Pacific Maritime
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Our Ref: JK:AM:2022528

28 July 2023

Sam O'Connor,
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By email: sam.oconnor@accc.gov.au

Dear Mx O'Connor,

Application For Authorisation AA1000646 – Townsville and FNQ Ports

We represent Pacific Tug Group, a family-owned supplier of tug and towage services on the Eastern Seaboard of Australia with a fleet of 26 vessels including barges and transfer vessels as well as tugs. Our client is based in Brisbane.

Thank you for the opportunity to make submissions in relation to this application.

In short, our client's view is that the application should be rejected because:

- the application is based on broad assumptions as to the current market definition and makes no effort to describe future market dynamics, despite seeking a 13 year duration; and
- the application proposes that it will result in a broader range of market participants, whereas the opposite will almost certainly be the case; and
- the applicant claims that there will be competition for the market, while at the same time proposing to more than double the length of the current exemption; and
- the applicant claims that in the event of a non-exclusive licence being granted, the practical outcome would be one operator in reach port; in which case there is no reason not to allow for a non-exclusive license; and
- the applicant claims that the proposed arrangement would lead to more efficient use of assets such as tugs, without making any effort at all to demonstrate whether a competitive market could or would produce even greater efficiencies; and
- the application is justified on the basis of cost savings in the procurement process, whereas in fact there is no reason that the ports cannot provide non-

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exclusive licence to any complying towage company. This would effectively eliminate the need to spend anything at all on a competitive tendering process; and

- the combination of an exclusive licence and approval for third line forcing means, effectively, that the approval sought would be an approval for the winning bidder to operate a monopoly, without that operator having been required to seek ACCC approval to do so; and

- the applicants, through their past conduct, have demonstrated that neither the Commission, the community, nor the industry can have confidence that the tender process (purportedly the competition for the market) will be conducted fairly.

We expand on each of these points below.

Assumptions about market constitution and market dynamics

We suggest that it is fundamental to an application of this type that the relevant market must be properly defined and well understood. "The identification of markets must be the essential first step in assessment of present competition and likely competitive effects." [*Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd* (1976) 25 FLR 169]

There is no law which might give comfort to any particular market definition for tug and towage services. In *Stirling Harbour Services v Bunbury Port Authority* [2000] FCA 1381 Burchett and Hely JJ said:

It was common ground that the relevant market is the market for the provision of towage services to shipping operators, and for the right to provide such services, in the Port of Bunbury. The primary judge noted that, absent concessions, there might be a case for a broader definition of the geographic market

Before the Applicants in the current application could make any valid case that they should be authorised to reduce competition in a market, the market itself must be defined. Furthermore, in an application for an authorisation which will run for 13 and possibly 15 years, the Applicants ought to make an effort to identify likely changes in the market during that period (and if such predictions are impossible, this in itself is a reason to deny such a long period for the authorisation).

In the application. The Applicants make a scant effort to identify the relevant market, in three short paragraphs in Clause 6 of the application. The application contains no economic modelling of any sophistication at all; no exploration, for instance, of the size of a market which might sustain more than one operator; no discussion of the impact of adjacent ports and the potential for smaller, more agile companies like our client to switch assets between ports depending on predictable patterns of demand.

To complicate this, the market also proposes to issue exclusive licences in relation to various potential configurations of the market. This in itself shows that the market should be more than one port; and that the market can be considered in different ways, each of which will have their own competitive dynamics.

It would, we suggest, be impossible for the Commission to authorise the proposed exclusive arrangements in circumstances where there is essentially no definition of the market.

For our part, our client says that each individual participant should be able to define the relevant market in accordance with their own operational strategy. Participants should be able to service markets individually or jointly as their resources and business strategies allow; and the approach of each market participant should be able to evolve along with the evolution of economic activity in that market and the evolution of technology in the tug and towage industry. Innovation arising from a contest between operators endeavouring to maximise distinct competitive advantages will be completely destroyed if such a simplistic market definition is allowed to ossify a market for a decade and a half.

Additional market participants?

At paragraph 3.4 the application makes the extraordinary claim that the proposed anticompetitive behaviour will "provide the potential for aggregated demand for towage services to as to attract a wider possible group of potential service providers."

To make this claim with any credibility, it would need to be demonstrated that the absence of such aggregated demand presented, or at least contributed towards, a barrier to entry for new market participants. No such argument has been attempted, and no such argument could credibly be attempted.

In fact, by aggregating demand and allowing only exclusive licences in respect of that demand, the proposal will eliminate smaller market participants, because only larger market participants will have the capacity to (exclusively) service that demand. The proposal will almost certainly result in two companies – Svitzer and Smit Lamnalco – being the only two market participants in the market. No other operators are large enough to service entire markets exclusively.

Furthermore there is no need to service entire markets. The market for tug and towage services is infinitely severable. There is no reason why, if eight vessels arrive in Port of Cairns on a particular day, four of them might not engage one company, three of them a second company, and one of them engage a third. Each vessel movement is completely independent on each other.

It is, of course, true, that economies of scale would determine whether operators wished to operate in particular markets, but these are almost doctrinally decisions which can be left to operators competing in each market. If a particular port or a particular market for port services turns out to be a natural monopoly, then this will be established by the actual behaviour of participants in the market.

There is no basis for the Commission to accept that this application has, as either its intention or its effect, the diversification of market participants. It will have the opposite effect.

Competition for the market

It is accepted that in circumstances where a market is regulated, and where the market characteristics are such that a natural monopoly exists, competition for the market is better than no competition at all. However, for competition for a market to realistically be so, the competition must be held at sufficiently short intervals that the competition is routinely tested. We suggest that the longer the period of proposed authorisation for anticompetitive conduct, the greater must be the justification. For instance, if the market activity involved building major new infrastructure which would take years to amortise, then this might justify a longer period of time.

The current proposal is for an approval to last 13 years.

The application attempts to justify this length of time by suggesting that each tug requires an investment of $7.5 million, and suggests that a total investment of $30 million would be necessary to supply services to Cairns and Mourilyan.

There are a number of things to note about these numbers.

First, the numbers are not, on their own, very large. At the Port of Lucinda, Svitzer's published rates are a mobilisation charge of $8915 per tug, and then an amount ranging from $20,000 to $35,000 per vessel movement. Given that revenue generation capacity, an investment of $7.5 million, or even $30 million, while still a substantial investment in absolute terms, is not a sufficiently substantial investment to justify competitive protection for the operator.

Second, the numbers used have seemingly been plucked from the air. No justification is given for the numbers used. This is crucial because one of the competitive advantages of smaller, more agile tug services such as our client is their ability to mobilise tugs between ports. The investment required to "swing in" to a port with a vessel which intends to "swing out" again is inevitably going to be much less than $7.5 million dollars.

If this efficiency argument is to be made by the applicants, it must be made properly, on the basis of properly developed and properly modelled costs, and on the basis of various models of operation. At present the Commission has before it only made-up numbers, which in any event do not justify protection form competition.

Practical monopolies

The application claims "The low number of towage jobs relative to the minimum number of tug vessels required to establish a towage operation means that each of the ports can only support one service provider in the long term."

If this is the case (which is not conceded) then, in our client's submission, this merely emphasises that there is no need for exclusive licencing. A port could issue non-exclusive licences to four different operators and then simply allow them to compete as they see fit. Some operators will leave some markets, potentially resulting in a monopoly in those markets, but this ought to happen as a result of market activity and not as a result of regulatory activity.

In any event, the proposition that markets can only sustain one operator is a mere assertion on the part of the applicant, unsupported by proper evidence. There is, on the contrary, evidence of ports such as Port Eden in NSW, a relatively small port where for some years towage services have been provided by both Svitzer and Pacific Tug, in competition. The argument in the application appears to be that because the ACCC previously considered that economies of scale would be exhausted at 8000 movements a year, each market should remain a monopoly until it reaches that threshold.

This view is not supported by even the most basic economic logic. No operator in any market for any goods or services is entitled to have the market to themselves until they *exhaust their economies of scale*. The application seems to conflate the minimum required demand to sustain a new entrant, with the figure at which economies of scale are exhausted. These are completely distinct concepts and there is no sense in which one can be used as a substitute for the other.

Absent the application, it will be for each non-exclusive licence holder to determine, in relation to each port, how much work they can obtain, and how much revenue they can obtain from that work, and then it will be for each non-exclusive licence holder to determine whether their business models support operation, or continued operation, in that market. These are perfectly normal business decisions, made by a thousand enterprises every day, in as many different competitive markets. No case has been advanced in the application as to why tug and towage providers should be sheltered from the need to make normal business decisions.

<u>More efficient use of tugs?</u>

It is claimed in the application that by allowing for exclusive licences to cover more than one port, the efficiency of the use of the tugs will be increased. And this might well be so – allowing vessels to service multiple ports seems obviously to increase efficiency.

What is <u>not</u> demonstrated, however, is whether the outcome under the application would be more efficient than the outcome arising from a competitive market. This is, surely, the proper inquiry for the Commission to be making in an application such as this one, and a rationale is not even attempted by the applicants. There is no reason to believe why normal market forces would not, if allowed to operate, result in the optimal number of tug and towage assets being located in the optimal positions to service Queensland ports at the best price to incoming vessels.

At the very least, we suggest it must be acknowledged that the application has not made this case.

Costs of procurement

Finally, it is suggested by the applicants that the costs of procurement will be much less if the procurement processes are combined, and are exclusive, and run for 13 years.

The application, however, ignores the obvious: it is open to the applicants to allow for multiple, non-exclusive licences to be awarded to any tug and towage provider who wishes to participate in a given port. It is, of course, necessary that each provider demonstrate that it has the vessels and the personnel to perform the services safely and competently; beyond this, however, the market can be allowed to operate. That being the case, the cost of conducting a competitive procurement process would be avoided altogether. And provider who was capable of putting together a compliant bid could simply be awarded a non-exclusive licence. This competitive process would, we suggest, be far more efficient than the noncompetitive process proposed by the application.

Third line forcing

A curiosity arising from the regulatory shape of the relevant ports is that while it is the port seeking approval from the ACCC for anticompetitive conduct, the actual anticompetitive conduct will be carried out by the successful bidder for the exclusive licence. The application is, therefore, classically an application for approval for third line forcing.

The application, with respect, does not even attempt to show what measures would be put in place to protect transport industries from the impact of third third line forcing. There is nothing in the application to prevent the successful bidder from providing tug and towage services at whatever cost they wish, or to prevent them from imposing whatever conditions they wish, on incoming vessels. The Commission is essentially asked to believe that the operator – who cannot yet be identified – will play fair.

The dangers of this situation are further exacerbated by the practical unavailability of substitution. Sugar and Molasses will only be loaded in Mourilyan, and there is no way for transport providers to (for instance) select another port at which to be loaded.

It is, in our submission, quite extraordinary that the applicant seeks approval for a third line forcing arrangement without saying what that arrangement will be; without even setting parameters for the bidding process.

Lessons from the past

When the licences for these ports were last contested, our client was a bidder. Our client's bid complied with the tender requirements, and the winning bidder – Svitzer – did not. Port authorities, when questioned about this, merely indicated that they had a commercial discretion to change the tender requirements.

It is, of course, not unheard of for tender requirements to evolve during the bidding process. However in circumstances where the tender process is the only opportunity to contest a market for *twelve years*, a much more stringent tender process must be insisted on.

The current application gives no details about how such a process would be conducted, and what measures would be proposed to ensure that the process is conducted fairly. Under such circumstances, and absent such detail, the approval ought not to be granted.

Summary

If it could be demonstrated, for instance, that absent an exclusive licence, no tug and towage services would be provided in (say) Mourilyan, then our client accepts this would be a very good reason for competition law to step in and to ensure the viability of that essential service.

Nobody, in this case, seeks to make such an argument. It is clear that whether the market for tug and towage operates under exclusive or non-exclusive licences, the mature industry in Queensland will service the relevant ports.

In this case, the Commission is quite simply being asked to perform the opposite of its fundamental statutory function: the commission is being asked to curtain competition in a way which will provide insurmountable advantages to the "big end of town" and drive smaller players from the market, in a way which may ultimately result in true monopoly or oligopoly in the markets.

Our client, Pacific Tug Group, seeks no assistance. Our client is willing to stand or fall in any market on the basis of the efficiency and professionalism of its seafarers; the quality of its service; and the cost it charges. All our client seeks is a level playing field. The current application would effectively shut out our client, and operators like our client, from providing services north of Gladstone.

All Australians who rely on the movement of goods and commodities through Australian ports – which means all Australians – will suffer if enterprises like Pacific Tug are forced from the market, and the market ultimately settles upon one or two players.

The current application must be refused.

Yours faithfully,
Pacific Maritime Lawyers

John Kavanagh
Principal Lawyer, Master Mariner