobs does not provide an accurate metric to determine the number of towage operators that a port can accommodate.
- 1.9 Svitzer does not, however, analyse or explain what the considerable changes are or how they are relevant to competition or public interest considerations.
- 1.10 Svitzer appears to claim (though it is not clear) that advances in forecasting supply and demand is one of those considerable changes. However, its submission does not make clear how those advances have caused the well-accepted, considered and tested measure of towage job numbers to become ‘arbitrary’, nor does it explain why the reasoning used in the 2002 Productivity Commission report is no longer valid or not sound from a competition law perspective.
- 1.11 The Applicants submit that very reliable and convincing evidence would be required to challenge what continues to be the most thorough, comprehensive and consultative analysis on competition issues relevant to the towage service market in Australia, namely the 2002 Productivity Commission report. Svitzer has not put forward any such evidence.
- 1.12 The Applicants do not agree that changes in the towage services market in Australia since 2002 have had a material impact on the competition or public interest considerations relevant to the proposed joint competitive tender by the Applicants. No convincing evidence has been submitted by Svitzer, or any other interested party, to challenge this view.
- 1.13 If the market has seen technological advances in supply and demand forecasting, an increase in the number of towage service operators or any other changes, those changes are ones that the Applicants’ joint competitive tender will operate on because that approach will drive intense competitive bidding from participants in the current market. The Applicants’ proposed competitive tender, and the

Merger and Authorisation Review Division
Australian Competition and Consumer Commission
Response to Svitzer submission – A91545

competition law principles that underpin it, remain as valid today as they were in 2002.

- 1.14 Finally, towage job numbers are a fundamental metric for towage service operators that choose to respond to a competitive tender for exclusive licences. That metric forms the very basis for each towage service operator calculating what work it is likely to enjoy under an exclusive licence.
- 1.15 This level of certainty cannot be achieved under an offer of non-exclusive licences and this competition effect is acknowledged by the Productivity Commission as a factor relevant to new entrants being able to justify the potentially significant sunk costs associated with market entry.¹
- 1.16 In any event, and for completeness, the Applicants confirm that towage job numbers are not the sole criteria that they have taken into account. Other characteristics including sunk costs, tug utilisation, crew flexibility, operational considerations relevant to each port and the geographic location of the ports in relation to each other are all factors that the Applicants have taken into account in deciding to proceed with the joint competitive tender approach described in application A91545.

Paragraph 2(b) – ‘Exclusive licences do not guarantee certainty of service’

- 1.17 Svitzer argues that exclusive licences provide no additional protection than non-exclusive licences with respect to the stability of towage services. It claims that the Applicant’s arguments that non-exclusive models involve higher risks with respect to stability are theoretical in nature and lack support by way of real-world examples.
- 1.18 With respect, Svitzer is not in a position to properly observe the disruptions caused by the exit of an operator from a port where a non-exclusive licence arrangement exists. The Applicants are in such a position.
- 1.19 In the Applicant’s experience, such an event causes delays and disruptions to port customers and port operations because the remaining operators are unlikely to be in a position to promptly absorb the demand that would otherwise have been fulfilled by the exiting towage service operator.
- 1.20 The Applicants have experienced the disruption caused by the unexpected exit of a towage service operator and strongly disagree with Svitzer’s claims that such an opinion is merely ‘theoretical’.
- 1.21 The Applicants submit that the exit of a towage service operator is a far more likely event under a non-exclusive licence arrangement, particularly in low-volume ports that are unable to sustain more than one operator on a long-term basis. It is precisely this risk that the Applicants seek to manage through a joint competitive tender approach offering the stability of exclusive licences.

¹ See further the public benefits and supporting footnote references at paragraphs 2.14(b) and 2.14(c) below.

Merger and Authorisation Review Division
Australian Competition and Consumer Commission
Response to Svitzer submission – A91545

1.22 Under that approach, the successful tenderer for a port is assured of receiving all towage service jobs at that port for the contract term (something which can only be achieved through the offer of an exclusive licence), thereby significantly reducing the risks, ongoing uncertainty and disruption caused by a towage service operator unexpectedly exiting a port under a non-exclusive licence arrangement.

Paragraph 2(c) – ‘Claimed public benefits associated with exclusive licences are attainable without exclusivity’

1.23 Svitzer claims that most, if not all, of the public benefits claimed by the Applicants could be achieved through non-exclusive licensing.

1.24 Svitzer notes that port authorities have the ability to impose minimum requirements on any towage operator to ensure operational expectations but does not otherwise analyse how a non-exclusive licence arrangement can achieve the same or better public benefits that are claimed by the Applicants with respect to their proposed joint competitive tender for exclusive licences.

1.25 The Applicants disagree that a non-exclusive licence arrangement is able to match or exceed the public benefits claimed by them with respect to the proposed joint competitive tender. Those public benefits are discussed in more detail at paragraph 2.14 of this letter.

1.26 Of those public benefits, one of the most crucial benefits is the ability of the proposed joint competitive tender approach to address the significant issue of the high sunk costs involved for a new towage service operator to enter a port.

1.27 Those high sunk costs can have a significant impact on new market entry and are most effectively managed through a joint competitive tender approach coupled with the offer of exclusive licences.

1.28 It is only through this approach that potential towage service operators can be offered the certainty that they need to assess the risk of incurring sunk costs and challenging incumbent towage service providers that have already incurred those costs. That certainty cannot be achieved under a non-exclusive licence model.

1.29 This level of certainty also gives potential towage service operators the confidence to offer competitive pricing, which may be at prices that are more competitive than those that could be offered under a non-exclusive licence scenario.

2 Objectives and motivations of the Applicants

2.1 As we have done with respect to the submissions that we have made on behalf of the Applicants for related notifications N99117 and N99118, we are instructed to make submissions about the objectives and motivations of the Applicants with respect to application A91545.

2.2 The Applicants do not have any incentive to maximise their own profits at the cost of port customers and they are very mindful that any process that lacks competitive tension may result in a poor outcome of the ports and port customers.

Merger and Authorisation Review Division
Australian Competition and Consumer Commission
Response to Svitzer submission – A91545

- 2.3 The Applicants are Queensland Government Owned Corporations and are motivated to secure reliable, safe, efficient and cost-effective towage services for the ports and their customers at a competitive price. This motivation benefits port customers, who use and pay for the towage services.
- 2.4 In addition, the Applicants each have statutory obligations to administer and approve towage services (as a ‘controlled activity’) for the benefit of their customers under Part 4A of the *Transport Infrastructure Act 1974* (Qld), including by granting exclusive towage licences.
- 2.5 The Applicants do not charge, nor will they recover, any costs from port customers for towage services. Any fees charged to port customers will be determined by the market through the competitive tender process described in authorisation A91545.
- 2.6 The pricing able to be charged by the winning towage service provider at each port will be fixed following the tender process with increases only permitted in accordance with a contractually agreed formula likely to be referenced to CPI. The exclusive licence holder will not be free to arbitrarily increase price or reduce service standards.
- 2.7 The Applicants propose to jointly procure towage services for the ports under exclusive licences via a competitive tender process for exclusive licences.
- 2.8 Such a procurement process is tried and tested. It has been used for many years to secure towage services in Australia. Its competitive effects and benefits have been acknowledged by:
- (a) the Productivity Commission;²
 - (b) by justices of the Federal Court of Australia;³ and
 - (c) in detailed submissions made by experienced industry stakeholders with respect to authorisation A91545 and with respect to a previous notification by POTL that was challenged (see submission by Ports Australia dated 7 February 2012 in response to the unsuccessful challenge made by Svitzer against notification N93775).
- 2.9 The Applicants submit that it is fundamental to any competition or public benefit assessment that the proposed grant of exclusive licences by them is not viewed in isolation.
- 2.10 The Applicants are not proposing to simply grant exclusive rights to towage service providers for those providers to then take advantage of those rights as they please. Instead, the Applicants propose to grant exclusive licences subject to strict contractual terms that lock-in tendered rates bid in response to a competitive tender process. That competitive tender process and the resulting

² Productivity Commission, *Inquiry report: Economic regulation of harbour towage and related services* (20 August 2002), pages 155-158.

³ *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* [2000] FCA 1381, [25]. See also the extract from this decision at paragraph 2.14(e) of this letter.

exclusive towage contracts that may be awarded go hand-in-glove, something which is effectively ignored by the Svitzer submission.

- 2.11 If exclusive licensing is divorced from a competitive tender process, the Applicants appreciate that competition concerns may arise. Together, however, they are a potentially powerful mechanism for fostering competitive tension and achieving significant public benefits.
- 2.12 In its report, the Productivity Commission drew the following conclusion (emphasis added in underline):

Is harbour towage a natural monopoly?

There is consensus that low demand levels, combined with ‘lumpy’ investments (due to minimum tug fleets needed to offer appropriate service levels) and economies of scale in towage operations, mean that most, if not all, Australian ports can efficiently support only one provider of towage services at a time (box 1).⁴

- 2.13 The number of towage jobs per year at each of the ports is well below 8000 jobs per year (which is a threshold figure noted in the Productivity Commission Report).⁵ For example, the number of tug jobs at the Port of Townsville during the 2015/2016 financial year was just 2,199 tug jobs. The other three ports the subject of the Notification have substantially lower annual volumes of tug jobs again, making them very low volume ports.
- 2.14 With respect to the ports the subject of the Notification, the Applicants have given due consideration to the Productivity Commission report, and genuinely believe that an exclusive licence model coupled with a competitive tender process is most likely to achieve the claimed public benefits for the following reasons:

- (a) A non-exclusive model could result in **less competitive prices**. This is because respondents to a tender for non-exclusive licences must price their offer based on the unknown volume of towage service jobs that they ‘might’ win when competing with other towage service providers for the same work.

Conversely, respondents to a competitive tender process for an exclusive licence are more likely to have the confidence to submit more competitive pricing because they have a much higher degree of certainty about the volume of work that they would receive if their bid is successful.

Evidence to support this claim is found on page 157 of the Productivity Commission report, which describes how the offer of an exclusive licence for the Port of Fremantle resulted in bids to reduce towage

⁴ Productivity Commission, *Inquiry report: Economic regulation of harbour towage and related services* (20 August 2002), XXVI.

⁵ *Ibid.*

Merger and Authorisation Review Division
Australian Competition and Consumer Commission
Response to Svitzer submission – A91545

charges by an amount in excess of 30% compared to a reduction of only 15% for a non-exclusive licence.

- (b) As noted in the 7 August 2016 submission by Townsville Shipping Agencies Pty Ltd with respect to authorisation A91545, the certainty offered by exclusive licences means that towage service providers responding to a competitive tender process are more likely to offer to (and be able to) **invest in new or upgraded tug boats** resulting in better service delivery to customers and improving the ports' capabilities to handle larger vessels. This is because an exclusive licence gives them the certainty that they need to amortise the high sunk costs associated with market entry.⁶
- (c) Another factor relevant to the high sunk costs of market entry is that a non-exclusive model has the **potential to discourage new entrants** because the incumbent has already incurred those sunk cost and is therefore able to engage in aggressive competitive activities that may discourage new entrants. Adopting an exclusive licence arrangement helps address this by enabling new entrants to more fairly compete with incumbents.
- (d) A non-exclusive model involves higher risks with respect to the **stability of the towage service providers** operating at the ports. This is because a non-exclusive arrangement for low-volume ports increases the prospect of one of the providers exiting the market (such ports are unable to sustain two towage service operators for a prolonged period of time).⁷ Such an event can be disruptive to the port operations and customers, result in job losses upon exit and can leave behind a single operator that is able to then command comparatively higher towage rates. In short, the Applicants are motivated not just to secure the best price from the market but also to ensure the stability of the towage service across the term of the awarded contract. This is most effectively achieved by offering an exclusive licence.
- (e) The exclusive licence model that is proposed to be adopted by the Applicants will be coupled with a competitive tender process (namely, the competitive tender process described in authorisation A91545). The Applicants submit that the public benefits claimed in the Notification are inextricably tied to that competitive tender process.

The Productivity Commission acknowledged **the efficiency and competition outcomes that can result from combining an offer of exclusive licences with a competitive tender process**.⁸ The reasons

⁶ Ibid, page 157 noting the experiences of FPA.

⁷ Ibid, page XXVI - XXVII.

⁸ Productivity Commission, *Inquiry report: Economic regulation of harbour towage and related services* (20 August 2002), pages 156-157.

Merger and Authorisation Review Division
Australian Competition and Consumer Commission
Response to Svitzer submission – A91545

why this combination results in increased efficiency and competition are explained on pages 156-158 of the Productivity Commission report.

The outcomes of this approach are also described by Justices Burchett and Hely in the Federal Court of Australia decision of *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (emphasis added in underline):

An exclusive licensee will be insulated from competitive pressures for the period of the licence, subject to any pressures associated with the extension or renewal of the terms of the licence. There will be a shift from a natural monopoly to a legally enforced and controlled monopoly, but the market behaviour of the successful tenderer will be regulated by the terms of the agreement which results from the competition for the market brought about by the tender process. The tender process creates competition between rivals for the opportunity to supply towage services for the next five years on the basis that the prices will be capped. Competitive outcomes are prescribed or sought within the contract entered into as a result of the bidding process, rather than through the operation of market forces during the term of the contract.⁹

In conclusion, rather than relying on the instability and disruption to port operations that can arise from allowing market forces to affect the provision of towage services at the ports, the Applicants argue that, for the ports the subject of application A91545, better and more certain public benefits can be achieved by the competition **for** the market brought about by a competitive tender process for exclusive towage licences.

Those benefits are with respect to the stability of the towage services offered, the quality of those services and with respect to the price payable by port customers for those services.

3 Conclusion

3.1 Thank you for the opportunity to respond to the Svitzer submission dated 29 September 2016.

3.2 Please feel free to contact me or James Cameron to discuss this letter.

Yours faithfully

Corrs Chambers Westgarth



Eddie Scuderi
Partner

⁹ *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* [2000] FCA 1381, [25].