

## Public Register version submission to Australian Competition and Consumer Commission



by Smit Lamnalco Towage Australia Pty Ltd

Regarding Exclusive Dealing Notification N10000453 lodged  
by Gladstone Ports Corporation Ltd (GPC)

6 April 2018

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## 1. Executive summary

1. Smit Lamnalco Towage Australia Pty Ltd (**Smit Lamnalco**) is pleased to have the opportunity to provide the Australian Competition and Consumer Commission (**ACCC**) a submission in response to the exclusive dealing notification N10000453 (**Notification**) lodged by GPC on 13 March 2018.
2. For the reasons set out in this submission, Smit Lamnalco supports the **Notification** in respect of a new exclusive licence for towage services in the Port of Gladstone.
3. Smit Lamnalco considers that the net public benefits of granting a new exclusive licence are likely to be substantial and will clearly outweigh any detriments to the public which might arise.
4. In this case, net public benefits will be likely to be generated for the Port of Gladstone, shipping clients of the port, the coal, resources and LNG export industries and others affected by the safety of shipping operations in the Port.
5. Smit Lamnalco strongly believes that, since 2011, when Smit Lamnalco commenced operations under the current licence, the exclusive towage licence in Gladstone has delivered numerous net public benefits to these stakeholders during its term. In particular these net public benefits include:
  - (a) **Increased competitive pressure on** Smit Lamnalco in relation to rates and service levels for customers;
  - (b) **Operational Efficiency** resulting in lower costs for the users of the Port;
  - (c) **On time vessel arrivals and departures** resulting in lower costs for the users of the Port; and
  - (d) **a safe, high quality towage service.**
6. Smit Lamnalco understand that the Act allows the Notification to stand, unless the ACCC forms the view that the notified conduct:-
  - (a) has the purpose or effect or likely effect of substantially lessening competition in a relevant market, and
  - (b) is not likely to result in a benefit to the public, or
  - (c) is likely to result in a benefit to the public but the benefits will not outweigh the detriment to the public from allowing the conduct to occur.
7. The fact that an exclusive licence in Gladstone has delivered significant public benefits to date provides strong support for the ACCC not to object to another Exclusive licence in Gladstone, if the market conditions and demand for towage services at the port have not materially changed to date and are unlikely to change in the foreseeable future.
8. Smit Lamnalco submits that, indeed, the towage demand conditions have not materially changed in Gladstone since the demand for towage services at the Port was last considered in 2012, and further, that those conditions are not likely to change materially until at least 2028 or thereafter.
9. Allowing the Notification to stand would also be consistent with the recent decisions of the ACCC on these issues in other ports and markets.

10. Smit Lamnalco submits that the “open competition” and “non-exclusive” two-operator model for towage services has largely proven unsuccessful in most Australian ports. Smit Lamnalco has observed that most Australian ports have not been able to efficiently support a second towage operator, or have only done so temporarily.
11. Smit Lamnalco submits that the available evidence clearly indicates the likely level of future towage demand in the Port of Gladstone is insufficient to support a second towage operator on an efficient basis. This conclusion is consistent with previous findings of the ACCC and of the Productivity Commission.
12. In this submission, Smit Lamnalco will explain its position based on its experience in Gladstone.
13. In 2014, SMIT Marine became a wholly owned subsidiary of, Smit Lamnalco. In this submission, references to "SMIT" or "Smit Lamnalco" include reference to both SMIT Marine and Smit Lamnalco.

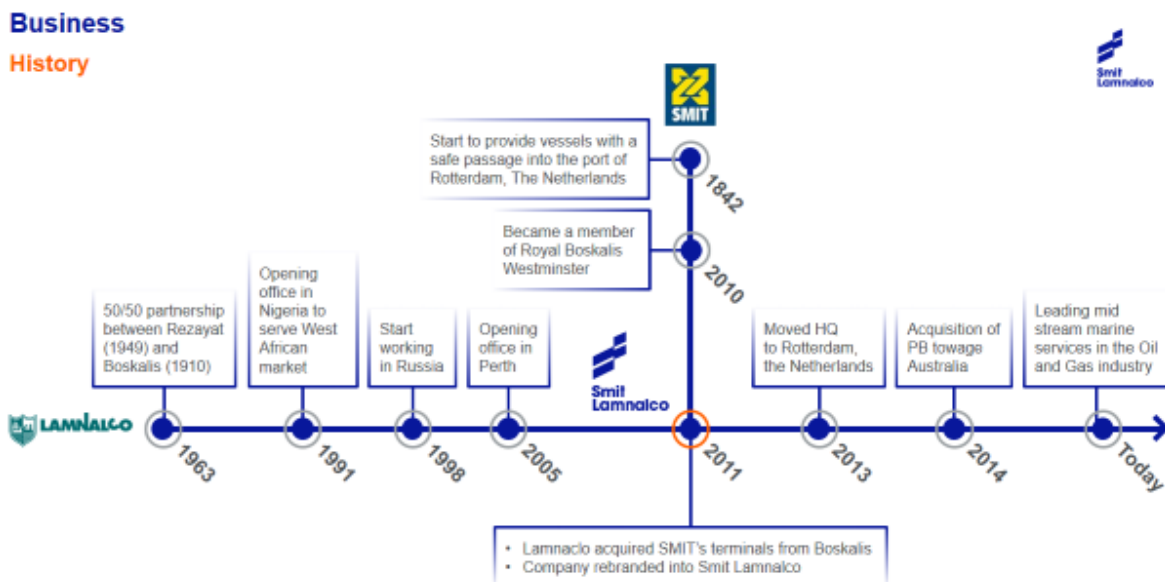
## 2. Background to Smit Lamnalco and its activities under the current exclusive licence

14. This section sets out background information regarding Smit Lamnalco and its activities conducted under the current exclusive licence at the Port of Gladstone.

### 2.1 Smit Lamnalco

15. Smit Lamnalco is highly experienced in operating successful and viable towage operations and understands the competitive dynamics involved in comparing an exclusive to a non-exclusive model. Smit Lamnalco is also an acknowledged LNG specialist, with over 200 vessels and 2,500 people working in 30 countries worldwide, and a leading international towage operator, focusing on mid-stream oil, gas and mining sectors.

16. A summary of Smit Lamnalco's business history is set out in the diagram below.



17. Smit Lamnalco's strong linkages to the shareholder Boskalis Group international joint ventures, including Keppel Smit in SE Asia, Saam Smit in the Americas and most recently Kotug Smit in Europe also bring a wealth of specialised harbour towage and emergency response experience, including salvage, as part of an expansive global network.

18. Smit Lamnalco's flagship investment in Gladstone was supported by the 2015 acquisition of PB Towage Australia, essentially to bring scale and capacity to their regional interests.

19. Smit Lamnalco Australia has a modern, multi-functional fleet of 40 vessels and 300 people currently offering services, principally harbour and terminal towage services, in 10 ports, including Gladstone, Mackay, Townsville, Weipa, Port Moresby, in addition to subcontract operations in Brisbane, Sydney, Melbourne and Newcastle.

## 2.2 Harbour towage under the current licence

20. Smit Marine Australia Pty Ltd holds the Licence for harbour towage and LNG terminal towage at Gladstone Port (the **Port**) until 31 December 2018, on an exclusive basis.
21. The Licence was originally issued in December 2009, following a competitive tender process in which a number of parties lodged tenders to provide towage services in the Port. The term of the Licence commenced on 1 January 2011. The terms of the Licence are confidential.
22. At the time of that tender, the anticipated requirements for towage in the Port involved five harbour tugs and a requirement for back up with a 36 hours response time. To fulfil this back up requirement Smit Marine positioned the *SMIT Leopard* in the port. The requirements for future LNG towage were anticipated, although not definite, given that, at that stage the LNG development plans had not been finalised.
23. On 1 January 2011 Smit Marine commenced harbour towage operations in the Port and commissioned five new tugs which were purpose built to meet the requirements of the Port. This investment in establishing these harbour towage operations was approximately **[Confidential to Smit Lamnalco]** in the period 2009 to 2011, made up of vessel costs **[Confidential to Smit Lamnalco]**, mobilisation costs **[Confidential to Smit Lamnalco]** and start-up costs **[Confidential to Smit Lamnalco]**.
24. Between 2012 and 2015 Smit Marine invested a further **[Confidential to Smit Lamnalco]**, having a further five identical, purpose built LNG escort tugs constructed and delivered to Gladstone. The LNG tugs were designed in close conjunction with GPC, MSQ and the LNG proponents during the course of 2011 and 2012. Smit Marine commissioned the new LNG fleet and trained additional crews specifically to the operational and safety requirements of GPC and the LNG proponents for the new trade. This investment comprised **[Confidential to Smit Lamnalco]** in construction and delivery of the five LNG tugs and a further **[Confidential to Smit Lamnalco]** in mobilisation costs and **[Confidential to Smit Lamnalco]** in start-up costs, to date.
25. Over the term of the Licence Smit Marine has invested some **[Confidential to Smit Lamnalco]** in port specific assets, training, support systems and set up of in its towage operations at the Port.

## 2.3 Development of LNG towage under the current licence

26. When the Licence was first issued to Smit Marine in 2009, it was recognised by GPC and Smit Marine that the development of the LNG terminals at Curtis Island would require towage services to be available to support LNG vessels entering the port, once the LNG trains entered production.
27. The effective operations of the new trade in the Port depended, for safety reasons, upon LNG shipping being reliably supported in all weather conditions by higher powered, specialised escort notated LNG tugs, as distinct from the existing harbour towage requirements.
28. On 9 September 2012, GPC gave notice to Smit Marine (later varied on 5 December 2012) requiring Smit Marine to commit to two LNG tugs from 5 April 2014. On 31 October 2013, GPC gave a second notice requiring another three LNG tugs to be procured and available within a period of 12 to 18 months (referred to as the **LNG Notices**). The LNG Notices required Smit Marine to commit to five additional LNG tugs in total.
29. A variation of the Licence was discussed and agreed with GPC in conjunction with the extension of the option in the Licence for the period 2015 to 2018. The variation was signed on 23 October 2014.

30. The first LNG tug arrived in Gladstone on 23 November 2014 and the second arrived on 28 January 2015. Subsequently the remaining three tugs arrived over the course of 2015.

31. The first LNG vessel arrived in the Port of Gladstone on 26 December 2014.

## 2.4 Costs incurred by Smit Marine to provide LNG towage services

32. Smit Lamnalco custom built five LNG escort tugs at the Sanmar shipyard in Turkey.

33. The LNG tugboats ordered by Smit Lamnalco were specially designed, in close conjunction with all stakeholders (GPC, MSQ and the LNG Industry) to meet the towage requirements of GPC and of the LNG terminal operators. In particular:

- (a) Each new LNG tug has a larger (80 tonne) bollard pull than a harbour tug, to assist the berthing and manoeuvring of LNG carriers with close attention to safety in a range of weather conditions;
- (b) The vessels are equipped with gas detectors and gas-type dampers on all air inlets and outlets for safety reasons, if there was a gas leakage; and
- (c) All electrical equipment including towing winches, navigation lights, outside lights and emergency stop buttons are of explosive proof design.

34. Prior to commissioning the five new LNG tugs, Smit Lamnalco arranged for extensive training of crews to operate the vessels, using the Smart Ship Australia simulator in Brisbane. This involved pilots and tug captains undergoing terminal specific training in a range of different simulated weather states and emergency response scenarios.

35. Additionally, on arrival of the tug vessels in Gladstone, further training was undertaken on board the vessels, overseen by experienced training masters.

36. Between 2012 and 2015 Smit Lamnalco invested approximately **[Confidential to Smit Lamnalco]**, in having the five LNG tugs in place and fit for use with fully commissioned crews trained to meet the operational and safety requirements of GPC, and the LNG terminals. This investment was made up of **[Confidential to Smit Lamnalco]** in construction and delivery of the five LNG tugs to Gladstone, a further **[Confidential to Smit Lamnalco]** in mobilisation costs, and **[Confidential to Smit Lamnalco]** in start-up costs.



### 3. Smit Lamnalco's experience in the Australian Industry

37. Having acquired PB Towing in February 2015, Smit Lamnalco's experience in the Australian market reaffirmed its view that it is not viable for a second operator to compete in most ports, even in large ports, without the protection of port regulation in the form of an exclusive towing licence.

38. In August 2002, the Productivity Commission published an Inquiry Report into the economic regulation of harbour towing and related services, which concluded that most, if not all, Australian ports can efficiently support only one towing service provider in the longer term. Specifically, the Productivity Commission report found that:

*'Enduring competition within most, if not all, Australian ports is unlikely due to low levels of demand, 'lumpy' investments and economies of scale. In the longer term, only one operator is likely to survive in any particular port.'*

39. Smit Lamnalco notes that this 2002 finding of the Productivity Commission is consistent with Smit Lamnalco's market observations to-date in 2018.

40. Smit Lamnalco had been one of the two physical operators in the ports of Newcastle, Botany, Brisbane and Newcastle. However, this proved to be unsustainable. In September 2015, Smit Lamnalco ceased operating tugs in its own right in the ports of Newcastle, Melbourne and Sydney and in February 2018, Brisbane. The ACCC has recently recognised this phenomenon.<sup>1</sup>

41. While a number of non-exclusive towing licences do exist in various forms, those arrangements have not attracted a second operator, reinforcing the conclusion that the towing market at each of those ports is a natural monopoly at current levels of demand. The absence of an exclusive licence has also meant that there has been limited competitive tension to constrain the incumbent (as is elaborated upon later in this submission). Unless the operator is protected by exclusive licensing, the cost of oversupply is prohibitive.

#### 3.1 Forecast Demand for Towing Services at Gladstone

42. Towing demand in the Port of Gladstone will, for the foreseeable future, be at a level which supports one operator. The port will continue to exhibit features of a natural monopoly in respect of towing services. These features are discussed at paragraph 56 below.

43. In particular, the economic cost of providing towing services is minimised under a single provider, given the forecast demand at Gladstone over the period. This is principally because the number of tugs required for one operator to service the current and forecasted level of demand is less than that required for two operators to service that demand. This is discussed further at paragraphs 66 to 70 below.

44. Smit Lamnalco has reviewed the submission by GPC in support of the Notification and agrees with the findings that:

- (a) the number of vessel calls at Gladstone in FY2017 has not reached the previously forecast levels (see paragraph 9.2(a));
- (b) the number of standard harbour calls has remained static (see paragraph 9.2(b));
- (c) there has been an increase of overall tug jobs with LNG exports; and

<sup>1</sup> ACCC, *Statement of Reasons in respect of the ACCC's review of a notification lodged by Port of Townsville Limited and Far North Queensland Ports Corporation Limited*, 9 December 2016, para. 19.



- (d) for FY2018, the GPC forecast of approximately 8928 tug jobs for the current year is reasonable (see paragraph 9.2(c)).
45. Smit Lamnalco has reviewed GPC's forecast of tug jobs until 2027, as set out in **Figure 3** of GPC's submission, and regards that forecast as reasonable, based on the limited information available to Smit Lamnalco and its experience in operating at the Port of Gladstone.
46. Smit Lamnalco's view is that the level of demand for tug jobs at Gladstone is unlikely, in the foreseeable term, to support the efficient operation of two towage operators. Smit Lamnalco believes that two efficient operators would require a level of demand much higher than 8,000 jobs per year.

## 4. There are net public benefits of granting an exclusive licence for towage services at the Port of Gladstone

47. Smit Lamnalco submits that there is a net public benefit associated with granting a new exclusive licence for towage services at the Port of Gladstone for the following reasons.

### 4.1 A tender for an exclusive licence will encourage increased competitive pressure

48. In 2009 the certainty of an exclusive licence encouraged SMIT (now Smit Lamnalco) to participate in the Gladstone tender process. Based on its experience over the past 9 years, SMIT would adopt a more cautious approach in considering any proposal to enter into the Port of Gladstone, or any other similar Port in Australia, under a different towage arrangement than an exclusive towage licence. This is due to the substantial upfront investment required to establish operations and the uncertainty around securing a level of tug jobs sufficient to recoup that investment over the licence term.

49. In 2009, at the time of assessing the proposed Gladstone Licence, SMIT acknowledged the market position held by a number of incumbent towage operators across Australian Ports. The barriers to enter the port of Gladstone and other ports in the Australian market were, and arguably remain, high. In this context, SMIT considered that the risk of not recovering its initial investment at the Port of Gladstone was too great if it was to compete with other towage operators at the then current level of demand for towage jobs at the port.

50. In the absence of the security offered by GPC in 2009 with its 5 year + 3 year option, SMIT would not have bid for the Gladstone licence in the same manner as it did. The security of the exclusive licence allowed SMIT to focus on competition in the delivery of a high quality, efficient service against the lowest possible cost, rather than focus on mitigating the risk of insufficient cost recovery.

51. Without that security, Smit Lamnalco would likely have considered including a premium in the towage rates quoted in the bid for the current licence to account for the higher risk of not fully recovering its establishment and operating costs. At the time, SMIT believed it was likely that the other (new entrant) bidders for the Gladstone tender would have done the same or not have bid for the licence, if it was not exclusive.

52. Based on its experience in tendering for the current towage licence at the Port of Gladstone, Smit Lamnalco expects that the offer of an exclusive licence, in any port which cannot viably support more than one operator, is likely to deliver a competitive level of tug rates without compromising the quality of service, due to competitive tension in the tender process. The high barriers to entering the market for towage services reduce the scope for the same level of competitive tension to be achieved without exclusivity.

53. With more bidders, and with a more attractive prize<sup>2</sup>, it can be expected that competition will be fiercer for an exclusive licence. On the other hand, experience has shown that non-exclusive licences have invariably resulted in fewer competitive bids and a much stronger prospect that the incumbent will be re-installed.

54. This occurred in the bidding for the licences at the Ports of Fremantle and Kwinana in 2001. The port authorities for these ports offered bidders the option of tendering for an exclusive or non-exclusive licence. Aside from Svitzer, who was the incumbent towage operator at these ports, all of the other bidders opted to tender for an exclusive licence. When the port authorities later decided to limit the tender to a non-exclusive licence, these bidders (which included a number of credible international towage operators) chose to withdraw from the

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<sup>2</sup> Due to eliminating uncertainty relating to the risk of not recovering large investments.

tender, rather than tender for a non-exclusive licence. Smit Lamnalco considers that the experience at these ports illustrates that the degree of competitive tension for the market is greater where an exclusive licence is on offer.

55. These experiences are unlikely to be coincidental. Over the past years, Bunbury, Townsville, Mackay, and Gladstone have all seen new towage providers supplant the incumbent as a result of competitive bids for exclusive licences.

#### **4.2 Fleet integration and operational efficiency from the existing Licence – achieving economies of scale and scope for public benefit**

56. There are a number of features of the Port of Gladstone which mean that it has particularly strong economies of scale (in terms of the size of the tug fleet). These include:<sup>3</sup>
- (a) a high proportion of bulk cargo (coal and other dry bulk cargo), with bulk ships typically requiring a higher number of tugs per vessel movement than container vessels with bow thrusters. For example, towage requirements differ from a single tug for the smaller “handy Size” vessels to 3 Tugs for the larger Capesize Coal carrier and up to four tugs for the LNG vessels;
  - (b) relatively longer duration of tug jobs at the Port of Gladstone, given the layout of the port and location of the LNG Terminals. In particular, an escort tug job can take upwards of 8 hours; and
  - (c) tidal constraints, whereby movements are compressed around the tide and dictate port capacity.
57. The ACCC has recognised these features as existing at the Port of Gladstone. In its review of the existing operating licence in 2012, the ACCC found that:
- “These features of the Port of Gladstone increase the minimum scale for new entry because, in order to meet time sensitive shipping schedules, an operator needs more tugs to service a given number of vessels during peak periods, compared to other ports where the trips are often shorter, tend to require fewer tugs per vessel call, and are more evenly spread out over the day”.*<sup>4</sup>
58. One of the greatest benefits of the current Gladstone towage fleet configuration is the flexibility afforded by the interchangeability of the original harbour tugs and larger LNG tugs, that is, the economies of scope available to a single operator, as discussed below.

#### **Public benefit as a result of Smit Lamnalco's integrated fleet and crew at the Port of Gladstone**

59. One of the biggest benefits of the current Gladstone towage fleet configuration is the scheduling flexibility afforded by the interchangeability of the original harbour tugs and larger LNG tugs.
60. Specifically, Smit Lamnalco's current operations at the Port of Gladstone provide efficiencies from the joint provision of LNG and traditional harbour towage services. These are:

<sup>3</sup> ACCC, *Statement of Reasons in respect of the ACCC's review of a notification lodged by Gladstone Ports Corporation*, 27 June 2012, para. 4.39.

<sup>4</sup> ACCC, *Statement of Reasons in respect of the ACCC's review of a notification lodged by Gladstone Ports Corporation*, 27 June 2012, para. 4.39.

- (a) the capability for the escort notated 70 tonne harbour tugs to assist in LNG manoeuvres, in all cases except the most marginal conditions; and
  - (b) the 80 tonne 'gas' tugs to handle larger dry bulk carriers allow for maximum scheduling flexibility.
61. Similarly, an integrated manning roster ensures a single pool of highly trained tug crews service both LNG and harbour towage requirements, in the most flexible, operationally efficient manner. This integrated rostering system also manages tug crew fatigue and other port safety requirements.
62. Smit Lamnalco has also invested in providing tug master training to its tug service crew and in ensuring their participation in joint simulation exercises. This is a long term investment that will pay ongoing, tangible benefits for the Port, particularly where towage is a key factor in the safety, security and success of the port.
63. Employee relations also is a key success factor, with Smit Lamnalco experiencing the benefits of a direct engagement model through working with our employees and their representatives in an honest, open and consultative manner to achieve the most optimally efficient service delivery outcomes and world's best practice in the towage operation at the Port of Gladstone.

#### ***Training, investment and other benefits***

64. Vessel operators calling at the Port of Gladstone have benefitted from the substantial investment in crew training made by Smit Lamnalco throughout the term of the existing licence. In particular, the following benefits have been realised as a result of the following training initiatives provided by Smit Lamnalco:
- (a) Vessel specific familiarization and induction;
  - (b) the reduction of the required LNG tug escort crew from 4 to 3 crew members, due to the relatively larger and specialised employee group employed and trained by Smit Lamnalco;<sup>5</sup>
  - (c) Smit Lamnalco's ASD Tug Master Training program and Check Master programs;
  - (d) Specialist Marine Engineer drive train courses; and
  - (e) LNG simulation exercises in close conjunction with GPC, MSQ and the pilots, including emergency manoeuvres at the Smart Ship simulator in Brisbane.
65. More recently, Smit Lamnalco has further invested in developing an in-house program of upgraded Tug Master training.

#### ***To maintain this level of service with multiple towage operators would lead to overcapacity, inefficiencies and higher costs for port users***

66. The Port of Gladstone could not maintain the current number of 10 tugs with two operators without this leading to slowing shipping movements and reducing the efficiency of the port.

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<sup>5</sup> The exclusive license facilitated a flexible employee group at the Port of Gladstone, such that Smit Lamnalco is able to identify personnel with the right attributes for development and training as LNG tug escort crew. This enhances the efficiency of each member of the LNG tug escort crew, allowing Smit Lamnalco to safely reduce the number of escort crew required for an LNG tug job from 4 to 3. Smit Lamnalco has passed on the associated cost savings directly to the port users.

67. To maintain the high efficiency in the Port of Gladstone, all towage operators would be required to hold sufficient tugs and crews to cater for demand from vessels. As the towage demand conditions are unlikely to change materially prior to 2028, this will likely result in inefficient overcapacity at the Port of Gladstone.
68. Further, multiple towage providers at the Port of Gladstone would likely result in a cost penalty for port users. This would be the result of the duplication of capital and costs required by the newer providers to achieve the same level of service.<sup>6</sup>
69. On the basis of the above, Smit Lamnalco considers that allowing another exclusive licence provides a net public benefit in due to:
- (a) reducing the ongoing costs of towage operations at the port, with any one towage operator able to operate at a lower total cost than two operators; and
  - (b) avoiding the costs associated with establishment of additional towage providers at the Port, such as the duplication of operating systems and the on-boarding of additional crew.
70. Allowing the exclusive licence operating model to continue will also achieve the economies of scale and scope associated with providing towage services in the Port of Gladstone.

#### **4.3 The Pricing Framework under the exclusive licence has ensured that towage rates have decreased during the term**

71. The investment made by Smit Lamnalco to establish its towage operations at the Port of Gladstone was undertaken on the basis that those costs would be recovered over a number of years, through normal operating charges levied in accordance with the strict pricing frameworks set by terms of the licence.
72. Smit Lamnalco recovers its costs through the pricing mechanism set under the current exclusive licence. That mechanism comprises a pricing framework for standard harbour towage and another framework for LNG Towage. Under both frameworks, Smit Lamnalco is restricted from increasing prices and can only do so based on prudent and efficient incremental costs, in accordance with the exclusive licence.<sup>7</sup>
73. Smit Lamnalco confirms the accuracy of PwC's explanation of the pricing frameworks under the current licence in the PwC report.<sup>8</sup>
74. Smit Lamnalco's experience is that these pricing frameworks have been effective in ensuring that there is a strong incentive for Smit Lamnalco to control its costs to ensure efficiency under both the harbour and LNG towage pricing mechanisms. By employing an annual revenue requirement and return on cost model, these pricing mechanisms promote the interests of port users by requiring Smit Lamnalco to pass on any cost savings to port users.
75. Smit Lamnalco confirms the accuracy of the analysis set out in section 2.6 of the PwC report.
76. In that analysis, PwC identifies that standard harbour towage charges have '*decreased significantly*' during the term of the licence, with the FY2018 charges being approximately

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<sup>6</sup> PricewaterhouseCoopers, *Future towage arrangements at the Port of Gladstone* (March 2018), at page 52.

<sup>7</sup> *Gladstone Ports Corporation Limited Submission in support of notification for exclusive dealing* (13 March 2018), at page 25.

<sup>8</sup> PricewaterhouseCoopers, *Future towage arrangements at the Port of Gladstone* (March 2018), at pages 13-15.

14.6% lower than those for FY2012.<sup>9</sup> PwC also identifies that towage costs at the Port of Gladstone are 'towards the lower end of the cost range' when compared with other ports.<sup>10</sup> This illustrates the effectiveness of the pricing frameworks in ensuring efficiency in Smit Lamnalco's provision of towage services at the Port.

#### **4.4 Key control mechanisms in the Exclusive Harbour Towage Licence**

77. Smit Lamnalco has observed that GPC has taken a responsible and considered approach to setting minimum standards under the current licence. This cautious and reasonable approach to standards has been reinforced during extensive computer simulation trials conducted by Smit Lamnalco during the course of the current licence.
78. The licence places extremely stringent conditions on Smit Lamnalco in terms of tug availability, substitute tugs, service levels, safety and internal/external audit requirements. GPC has formulated key performance indicators to apply to Smit Lamnalco for operations, safety, customer satisfaction and pricing.

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<sup>9</sup> PricewaterhouseCoopers, *Future towage arrangements at the Port of Gladstone* (March 2018), at page 16.

<sup>10</sup> PricewaterhouseCoopers, *Future towage arrangements at the Port of Gladstone* (March 2018), at page 17.

## 5. Introducing more than one towage operator at the Port of Gladstone would be inefficient

79. Demand for towage services at the Port of Gladstone is based on expected shipping volumes from the various industries at the Port, including coal, LNG, resources, and general cargo. Demand for towage services increases as the number of calls made by commercial vessels increases. However, the number of vessel calls cannot be relied upon alone, as the size of the vessels entering and existing the port impacts on the number and size of tugs needed to service those vessels.
80. Based on the forecast provided in the PricewaterhouseCoopers Report attached to the Notification, the expected demand for towage services in the Port of Gladstone would not be sufficient, in Smit Lamnalco's view to support a second towage operator at the Port.<sup>11</sup>
81. This chapter sets out the economic rationale for a single operator model at the Port of Gladstone, as well as a summary of previous consideration by regulators of the single operator model at other Australian ports.
82. Smit Lamnalco is firmly of the view that a single towage service provider operating under an exclusive licence is the most efficient and cost effective towage structure for the Port of Gladstone and users of the port.

### 5.1 Economic rationale for a single operator model in Gladstone

83. Generally, competition is most likely to deliver an efficient market outcome, in terms of product quality and cost, and the allocation of resources. However, competition is often not preferable in markets characterised by the following conditions:
- (a) investments are indivisible, or 'lumpy', i.e. when the minimum investment required to efficiently operate in the market are large relative to the size of the market and can only be undertaken in large increments;
  - (b) investments involve large, 'sunk' cost , i.e. costs that cannot be recouped once they have been incurred;
  - (c) 'economies of scale' exist, in particular, when average costs decline as output increases, allowing for one producer to supply the market at a lower cost than two or more producers; and
  - (d) 'economies of scope' exist, i.e. where it is less costly to have one firm supply a number of products or services than to have each product or service provided by a different firm. In other words, it is more efficient to have only one supplier of the relevant products in the market.
84. These conditions are the typical indicia of markets known as 'natural monopolies', where, the demand for a good, service or facility is such that one firm can meet that demand at a lower cost than can two or more firms.
85. Smit Lamnalco supports the GPC's submission in the Notification that the market for towage services at the Port of Gladstone, comprising towage for both the harbour and LNG terminals, exhibits the characteristics of a natural monopoly. In particular, the towage operator at Gladstone must:

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<sup>11</sup> PricewaterhouseCoopers, *Future towage arrangements at the Port of Gladstone* (March 2018), at pages 12-13.



- (a) invest in a fleet of tug boats sufficient to service the vessels visiting the port, without causing delays from vessels waiting for tug jobs, the investment in a tug boat fleet is large and indivisible;
- (b) incur upfront sunk costs associated with crew training and modifications to tugs to meet Australian requirements, as well as the back-end costs of tug demobilisations and crew redundancy payments;
- (c) achieve economies of scale, with large fixed costs and low ongoing operational costs (with the provision of both LNG and harbour towage); and
- (d) achieve economies of scope through operational efficiencies from combining tug fleets and a single workforce (crew) to provide harbour and LNG terminal services.

86. In markets with natural monopoly characteristics, the most efficient outcome is typically achieved through a single operator that faces some price, and often quality, constraints. This is consistent with the ACCC's reasons for its 2009 decision to allow an exclusive licence at the Port of Gladstone.<sup>12</sup>

Smit Lamnalco supports the analysis in the Notification that an exclusive licence will achieve the most efficient outcome and deliver net public benefits for all users of the Port.

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<sup>12</sup> ACCC, Decision in respect of the ACCC's review of a notification lodged by Gladstone Ports Corporation, 1 May 2009, at para. 4.21.

**6. Allowing the Notification to stand is consistent with the ACCC's approach in previous matters**

- 87. Smit Lamnalco considers there to be a strong case for the ACCC to not object to another exclusive licence for the Port of Gladstone.
- 88. Granting another exclusive licence would be consistent with the ACCC's recent approach in considering the relevant issues in Gladstone and other ports.