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Sustainable competition in harbour towage – how do we get there?

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2020 marks almost 30 years since the provision of harbour towage at the ports of Melbourne, Sydney (Port Botany and Port Jackson), Newcastle, Brisbane, Fremantle and Adelaide first commenced as a ‘declared’ service under the *Prices Surveillance Act 1983.* The declaration was made to address concerns over the lack of competition in the provision of harbour towage.

Eleven years later, in 2002, the Productivity Commission again looked at whether harbour towage should continue as a declared service. The enquire found “in nearly all Australian ports, there is only one provider of towage services. Moreover, one company currently dominates the industry in Australia. The potential for monopolistic behaviour by towage providers is the principal reason for the current price regulation of harbour towage and the main reason for this inquiry”. The enquiry further found that “Enduring competition within most, if not all, Australian ports is unlikely due to low levels of demand, ‘lumpy’ investments and economies of scale. In the longer term, only one operator is likely to survive in any particular port”.

To overcome barriers to entry, and to encourage competition, the enquiry went on to recommend that “Contracting and licensing can be used by towage users and port authorities to exert even more pressure. This has occurred at many regional ports. Competitive tenders for the right to operate at multi-user ports for a fixed period likewise could be used to promote more competitive towage outcomes”. In effect, the Productivity Commission was supporting the use of what we know today as an ‘exclusive towage license’.

Return to present day and several port operators have implemented the exclusive licensing regime, whereby a tender is held up-front for the provision of towage services for a fixed period. The system benefits port users, in that certainty of efficient pricing is assured, as well as providing operators with revenue


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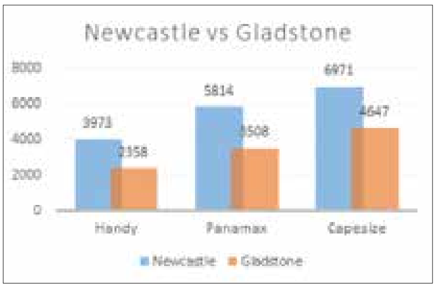
security and therefore, the confidence to invest in a fit-for-purpose tug fleet that meets the operational profile of the port. A slightly modified 'non-exclusive' licensing process also appears to be gaining popularity, where a tender is held to lease the only suitable tug berths within a port. In effect this results in an almost identical outcome for port users and towage operators as the traditional exclusive license.



So does exclusive licensing work? Figure 1 shows the current towage costs for Handy, Panamax and Capesize vessels within the 'open' port of Newcastle verses the exclusive licensed port of Gladstone. Both ports are of similar size and with a comparable operating profile. As can be seen, there are substantial savings for port users under an exclusive license, with an average 37 per cent lower cost per tug job.

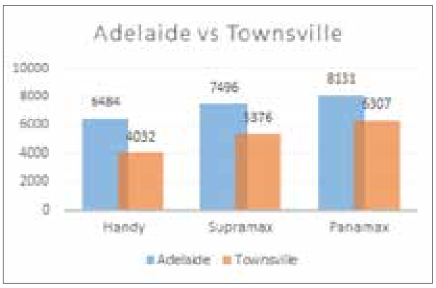


Figure 2 shows data for the similarly sized open port of Adelaide verses the exclusive license operating in the port of Townsville. As can be seen, the same trend exists as per Figure 1, with an average 30 per cent reduction in towage costs in the exclusive license port.

Augments against the exclusive license concept include the potential for industrial action against the single operator to close an entire port. Whilst this is true for any port where a single operator exists (as has been seen recently), Smit Lamnalco's experience is that unions and employees understand that exclusive licenses contain a fixed pricing escalation formula, therefore the prospect of an ambit pay claim succeeding is highly unlikely. Certainly there is some complexity around the requirement for the port operator to engage with the ACCC for an 'exclusive dealing' with one towage operator. However, this process is now well understood, with enough historical data being available to comprehensively show the public benefits of exclusive licenses.

Returning to the original 1991 list of 'declared' ports: Melbourne, Sydney (Port Botany and Port Jackson), Newcastle, Brisbane, Fremantle and Adelaide have all had vastly differing competition landscapes over the years. However, except for Smit Lamnalco's recent investment in the Engage Towage business, which is far too embryonic to consider at this point, there is no on-water competition occurring in any of these major capital city ports. Indeed, the same monopolistic position that was flagged in 1991, still exists in 2020. This is despite the best efforts of AMS, PB Towage, and Smit Lamnalco, all of whom have been unable to maintain sustainable on-water operating positions.

The problem has been compounded recently with several non-exclusive licenses being issued by port operators, which stipulate service standards and fleet composition but neglect to consider the commercial reality of these requirements. Case in point, the recent introduction of non-exclusive licenses in Port Jackson and Port Botany, which require each licensee to maintain a fleet of five tugs, plus provide one operational spare. All seems reasonable until you realise that the total towage revenue of the two ports is less than the fixed cost of operating 12 tugs. Eventually this results in either towage costs going up to support the additional vessels and crews or, more than likely, one of the operators being forced to leave the market. Either way, towage costs go up for port users.

In my many discussions with shipping companies and port operators around the country, there would appear to be an overwhelming desire for sustainable competition in harbour towage. So how do we get there? Exclusive licensing is a proven and efficient model that works well in ports with steady-state operations. Non-exclusive licensing where only one tug berth can exist is also a viable option, provided a competitive and open tender process is completed up-front.

The third option, and the one which would benefit our capital city ports, are multiple non-exclusive licenses with mandatory inter-hire arrangements between operators. The inter-hire arrangement prevents over-capacity, as operators can 'borrow' a tug from each other when operationally required. This practice is common in other parts of the world.

As a hypothetical, consider a port requiring six tugs total, where the majority of ship moves are completed with two tugs, three tugs are used occasionally, and once in a blue moon there is a four tug move. This port could most efficiently be serviced by two operators, with three tugs each, and with a mandatory inter-hire agreement in place. There is no additional capacity required above the operationally required six tugs, the port and customers are fully serviced, and multiple operators are sustainably competing on price and service. Depending on the size of the port, the concept can also work with three or more providers.

Apply this model to the previous example in Port Botany and Port Jackson, and any enquiring mind would reasonably have to ask "why do we now need the cost of 12 tugs, when the ports have been serviced adequately for many years with only six?". The answer is that port operators are unwilling to mandate inter-hire arrangements because they are reluctant to "wade into" commercial matters. However, I would argue that directing inter-hire is more about implementing what is required to finally enable a sustainable, competitive towage market. If that means port operators need to "wade into" the commercial ocean, then that is what needs to happen to satisfy the market's desire for sustainable competition.

Who is up for a swim?