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28 October 2020

Shipping Australia Limited Submission on Port of Melbourne's Proposed Tariff Rebalancing

References:

a. Port of Melbourne's Industry update and Tariff rebalancing consultation email 29 Sep 2020
b. Port of Melbourne – Tariff Rebalancing Consultation – September 2020.pdf
c. Port of Melbourne – Tariff Rebalancing Consultation – September 2020 – Bass Strait Trade.pdf
d. Video discussions Shipping Australia / Port of Melbourne of 14 October

Background

Shipping Australia Limited (SAL) is a peak shipowner association with 29 member Lines and shipping Agents and with 44 corporate associate members, which generally provide services to the maritime industry in Australia including: port and terminal operations, pilotage, insurance and legal advice. Our member Lines are involved with over 80 per cent of Australia's international liner container and car trade as well as over 70 per cent of our break bulk and bulk trade. Our member ships' agents are responsible for arranging logistics for visiting ships and for embarking and disembarking maritime crew members. For a list of members and details of our structure and activities please visit: www.shippingaustralia.com.au.

Introduction

Shipping Australia appreciates the opportunity to comment on this proposal, the extension of the consultation response deadline to 28 October and the informative discussion with senior Port of Melbourne finance personnel on 14 October.

Shipping Australia Limited is pleased to provide comments on the specific questions at reference a.

Some comments are related to matters of principle but importantly we note that the financial outcomes of the proposed rebalancing are very significant over the remaining period 46 years of the port lease. Importantly any projection of financial outcomes are extremely sensitive to the accuracy of modelled input variables such as: the rate of increase in percentage of TEU carried in big ships, the growth rate of TEUs through the port, and the inflation rate.

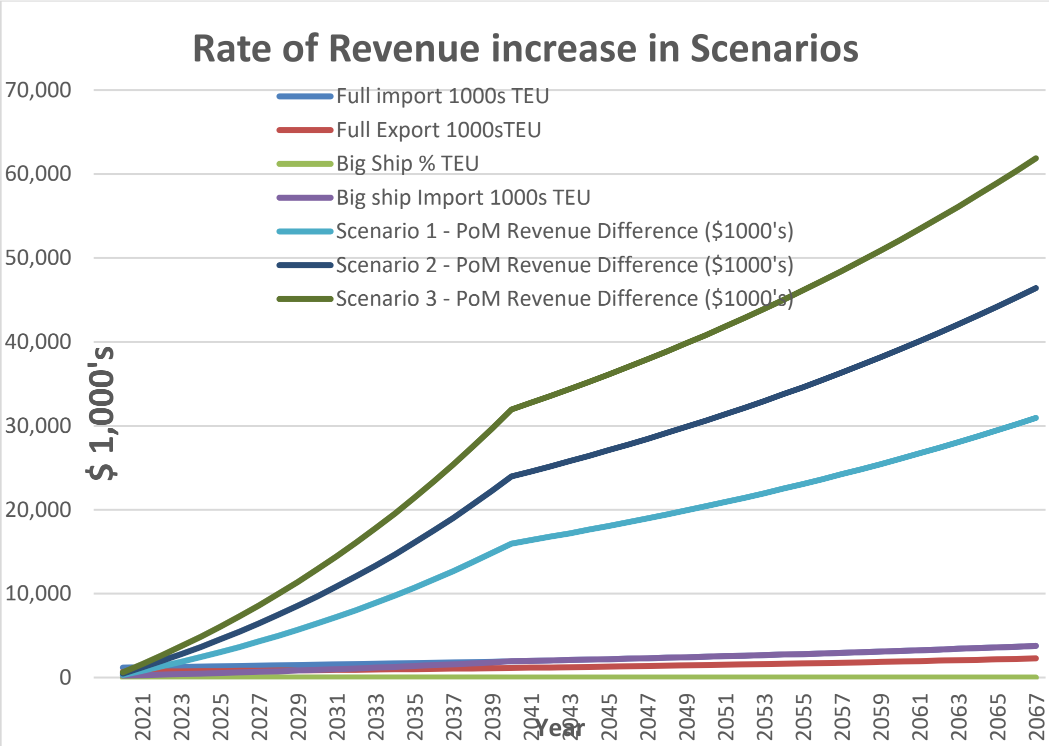
It is also a fundamental point that the requirement for the Port of Melbourne to support larger ship sizes should not have come as a surprise, it was completely predictable, and emphasised by Shipping Australia in all our pre-privatisation briefings to bidders. The opening of the widened Panama Canal in mid-2016 is the single most important factor that has changed the fundamental of ship design since the birth of containerisation. This occurred before the final sale of the port and any effective due diligence conducted by a potential purchaser should have identified the need and factored the necessary investment costs into its purchase bid. It is also noted that the cost of money is at an all-time low and so the cost of financing investment now to ensure that the port is in the position to properly accommodate the projected larger vessels of the future is as low as it is ever likely to be.

Another statement made by the port (at 4.5 ref. b. and ref c.) which is concerning, is that the volume of cargo does not increase due to the size of the vessel. While the total port throughput may not have increased, it is a fact that larger ships carry more cargo and conduct higher container exchanges, faster and more efficiently by operating more cranes concurrently and reducing inefficiencies by requiring fewer ship moves. This increases the efficiency of the port and hence its earning potential through wharfage. Big ships also pay higher channel fees (which are based on GRT) thus, bigger ships already return a greater earning to the port than smaller ones. Additionally, big ships are required to pay for additional escort tugs to negotiate the Yarra river and additional pilotage fees, so are already financially penalised for their size.

During our discussions (ref. d) PoM advised that last year big ships accounted for 13 per cent of the number of ships and 20 per cent of the TEU. The graph provided at paragraph 4.2 of ref. b. (repeated below) shows that the increase in visits of vessels over 8,000 TEU over the past two years is about 4 per cent per year and mainly comes at the expense of ships between 5,000 to 7,000 TEU.

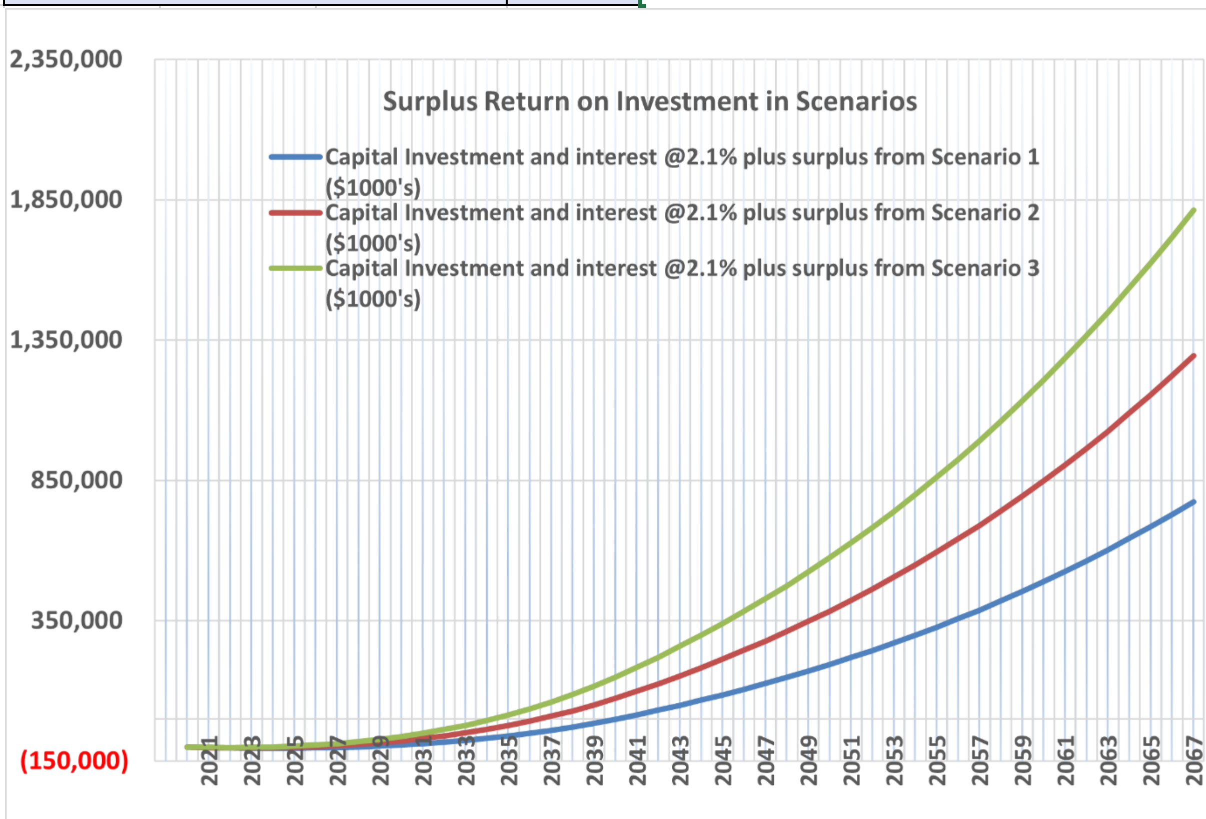
This trend only appears in two years of data and it would be dangerous and unreliable to project these early trend figures for another 46 years until the expiration of the current port lease. Nevertheless, we need to do so to quantify the possible returns on the proposed scenarios. Though if the growth of big ships follows the same pattern as that shown for 5000 – 6000 TEU ships when they started to appear, then it is destined to accelerate quickly. I request that further detail be provided on the assumptions and projected financial impacts of the proposed rebalancing through the life of the lease.

In all three scenarios offered at paragraph 5.3 of ref. b. the offset for charging higher wharfage on full import containers delivered by big ships is to reduce the wharfage on export containers. However, export containers are a small proportion of turnover and while the proportion of cargo carried by big ships is estimated to grow at around 4 per cent, the volume of TEU imports and exports is only estimated at 2.6 per cent, leading to an accelerating rate of recovery until (theoretically) all cargo is carried by big ships from about 2040 onwards.



Given the assumptions taken from references b and d as shown, an initial investment of 100 million in 2020 would be recovered by 2040 in Scenario 1, 2037 in Scenario 2 and 2035 in Scenario 3 and the

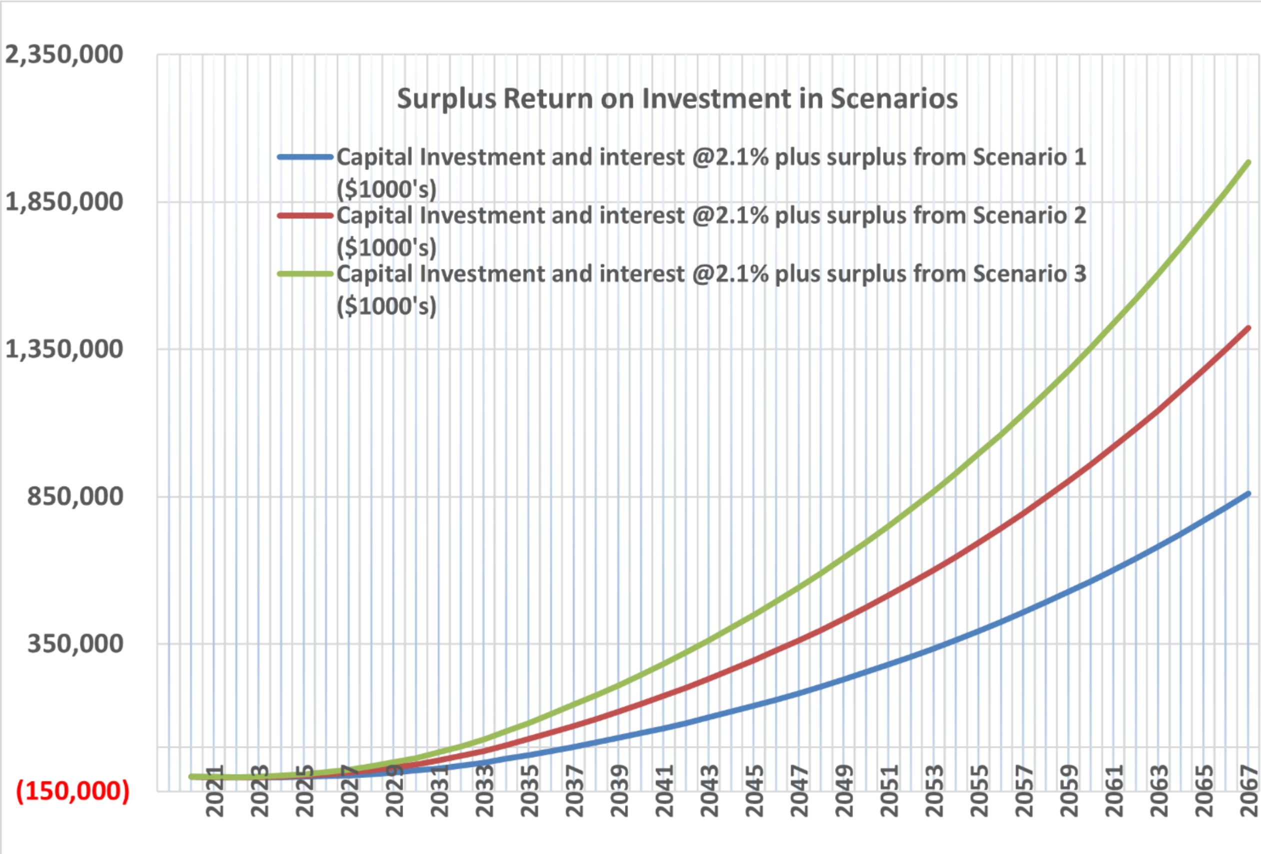
Variables:	Increase in Big Ship % of TEU pa	4.0%
	Growth in Container throughput pa	2.6%
	Inflation Rate	2.1%



surplus revenue over and above the current TAL capped levels would be up to $1.85 billion (Scenario 3) by the end of the lease period.

However, if the rate of increase in cargo on big ships was 6 per cent (as shown on the graph below) then all cargo would be on big ships (theoretically) from 2032 and the surplus for Scenario 3 would hit 2 billion by the end of the lease period.

Variables:	Increase in Big Ship % of TEU pa	6.0%
	Growth in Container throughput pa	2.6%
	Inflation Rate	2.1%



The facilitation of big ship visits to the Port of Melbourne is not a choice for the port, it is an essential investment to ensure the future of the port and one that was clearly apparent before the port was privatised. It seems incongruous to now ask the port users to fund the investment now in order to increase the port's future revenue stream and to rectify the fact that the successful bidder for the port did not allow for this investment in their purchase and bid too high for the purchase.

Shipping Australia is not entirely clear on how any price controls or monitoring will apply after the completion of the TAL between 2032 and 2037 and would appreciate a more detailed briefing on this from the port or the Essential Services Commission.   Based on our calculations it would appear that if the rebalancing goes ahead then there is a strong case for removing the additional charges on big ships once the capital investment is recovered (2035 for Scenario 3 and 2040 in Scenario 1 based on the forecast variable shown above). As currently proposed, the overall impact of the proposed tariff rebalancing is to boost the revenue of the port throughout the lease period between $850 million and $1.8 billion.

Investment Need

PoM has identified a need to invest in providing services to 'larger vessels' (i.e. vessels that exceed the port design vessel of 300m LOA by 40m beam) and outlined an investment program comprising recent and planned investments.

1) ***Do you agree on the drivers for, and approach to, PoM's investments to facilitate larger vessels?***

Shipping Australia supports the recent, current, and future investment by the PoM to accommodate larger vessels and considers this prudent investment.

The 2050 PDS identifies "sweating the assets and timing investment to provide capacity when required", however some of this investment is already too late. Big ships are already subject to delays of around 48 hours queueing for a berth and investment in removing the "knuckle" to double the big ship capacity of Webb dock should not be further delayed.

The inability of the Port of Melbourne to accommodate larger vessels has been seen as a shortfall of the port for at least the past 20 years and led to the development of Webb Dock and the Government's consideration of other options such as Hastings and Bay West as an alternate site for a container port servicing Melbourne. The current owner has argued that the existing port can meet these future requirements for the next 50 years and the Government has accepted that position, therefore it is up to the port to deliver on the support of larger ships.

Rebalancing Objectives

PoM's objectives in rebalancing tariffs are to support cost recovery, provide efficient pricing signals, and support trade growth and competitiveness of the port.

2) ***Are the rebalancing objectives appropriate?***

The suggested Vision statement generally captures the key desirable attributes. However:

a. the definition of 'Larger Vessels' as exceeding either 300m LOA <u>or</u> 40m beam is unique to Melbourne and would be more reasonable if defined exceeding 300m LOA <u>and</u> 40m beam. Vessels shorter than 300m do not cause the underutilisation of berth space referred to in ref. b. With the expansion of the Panama Canal, ships design has changed such that even smaller TEU capacity ships now exceed 40m beam, and

b. The Cost Recover objective seems one sided. It should only apply to new investment that was not considered as part of the purchase of the port. The requirement to invest to make the port suitable for larger vessels was identified before the port was privatised. It seems incongruous to now ask the port users to fund the investment now in order to increase the port's future revenue stream and to rectify the fact that the successful bidder for the port did not allow for this investment in their purchase and bid too high for the purchase.

3) ***Should PoM have regard to or consider other objectives?***

The objective of efficiency should also include reference to the efficiency of the port from a vessel perspective, i.e. the value for money for the port user. This should aim to minimise the delays in ships schedules and minimise the costs of visiting the port.

Tariff structure and design

Rebalancing tariffs towards high-growth services provides incremental revenue to fund investment. To promote efficient use of, and investment in, services to larger vessels, PoM has proposed an increase in the wharfage fee for containerised imports on larger vessels.

4) ***Should cost recovery target larger vessels, or should costs be recovered more broadly from other Port Users (i.e. from vessels that do not meet the 'larger vessel' definition)?***

Shipping Australia members support the general principle of user pays.

5) ***Is the definition of a 'larger vessel' (any vessel exceeding 300m LOA or 40m beam) appropriate? Are there alternative definitions PoM should consider?***

The definition of 'Larger Vessels' as exceeding either 300m LOA or 40m beam is unique to Melbourne and would be more reasonable if defined exceeding 300m LOA and 40m beam. Vessels shorter than 300m do not cause the underutilisation of berth space referred to in ref. b. With the expansion of the Panama Canal, ships design has changed such that even smaller TEU capacity ships now exceed 40m beam.

Indicative tariff levels

Under the rebalancing approach, an increase in any one tariff must be balanced by an equivalent decrease in another tariff (weighted by historical revenues from each tariff).

6) ***Is the increase in the 'larger vessels' tariff justified given the level of investment and operational savings to larger vessels?***

The requirement for a rebalancing, to finance investment that was clearly identifiable prior to bidding for the port is not agreed. Also the three scenarios all appear based on the trend information provided by Port of Melbourne to recover the full cost of the proposed investment between 2035 and 2040, then if not discontinued produce an over-recovery of between $850 million and $1.8 billion by the end of the lease period. This seems excessive and should a rebalancing be approved then a lower cost scenario should be considered.

It appears that the port considers that it has a right to make a claim on the "operational savings" of larger vessels. This is not agreed. Shipping lines need to invest a great deal more in their larger vessels than the Port of Melbourne is planning to invest to accommodate them. Also, these operational savings only occur if the vessel is full. Even with investment, the draught and height limitations of the Yarra river prevent this for larger vessels at some terminals at the Port of Melbourne. Additionally, larger vessels also pay higher channel fees (which are based on GRT) thus, larger vessels already return a greater earning to the port than smaller ones. Additionally, big ships are required to pay for additional escort tugs to negotiate the Yarra river and additional pilotage fees so are already financially penalised for their size.

7) ***Is the reduction in export tariffs likely to assist trade growth?***

This small reduction in export tariff would not make a significant impact on trade growth. But over a longer period and at the same time as NSW Ports are reducing their discount on exports it could possibly lead to more export cargo being attracted from the southern NSW region where land transport cost could be similar from each port. But it is not considered a major catalyst for increasing export trade.

Implementation and transaction costs

In rebalancing tariffs, PoM's intention is to minimise transaction and administrative costs to the industry

8) ***Are cargo-based charges (wharfage fees levied per TEU) preferred over vessel-based charges (channel fees levied on gross registered tonnage (GT))?***

Yes. The wharfage charge is an efficient and transparent charge, whereas ship-based (GRT) charges are more difficult to process and more likely to attract additional processing costs adding to the overall costs of moving cargo through the port.

9) ***Are there administrative challenges (i.e. transaction costs) for the proposal? If answered yes, please outline the challenges?***

Shipping Australia is not aware of any other port in the world where a wharfage charge on containers varies depending on the size of the vessel. This may appear unfair to some importers who may demand that their cargo is carried on smaller ships or will impact on the ability of the larger vessel operators to recover the full wharfage costs from their customers.

Port User response

PoM understands that larger vessels can create efficiencies in shipping costs and that shipping lines will benefit from investments that support the use of larger vessels.

10) ***How might shipping lines and/or cargo owners respond to the changes in tariffs being considered?***

The Port of Melbourne is already the most expensive container port in Australia for a ship to visit. The proposed rebalancing does nothing to improve this situation. Shipping lines agree that there should be investment to accommodate larger vessels, however they do not agree that this was unforeseen investment. It should have been factored into the bid price for the Port. The Port of Melbourne is however a geographic monopoly and for the foreseeable future ships effectively have no choice but to call. Some importers who may demand that their cargo is carried on smaller ships may have less schedule choice.

11) ***Is an increase in the larger vessels wharfage tariff of the magnitude being contemplated ($10-$20 per TEU) likely to deter shipping lines from deploying larger vessels?***

The decision of what ship size to deploy on a particular loop is complex and takes into account many factors including: partners, average utilisation, peak season utilisation, competition, relative costs at all ports, charter rates and much more. The proposed increase in wharfage would be an included factor.

Stakeholder engagement

12) ***What is your preferred method for further engagement on this topic (e.g. attend presentation on draft proposal / emailed draft proposal for comment / other – please specify)?***

Shipping Australia accepts video conference meetings and discussions. We prefer four weeks notice (minimum of two weeks) of industry presentations and provision of detailed documents relating to the presentation or proposal at the time of the notification. This allows us to consult with our members, become familiar with the information and develop proper questions to be addressed during a meeting.

Submission authorised by:
Rod Nairn, AM
Chief Executive Officer