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25 June 2018

To	Mr David Hatfield Director – Adjudication Branch, Merger and Authorisation Review Australian Competition & Consumer Commission 23 Marcus Clarke Street Canberra ACT 2601 **david.hatfield@accc.gov.au**	Ms Elizabeth Batten A/g Assistant Director – Adjudication Branch, Merger and Authorisation Review Australian Competition & Consumer Commission 23 Marcus Clarke Street Canberra ACT 2601 **elizabeth.batten@accc.gov.au**
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Dear David and Elizabeth

N10000453 – GPC's response to Svitzer's submission dated 11 June 2018

Thank you for providing us with a copy of the submissions lodged with the Commission by:

- Svitzer Australia Pty Ltd (**Svitzer**) (including Synergies Economic Consulting's Report) on 11 June 2018; and
- Inch Cape Shipping Services on 31 May 2018.

We have been instructed by the Gladstone Ports Corporation Limited (**GPC**) to respond to the submission lodged by Svitzer (including Synergies Economic Consulting's Report) as follows.

It is not correct to contend, as Svitzer does,[1] that the conduct described in the Notification "requires GPC to essentially act as a quasi-regulator". The conduct described in the Notification reflects GPC's statutory powers and functions and its obligations as a Government Owner Corporation (**GOC**) Port Authority. This is evidenced by:

1 GPC is a Government Owned Corporation with statutory powers and functions that relate to the Port and its users as a whole

GPC is a GOC under the *Government Owned Corporations Act 1993* (Qld) and a "port authority" under the *Transport Infrastructure Act 1994* (Qld).

GPC's statutory powers and functions include the following.

[1] See page 2 of Svitzer's submission dated 11 June 2018.

1.1 Functions of "port authorities" under the *Transport Infrastructure Act 1994* (Qld)

Section 275 of the Transport Infrastructure Act concerns the functions of "port authorities." It provides:

(1) *The functions of a port authority are –*

(a) *to establish, manage, and operative effective and efficient port facilities and services in its port; and*

(b) *to make land available for –*

(i) *the establishment, management and operation of effective and efficient port facilities and services in its port by other persons; or*

(ii) *other purposes consistent with the operation of its port; and*

(c) *to provide or arrange for the provision of ancillary services of works necessary or convenient for the effective and efficient operation of its port; and*

(d) *to keep appropriate levels of safety and security in the provision and operation of the facilities and services; and*

(e) *to provide other services incidental to the performance of its other functions or likely to enhance the usage of the port; and*

(f) ...

(g) *to perform any other functions as provided under this or another Act or under the regulations.*

1.2 "Port services functions" of "port authorities" under the *Transport Infrastructure Act 1994* (Qld)

Section 276 of the Transport Infrastructure Act provides for "port services functions" of "port authorities". It states:

(1) *A port authority has, in addition to its functions under section 275, the function of providing port services and ancillary services –*

(a) *whether in or outside its port; and*

(b) *whether in or outside Australia; and*

(c) *whether for another port authority or for someone else.*

(2) *A GOC port authority is taken to have had the function mentioned in subsection (1) from when it became a GOC.*

1.3 "Powers of "port authorities" under the *Transport Infrastructure Act 1994* (Qld)

Section 278 of the Transport Infrastructure Act sets out the powers of "port authorities". It states:

(1) *In addition to the power of a port authority has because of this chapter, each port authority has all powers necessary or convenient for performing its functions.*

(2) *Without limiting subsection (1), a port authority's power include power –*

(a) *to dredge and otherwise maintain or improve navigational channels in its port; and*

(b) *to reduce or remove a shoal, bank or accumulation in its port that, in the port authority's opinion, impedes navigation in its port.*

(3) *A port authority is not liable to pay royalties or similar charges for extractive material removed –*

(a) *to maintain or improve navigational channels in its port, or improve navigation in its port, if the material is disposed of –*

(i) *in an area associated with port activities and approved by the Minister; and*

(ii) *under relevant statutory environmental controls; or*

(b) *to reclaim land that is, or is proposed to be, strategic port land.*

Section 278 of the Transport Infrastructure Act provides:

This chapter does not limit the functions or powers a port authority that is a GOC may have.

1.4 *Government Owned Corporations Act 1993* (Qld)

GPC is a GOC under the *Government Owned Corporations Act.*

Under section 102 of that Act, each GOC must prepare a Statement of Corporate Intent for each financial year.

GPC's 2016-17 Statement of Corporate Intent states:

- GPC is required to earn a commercial rate of return through improved capacity throughput and financial performance driven by efficiency whilst ensuring there is not an exploitation of monopoly power.
- GPC has a key obligation to ensure that its activities are undertaken in a manner which complies with the requirements of its approvals and does not adversely affect the environments in which it operates.
- GPC will maintain AS4801 certification for the safety management system, ensure safety compliance obligations are met and instil a positive safety culture within the workforce.

GPC's main undertakings in the Statement of Corporate Intent

GPC's operations are key contributors to the Queensland Government's objective of developing a strong, diverse economy that can withstand external shocks and provide continued jobs growth into the future. GPC directly supports the resources sector by operating the facilities required to export significant quantities of the State's vital resources (coal/aluminium/Liquefied Natural Gas (**LNG**) and other commodities) to international markets and by planning and building infrastructure to grow the region for the Queensland economy. GPC supports a diverse range of industries through the import/export of agricultural products, containerised trade and other smaller commodities.

GPC's corporate objectives for commercial stakeholders and the State of Queensland are to:

- ensure continued sustainable returns are achieved for shareholders whilst maintaining competitive charges to encourage new trade and maintaining existing trade;
- facilitate increased use of the Ports to maximum potential for the economic benefit of stakeholders;
- manage and operate an efficient and cost effective cargo handling operation;
- conduct business with a robust corporate governance framework;
- maintain effective asset management plans and processes;
- maintain effective labour resourcing plans and processes;

- develop strategies to remedy non-commercial returns where practical;
- continue to improve Port performance, productivity and reliability;
- develop significant projects in consultation with the Department of State Development, Department of Infrastructure, Local Government and Planning (**DILGO**), Queensland Treasury, Department of Transport and Main Roads and Infrastructure Queensland;
- seek support to establish the Gladstone Economic and Industry Development Board (**GEIDB**) as a single source to facilitate existing and new industry development in the region; and
- maximise existing infrastructure and Port capacity.

GPC's objectives for customers and Port users are to:

- provide and maintain cost effective Port infrastructure;
- provide cargo handling services for bulk commodities and facilitate the handling of non-bulk cargoes while being responsive to customer needs;
- provide a world class pilotage service and manage tug operations;
- ensure efficient management of the Port of Gladstone shipping channel and compliance to agreed commercial outcomes;
- develop, manage and lease land for Port purposes;
- deliver on agreed operational, commercial and contractual performance levels; and
- maintain an "open for business" culture with the aim to attract new investment and trade.

GPC's objectives for the environment, community and the State of Queensland are to:

- undertake Port activities in a manner which is consistent with the targets, actions, objectives and outcomes of the Reef 2050 Long-term Sustainability plan, and ensure that Gladstone Harbour remains a productive fishing and crabbing harbour;
- manage environmental approvals for major projects;
- implement environmental offset programs for Port development;
- maintain involvement in the Gladstone Healthy Harbour Partnership (**GHHP**);
- maintain Port security and critical infrastructure regimes;
- promote the Port of Gladstone's community facilities and seek external funding, where applicable, for future growth options; and
- identify and implement energy efficient and long term sustainability projects.

1.5 Points of differentiation between a GOC "port authority" and a private business

As a GOC "port authority" with statutory powers and functions which oblige GPC to:

- "establish, manage, and operate effective and efficient port facilities and services in its Port";
- "provide and arrange for the provision of ancillary services and works necessary or convenient for the efficient operation of its Port";
- "provide other services incidental to the performance of its other functions or likely to enhance the usage of the Port";

- prepare a transparent written Statement of Corporate Intent each financial year having regard to the Queensland Government's objective of developing a strong, diverse economy that can withstand external shocks and provide continued jobs growth into the future including through facilitating the increased use of its Port to its maximum potential for the economic benefit of stakeholders; and
- continue to improve Port performance, productivity and reliability,

GPC's incentives are distinguishable from those of a private business, such as Svitzer.

The overarching legitimate objectives of a private business are to maximize profits and to create options for doing so, for the benefit of its shareholders. In Svitzer's case, the following extract from its parent's most recent Annual Report evidences this.

DIRECTORS' REPORT STRATEGY AND PERFORMANCE PERFORMANCE IN 2017 | SVITZER

Svitzer improved both profitability and cash flows

Svitzer has been optimising its existing market portfolio by focusing on growth in selected markets such as Argentina and Brazil. Furthermore, Svitzer has ceased operations in locations with less strategic fit such as in Montreal, Canada.

Higher market shares in Europe and Australia and port entries in Latin America along with fleet optimisation have improved utilisation and profitability in harbour towage in 2017.

Overall, revenue in terminal towage remained flat, however, the divestment of idle fleet and other cost-reduction initiatives including reductions of administrative costs improved profitability.

→ Revenue was USD 659m (USD 642m), mainly impacted by a USD 32m increase in revenue in Australia and the Americas offset by a USD 12m decrease in revenue in Europe. Organic growth adjusted for currency development totalled 2.4%.

Svitzer's harbour towage activities increased by 3% compared to 2016, driven by increased activity in Australia and the Americas. Volumes in Australia improved during 2017 because of higher commodity exports, and because the market share for harbour towage in competitive ports in Australia was slightly higher in 2017 than in 2016.

While activity in Europe remained stable, Svitzer's market share for harbour towage in competitive ports was slightly higher in 2017 than in 2016. However, more intense competition from consolidation amongst towage providers and the increasing supply of tugs led to lower prices.

In the Americas, activity in Argentina increased in 2017, driven by towage services provided at two LNG terminals and other harbour towage activities, amongst others in Buenos Aires, where Svitzer started operations in October. In Brazil, Svitzer grew its activities, driven by new customers in the ports entered during 2017 as well as additional volumes and market share in existing operations.

In Asia, the Middle East and Africa, activity remained unchanged compared

SVITZER FINANCIAL HIGHLIGHTS

USD million	2017	2016
Revenue	659	642
Profit/loss before depreciation, amortisation and impairment losses, etc. (EBITDA)	**197**	**166**
Depreciation, amortisation and impairment losses, net	101	86
Gain on sale of non-current assets, etc., net	6	5
Share of profit/loss in joint ventures	7	11
Share of profit/loss in associated companies	1	1
Profit/loss before financial items (EBIT)	**110**	**97**
Tax	8	6
Net operating profit/loss after tax (NOPAT)	**102**	**91**
Underlying profit	**114**	**89**
Cash flow from operating activities	179	144
Cash flow used for capital expenditure	-96	-192
Invested capital	1,334	1,203
ROIC, annualised	7.9%	7.5%

44 A.P. Moller - Maersk | Annual Report 2017

to 2016, while significant cost reductions were achieved. The cost reductions related to trimming the onshore organisation as well as the divestment of idle vessels.

Cash flow from operating activities was USD 179m (USD 144m), mainly impacted by improved operational profitability. Cash flow used for capital expenditure was USD 95m (USD 192m), which was mainly impacted by fewer vessels on order, divestments of idle fleet and maintaining strict discipline on capital expenditure. In 2017, Svitzer sold 18 vessels with a cash flow impact of USD 37m.

Free cash flow amounted to USD 83m (negative USD 48m).

Svitzer's fleet increased by 13 vessels to 356 vessels, with 339 owned and 17 chartered at the end of 2017. A total of 10 vessels are on order, which will all be delivered in 2018.

The market

The activity in the harbour towage markets where Svitzer is present remains stable. For harbour towage in Europe, consolidation of the industry is ongoing, leading to stronger competitors and more intense competition.

Svitzer's strategic response is to continuously improve cost levels and productivity while utilising and expanding its global footprint to ensure closer cooperation with targeted customers. Svitzer will further develop its cooperation with the other Maersk businesses to harvest synergies through improved operational optimisation, collaboration and scaling across ports and regions.

The market activity in terminal towage remains low as oil companies continue to postpone projects. Due to the challenging economic environment and the excess supply of tugs, several oil and gas customers are seeking rate reductions leading to continued price pressure. •

FLEET OVERVIEW

	2017	2016
Number of vessels		
Owned	339	334
Chartered	17	9
Total	**356**	**343**
Newbuilding		
Delivery within one year	10	16
Delivery after one year	-	2
Total	**10**	**18**

REVENUE

Per region, USD million	2017	2016	Growth %
Australia	263	240	10%
Europe	236	240	-5%
Americas	78	69	13%
Asia, Middle East & Africa	82	85	-4%
Total	**659**	**642**	**2.6%**

Per segment, USD million	2017	2016	Growth %
Harbour towage	456	444	3%
Terminal towage	209	210	-0.3%
Eliminations	-6	-12	N/A
Total	**659**	**642**	**2.7%**

Key initiatives in 2017

To address the increased commercial pressure resulting from fewer new projects, slow growth in vessel calls and overcapacity of towage tonnage in certain geographic markets, Svitzer continues to optimise its fleet utilisation by repositioning or selling vessels. With increased market shares and an unchanged fleet, vessel utilisation has improved across the harbour towage fleet.

Within harbour towage, Svitzer has initiated operations in Santos in Brazil in Q4, and will also be entering Rio Grande in Brazil in early 2018. Both entries are being executed in close cooperation with Hamburg Süd and Maersk Line.

Svitzer has prepared for further expansion. The new terminal towage projects in Australia, Bangladesh and Costa Rica continue to progress as planned, and will commence operations in 2018. Through cooperation with APM Terminals, Svitzer has also signed new towage contracts with terminals in Poti in Georgia, and Tangier Med II in Morocco, and operations are planned to commence in early 2018 and Q1 2019, respectively.

While GPC "must ensure continued sustainable returns for its shareholder", it must also "maintain competitive charges to encourage new trade and maintain existing trade" and undertake a wide range of other activities consistent with the totality of its statutory powers, functions and obligations.

The totality of GPC's statutory powers, functions and obligations mean GPC must not operate with an overarching objective to maximise profits and create options for doing so, for the benefit of its shareholder.

Rather, GPC must sacrifice potential profits to ensure "the effective and efficient operation" of the Port as whole and take into account the needs of a large and diverse range of stakeholders, including all users of the Port. The Port is used by a diverse group of companies and individuals, each with some unique needs. All of those needs must be taken into account and weighed appropriately by GPC when performing its statutory powers, functions and obligations.

GPC has no particular interest in the identity of the towage services provider at the Port, outside of what is mandated by its statutory powers, functions and obligations.

In contrast, Svitzer has an obvious self-interest. Svitzer might be prepared to be the counterparty to an Exclusive Licence to provide towage services at the Port – it has been prepared to do so in the past – but also needs to take steps to conserve its options in the event that it does not submit an offer to become the Counterparty or, should it do so, is out-competed by another towage services provider in the competitive tender process the GPC is conducting.

Consequently, it is not correct to contend, as Svitzer does,[2] that the conduct described in the Notification "requires GPC to essentially act as a quasi-regulator". The conduct described in the Notification reflects GPC's statutory powers and functions and its obligations as a GOC.

Any contract for the provision of towage services at the Port, whether it be exclusive or non-exclusive, short-term, medium-term or long-term, will contain prices and service levels. In GPC's case, those prices and service levels will reflect its statutory powers, functions and obligations; its past experiences in securing towage services for the Port (including from Svitzer), and its understanding of best practice and market trends at other ports in Australia and other countries.

The letters of support for the conduct described in the Notification provided by the majority of users of the Port indicate that those users are comfortable with GPC's proposed conduct, including the efficiency benefits that will likely flow to them from the Exclusive Licence.

2 GPC has a complete defence from prosecution for Exclusive Dealing Conduct

Finally, it is not correct to state that "GPC is seeking immunity for a third line forcing notification."[3]

GPC sought a complete defence from prosecution for exclusive dealing conduct when it lodged its Notification on 13 March 2018. It obtained the complete defence from prosecution five days later and is now responding to submissions made by Svitzer in support of the Commission making a decision to revoke the complete defence.

The per se prohibition on third line forcing, and the dedicated statutory notice and process required to obtain the complete defence from prosecution for third line forcing, were repealed on 6 November 2017. They were replaced by a single statutory notice and process for all Exclusive Dealing Conduct, whether it be third line forcing or not.

3 GPC assessment of the counterfactual scenario

The counterfactual scenarios proposed by GPC and modelled by PricewaterhouseCoopers are based on those situations that would have a real chance of arising in absence of an Exclusive Licence.

It is GPC's understanding that it is often the case, where ports have multiple towage service providers, that they operate on the basis that each towage provider services a particular terminal. The Port of Hay Point is one such example, where there are discreet towage providers for each of the Hay Point Terminal and the Dalrymple Bay Terminal, with no competition between them.

The nature and configuration of the navigable channels within the Port of Gladstone rely on complex scheduling that effectively and efficiently optimises the available water space. The range and distribution of ship type requiring access to the Port's channels, when combined with the channel configuration, is a significant influence as to whether it would be more feasible or more efficient for multiple towage service providers to compete for each customer's demand.

It is prudent to acknowledge that the channel configuration and the range of ship types trading through the Port of Gladstone deliver some uniqueness. Further, with multiple towage operators, it is

2 See page 2 of Svitzer's submission dated 11 June 2018.

3 See page 4 of Svitzer's submission dated 11 June 2018.

considered reasonable to expect a loss of efficiencies that are otherwise gained by the proven exclusive towage licence approach.

4 GPC's response to Synergies Economic Consulting's Report

Please find attached a response prepared by PWC, on behalf of GPC, to the Report prepared by Synergies Economic Consulting and attached to Svitzer's submission dated 11 June 2018.

Please let us know if the Commission would like any additional information from GPC in support of its submissions for the Commission to allow its complete defence from prosecution for Exclusive Dealing Conduct to stand.

Yours sincerely

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Gladstone Ports Corporation
Response to Switzer supplementary submission

Gladstone Ports Corporation

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25 June 2018

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1 Introduction

This supplementary report has been prepared by PricewaterhouseCoopers (Consulting) Australia Pty Limited (PwC) in our capacity as advisors to Gladstone Ports Corporation Limited (GPC) in accordance with our engagement letter dated 6 July 2017 ('Agreement').

The supplementary report responds to the supplementary submission provided to the Australian Competition and Consumer Commission (ACCC) by Svitzer Australia Pty Ltd (Svitzer), and in particular the accompanying report from Synergies Economic Consulting Pty Ltd. This supplementary report does not seek to respond in detail to each individual assertion in Svitzer's supplementary submission, and in many respects Svitzer's supplementary submission introduces no new information from that already provided to the ACCC.

However, some claims in Svitzer's supplementary submission do warrant a response, in particular as there are areas where the supplementary submission is misleading, inaccurate or presents claims which are unsupported by relevant facts.

The information, statements, statistics and commentary (together the 'Information') contained in this supplementary report have been prepared by PwC from publicly available material, discussions with industry experts, and from material provided by GPC. PwC has relied upon the accuracy, currency and completeness of the Information sourced in the public domain and that provided to it by the GPC and stakeholders and takes no responsibility for the accuracy, currency, reliability or correctness of the Information and acknowledges that changes in circumstances after the time of publication may impact on the accuracy of the Information. The Information may change without notice and PwC is not in any way liable for the accuracy of any information used or relied upon by a third party.

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Accordingly, whilst the statements made in this supplementary report are given in good faith, PwC accept no responsibility for any errors in the information sourced or provided by GPC or other parties nor the effect of any such errors on our analysis, suggestions or report.

PwC has provided this supplementary report solely for the benefit of GPC and disclaims all liability and responsibility to any other parties for any loss, damage, cost or expense incurred or arising out of any person using or relying upon the supplementary report.

Liability limited by a scheme approved under Professional Standards legislation.

2 Response to key issues

Competition between towage providers

Svitzer's supplementary submission dedicates significant attention to various ports where multiple towage providers operate. Synergies, acting for Svitzer, considers that this evidences significant and robust competition in those markets. Based on our understanding of operational and commercial arrangements at those ports, we consider the Synergies report overstates and provides no evidence of genuine competition between multiple towage providers.

In a number of ports where there are multiple towage providers, each services a particular terminal, user or collective of customers, with no evidence of genuine contestability between these market segments. Towage arrangements at the Port of Hay Point are an example here, where there are separate towage providers for each of the Dalrymple Bay Coal Terminal and for Hay Point Coal Terminal, but with no contestability whatsoever between them.

Svitzer provided information for other Ports (including the Port of Newcastle and Port of Brisbane), claiming vigorous competition between Svitzer and SMIT despite service level agreements which exist between the towage operators at those ports. The evidence purported to support this claim is largely redacted, such that we are unable to respond to those claims.

However, we understand from GPC, through its engagement with Port customers which ship through Gladstone and other ports, that those users do not regard these multi-provider arrangements as competitive in any meaningful way. The perspective of Port users is that the towage operators are clearly aware of their reliance on each other, and have no, or at least very limited, incentive to genuinely compete on price or service quality.

No consideration of complexities other than the number of tug jobs

The Synergies report makes various claims to the effect that the Productivity Commission's reference point of 8,000 tug jobs, is 'adopted' by PwC in the modelling we provided in support of GPC's submission (Synergies report, p.27). This inference is incorrect.

Although the PwC report and GPC's initial submission both refer to the Productivity Commission's earlier assessment of 8,000 tug jobs as being the point at which economies of scale may be exhausted, PwC's modelling is not in any way influenced or informed by that parameter. PwC's modelling uses towage cost and operational performance benchmarks, and port modelling by Aurecon, to examine whether there is a cost-advantage associated with a single provider arrangement, relative to certain alternative scenarios where the towage market is stratified. The modelling is completely independent of the '8,000 tub jobs' figure.

Indeed, the demand forecasts provided in GPC's initial submission to the Australian Competition and Consumer Commission (ACCC), which form the basis of PwC's modelling, indicate that GPC anticipates that demand at the Port of Gladstone will exceed this threshold. This clearly shows that the PwC modelling has not relied upon the Productivity Commission's benchmark.

Further, the Synergies report ignores that the number of tug jobs is not the only relevant consideration in assessing the likely existence and extent of economies of scale. Different ports have different physical and operating characteristics, and factors that also are relevant include:

- the number of tugs required for each vessel movement
- the impact of channel capacity, vessel scheduling and concurrent demand for towage services,
- specific customer and port safety requirements, including in the case of the Port of Gladstone, the specific tug configuration and operational requirements for the LNG sector, and
- the spatial distribution of port facilities and impacts on tug job duration and also tug transit time.

These factors were detailed at length in GPC's initial submission, and also the PwC report which accompanied that submission. The collective effect is that GPC considers the point at which scale economies diminish is likely to be significantly higher at the Port of Gladstone than in other ports, and certainly higher than the benchmark posited by the Productivity Commission. This view was supported by PwC's modelling, which indicated a significant cost-penalty from plausible market-segmentation scenarios.

Sunk costs and barriers to entry

Synergies claims that 'sunk costs in the provision of towage services are not material' and 'sunk costs are not economically important because contestability of the market will determine the number and identity of service providers' (Synergies report p.5).

Synergies' analysis focuses on the fact that the tug vessels themselves are explicitly mobile assets, and therefore can be 'readily deployed to another port' (Synergies report, p.6). Ignored are the practical and unavoidable realities that markets do not always perform in a textbook fashion.

The Synergies report fails to recognise the differentiation of tug vessels and the specifications regulated at different ports. This effect generally diminishes the ease of vessel portability.

Rather being 'relatively easy for an entrant to enter the market' (Synergies report p.6), effective and successful market entry requires a new entrant to acquire, train and retain sufficient tug crews, including Port-specific tasks such as familiarisation with port facilities, port protocols and operating procedures, as well as mobilise sufficient tug vessels (which comply with relevant port safety and other standards), establish local supply chains (including access to berthing and provisioning facilities), and to establish commercial arrangements with potential users.

A key factor in this regard is time - the time taken to mobilise vessels and crews, to experiment with an entry strategy at one port, and if that strategy is unsuccessful then to demobilise and transfer to another port, and build a market presence there. To the extent that there is any under-utilisation of tug vessels, such that during any period of competition they are not earning a full return, then the cost of that less-than-optimal utilisation cannot simply be ignored (or assumed to be borne solely by the towage provider).

These risks and accompanying transactions costs are not immaterial, as is suggested by Synergies. Further, any rational market entry strategy would necessarily include an expectation of an entrant being able to recover those costs, which ultimately would need to occur through higher towage charges on users.

PwC understands that GPC's experience is that it can take a new provider up to 12 months to effectively mobilise a towage operation into a new port. The notion of the towage market being able to adjust with ready entry/exit, in close to real-time, would seem to depend on a presumption of currently under-utilised tug capacity at other domestic ports, which could be redeployed to the Port of Gladstone with no impact on those other Ports. Moreover, we understand that GPC is not aware generally of such an evident over-supply of tugs, and indeed the demonstrated need for operators such as Svitzer (at the Port of Newcastle, for instance) to sub-contract services to another operator, when a clearly superior commercial strategy would have been for them to use their own (redeployed) tugs, would seem to support this.

An Exclusive Licence arrangement can effectively manage uncertainty in future demand

GPC has developed its forecast of future demand using information from various sources. This includes advice from existing and prospective future customers as to shipping and cargo volumes, known or anticipated future Port developments, and known or anticipated (changes to) Port protocols and other operational requirements.

GPC believes that the demand forecast it has provided to the ACCC, which is consistent with forecasts that underpin its wider commercial and corporate planning and reporting to its shareholders, is reliable. The risks of significant demand variability over the five year term of the Licence are low, as there is no anticipation of significant entry or exit of major port trades over the proposed five year Licence term.

GPC acknowledges that at the time the previous Licence was established there was significant uncertainty relating to future towage demand, which largely was a function of uncertainty regarding vessel movements attributable to new Port trades. The impact of the global financial crisis on the resources sector was still to be fully realised, and there were two significant user-sponsored developments either underway (Wiggins Island Coal Terminal (WICT)) or contemplated (LNG) during the Licence term. PwC understands that these factors were explicitly made transparent to potential tenderers.

The Synergies report infers that an Exclusive Licence necessarily involves a 'once only' assessment of demand, with any uncertainty creating a risk which ultimately by port users ('under the exclusive licensing arrangement demand forecasting risk and its associated cost implications are borne fully by towage users not operators', Synergies report p.67).

GPC's experience is that a pricing framework can be defined that:

- is dynamic with respect to variation in demand, and which includes adjustment mechanisms which accommodate variability in demand in a transparent and understandable way. In the case of the current Licence, the framework developed to adjust towage charges each year has continued to deliver significant real reductions in towage charges for Standard Harbour services, despite initial expectations of demand from WICT being unrealised

- provides for a sharing of demand risk between the towage operator and users - acknowledging that there are short-term rigidities (such as assembling sufficient crews and tug vessels sufficient to meet expected demand) which are harder for the towage operator to manage, but over a longer period there are more adjustment options available.

Synergies claim that demand forecasting risk is 'borne fully' by towage users is not correct. For Standard Harbour towage services, for instance, while towage charges are adjusted annually based on forecast demand (according to an escalation framework defined at the time the Licence was tendered), there is a cap/collar arrangement which means that within-year demand variability (within a pre-defined range) is borne by the towage provider. For LNG towage, LNG users were directly involved in determining the number, configuration and timing of entry of new tug vessels (to service the advent of the LNG trade through the Port of Gladstone), and appropriately in that instance are responsible for demand forecasting risk.

GPC intends for the forthcoming Licence period to address demand forecasting risk in various ways:

- tender documentation will provide a forecast of expected vessel traffic, and associated tug jobs, for the five year term of the Licence. Respondents will be asked to tender rates (not costs, see below), within a clearly defined framework for adjustment of rates over the Licence term, using independent cost indexes (for instance, various ABS and other published indexes).

- rate adjustment provisions will include a transparent mechanism to adjust rates annually in anticipation of forecast demand for each year, and which is intended to include a cap/collar arrangement similar to that currently in place for Standard Harbour towage charges.

- clear processes will be defined for any change in the number of tugs required at the Port, whether due to an unanticipated increase/decrease in towage demand, or other operational or safety considerations.

GPC's objective is to provide a transparent, predictable and auditable framework for the adjustment of towage charges over the five year term of the Licence, which dynamically adjusts for any variation in demand from that originally forecast and where that demand risk is shared between Port users and the towage Licensee.

Supplementary submission makes other misleading and factually incorrect statements

There are a number of statements in the supplementary submission which are misleading or factually incorrect:

- Synergies claims that the proposed Licence 'will be likely to reduce service levels and increase cost for customers …' (Synergies report, p.11). There is no basis whatsoever for the first statement (service levels are determined by Maritime Safety Queensland (MSQ), in conjunction with GPC and Port users. The second statement is inconsistent with the actual experience at the Port of Gladstone during the last Licence period and where actual towage cost outcomes for Port users have reduced in real terms of the Licence, and towage costs compare favourably to other Australian ports.

- Throughout the supplementary submission there is continued reference to a Licence period of '8 years' (see, for instance, Gilbert & Tobin pp. 2, 13), whereas the Licence term is clearly specified as being for five years. Including in the Licence term the option to extend the Licence for a further three year is misleading as it deliberately obscures the ability for the Port to not proceed with the proposed Licence extension, were Licensee conduct or other factors to negate the continued benefits of it beyond the proposed five year term.

- The Synergies report provides a comparison Table 1 and Figure 5, from which it claims GPC is Australia's 'third busiest port' by number of tug jobs. This analysis appears to omit the Port of Hay Point, which is the closest geographic export bulk port to Gladstone, and other key bulk ports such as the Port of Dampier.

- Synergies claims that, at the time of the previous tender, GPC determined to 'adopt a risk averse' posture of requiring higher specification tugs, which directly caused towage costs to users to be higher than necessary on account of an 'upgrade being forced upon customers through the exclusive licence tendering process' (Synergies report, p.69). GPC introduced tug vessel specifications and numbers on advice from customers, industry and as prescribed MSQ in its role as the regulator of vessel traffic. To suggest that GPC 'forced' upon Port users higher standards, and hence costs, is misleading.

- Synergies claims that '... the cost of these new [LNG] tugs are currently being recovered from LNG users under an accelerated capital recovery time line' (Synergies report, p.67). This statement is not correct. The only costs which are being amortised over an accelerated period are the costs of mobilising the five new LNG tugs into the Gladstone market, and where these costs are recovered over the term of the Licence. Otherwise, the costs of acquiring the new tugs is being amortised over the life of the vessels, based on industry-standards.

Towage pricing is not set by GPC

Through the Synergies report there are statements which imply that GPC is a 'quasi-regulator' whom assesses and allocates costs, and has an overarching role in setting towage charges (Synergies report, p.70). These statements are either incorrect, or misleading as they wrongly imply what GPC's intentions are with respect to the forthcoming Licence period and the tender process proposed to support it.

The Synergies report claims 'GPC is responsible for pricing towage services across the harbour towage and LNG services with efficient cost assessment and cost allocation processes being undertaken by it' (Synergies report, p.71). This is factually incorrect. The current Licence includes two separate pricing frameworks. The Standard Harbour towage framework is based on SMIT's originally tendered towage charges, which have been escalated according to the indexation and other adjustment provisions as set out in the Licence. These indexation and adjustment provisions generally are independent of SMIT's actual costs.

Synergies further claims that 'prices will be determined by GPC through its assessment of allowable cost recovery and cost allocation, and GPC will not have the same incentive or ability to reduce costs and improve services ...' and 'pricing under an exclusive licence will be set by GPC ...' (Synergies report, p.85). These statements are incorrect and misrepresent both the arrangements under the current Exclusive Licence and as intended by GPC to apply for the Exclusive Licence arrangement going forward. Towage charges will be determined through a tender process, which is independent of any assessment of towage provider costs or any view on allowable cost recovery. All bidders will have full visibility of the framework for adjustment of towage charges over the term of the Licence - essentially a mechanical indexation and volume-adjustment arrangement - and which is independent of any provider-specific factors such as tug age or value, crewing or rostering arrangements, etc.

GPC's role under the Licence is not a 'quasi-regulator' (Synergies report, p.70). GPC would not be an arbiter of allowable costs, crewing rosters or key cost parameters such as the term for capital amortisation or allowable rates of return. The Licence framework would require bidders to tender towage charges, with a pre-determined framework for adjustment of those charges using indexation and volume-adjustment mechanisms.

Customer service levels and price outcomes should be the Commission's key considerations

Ultimately, competition is desirable as a means of providing choice to users and incentives to providers for efficiency in the delivery of services.

The reality of a shared service such as towage, and within a multi-user port environment, is that customers cannot simply exercise choice in an unconstrained way. Key non-price service attributes are substantially determined by Port safety and operational factors. And there are obvious advantages to users in the shared provision of towage costs, as for all but the very largest of users it would generally be uneconomic to procure towage on a stand-alone basis. The nature of port operations is that the effective utilisation of tug vessels typically is low, and this would be exacerbated in an environment of stand-alone provision. Necessarily, then, sharing implies a need to accept some constraints on the degree of choice able to be exercised by any individual user.

GPC fundamentally is seeking to use contestability and competition to drive efficient and effective outcomes for Port users. Despite Synergies' claims of vigorous and robust competition pervading other ports, GPC's view, informed by its own experience and engagement with Port users and other port managers, is that an Exclusive Licence offers greater scope to use contestability to deliver efficient outcomes for Port users.

GPC's experience indicates that an Exclusive Licence has delivered both an initial reduction in towage charges, with average charges thereafter effectively unchanged over the Licence term (equivalent to a 14.6 per real decline in Standard Harbour towage charges). Public benchmarking of towage costs across Australian ports indicates that, over broadly the same term, towage charges increased by a nominal 20 per cent.[1] Benchmarking provided in PwC's report indicates that towage charges in Gladstone are lower than quoted rates at comparable ports.

PwC understands that GPC strongly refutes Synergies' suggestion that GPC would act outside the interests of its customers (Synergies report, p.86):

- Port safety and other technical standards set by MSQ, including through consultation with port users. The safe movement of commercial shipping into and out of the port of Gladstone is shared priority held by GPC, MSQ and customers. We understand this position is reaffirmed at regular Port Trade Partner Forums attended by GPC, Port users and MSQ on a quarterly basis.

- Where there are key events which required changes to towage services as required under the Licence, GPC has consulted extensively with users. For instance, LNG users were engaged directly to determine and seek their agreement as to the number and configuration of LNG tugs required to support the introduction of that trade to the Port. Subsequently, GPC has facilitated user-initiated charges to LNG towage stand-by arrangements, with direct flow-on cost savings for LNG users in towage charges.

- GPC is continuing to engage with LNG users on prudent and efficient means of safely moving LNG vessels in and out of the Port of Gladstone. This process is collaborative and GPC has the support of MSQ and LNG customers.

A number of GPC's customers have indicated through submissions to the ACCC their broad support for an Exclusive Licence arrangement to continue at the Port of Gladstone, and we understand GPC remains in active dialogue with its customers regarding the design of the tender process and standards for towage services to apply over the coming Licence term.

[1] Essential Services Commission of South Australia (2017), *Port price benchmarking study*, March, p. 19

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