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**Svitzer Australia Pty Ltd**  
**Initial submission in opposition to the**  
**notification by Gladstone Ports Corporation**  
**Limited for exclusive dealing**

Svitzer Australia Pty Ltd

**20 April 2018**

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# 1 Executive Summary

We act for Svitzer Australia Pty Limited (**Svitzer**). Svitzer files this submission in opposition to notification N10000453 (the **Notification**), filed on 13 March by Gladstone Ports Corporation Limited (**GPC**) with the Australian Competition and Consumer Commission (**ACCC**), in relation to a proposed third line forcing arrangement pursuant to section 47(6) and 47(7) of the *Competition and Consumer Act 2010* (Cth) (the **CCA**). GPC describes the relevant conduct as requiring any vessel requiring towage services at the Port of Gladstone to acquire towage services from the holder of the exclusive licence for the period 1 January 2020 to 31 December 2027 (**Third Line Force**).

Svitzer considers that the GPC Notification, limited to a Third Line Force, is wholly misconceived, both as to the way the relevant conduct is defined and also in ignoring the significant anticompetitive effects arising out of the proposed grant of an exclusive licence to a single towage operator in the Port of Gladstone for an 8 year period (**Exclusive Licence**). Moreover, the Notification also will have the practical effect of extending the current exclusive licence issued to Smit Marine Australia Pty Limited (**Smit**), the Australian subsidiary of the global corporation Smit Internationale NV (Netherlands), by a year, meaning that the Notification *de facto* proposes to lock up competition at the Port of Gladstone for nine years until 31 December 2027. A Notification based on the proposed Third Line Force should not be used as a back-door to immunise the significant anticompetitive effects that arise from the proposed Exclusive Licence.

Svitzer submits that both the Third Line Force and the Exclusive Licence are unlawful and in breach of the CCA, likely to have significant anticompetitive effects which are not outweighed by any public benefits. Accordingly, the proposed Notification should not be allowed to stand, for the following reasons:

- The Exclusive Licence and Third Line Force are likely to have an anticompetitive effect in the market for towage services in Gladstone. In particular, foreclosing competitors and/or customers from supplying their own towage services will be likely to result in higher costs, reduced choice and service levels to customers requiring towage services in the Port of Gladstone than otherwise would be achievable if the market for the supply of towage services was contestable. The Exclusive Licence would:
  - preclude competition between towage operators that takes place at other ports, primarily outside of those owned by the State of Queensland;
  - eliminate the competitive constraints by reason of the threat of entry over the term of the Exclusive Licence; and
  - stifle the ability of market forces to constantly test and shape market structure, allowing market participants the flexibility to adapt to changing market conditions.
- In view of the restricted scope of the Notification, any asserted public benefits resulting from the Exclusive Licence cannot outweigh these anticompetitive effects. In any event, as described below, any public benefits are limited or non-existent. In particular:
  - an exclusive licence is unlikely to increase competition for the market and increase competitive pressure. Contrasting competition in the market with competition for the market is a false dichotomy. The process of transformation of competition between these two states and continued threat of re-entry provides significant competitive tension and public benefit. The ability to enter into joint ventures, seek customer sponsorship and cross-hire provides a new entrant the capacity to gain a foothold in the market, without depriving customers the benefit of competition;
  - an exclusive licence is unlikely to decrease prices. Indeed, an exclusive licence is more likely to have the opposite effect, as evidenced by Smit's price increase in the last exclusive licence period when volume forecasts were not met. That prices are likely to be

lower, in the absence of an exclusive licence, is in fact reinforced by GPC's own admission; the so called "resource costs associated with any price war" mischaracterises the pro-competitive process and significant benefit to the customer in terms of lower pricing without any apparent justification;

- an exclusive licence is likely to reduce the opportunity and incentive to reduce costs both through innovation and other cost reducing mechanisms such as industrial relations reforms. The concern as to the introduction of spare capacity can be resolved by cross-hiring, without the need to restrict competition by an exclusive licence. Logistics relating to the channel width and safety concerns are not a function of the number of towage operators in the port, and administrative costs in relation to coordination will be incurred irrespective of competition in the port. Any need to construct further tugboat berths would be underwritten by towage operators wishing to do business in the port; and
- many of the benefits cited in favour of an exclusive licence (such as the determination of safety, service and operational standards) can be obtained under other, pro-competitive, models of service provision. It is clear that the vast majority of ports in Australia do not grant exclusive licences and nevertheless achieve high safety, service and operational standards.

Accordingly, Svitzer opposes the grant of the Exclusive Licence at the Port of Gladstone and considers that the Port should be opened to competition at the end of the existing exclusive licence period.

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## 2 Background

### 2.1 Svitzer

Svitzer is a global provider of harbour towage, terminal towage and salvage, and emergency response services. Svitzer is a subsidiary of AP Moller-Maersk. Svitzer provided towage services in the Port of Gladstone until December 2010.

Svitzer has been present in Australia since it acquired Adsteam Marine Limited in 2007. Svitzer provides harbour towage services<sup>1</sup> in 28 ports in Australia. In four ports in Australia (Newcastle, Brisbane, Port Botany and Melbourne), Smit Lamnalco Towage (Australia) Pty Ltd, (a related entity of Smit) subcontracts to Svitzer the provision of towage services for Smit's customers, for which Smit continues to compete on price independently of Svitzer and maintains a direct relationship with those customers.

Svitzer has consistently opposed the grant of exclusive licences in harbour towage, in favour of the open market, and has made previous submissions to that effect in relation to previous authorisations and notifications opposing the grant of exclusive licensing.<sup>2</sup>

### 2.2 Productivity Commission Report in 2002

Prior ACCC decisions that have allowed notifications in relation to the exclusive supply of towage services have placed significant reliance on certain findings from the 2002 Productivity Commission Report, *Economic Regulation of Harbour Towage and Related Services (PC Report)*.<sup>3</sup>

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<sup>1</sup> Svitzer uses the term 'harbour towage' to include jobs both to the Port of Gladstone (i.e. harbour towage) and to the various terminals located near to the Port of Gladstone (i.e. terminal towage).

<sup>2</sup> See, for example, Notification N93770 (<https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/exclusive-dealing-notifications-register/gladstone-ports-corporation-limited-notification-n93770>) and Authorisation A91545 (<https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/port-of-townsville-limited-authorisation-a91545>).

In the PC Report, the Productivity Commission (**PC**) refers to a figure of 8,000 vessel movements per annum as the level at which economies of scale could be exhausted. However, the source of this figure is a third party submission to the PC by consulting firm Dale Cole and Associates (**DCAPL**), on behalf of the Port of Auckland Ltd (**POAL**).<sup>4</sup> DCAPL provides no analytical framework or evidence to support the basis for its cited 8,000 tug jobs.

The PC does not independently verify the purported calculation and merely notes that *“there is some suggestion that economies of scale for a (minimum) tug fleet (and one operator) could be exhausted at around 8000 tug jobs per year.”*<sup>5</sup>

In contrast, another third party submission, by PB Towage, argued that this was not necessary, stating that, *“our low cost, self-managed model requires a port volume in the order of 5,000 jobs to support a two tug entry.”*<sup>6</sup>

Svitzer submits that little reliance should therefore be placed on the “8000 tug jobs” proposition cited in the PC Report. There is significant uncertainty as to what level of demand is required to make multiple operators viable. This suggests that it is not appropriate to prescribe any number at which competition is possible, as a range of factors will be relevant, including efficiency in towage operators, level of service, the ability to cross-hire, the ability to offset any underutilisation with salvage operations, and onshore support for tug and barge operators, enabling a second operator to be viable with a relatively low number of tug jobs.

## 2.3 Port of Gladstone

The Port of Gladstone is Queensland's largest multi-commodity port. It is located in the city of Gladstone in central Queensland, 525km north of Brisbane and is owned and managed by GPC, a statutory body of the Government of Queensland.

Svitzer operated in the Port of Gladstone, under an exclusive licence from 2002 which expired on 30 June 2010. In 2009, GPC ran a tender process for a five year exclusive licence with an optional three year extension period. Smit was awarded an exclusive licence and began operations in the Port of Gladstone on 1 January 2011. GPC opted to extend Smit's licence in 2015 for the additional three year period and it is now due to expire on 31 December 2018.

On 13 March, the Notification confirmed that the Port of Gladstone intended to issue a further exclusive licence commencing on 1 January 2020. Svitzer notes that this effectively extends Smit's exclusive licence for an additional year, through 2019.

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## 3 GPC's application is fundamentally misconceived

### 3.1 The Notification ignores fundamental competition law concerns of the proposed conduct

The Notification was made by GPC regarding proposed third line forcing under section 47(6) and 47(7) of the CCA. Specifically, GPC is proposing to require all vessels requiring towage services at the Port of Gladstone to use the services of the Exclusive Licence holder.

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<sup>3</sup> Report No. 24, 20 August 2002: <https://www.pc.gov.au/inquiries/completed/harbour-towage/report>.

<sup>4</sup> DCAPL notes that it has represented POAL in relation to tendering for exclusive licences in the ports of Fremantle and Gladstone.

<sup>5</sup> At page 77.

<sup>6</sup> PB Towage Submission to the ACCC, dated 6 March 2009, available at: <http://registers.accc.gov.au/content/trimFile.phtml?trimFileTitle=D09+21188.pdf&trimFileFromVersionId=1063360&trimFileName=D09+21188.pdf>.

While GPC limits its Notification to a proposed third line force proposed to be imposed on towage customers, this limited focus misconceives the actual scope of the conduct and, accordingly, ignores the more fundamental competition law problems related to the proposed conduct which gives rise to the third line force; namely, GPC's proposal to issue the Exclusive Licence to supply all towage services in the Port of Gladstone for an 8 year period. Moreover, if the Notification is not revoked, it will have the effect of extending the current exclusive licence by a further year (to a total of nine years), by effectively preventing entry in advance of the grant of the Exclusive Licence.

Svitzer submits that the proposed Exclusive Licence would have the effect, and/or likely effect, of substantially lessening competition in relation to the supply of harbour towage services in the Port of Gladstone, preventing any competition in the market for harbour towage services, and preventing any port-user from choosing or supplying its own harbour towage services. The proposed Exclusive Licence would foreclose the market in Port of Gladstone for a further 8 years, in breach of s 47 (or 45) and s 46. As the Notification applies only to the Third Line Force, any public benefit arguments are not relevant to the lawfulness of the Exclusive Licence. In any event, to the extent any public benefits may be asserted these do not outweigh the likely anticompetitive effects, for the reasons set out in more detail below.

### **3.2 Exclusive Licensing and competition**

#### **(a) A false dichotomy**

Advocates of exclusive licensing argue that competitive bidding for an exclusive licence establishes the conditions in which the vigour of competition for the market is likely to be enhanced compared to open entry and is therefore pro-competitive.

Svitzer considers that framing the question as a choice between competition 'for the market' against competition 'in the market' sets up a false dichotomy. Competition 'in the market' does not preclude competition 'for the market'. In fact, in workably contestable markets, competition 'in the market' often transforms into competition 'for the market'. It is this contest which is the essence of the competitive process.

Whilst competition in the market has not always persisted in the longer term, it has resulted in significant benefits to customers. Svitzer has repeatedly been forced to reduce its costs, innovate and improve its service and prices as a result of the competitive pressure caused by the actual and/or potential entry of competitors at ports in which it operates. Many of Svitzer's customers have significant purchasing power and Svitzer is well aware that if Svitzer's prices are not competitive, those customers have the ability and the incentive to sponsor entry of a competitor.

Svitzer considers that the barriers to entry in the provision of towage services across Australian ports are not sufficiently high to justify the imposition of exclusive licences, including the Exclusive Licence. This is demonstrated by both successful and unsuccessful entry attempts in a wide variety of ports in Australia.

The examples of Fremantle and Bundaberg below indicate that competitive entry is possible, and that it may result in either sustained competition or ultimate rationalisation with the survival of the most efficient operator, yet remaining subject to the constant threat of new entry. The third example (the Port of Eden) illustrates a situation in which the outcome of the competitive process is still uncertain (i.e. whether competition in the market will transform to competition for the market), but in any event the forces of competition yield significant benefits to towage customers.

#### **(b) Fremantle: sustained competition**

The Port of Fremantle illustrates that it is far from clear that competition does not have the ability to persist. The Port of Fremantle designates 3 classes of tugs:

A     *Z Peller with a bollard pull of >44T @85% MCR over the bow*

B *Z Peller with a bollard pull of >35T @85% MCR over the bow*

C *Twin Screw, twin runner launch with a bollard pull of 10T @ 100% MCR.*<sup>7</sup>

C Class tugs may be used in the Port of Fremantle by vessels under 140 metres in length. The Port of Fremantle has had at least two competitors for C Class towage services for at least the past 20 years: Svitzer and Total AMS. Further, in 2014, a third operator, Mackenzies entered the market, obtaining a licence for C Class towage in the Port of Fremantle. The nature of the market in Fremantle sees the three competitors compete against each other. However, overflow or clash work is regularly outsourced in full (i.e. the full vessel is outsourced) if any of the three competitors cannot service their contracted customers.<sup>8</sup> Svitzer notes that whilst C Class tugs serve only a segment of the towage market in Fremantle, it considers that this is a valuable illustration of competition in the market. Moreover, the ability to serve the market with a C Class tug may provide a foothold for a competitor to expand and provide other services, including A and B Class towage services, where sufficient demand exists.

(c) Bundaberg: exit of the less efficient party

The outworking of the competitive process is starkly illustrated by the Port of Bundaberg, which is not subject to exclusive licensing. After Svitzer lost its licence at the Port of Gladstone, it remained in Bundaberg Port with a single tug and continued to compete. Most of the jobs in the Port of Bundaberg required only one tug, as most vessels were not large enough to require two tugs. From time to time, when a vessel required two tugs, a second tug would be brought into the Port from a nearby port, typically by Smit from the Port of Gladstone. In this case, the vessel would contact both Smit and Svitzer directly.<sup>9</sup> If Smit were unable to provide the additional tug, Svitzer would provide the additional tug from Brisbane.

In 2014, Wide Bay Shipping (a joint venture between two towage operators, Pacific Tug and Mackenzies) approached the main customer at Bundaberg, Queensland Sugar, and reached a direct commercial agreement on more competitive terms than had been offered by Svitzer, facilitating Wide Bay Shipping's entry into the Port of Bundaberg. Svitzer ultimately withdrew from the Port of Bundaberg, sold its tug and most of the incumbent employees moved to the new operator. The costs of exiting the market were borne by Svitzer alone. However, it was the competitive process that transformed competition in the market to competition for the market, yielding significant benefits to the customer. As the Port of Bundaberg was not subject to exclusive licensing, the threat of entry or re-entry provided customers with significant ongoing countervailing power. If the Port of Bundaberg was subject to an exclusive licence, this competitive process would not have occurred.

(d) Eden: outcome as yet uncertain

More recently, Wide Bay Shipping adopted a similar tactic when it entered the Port of Eden, a small port with fewer than 200 tug jobs in FY2017. Prior to entry, Wide Bay Shipping directly approached a large group of customers at the port, who predominantly ship wood chips, and reached a commercial agreement with more competitive terms than offered by Svitzer. On the basis of that contract, Wide Bay Shipping entered the market in November 2016 with two tugs. Svitzer and Wide Bay Shipping are currently in competition for harbour towage in the Port of Eden, each operating with two tugs. Svitzer considers that Wide Bay Shipping is likely to have lower costs in the Port of Eden than Svitzer, as it uses non-unionised crew, resulting in a significant reduction in crewing costs. While it is not clear if

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<sup>7</sup> See <http://www.fremantleports.com.au/SiteCollectionDocuments/Port%20Information%20Guide.pdf>, at 81.

<sup>8</sup> Svitzer notes that it has also had an overflow arrangement in place in the Port of Darwin with Coastal Tug & Barge since 2011. Pursuant to this arrangement, each company will sub-contract services to the other if it does not have capacity for a particular job.

<sup>9</sup> Svitzer notes that, pursuant to this arrangement, each customer would be billed separately by Svitzer and Smit, respectively.

competition in the market may transform into competition for the market, the customer benefits from this competitive process and in doing so, is able to exert countervailing power vis-à-vis towage operators in the Port of Eden.

(e) The difficulties with exclusive licences

Framing the terms of an exclusive licence, and assessing the relative merits of bids, inevitably requires the port authority to take a definitive position on matters, such as the structure of future demand, that are unknowable at the time the licence is issued. These assumptions are examined below. Svitzer considers that the proposed Exclusive Licence (or any exclusive licensing process) may have the effect of depriving an incumbent service provider of the rewards for investment in innovation and productivity improvements.

Further, Svitzer considers that there is a principal-agent problem in an exclusive licensing process conducted by the port authority. The port authority effectively acts as a proxy for the customer when it grants an exclusive licence, but will have imperfect knowledge of the needs and preferences of the users of towage services and its objectives will not align completely with users. Exclusive licensing tends to entrench an outcome and a cost structure on an industry, which in an uncertain environment is not consistent with the promotion of efficiency.

Finally, Svitzer considers that many of the benefits cited in favour of the Exclusive Licence (such as the determination of safety, service and operational standards) can be obtained under other, pro-competitive, models of service provision.<sup>10</sup> It is clear that the vast majority of ports do not grant exclusive licences and yet nevertheless achieve high safety, service and operational standards.

### 3.3 The PwC analysis is based on inaccurate assumptions

The analysis contained in the PwC report is based on a number of flawed assumptions:

**(a) The pricing analysis performed by PwC does not appear to compare the Port of Gladstone with comparable ports, and in any event, ignores the distinction between public 'off-contract' pricing and private on-contract pricing**

The PwC Report contains a comparison of towage charges at the Port of Gladstone relative to the published pricing of nine other unnamed Australian ports.<sup>11</sup> The PwC Report uses this data to demonstrate that the *"total cost per vessel call for a Cape sized vessel at the Port is approximately 61% cheaper than at Australian Port #9."* Svitzer does not recognise these figures and can only assume that 'Australian Port #9' is significantly smaller than the Port of Gladstone.

Svitzer considers that this analysis should be given little weight as:

- it is not possible to assess whether the unnamed ports included in the analysis are of a comparable type to the Port of Gladstone and whether they have a comparable volume of towage jobs;
- each port has individualised factors which may influence the cost per tug job, including the scale (i.e. the number of tug jobs) and may include other factors such as the geography of the port, remoteness and homogeneity of calling vessel fleet;

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<sup>10</sup> See further paragraph 4.62 of the ACCC's Statement of Reasons dated 27 June 2012 in which the ACCC *"agreed... that high standards of safety and standards of service can be elicited through mechanisms other than exclusive licences."*

<sup>11</sup> See Figure 6 of the PwC Report, on page 18, which is attributed to: PwC analysis, various sources.



- reliance on published pricing for the actual cost of towage is misleading, as many customers can and do negotiate significant discounts to published prices in ports not subject to exclusive licensing; and
- more discounting occurs at ports without exclusive licensing. In ports with exclusive licences, pricing is set upfront as part of the tender process and is invariably tied to pricing formulae. As the harbour towage provider has exclusivity for the period of the licence it is not subject to any competitive pressure, it therefore has few incentives to offer further or larger discounts to customers. In contrast, off-contract prices at ports without exclusive licences vary significantly from the actual prices paid by customers on preferred supplier contracts. At those ports, discounts are frequently negotiated in exchange for volume increases.

**(b) PwC’s economic model fails to test the most appropriate counterfactual**

PwC’s report refers to five options for the future provision of towage services, ranging from one towage operator for all Port of Gladstone users through to non-exclusive service provision by several firms:

1. A single exclusive licence;
2. Two exclusive towage providers for, respectively, LNG vessels and the rest of the Port;
3. Three exclusive towage providers for, respectively, LNG vessels, Party A and the rest of the Port;
4. Two exclusive towage providers for, respectively, Party A and the rest of the Port; and
5. Open competition.

All of the options involving more than one operator that are tested by PwC share a common feature: they assumed a partitioned market in which the activities of each operator are confined to one or other of the resulting market segments. PwC explicitly acknowledges this: “*the analysis does not consider any open market competition impacts between service providers, nor any dynamic efficiency benefit in the form of competition-induced improvements... in operating cost efficiency or similar.*”<sup>12</sup>

Essentially, what PwC is testing is the relative efficiency on the one hand, of a single exclusive licence under which the licensee has access to the total port market; and, on the other, of two or more exclusive licences, under which each licensee has exclusive access to a defined segment of the total market. The difference between the multi-server options analysed reduces to a difference in exactly how the market is partitioned.

In other words, PwC’s modelling of options 2, 3 and 4 essentially splits the Port into two or three customer groups and allocates a separate towage provider for each of those groups which has enough tugs to ensure that each group can be immediately serviced when multiple ships in an individual group require towage simultaneously. Svitzer considers that this is unrealistic – not least because cross-hiring arrangements occur in other ports with multiple competitors.

For example, in the Port of Fremantle which currently has three towage providers, overflow work in the provision of C Class towage services is shifted between the three competitors on a ‘full job’ basis. In essence, this means that a full vessel movement is allocated to the competing service provider if there is a clash in vessel movements. For example, if multiple vessels which have contracts with Svitzer require towage at the same time for which Svitzer is, due to insufficient tug numbers, unable to

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<sup>12</sup> PwC Report, page 36.

provide, then Svitzer sub-contracts the service to one of the competing operators, Total AMS or Mackenzies (and vice-versa).

Similar arrangements currently occur in other ports in which Svitzer is present, including the Port of Darwin.

The proposed artificial segmentation is very different from a genuine open entry environment, in which each operator would configure its operations to serve its target efficiently and each party's operations would adjust as demand conditions change and new commercial opportunities emerge.

Surprisingly, PwC identifies 'open competition' as 'option 5' but asserts that open competition is not feasible as it would require:

- 1 redundant investment in tug capacity; or
- 2 co-operative and/or cross-hiring arrangement to be established between two or more providers, suggesting a structure more like a joint venture arrangement than a contestable market.

Svitzer considers that redundant investment in tug capacity would only be necessary if cross-hiring arrangements were not permitted. Moreover, as the case studies above demonstrate, open competition yields significant benefits to customers, and even if the transformation to competition for the market has not occurred, the continued threat of entry and ability of customers and/or the port to sponsor new entry constrains incumbents.

### **3.4 The Notification contains significant factual inaccuracies**

#### **(a) Availability of alternative ports**

Svitzer considers that it is fundamentally misleading to say in section 9.3 of the Notification application form that port users have the ability to "*bypass the Port of Gladstone altogether*". The vast majority of port users have invested heavily in infrastructure which means they have no realistic ability to bypass the Port of Gladstone. In particular, LNG customers have invested billions of dollars in plants located in the Port. Similarly, coal customers have invested heavily in relevant infrastructure to use the Port of Gladstone. Svitzer considers that only a very small minority of port users, primarily those using shipping containers, have any realistic ability to bypass the Port of Gladstone.

#### **(b) Safety / operational concerns**

Many of the benefits cited in favour of an exclusive licensing arrangement (such as the determination of safety, service and operational standards) can be obtained under other, pro-competitive, models of service provision.

Svitzer notes that the exclusive licensing of harbour towage services currently only occurs in ports in one state: Queensland. Svitzer is not aware of any statistical evidence which suggests that safety and operational outcomes in other States are inferior to those in Queensland nor is it aware from its operations across Australia of any factors or incidents which might suggest that this is the case.

Svitzer notes that in 2012 the ACCC stated that: "*the ACCC does not consider that an exclusive licence will necessarily deliver greater public benefits in the form of enhanced safety and compliance with standards of service than other forms of licence agreements.*"<sup>13</sup>

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<sup>13</sup> ACCC Statement of Reasons, 27 June 2012, at paragraph 4.63.

The Notification also makes a variety of questionable assertions as to the operational effect of having a second towage provider, for example:

*“The unique characteristics of the Port’s single lane channel and its trade and vessel mix mean it would be inefficient for two towage service providers to operate in the Port without substantial capital expenditure to widen the channel.”<sup>14</sup>*

Svitzer notes that, regardless of the number of towage providers operating at the Port, vessels pass through the channel one after another. Widening the channel would only be required if GPC wanted to bring in larger vessels, which has no relevance to the number of towage providers.

Further, GPC asserts that the Exclusive Licence would avoid the “costs of constructing and managing a second berthing facility”.<sup>15</sup> Svitzer notes that the cost of constructing a second berthing facility would be met by a second entrant to the Port, in any event. This occurred in Port Hedland and Svitzer has built or upgraded tug infrastructure in multiple ports where it operates.<sup>16</sup>

Finally, the basis upon which GPC asserts both that a second towage operator entering the Port of Gladstone would be unsuccessful is unclear, and, in any event, even if it was unsuccessful, it is unclear why this cost would be met by GPC or port users generally, as opposed to the towage operator.<sup>17</sup>

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## **4 The Proposed Exclusive Licence - and Third Line Force - would substantially lessen competition in the Port of Gladstone**

### **4.1 Overview**

As discussed in more detail below, the Exclusive Licence and Third Line Force would be likely to result in a substantial lessening of competition in the supply of towage services for a substantial period of time, by precluding competition for the duration of the licence in terms of price, service levels and innovation in a key Australian port which is forecast to grow.

The Exclusive Licence and Third Line Force would also prevent smaller competitors from being able to enter to compete at Port of Gladstone, to compete for a limited number or type of jobs, or to enter into alliances and joint ventures that enable them to compete on a larger scale. While smaller operators may have an ability to enter and supply some services at Port of Gladstone, they are unlikely to have the resources and ability to meet all of the Port’s requirements on a standalone basis. Moreover, the Exclusive Licence and Third Line Force would prohibit customers from self-supplying towage services.

Svitzer submits that the anticompetitive effects that are likely to result from GPC’s proposed Third Line Force and Exclusive Licence are significant, compared with a scenario where there is no exclusivity, noting that no sufficient justification is established to depart from an open market:

- The simultaneous operation of competing towage operators, which has been and is taking place in several ports – other than Queensland – over substantial periods, is effectively precluded;
- The ongoing pressure of the threat of competitive entry is effectively eliminated; and

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<sup>14</sup> Section 1.2(b)(ii) of the KWM submission in the Notification, at page 3.

<sup>15</sup> Section 1.2(b)(ii) of the KWM submission in the Notification, at page 3.

<sup>16</sup> Including Port Kembla, Melbourne, Whyalla and Darwin.

<sup>17</sup> Section 1.3 of the KWM submission in the Notification, at page 4.

- The ability of market forces to continually test and shape the appropriate market structure in the face of evolving market conditions is vitiated.

#### **4.2 Any departure from an open market should be clearly justified**

Svitzer considers that there should be a clear presumption in favour of open markets as a means of ensuring efficiency, innovation and responsiveness. Accordingly, there should be a clear presumption in favour of an open market unless there is a compelling case to the contrary. Svitzer considers that no such compelling case exists in relation to the Port of Gladstone.

Svitzer has consistently contended that an open market is almost invariably the optimum market framework for ports, regardless of size, but considers that the arguments become considerably stronger the larger and busier a given port is. In particular, Svitzer notes that the Port of Gladstone has grown significantly, with 8,670 tug jobs in FY2017, and the PwC Report forecasts that the number of towage jobs at the Port of Gladstone will continue to expand.

#### **4.3 Market dynamics in open markets**

Svitzer considers that the failure to consider model option 5, the open market, deprives PwC's modelling of any relevance. Svitzer considers that it is critical to understand competition through the exercise of constantly changing market dynamics, with individual players operating in response to constantly changing incentives, which test the market. This is in stark contrast to the modelling in the PwC Report which ignores the competitive tension created in an open market, and instead compares a series of hypothetical static markets based on a series of forecasts and assumptions covering the period up to 31 December 2027.

Svitzer considers that, even leaving aside the artificiality of the assumed conditions, a fundamental flaw with this approach is that it overlooks one of the main advantages of the open market: that market structures can readily adapt to changes in conditions of supply and demand. By contrast, committing to an exclusive licence for an extended period effectively ossifies the market structure in a form that is judged to be appropriate by the controlling licensor at the time of the tender process. This judgement is inevitably made in the context of imperfect information about consumer preferences, supplier costs and the structure of future demand.

#### **4.4 An exclusive licence is not required to ensure competition in towage services**

The claim that towage is a 'natural monopoly', at least at the local level, has been used to justify the use of exclusive licensing. In the *Stirling Harbour Services*<sup>18</sup> case, the Federal Court suggested that exclusive licensing simply implies a "shift from a natural monopoly to a legally enforced and controlled monopoly." The assumption that the existence of a natural monopoly makes the use of exclusive licensing desirable permeates the PwC Report.

Svitzer considers that harbour towage is not a natural monopoly; while competition in the market may transform to competition for the market, absent exclusivity, the threat of entry provides a powerful competitive constraint, restricting the ability of any sole operator in a port to behave as a monopolist. However, Svitzer considers that, even if towage services were a monopoly, it does not follow that bidding for an exclusive licence would be an appropriate solution.

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<sup>18</sup> *Stirling Harbour Services Pty Limited v Bunbury Port Authority* [2000] FCA 1381 (29 September 2000).

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## 5 Exclusive Licensing assumptions are inapt here

A number of assumptions are usually made (either implicitly or explicitly) to justify the use of tenders for an exclusive licence. Among the most important assumptions are that:

### 5.1 The structure and level of demand can be reliably predicted until December 2027 and the requirements of users are predictable and known to GPC

Svitzer considers that it is exceptionally difficult to forecast what the structure and level of demand will look like today until the end of the proposed Exclusive Licence period: i.e. until 31 December 2027. Markets may be extremely volatile for the next nine years and potentially unforeseen technological changes will affect both tugs and vessels.

Svitzer considers the difficulty is clear from the current exclusive licence period: the demand from larger coal vessels did not develop at anything like the rate which was anticipated at the time the previous exclusive licence was issued. Clearly, however, the tugs which GPC has anticipated it would require had already been purchased and port users were therefore forced to pay for the premature investment when prices were raised in response to the downturn.

It is also clear from the PwC Report that there was (and in Svitzer's view continues to be) considerable uncertainty as to both whether and when demand from LNG vessels will increase.

PwC explicitly assumes that current operational and shipping dynamics continue at the expiry of the current licence term and that the Gladstone Port Procedures Manual will remain unchanged until December 2027. In contrast, Svitzer considers that it is likely that these factors will change significantly between now and December 2027.

#### (a) The difficulties encountered during the current exclusive licence at the Port of Gladstone

The difficulty of forecasting demand is clearly demonstrated by the previous exclusive licence. In 2009, Svitzer operated a total of five tugs in the Port of Gladstone, two of which had a power rating of 46T and three with a power rating of 62T.

GPC's exclusive licensing process specified as part of the tender process in 2009 that a successful applicant must provide at least five 70T tugs. The result of this was that Svitzer's five tugs, which were capable of servicing boats at the Port of Gladstone at the time, were suddenly considered not fit for purpose by GPC.

Svitzer considers that the increased tugboat specifications which were stipulated as terms of the tender were not appropriate. Primarily, the specifications reflected a "gold plated" approach by GPC due to the difficulties of forecasting the structure and level of demand for the period of the exclusive licence. This resulted in requiring a commitment to the supply of towage capacity to the Port of Gladstone that over-estimated demand, without any flexibility to adjust capacity depending on fluctuations in demand levels over the exclusive licence period. Moreover, these specifications unnecessarily limited the ability of towage operators, which could not comply with the gold-plated specifications, to compete in the tender process, thereby limiting the level of competition for the market. In the absence of exclusive licensing, upgraded tugs would instead have been provided in stages, as and when upgraded tugs were necessary for the proper operation of the Port in response to actual demand volumes.

Further, several years after the grant of the exclusive licence, GPC entered into negotiations with Smit to purchase five additional high powered LNG tugs. Whilst the later purchase of LNG tugs demonstrates that the tender process for exclusive licensing does not *necessarily* prevent further and/or upgraded tugs being purchased during the licence period, it does demonstrate how this can significantly erode the supposed efficiency benefits of the fixed exclusive licence period allowing providers to spread their fixed costs over the exclusive licence period.

## **5.2 The conditions under which a port can support only a single operator are clear and known, and these conditions will remain the case over the licence period**

Svitzer contends that, as illustrated by the vigorous competition evident in the Port of Eden, a much smaller port, it is simply not plausible to assert that competition between two operators could not occur in the Port of Gladstone today. Moreover, it is far from clear that the current conditions in the Port of Gladstone will remain static.

Svitzer considers that it is certain that technological advances will lead to unanticipated developments both in terms of tugs and vessels. For example, more advanced tugs and vessels may reduce the number of tugs required for certain types of vessel movements before the end of 2027. Technology may provide for significant economies of scale which could be spread amongst ports. In the future, certain roles currently conducted by crew physically present on tug-boats may be conducted by crew situated onshore, who could therefore move between tugs rapidly, as needed.

## **5.3 Barriers to entry are so high in towage that the threat of entry does not impose an effective discipline on the behaviour of the incumbent**

Svitzer considers that, although the costs of entry are not trivial, many of these costs can be recovered on exit. The sunk cost problem that arises in the case of transport infrastructure (for which franchise bidding is a reasonable option) is much less significant in the case of towage. Irrecoverable costs are small relative to the revenue from towage operations in a substantial port. Further, the suggestion is contradicted by the observed fact that entry has occurred in a number of ports which have varied materially in the size and scope of demand.

## **5.4 The priorities of the towage customer and GPC are not aligned**

Svitzer considers that GPC's priorities are different from those of its customers. Svitzer considers that a clear example of this was the decision to require a significant upgrade of the towage fleet at a time when GPC was granting the current exclusive licence, as noted above. At that time, the vast majority, if not all, of its customers would have been content for such an upgrade to have been delayed until it was necessary in order to reduce costs. Svitzer contends that whilst part of this is due to the artificiality of the licence period, part of it is simply due to the fact that GPC does not pay for towage, which resulted in gold-plated towage requirements in the current exclusive licence granted to Smit.

A further example of this is the weight which GPC puts on the "administrative benefits" in having a single operator and the complaint that "*multiple towage operators would require the development of priority systems and other processes.*" Svitzer notes that the Port of Gladstone must already consider a wide variety of factors when scheduling each vessel arriving or departing the Port and the addition of a second towage provider is, relative to all of the other factors, not remotely material. Svitzer submits that a port's focus on administrative simplicity cannot outweigh the ability of competition to drive benefits for port users.

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## **6 No public benefits of the Exclusive Licence or Third Line Force outweigh the anticompetitive effects**

Svitzer considers that it is clear that excluding competition in towage services from a harbour as large as the Port of Gladstone has both the purpose and the effect, or likely effect, of substantially lessening competition, and that, in all the circumstances, the conduct will not result in likely public benefits which would outweigh the likely public detriment.

Moreover, as indicated above, any public benefits are not relevant to the question of the lawfulness of the proposed Exclusive Licence. In any event, Svitzer considers that there are no countervailing public benefits to outweigh the anticompetitive effects.

GPC contends that a rationale behind the Third Line Force is that it leads to efficiencies which would allow a provider to earn a reasonable rate of return and that these efficiencies could be passed on to port users. Specifically, GPC argues that a further Exclusive Licence will result in public benefits arising from:

- 1 increasing competition for the market, thereby increasing competitive pressure;
- 2 decreased prices; and
- 3 avoidance of costs.

Svitzer addresses each of these points in turn.

### **6.1 Exclusive Licences do not increase competition for the market and reduce competitive pressure**

GPC argues that an exclusive licence will “*continue to increase competition for the market*” and that granting the Exclusive Licence “*should lead to lower costs and increased efficiencies than a tender for a non-exclusive licence.*”

Svitzer notes that one effect of the Notification and the proposed licensing process is that Smit will not be subject to any competitive pressure until (at least) the Notification is revoked or the next exclusive licence is granted. Simply, the prospect of an exclusive licence being granted from 1 January 2020 will effectively prevent any entry into the market following the expiry of Smit’s current licence at the end of this year.

An Exclusive License is not necessary to provide a new entrant a foothold in the market. If Smit were to be awarded the Exclusive Licence, then Smit will effectively benefit from nine years of exclusivity as a result of its current exclusive licence. In that context, it is unclear how any competition for the market will ‘continue to increase’ or how lower costs and increased efficiencies arise from a further year following the expiry of the current exclusive licence without competition.

GPC asserts that the Exclusive Licence provides certainty to the single provider and that, in contrast, potential applicants for a non-exclusive licence “*will need to factor into their business cases the risk that they may not be able to supply harbour towage services to all the users of the Port of Gladstone.*” Svitzer considers that such an argument ignores the uncertainty caused by the exclusive licensing period that the operator will be ejected from a port when the exclusive licence ends. This is particularly the case when investments need to be made several years into an exclusive licensing period, such as the significant investment Smit made in purchasing five LNG tugs. Svitzer considers that this uncertainty fed directly through to the prices charged to LNG customers when Smit agreed to invest huge sums in these tugs several years into the current exclusive licence (as noted above in section 5.1).

Svitzer notes that this is just one example of the static market fallacy which permeates the arguments in favour of exclusive licensing. These arguments ignore the difficulties and errors arising from the assumptions underpinning the Exclusive Licence, as explained in section 5, above.

In any event, as set out in section 3.2 above, framing the Exclusive Licence as a choice between competition ‘for the market’ and competition ‘in the market’ is a false dichotomy.

### **6.2 An Exclusive Licence is unlikely to decrease prices**

GPC notes that its previous competitive tender for an exclusive licence resulted in towage charges falling by approximately 3% in the Port of Gladstone when the exclusive licence began and that the tender process for the Exclusive Licence will “*provide the necessary competitive pressures to result in lower costs*” for port users in the Port of Gladstone.

Svitzer notes that shortly after the grant of the current exclusive licence, Smit was able to raise prices when forecast demand was not met for harbour towage users. Further, it was able to (and in fact did) charge uncompetitive prices to LNG users when asked to purchase further LNG tugs. Svitzer considers that this resulted in LNG users effectively cross-subsidising other port users at the Port of Gladstone.

As set out in section 3.3 above, Svitzer considers that the pricing analysis prepared by PwC for GPC is flawed for a number of reasons, including that:

- the relevant ports are not identified;
- costs are influenced by economies of scale and the physical characteristics of a port; and
- it does not consider the considerably higher levels of discounting which occur at ports without exclusive licences.

Svitzer also notes that the assumptions underlying exclusive licences lead to increased costs which have demonstrably occurred during the current exclusive licensing period, as noted in section 5.

### **6.3 An Exclusive Licence is likely to reduce opportunities to avoid costs**

GPC argues that the Exclusive Licence would lead to public benefits by providing certainty that there would be a single towage operator in the Port of Gladstone and various costs associated with having more than one towage operator will be avoided by the Exclusive Licence. Svitzer considers that the calculated efficiencies exist only in a static world in which the market is neatly divided up between two providers and no cross-hiring arrangements occur, as noted above in section 4.

The current period of exclusive licensing has clearly demonstrated that the market is not static and market conditions will continue to develop and change, inevitably undermining any assumptions which can be made for a lengthy exclusive licence period. Costs, in particular, may change dramatically based on changes to working practices and technological change.

Svitzer considers that, in contrast, the Exclusive Licence would build rigidity into system in the long-term which prevents the fluid negotiation of prices based on any changes arising from different operating environments and technological change.

For example:

- In relation to technological change, modern vessels (and in particular, new cruise ships) have advanced control systems which allow them to manoeuvre precisely, increasingly reducing their dependency on tugs. These systems may increasingly be fitted to cargo vessels. Svitzer considers that technology will continue to develop rapidly between the present day and the end of 2027.
- In future, tugboats may be able to be remotely piloted between tug jobs, such that the crew can rest during long-transits to and from tug jobs, and commence their shifts at the beginning of the actual tug job.



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## 7 Conclusion

For the reasons set out above, Svitzer opposes the Notification.

In summary:

- The Notification is fundamentally misconceived. A Notification based on the proposed Third Line Force should not be used as a back-door to immunise the significant anticompetitive effects that arise from the proposed Exclusive Licence.
- The proposed Exclusive Licence and the Third Line Force would give rise to significant anticompetitive effects compared to a competitive landscape without the Exclusive Licence, depriving customers of the benefits of the competitive process to negotiate price and other terms of supply, for which a port authority cannot serve as a good proxy.
- While public benefits are not relevant to the assessment of the Exclusive Licence, there are no public benefits that arise by reason of the Third Line Force, or indeed the Exclusive Licence:
  - An exclusive licence is unlikely to increase competition for the market and increase competitive pressure. Contrasting competition in the market with competition for the market is a false dichotomy. The process of transformation of competition between these two states and continued threat of re-entry provides significant competitive tension and public benefit. The ability to enter into joint ventures, seek customer sponsorship and cross-hire provides a new entrant the capacity to gain a foothold in the market, without depriving customers the benefit of competition;
  - an exclusive licence is unlikely to decrease prices. Indeed, an exclusive licence is more likely to have the opposite effect, as evidenced by Smit's price increase in the current exclusive licence period when volume forecasts were not met. That prices are likely to be lower, in the absence of an exclusive licence, is in fact reinforced by GPC's own admission; the so called "*resource costs associated with any price war*" mischaracterises the pro-competitive process and significant benefits to the customer in terms of lower pricing without any apparent justification; and
  - an exclusive licence is likely to reduce opportunities to reduce costs both through innovation and other cost reducing mechanisms such as industrial relations reforms. The concern as to the introduction of spare capacity can be resolved by cross-hiring without the need to restrict competition by an exclusive licence. Logistics relating to the channel width and safety concerns are not a function of the number of towage operators in the Port of Gladstone, and administrative costs in relation to coordination will be incurred irrespective of competition in the Port of Gladstone. Any need to construct further tugboat berths would be underwritten by towage operators wishing to do business in the Port.