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Productivity Commission

Review of Part X of the *Trade Practices Act 1974*: International Liner Cargo Shipping

Productivity Commission Inquiry Report

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The Honourable Peter Costello MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's report on the *Review of Part X of the* Trade Practices Act 1974*: International Liner Cargo Shipping*.

Yours sincerely

Judith Sloan
Presiding Commissioner

Gary Potts
Associate Commissioner

Terms of reference

PRODUCTIVITY COMMISSION ACT 1998

2004 REVIEW OF PART X OF THE TRADE PRACTICES ACT 1974

I, ROSS CAMERON, Parliamentary Secretary to the Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998* and in accordance with the Government's Legislation Review Schedule, refer Part X of the *Trade Practices Act 1974* and associated regulations to the Productivity Commission for inquiry and report within six months of receipt of this reference. The Commission is to hold hearings for the purpose of the inquiry.

Background

2. Part X of the Trade Practices Act 1974 is the Australian regulatory regime for international liner cargo shipping operations. It describes the conditions under which international liner operators are permitted to form conferences to provide joint liner cargo shipping services for Australian exporters and importers.

Scope of Inquiry

3. The Commission is to report on the appropriate arrangements for regulation of international liner cargo shipping services, taking into account the following objectives:

a) legislation/regulation should be retained only if the benefits to the community as a whole outweigh the costs; and if the objectives of the legislation/regulation cannot be achieved more efficiently through other means, including non-legislative approaches;

b) regard should be had to the effects on: the access of Australian exporters and importers to competitively priced international liner cargo shipping services that are of adequate frequency and reliability; public welfare and equity; economic and regional development; consumer interests; the competitiveness of business including small business; and efficient resource allocation; and

c) the Government's commitment to accelerate and strengthen the micro-economic reform process, including through improving the competitiveness of markets, particularly those which provide infrastructure services, in order to improve Australia's economic performance and living standards.

4. In making assessments in relation to matters in paragraph 3, the Commission is to have regard to the analytical requirements for regulation assessment by the Commonwealth, including those set out in the Competition Principles Agreement, as well as recent technological and institutional changes in the international liner shipping market since the last review of the industry in 1999. The report of the Commission should:

a) identify the rationale for Part X, quantifying issues as far as reasonably practical;

b) assess whether Part X currently satisfies the rationale identified in (a);

c) identify if, and to what extent, Part X restricts competition and, if so, whether this restriction is necessary to achieve the rationale identified in (a);

d) identify any problems, particularly those involving discussion agreements, experienced with the operation of Part X by those with an interest in international liner cargo shipping, in particular Australian shippers using liner cargo shipping services, and recommend, in light of (a), preferred means of addressing those problems;

e) identify relevant alternatives to Part X, including the authorisation processes in Part VII of the *Trade Practices Act 1974* and non-legislative approaches, and the extent to which these would achieve the rationale identified in (a);

f) identify the liner cargo shipping regimes of Australia's major trading partners and any recent reviews of these regimes, and determine the compatibility of the alternatives identified in (e);

g) analyse and as far as reasonably practical, quantify the benefits, costs, impacts (including with respect to predictability of the outcome on the standards of shipping services provided), and cost effectiveness of Part X and the alternatives identified in (e);

h) identify the different groups likely to be affected by Part X and alternatives in (e);

i) list the individuals and groups consulted during the review and outline their views;

j) determine a preferred option for regulation, if any, in light of objectives set out in paragraph (3); and

k) if it is considered that Part X should be retained as industry specific regulation for international liner cargo shipping, examine possible mechanisms for increasing the overall efficiency.

5. In undertaking this review, the Commission is to advertise nationally, consult with key interest groups and affected parties, and publish a report.

6. The Government will consider the Commission's recommendations and its response will be announced as soon as possible after the receipt of the Commission's report.

ROSS CAMERON
[Received on 23 June 2004]

THE HONOURABLE CHRIS PEARCE MP

Parliamentary Secretary to the Treasurer
Federal Member for Aston

Mr Gary Banks
Chairman
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Mr Banks

Thank you for your letter to the Treasurer of 19 October 2004 seeking extensions to the reporting dates for the inquiries into the Review of National Competition Policy Reforms, the Australian pigmeat industry and the Review of Part X of the *Trade Practices Act 1974:* International Liner Cargo Shipping.

As part of my portfolio responsibility for this matter, I have already notified you of my agreement to extend the reporting date for the inquiry into the Review of National Competition Policy Reforms.

Following consultation with my colleague, the Minister for Transport and Regional Services, Hon John Anderson MP, I agree to your request for an extension to the Review of Part X of the *Trade Practices Act 1974:* International Liner Cargo Shipping.

The Commission should report to the Government by 23 February 2005.

Yours sincerely

CHRIS PEARCE
14 DEC 2004

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Abbreviations and explanations

Abbreviations

AAA	Australia–Asia Alliance Container Consortium
AADA	Asia Australia Discussion Agreement
AAX	Asia–Australia Express Container Consortium
ABC	ABC Container Line
ABS	Australian Bureau of Statistics
ACA	Australian Consumers’ Association
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACCLA	Australia–Canada Container Line Association
ACS	Australian Customs Service
ACT	Australian Competition Tribunal
AELA	Australia to Europe Liner Association
AFIF	Australian Federation of International Forwarders
AHEA	Australian Horticultural Exporters Association
ANLCL	ANL Container Line
ANSCON	Australia Northbound Shipping Conference
ANZDL	Australia–New Zealand Direct Line
ANZECS	Australia–New Zealand–Europe Container Service

AOTA	Australia Oversea Transport Association
APL	APL Lines
APSA	Australian Peak Shippers Association
ASA	Australia–South Asia Container Consortium
ATPR	Australian Trade Practices Report
AUSCLA	Australia–United States Container Line Association
BAF	Bunker adjustment factor
BTCE	Bureau of Transport and Communications Economics
BTE	Bureau of Transport Economics
CAF	Currency adjustment factor
CGM	Compagnie Generale Maritime
cif	Cost insurance freight
CMA	Compagnie Maritime D'Affretement
CP	CP Ships
CPA	Competition Principles Agreement
DCN	Daily Commercial News
DTRS	Department of Transport and Regional Services
DWT	Dead weight tonnage
EC	European Commission
EDI	Electronic data interchange
FEU	Forty foot equivalent unit
fob	Free on board
FMC	Federal Maritime Commission (United States)

GATS	General Agreement on Trade in Services
H&M	Hull and machinery
IAA	Importers Association of Australia
IAC	Industries Assistance Commission
IC	Industry Commission
ICSD	International Cargo Statistics Database
ISC	Individual service contract
IMTL	International Marine Transport Line
LCSA	Liner Cargo Shipping Authority
LLDCN	Lloyd's List Daily Commercial News
LSS	Liner Shipping Services
MISC	Malaysia International Shipping Corporation
MSC	Mediterranean Shipping Company
MTC	Maritime Transport Committee (United States)
NACON	North American Conference
NCP	National Competition Policy
NEC	National Electricity Code
NEM	National Electricity Market
NOL	Neptune Orient Lines Ltd
NVOCC	Non-vessel operating common carrier
OECD	Organisation for Economic Cooperation and Development
OSRA	Ocean Shipping Reform Act of 1998 (United States)
PC	Productivity Commission

pers. comm.	Personal communication
P&I	Protection and indemnity
P&O	The Peninsular and Oriental Steam Navigation Company
PSA	Prices Surveillance Authority
PSC	Port service charges
PSS	Peak season surcharge
R&M	Repair and maintenance
ro-ro	Roll-on roll-off (vessel)
SAL	Shipping Australia Limited
TACA	Trans-Atlantic Conference Agreement (decision by EC)
TEU	Twenty foot equivalent unit
TFG	Trade Facilitation Group
THC	Terminal handling charge
TPA	*Trade Practices Act 1974*
TPC	Trade Practices Commission
trans.	Transcript
sub.	Submission
UASC	United Arab Shipping Company
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

Explanations

Billion	The convention used for a billion is a thousand million (10^9).
Findings	*Findings in the body of the report are paragraphs highlighted using italics, as this is.*
Recommendations	***Recommendations in the body of the report are highlighted using bold italics, as this is.***

Glossary

accord	An agreement or arrangement between conference and non-conference carriers on a trade route, resulting from discussions on matters of mutual interest such as capacity and freight rates.
agreement	Any contract, agreement, arrangement or understanding, whether made in or outside Australia.
authorised officer	An officer of the Department of Transport and Regional Services who is authorised, in writing, by the Minister under Part X of the TPA.
break-bulk	Non containerised cargo, that is usually of peculiar mass of shape and difficult to pack in containers.
bunker adjustment factor (BAF)	An adjustment in freight rates for fluctuations in bunker (fuel) prices.
carrier	Shipping line (see also 'ocean carrier').
cartel	An association of competitors that, by agreement, limits the degree of competition that would otherwise prevail in the buying and selling of goods and services by members of the cartel.
comity	The courtesy by which a nation allows another's laws to be recognised within its territory.
conference	Internationally, a 'conference' is a particular type of agreement being: a route-specific agreement between carriers on conditions for the carriage of cargo. Carriers agree to apply uniform of common freight rates, coordinate the scheduling of sailings and ports of call, regulate capacity, and allocate cargo and revenues.

conference agreement	Under Part of the TPA, this means an unincorporated association of two or more ocean carriers carrying on two or more businesses each of which included, or is proposed to include, the provision of outwards liner cargo shipping services or inwards liner cargo shipping services.
consortium	A consortium typically involves cooperation among different carriers of their operating services by means of technical, operational or commercial coordination.
currency adjustment factor (CAF)	Factor applied to freight rates to adjust for fluctuations in the exchange rate(s).
dead weight tonnage (DWT)	The container capacity of a vessel measured by tonnage when fully loaded.
discussion agreement	Discussion agreements (or stabilisation agreements) provide a forum for carriers to discuss and share commercial information relevant to a specific trade route. Such agreements often including both conference and non-conference lines, and may reach a non binding consensus over, for example, the charging of rates, surcharges, and a variety of service arrangements.
forty foot equivalent (FEU)	The standard measurement of a 40 foot by 8 foot by 8 foot container.
freight rate agreement	A conference agreement that consists of, or includes, freight rates.
freight rate charges	Those parts of the conference agreement that specify freight rates (including base freight rates, surcharges, rebates and allowances).
general tariff	The level of freight rates that is negotiated between the parties to a registered agreement and a peak shipper body designated under Part X.
intermodal	Transport involving transfer between two or more modes to exploit the comparative advantages of each mode.

landbridging	The movement of containerised cargo between sea ports by road and rail rather than sea, thus enabling more efficient utilisation of containerships.
liner cargo shipping service	A scheduled service on a particular trade route.
load factor	The capacity utilisation of a vessel measured in terms of full containers divided by the number of slots.
loop	A service rotation by liner, for example, from Australia to North East Asia and back again.
minimum service levels	The level of service on a trade, that shipping lines commit to dedicate to a liner trade.
negotiable shipping arrangements	The arrangements for, or the terms and conditions applicable to, liner cargo shipping services provided, or proposed to be provided, under the conference agreement (including for example, freight rates, charges for inter-terminal transport services, frequency of sailings and ports of call).
peak season surcharge (PSS)	A temporary surcharge imposed by lines in periods of seasonally high demand.
port service charge	A land-based charge for statutory port costs that is passed on to the shipper by the shipping line.
rate restoration program	The process of raising average freight rates in the market back to the level of the General Tariff.
registered agent	The person specified in the register of ocean carrier agents as the agent of the ocean carrier.
relay	Transhipment liner operator.
roll on roll off (Ro Ro)	Liner service for vehicular trades.
reefer	Refrigerated container.

scheduled cargo shipping service	A scheduled service for the transport of various types of general cargo by sea on particular routes, generally by container and generally at predetermined freight rates.
shipper	The party on whose account goods are consigned (a shipper can be an importer or an exporter).
slot	Space on a vessel for a container.
slot charter	The buying by one shipping line of bulk space or slots on a vessel owned or managed by another shipping line.
stevedoring	The loading and unloading of ships' cargoes. Generally, stevedoring of container vessels is carried out at a container terminal but general cargo wharves may be used.
terminal handling charge (THC)	The recovery surcharge imposed by lines for container stevedoring costs.
transhipment	The transfer of cargo from one vessel to another at an intermediate port between the port of origin and the final destination port.
twenty foot equivalent unit (TEU);	The standard measurement of a 20 foot by 8 foot by 8 foot container.
vessel utilisation	Same as load factor.

OVERVIEW

Key points

- Part X of the *Trade Practices Act 1974* (TPA) gives immunity to ocean carriers which provide liner cargo shipping services to Australian shippers (exporters and importers) to form agreements for the joint supply and pricing of such shipping services. Designated shipper bodies are also given immunity to consult and negotiate collectively with carriers.
- The immunities provided under United States and European Union regulations have recently been narrowed in scope as part of a move to more pro-competition arrangements.
- The wide variety of agreements registered under Part X have varying potential to provide a net public benefit for Australia, depending on the nature of the agreement and their impact on competition in the trade routes on which they operate.
  - Agreements on operational matters, such as joint scheduling and use of shipping assets, can, in principle, offer significant cost savings and pose little anticompetitive risk.
  - Agreements which fix prices and control the supply of shipping to a trade route pose the greatest anticompetitive risks.
- Evaluation and selective registration of agreements is therefore necessary if Australia is to be confident that only those that provide a net public benefit are allowed to operate.
- The Commission considers that the most effective way to introduce selective approval of carrier agreements would be to repeal Part X and, as occurs for other industries, rely on authorisation under Part VII of the TPA. Under Part VII, agreements would be assessed individually on the basis of their net public benefit by the Australian Competition and Consumer Commission.
- Authorisation under Part VII is the Commission's preferred option. With a four-year transitional arrangement, repeal of Part X should not disrupt the provision of liner cargo shipping services to or from Australia. It is clear from overseas experience that the industry is capable of adapting effectively to new rules.
- If Part X is not repealed, the current arrangements could be improved by either: (i) selectively registering only agreements that do not contain provisions to discuss or set prices and/or limit capacity offered on a trade route, and by revoking registration for those that do; or
  (ii) excluding from registration, and by revoking the registration of, 'discussion agreements', together with providing for the protection of confidential individual service contracts between carriers and shippers.
- If no selectivity were introduced for the registration of agreements under Part X, some improvement to current arrangements could be made by providing for the protection of confidential individual service contracts between carriers and shippers.

Overview

Part X of the *Trade Practices Act 1974* (TPA) gives ocean carriers immunity from key parts of Australia's trade practices legislation, allowing them to form agreements to provide joint liner (regular scheduled) cargo shipping services to Australian shippers (exporters and importers).

Currently, a wide variety of agreements is registered under Part X. Each is specific to an individual trade route. They operate on nearly all Australian trade routes and cover varying amounts of trade on each route.

The inclusion of Part X in the TPA reflects a view that market forces and their general regulation under the TPA are inadequate for the efficient supply of liner cargo shipping services. It reflects the view that allowing collusive agreements between ocean carriers is necessary to prevent market instability ('destructive competition'), as well as acknowledging the benefits from coordination of operations, spreading of risk, economies of scale in the industry and reduced costs of obtaining regulatory approval for agreements. It is further argued that the individual evaluation of agreements would not be handled in a timely and cost-effective manner, or with due regard to the particular circumstances of liner shipping. Testing these views was an important part of the Commission's assessment.

In brief, the Commission's task in reviewing Part X was to consider:

- whether such industry-specific exemption from key provisions of the TPA regulating restrictive trade practices is justified; that is, whether Part X should be retained;
- alternatives to Part X if it were to be abolished; and
- if Part X were to be retained, could changes be made to improve its effectiveness.

This review forms part of the Legislation Review Program agreed to by Australian Governments in 1995. In accordance with the Competition Principles Agreement, the 'onus of proof' is placed on those recommending retention of legislation with anticompetitive effects or costs for business. That is, the advocates of Part X must make the case, and present supporting evidence, that permitting and registering ocean-carrier agreements is of net benefit to the Australian community as a whole,

and that alternative regulatory arrangements would not achieve better outcomes (including, say, selective authorisation under Part VII). If such a case is not made, Part X should be repealed or modified.

The Commission previously reviewed Part X in 1999, finding at the time that, on balance, it served Australia's national interest. A number of amendments were recommended to improve its operation, many of which were implemented. Since then:

- other countries, notably the United States and European Union, have narrowed the scope of immunities provided to carrier agreements as part of a move towards more pro-competition arrangements;
- discussion agreements (see below) with high market shares have emerged on many of Australia's trade routes;
- tighter international market conditions have highlighted the effects of collaborative price-setting arrangements; and
- Australian shippers, who had previously provided unqualified support for Part X, have become critical of aspects of its operation, with some calling for its abolition. Many have become concerned about the effects of the spread of non-binding discussion agreements and the general ineffectiveness of their collective negotiations with carriers to deliver adequate shipping services at prices which reflect the costs of providing the service.

Also, following the Dawson review of the operation of parts of the TPA, the Australian Competition and Consumer Commission (ACCC) is to be required to make authorisation assessments under Part VII within six months (previously, there was no explicit deadline). Authorisation under Part VII is the alternative to Part X used by other industries and the change to a six-month timetable should ensure faster outcomes from that process.

Part X of the Trade Practices Act 1974

Part X exempts ocean carriers from key sections of Part IV of the TPA which regulate restrictive trade practices. The exemptions allow ocean carriers to confer and collaborate on the joint provision of regular scheduled shipping services and on freight rates charged. Without the exemptions, ocean carriers would be in danger of contravening section 45 of the TPA (which prohibits agreements that restrict dealings or affect competition) and section 47 (which prohibits exclusive dealing).

Australian importers and exporters are also provided with exemptions from these provisions of the TPA. This enables them to consult and negotiate collectively,

through designated shipper bodies, with ocean carriers in relation to the provision of liner cargo shipping services.

To receive exemption, carriers must register their agreements and negotiate with designated shipper bodies representing Australian exporters and importers over minimum service levels to be provided by the agreement parties. While an agreement is in operation and when requested by a designated shipper body, carriers are required to negotiate about service conditions, including freight rates.

If a review by the ACCC makes an adverse finding as to the behaviour of parties to the agreement, the Minister for Transport and Regional Services has the power to deregister an agreement, in part or in full. However, the Minister must provide carriers with an opportunity to give undertakings as to future behaviour if doing so would make deregistration unnecessary. Once an agreement is deregistered, parties would be subject to the full force of the TPA, if the collusive behaviour continued.

The exemptions provided to carriers under Part X are very extensive. No assessment is made of the benefits and costs of each agreement registered because the existence of Part X is based on a general presumption that agreements will provide net benefits (unless an existing agreement is found not to, and is thus deregistered). No time limits apply to registered agreements. Registration of agreements is, to all practical purposes, automatic. The obligations placed on carriers are minimal and can be changed at short notice. The only available sanction is deregistration, and this has never been used.

Liner cargo shipping

Australia's major liner export and import cargoes have different characteristics and shipping requirements. In 2003, some 47 per cent of the $87 billion of Australia's exports carried by sea were shipped under liner carriage. They included major commodities such as meat, cereals, animal feedstuffs, aluminium and aluminium alloys, and dairy products. Many are considered dense cargoes — that is, have a relatively high weight to volume ratio — and many require refrigerated containers.

Of the $93 billion of Australia's imports carried by sea in 2003, some 80 per cent were shipped under liner carriage. These were largely manufactured goods, such as machinery, paper products, non-metallic mineral manufacturers, chemicals, road vehicles and transport equipment. Imports tend to be less dense than exports and typically use 'dry' containers.

On the basis of Australian Bureau of Statistics data, the Commission estimates that, in 2003-04, the value of liner cargo shipping services used by Australian exporters and importers totalled almost $6 billion.

As a result of Australia's relative distance from major trading partners and the size of its economy, many of Australia's liner trades have been described as 'long and thin'. However, carriers have increasingly established integrated global networks. The growth in the importance of networks centred around hubs, such as Singapore, has also increased the viability of feeder trade routes, such as those to and from Australia. Australia is geographically close to Asia, a region which is accounting for an increasing proportion of Australian and world containerised trade.

World demand for liner shipping services is currently strong, largely driven by growth in trade volumes to and from the Asian region. This has been reflected in higher freight rates on many international routes, including those servicing Australia. There are lags in the supply of new liner capacity, but many very large containerships are under construction around the world.

International regulation of cargo liner shipping services

Different countries provide differing levels of immunity to carrier agreements from competition laws. Europe favours distinguishing between the various types of agreements (box 1) and, in some cases, their market share on individual trade routes. The United States applies the same obligations on all forms of agreement.

The regulatory regimes of the United States and the European Union exert a major influence on the international liner cargo industry due to their effects on the main east–west trades. These regulations also influence the behaviour of carriers worldwide as many carriers operate on other trade routes as well as American and European routes.

Within these two jurisdictions, there has been a trend away from blanket protection of conferences towards encouraging the adoption of pro-market behaviour within the industry. In particular, exemptions for conference agreements have been made dependent on allowing the use of confidential individual service contracts. This has significantly affected the ability of conferences to fix freight rates, with around 90 per cent of trade between the United States and Europe now being carried under confidential individual service contracts between ocean carriers and shippers.

In addition, Europe does not provide a special exemption for discussion agreements and imposes different regulatory requirements on conferences and consortia. Ocean carrier agreements which qualify as consortia are provided with a separate block

exemption, do not contain common freight-setting provisions and are subject to maximum market share criteria. Agreements which qualify as conferences do not have those constraints and currently qualify for a different block exemption. However, the European Commission is reviewing the block exemption for conferences and has proposed its repeal (box 2).

Box 1 **Liner shipping agreements**

Conference

A conference is a route-specific agreement between carriers on conditions for the carriage of cargo. Under a conference, the carriers agree to apply uniform or common freight rates, coordinate the scheduling of sailings and ports of call, regulate capacity, and allocate cargo and revenues. In recent years, these have declined in importance as US and EU regulation of liner cargo shipping have promoted and protected confidential individual service contracts between carriers and shippers for the carriage of goods.

Discussion agreement

Discussion agreements (or stabilisation agreements) provide a forum for carriers to discuss and share commercial information relevant to a specific route; for example, demand and supply forecasts or the introduction of capacity. Discussion agreements can also include route-specific but non-binding agreements between carriers on mutual issues, such as the level of capacity, type and amount of cargo carried, or 'recommended' freight rates. Discussion agreements often involve both conference and non-conference carriers servicing a particular route.

Operational agreements (consortia)

Operational agreements typically involve cooperation among different carriers of their operating services by means of technical, operational or commercial coordination. Their scope can vary from simple slot chartering or vessel sharing arrangements to consortia or more extensive operational agreements that include managing port installations and marketing activities. They typically operate under the umbrella of a discussion agreement or conference and on a trade route, a carrier may be party to a number of different operational agreements. The EU makes a distinction between conference and consortia agreements on the basis that the latter include operational agreements that do not contain common freight rate setting provisions. Under Part X, an operational agreement can be registered with common freight rate setting provisions.

Source: WTO 2001, *Maritime Transport Services*, Council for trade in services special session, S/CSS/W/106, 4 October; EC 2004c, *White Paper on the review of Regulation 4056/86, applying the EC competition rules to maritime transport.*

Box 2 **European review of the block exemption for liner conferences**

In a recent White Paper analysing whether to maintain, modify or repeal the current block exemption for liner conferences, the European Commission also discussed whether it would be appropriate to replace the exemption with other Community instruments covering any new business framework for cooperation between carriers. It concluded that:

> There is no conclusive economic evidence that the assumptions on which the block exemption was justified at the time of its adoption in 1986 are, in the present market circumstance and the basis of the four cumulative conditions of Article 81(3) of the Treaty [of Rome, namely: economic efficiency; pass-on of benefits to consumers; indispensability; and no elimination of competition], still justified. (2004c, p. 5)

The European Commission proposed the repeal of the block exemption for conferences and that there should be further examination to see if an instrument was needed to replace the existing exemption. The Commission is yet to conclude its final examination (scheduled for late 2005) and forward its proposals to the European Council.

Source: EC 2004c, *White Paper on the review of Regulation 4056/86, applying the EC competition rules to maritime transport.*

In 2002, the OECD reviewed the need for special regulation of conference agreements, and proposed three principles. It recommended that member countries use these principles to guide further assessments of the validity of antitrust exemptions for price fixing, rate discussions and capacity agreements between competitors in the liner shipping sector. These principles are:

- *freedom to negotiate*: shippers and ocean carriers should always have the option of freely negotiating rates, surcharges and other terms of carriage on an individual and confidential basis;
- *freedom to protect contracts*: shippers and ocean carriers should always be able to protect contractually key terms of negotiated service contracts, including information regarding rates, and this confidentiality should be given maximum protection; and
- *freedom to coordinate operations*: ocean carriers should be able to pursue operational and/or capacity agreements with other carriers, as long as they do not confer undue market power to the parties involved.

The regulations in the United States and European Union, on balance, are now significantly more pro-competition than Part X of the TPA. All Australian liner cargo trade to the United States and the European Union is now governed by the more restrictive immunities that each provides for collusive behaviour. The European and American amendments have demonstrated that, for their markets (including those to and from Australia), price fixing is not needed for the supply of

liner cargo services. Further, the introduction of greater internal competition in carrier agreements has resulted in lower freight rates than were present with price fixing, without loss of capacity or service.

Is liner cargo shipping unique?

It has been argued that the liner shipping industry has economic characteristics which differentiate it from other industries, in particular in relation to cost structures. However, on the basis of its review of available theoretical and empirical evidence (chapters 3 and 4), the Commission considers that useful parallels can be drawn between liner shipping and other transport industries such as airlines, some road transport and rail freight which also offer regular scheduled services and have relatively high fixed costs. In many countries, these industries were formerly accorded special treatment under competition laws or subject to industry-specific regulation. Deregulation of these industries has occurred without evidence of unacceptable market instability. Indeed, deregulation, with regulatory approval of operational agreements, has generally been associated with improved service provision and lower prices.

Are all carrier agreements the same?

As shown in box 1, there are three main types of carrier agreements, namely: conferences; discussion agreements; and operational agreements (consortia). Ocean carriers enter into agreements for a variety of reasons, the most important being to reduce costs, allow them to differentiate the service they provide to shippers, expand on existing, or develop new, trade routes and, in some cases, to limit competition.

The traditional purpose of conferences was to limit competition in the market for liner shipping and provide for operational cooperation. Their ability to limit competition depends on the extent to which they can limit internal competition among agreement members, as well as collectively reduce competition on a trade route. Market share is an important indicator of this ability, but also important are the reactions of other carriers on the trade route and the contestability of the trade route by other carriers.

As a result of a number of market and regulatory developments, conferences have become less important and, on a number of major trade routes including Australian ones, their key roles have largely been subsumed into discussion agreements and operational agreements. Discussion agreements provide a forum for members to exchange commercial information about individual trade routes, including details of

contracts with individual shippers. The ability to exchange freely such information, together with the informal structure of discussion agreements, has made them attractive for many carriers, and as a result they have become prevalent on a number of Australia's major trade routes. However, as means of exchanging commercial information and reaching agreement (albeit on a non-binding basis) over pricing policy and route capacity, discussion agreements have the potential to exert considerable influence over the market. Exercise of this potential appears to be greatest at times when demand is strong and capacity utilisation is high.

Operational agreements vary considerably in the degree and nature of interaction between members. Some are 'arms-length' commercial arrangements, such as slot or vessel charters, which attempt to rationalise the amount of joint capacity committed to a route. Others are for joint provision of a service and include a common price. Carriers may enter into a number of different operational agreements on an individual trade route. All are aimed at achieving operational efficiencies and/or the better supply of services to shippers. On Australian trade routes, they typically operate under the umbrella of a discussion agreement.

Significance of agreements on Australian trade routes

The Commission's analysis of Australian trade routes and agreements indicates that there were 130 agreements registered under Part X in 2003-04. Only 52 of those agreements were active. They operated on 14 of Australia's 18 trade routes. When adjusted for the many agreements that operate on more than one trade route (such as to and from a destination) to reflect the separate markets involved, some 92 agreements may be identified as influencing the supply of liner cargo shipping services to Australia (table 1).

Table 1 **Part X agreements[a]: number by type and capacity share, 2003-04**

	Capacity share of agreement on trade route			
Type of agreement	*<35%*	*35%–50%*	*>50%*	*Total*
Discussion agreement	6	3	11	20
Conference	9	1	3	13
Operational agreement (consortium)	45	9	5	59
All trade routes	**60**	**13**	**19**	**92**

[a] Where a registered agreement operates on more than one trade route (such as to and from a destination) the agreement is counted twice to reflect the separate import and export markets involved.

Source: Commission estimates, see table 2.8.

Of the 92 agreements, 59 could be classified as *operational agreements*. These operated on 12 of the trade routes. Some 45 of the agreements individually covered less than 35 per cent of the capacity provided to a route. Of these, 32 operated on the Australian trade routes to and from North Asia and South East Asia, with a further 10 operating on the routes to and from the east coast of North America.

A total of 20 *discussion agreements* also operated on 12 of Australia's trade routes. They did not operate on the trade routes to and from the European Union, where no block exemption is provided for them. Of the total, 11 individually covered more than half of the capacity provided on a route. These operated on the trade routes to and from the west coast of North America, North Asia, South East Asia, and New Zealand and the South Pacific. Only six discussion agreements covered less than 35 per cent of capacity provided on a trade route and three covered between 35 per cent and 50 per cent of the capacity provided.

A total of 13 *conferences* operated on 10 of Australia's trade routes. Three conferences individually covered more than half of the capacity on a route. These operated on the trade routes to and from the west coast of America (in conjunction with discussion and operational agreements) and on the route from Europe. On the trade route to Europe, the capacity share provided was just under a half. The other nine conferences each covered less than 35 per cent of the capacity provided on a trade route.

There were two Australian trade routes on which all carriers were party to an agreement registered under Part X — those to and from the west coast of North America. Four trade routes also had no registered agreement with liner shipping services being provided by carriers independently. These were the smaller routes to and from Africa and the Indian Ocean, and to and from Papua New Guinea. Carriers operating individually on a route provided more than half of the capacity on a further four routes and on an additional two, they provided between 35 per cent and 50 per cent.

Evaluation of Part X

As indicated above, Part X provides, to all practical purposes, automatic registration of virtually all types of ocean carrier agreements for the joint provision of liner cargo services. It reflects a judgment that most agreements are beneficial (that is, that they would generate a net public benefit) and that it would be too difficult or costly to identify and exclude those that are not. Agreements are allowed to operate until complaints by shippers are sufficient to initiate an ACCC investigation and that investigation concludes that the agreement should be deregistered. Even then,

the Government must allow the carriers to modify their agreement by providing the Minister with undertakings sufficient to avoid such an outcome.

This presumption of net public benefit runs counter to the general provisions of the TPA, where those seeking exemptions for anticompetitive behaviour are required to demonstrate a net public benefit before such exemptions are provided. It also runs counter to the spirit and intent of competition policy where the 'onus of proof' is placed on those recommending the retention of anticompetitive arrangements to make the case and present the supporting evidence.

Given the structure of the international liner cargo shipping industry, the types of benefit agreements can provide ocean carriers can be divided into two, namely supply-side benefits and demand-side benefits. They differ in the potential each has to provide public benefits for Australia. Supply-side benefits derive from carriers making agreements which provide for better liner services than each could provide individually and from cost savings by formally coordinating their operations. Operational agreements are made by carriers for these purposes. Such agreements can result in public benefits to Australia if the supply-side benefits are passed on in the level, quality and price of services to Australian shippers. Competition among carriers, and groups of carriers, is the most effective means of ensuring that this occurs. As indicated above, the capacity shares of most operational agreements are unlikely to pose major risks of anticompetitive behaviour that would negate the passing onto Australian shippers of supply-side benefits realised by carriers. For example, almost two of every three operational agreements registered under Part X cover less than 35 per of the capacity provided on a trade route. (A qualification is that, on some routes, some carriers belong to a number of such agreements.)

The demand-side benefits of agreements for ocean carriers stem from the control that agreements give over the supply and pricing of liner cargo shipping services on a trade route. Discussion agreements and conferences are made among carriers for such purposes. (Conferences also provide for supply-side benefits.) However, such demand-side benefits achieved by carriers are likely to be at the expense of shippers. Were such collective behaviour to occur in other industries, it is likely that it would be regarded by the ACCC as posing significant anticompetitive detriment and would be authorised only if significant public benefits were demonstrated. As indicated above, one in five of the agreements registered under Part X is a discussion agreement and over half of them cover more than 50 per cent of the capacity provided on a trade route. Further, one in seven of the agreements registered under Part X is a conference and one-quarter of them cover more than 50 per cent of the capacity provided on a trade route. Of the combined number of conferences and discussion agreements, roughly one-half have a market share of

more than 35 per cent — a threshold used by the ACCC in authorisation applications in the airline industry.

The Commission considers that no compelling case has been made that all agreements currently registered under Part X operate to provide a net public benefit. Nor on the basis of evidence provided to it and from its own investigations could the Commission find sufficient evidence that so few agreements would fail to provide a net public benefit that the added costs of individual authorisation would not be warranted. On the balance of evidence now available about the types of agreements registered under Part X and the characteristics of the markets in which they operate, it would appear that many agreements could pass a net public benefit test. Equally, however, many other agreements would be likely to have difficulty in demonstrating a net public benefit, and for many others detailed examination would be required to determine the balance of benefit and detriment.

Countervailing power

To offset the potential power provided to ocean carriers from registering agreements, Part X facilitates collective negotiations by Australian exporters and importers. It mandates collective negotiations between carriers and shippers in the belief that it provides some countervailing power to Australian shippers in their dealings with the members of agreements. However, it does not appear to work effectively to enhance public benefits. Shipper bodies have no contractual influence over the supply of cargo and are therefore unable to exercise any true market power. In contrast, the carriers are typically operating under contractual agreements between the parties for the joint supply and pricing of the services offered to shippers. At best, the shipper bodies are able to discuss quality control issues and undertake some of the aspects of consultation and negotiation for smaller shippers with carriers that would otherwise be undertaken by freight forwarders.

As with joint action by carriers, joint action by shippers would, in the absence of Part X, be in danger of breaching the anticompetitive provisions of the TPA. However, where collective negotiation by shippers can be shown to be in the public interest, it is able to be authorised under Part VII without the need for exemptions under Part X. Previous authorisations by the ACCC to chicken growers, dairy farmers, sugar cane growers, lorry owner-drivers, TAB agents, newsagents and small private hospitals indicate that groups of exporters and importers not of significant size individually could receive authorisation for collective consultation and negotiation.

In the market and regulatory circumstances that have evolved over recent years, a policy of promoting countervailing power is very much a 'second-best' approach.

The majority of cargo is now carried under individually negotiated service contracts. Freight rates that are negotiated collectively between Australian shippers and ocean carriers have little relevance to the actual rates at which cargo is carried, other than sometimes providing a point of reference for individual negotiations and a ceiling rate in some circumstances. To be effective, it would require not only the formation of shippers into effective monopsonies, which is not feasible given their diverse commercial interests, but also a 'turning back of the clock' to 'traditional' monopolistic conferences. The objective of improving public benefits is much more likely to be achieved by providing for the rights of shippers to consult and negotiate collectively, based on Part VII authorisation, while introducing more competitive forces in carrier negotiating circumstances.

Review and enforcement

The review and enforcement processes under Part X are not effective. While there have been many complaints and a number of reviews, none has led to the deregistration, either in part or in full, of any conference agreement. This may mean that not one of the agreements has ever operated to the public detriment. However, it is the view of the ACCC, which has undertaken a number of reviews, that the procedural and evidentiary requirements are too onerous to secure a successful prosecution. In addition, the range of penalties is too limited and inflexible, involving only deregistration, while the requirement to offer to accept undertakings to modify future behaviour before deregistration can proceed, means that carriers can effectively avoid any penalty for past behaviour. To all practical purposes, Part X has operated as a penalty-free system. If Part X were to be retained, the review and enforcement processes should be strengthened.

Evaluate agreements

In summary, the existence of Part X was based on the judgment that so few agreements would fail a net public benefit test that the added costs of individual authorisation were not warranted. At best, this judgment is now untested. As the analysis of market share indicates, there are a number of agreements currently operating which are unlikely to provide a net public benefit. The Commission finds that, in this sense, Part X as currently structured, no longer meets its primary purpose and that evaluation of agreements is needed to ensure that registration is provided only to agreements that are likely to provide a net public benefit. This may be achieved either through repealing Part X and relying on the existing alternative mechanism of authorisation under Part VII of the TPA or by modifying Part X.

Alternative to Part X

The existing alternative to Part X of the TPA is authorisation under Part VII. Authorisation, where granted, provides immunity (similar to that under Part X) from the application of the restrictive trade practices provisions contained in Part IV of the TPA. Both carriers and shippers can seek authorisation for their respective agreements if they contain provisions likely to breach those anticompetitive provisions.

Unlike the blanket immunity provided by Part X, the authorisation process requires those seeking legal immunity to demonstrate that their proposed conduct is likely to result in public benefits that outweigh the detriments constituted by any lessening of competition in the relevant market. If an applicant demonstrates a net public benefit, the ACCC must approve the application. If an application fails the public benefit test, the ACCC may reject the application or impose conditions, or request undertakings, to enable the agreement to pass the public benefit test.

Upon receiving an application for authorisation, the ACCC must follow specified procedures. It must advertise and invite submissions, release a draft determination, hold conferences, and publish a final determination. The ACCC's final decision is appealable to the Australian Competition Tribunal.

Stakeholders raised several concerns about the authorisation process, particularly the uncertainty and time involved in seeking authorisation and the increased compliance costs compared with Part X. It is true that using Part VII is a more demanding process, and will involve more time and effort on the part of carriers. However, the process should be streamlined by the foreshadowed six-month time limit and the ACCC's use of interim authorisations which can be granted quickly for proposals that represent a continuation of current arrangements.

The Commission acknowledges that the costs of demonstrating a net public benefit would be high if authorisation was sought for highly anticompetitive behaviour (such as price fixing and supply control) as it would be difficult to demonstrate that such behaviour could result in a net public benefit. The Commission considers that this is not unreasonable given the potential of some agreements to provide significant anticompetitive detriment. However, as indicated above, for many agreements, it would be clear that authorisation would offer significant cost savings with little anticompetitive risk. It could be expected that such agreements would be authorised expeditiously at modest cost and, indeed, some may not even require authorisation.

Transitional arrangements

The Commission's preferred option is for Part X to be repealed and the liner cargo shipping industry to be subject to the general provisions of the TPA. As this would involve a substantial departure from established practice, transitional arrangements should be introduced so as to limit any changeover costs and achieve a smooth transition. This could be achieved by: allowing a year for all operative agreements to be identified and deemed authorised by the ACCC; and then providing a further three-year transitional period during which the ACCC would, on request, provide advisory assessments as to the requirements for each agreement to be eligible for authorisation under Part VII. At the end of that four-year transition period, the general provisions of the TPA would apply and parties that had not already done so would need to apply for authorisation if they wished to continue with their agreements with legal immunity.

The anticipated effect of repealing Part X and relying on individual authorisation under Part VII of the TPA is unlikely to result in any practical inconsistencies with the regulations as currently applied in both the United States and the European Union. Further, should the European Union remove its block exemption for conferences, the Australian regulation of liner shipping under Part VII would, in practice, mirror the regulation of the European Union.

Modifications to Part X

The Commission's strongly preferred option is to repeal Part X. If Part X were to be retained, then the Commission considers that a more selective registration process should be introduced which recognises that different agreements provide a different mix of benefits and costs. It would involve continuing the faster and lower-cost registration procedures available under Part X for those agreements that provide the greatest potential for public benefit with the lowest risk of anticompetitive detriment. Other agreements would be required to seek authorisation under Part VII and be subject to individual evaluation.

The Commission considers that Part X could be modified in one of three ways:

- Option 1: select agreements by key characteristics;
- Option 2: exclude discussion agreements together with the introduction of confidential individual service contracts; or
- Option 3: introduce confidential individual service contracts.

The first two options include methods for screening agreements as to suitability for registration under Part X. Either would be an improvement on the existing operation

of Part X by providing more assurance of registering agreements likely to provide a net public benefit. However, both could still provide 'automatic' registration to agreements that were unlikely to provide a net public benefit. The third option would only seek to introduce more competition into carrier negotiation circumstances.

Either of the first two options, and the Commission's preference for the removal of Part X, would be in conformity with the review principles advocated by the OECD. The third option, while ensuring that there would be freedom to negotiate, freedom to protect contracts and freedom for ocean carriers to coordinate their operations, would not prevent carriers concluding agreements conferring undue market power.

Regardless of the other changes made, the objectives of Part X should be changed to give them a more pro-competition focus in line with overseas developments and be streamlined. A key point of the objectives should be to achieve Part X's goals within a pro-competition framework that limits the ability of suppliers to exploit market power and which provide incentives for them to be responsive to the needs of buyers. And within that framework, the objectives should be to facilitate agreements between ocean carriers for coordination and joint provision of liner cargo shipping services which assist exporters and importers to have access to liner shipping service of adequate frequency, geographical coverage and reliability at internationally competitive freight rates. Participants in the review generally supported such a change.

Option 1: select agreements by key characteristics

The Commission considers that Part X could be modified to distinguish between agreements on the basis of their key characteristics. Agreements that seek cost savings from jointly managing shipping assets and the scheduling of services (for example, slot chartering and vessel sharing) would continue to be eligible for registration under Part X. Agreements that seek to influence markets by joint price setting and supply control (such as traditional conferences and discussion agreements) would require individual authorisation under Part VII.

Selectivity on this basis would enable key types of existing agreements to continue to be registered under Part X, notably operational agreements which exclude pricing provisions. Other types of agreement would only be eligible for 'automatic' registration if clauses covering price setting matters and route capacity were removed.

The 'automatic' registration process for key types of agreements would reduce administrative and compliance costs; provide greater certainty than would be

available if all agreements needed case-by-case evaluation; and would enable the organisation of scheduled liner cargo shipping services to continue to be provided with minimal disruption.

Introducing different treatment of agreements on the basis of their inclusion of price-fixing provisions would not be unique to Australia. As noted above, the European Union has provisions for the differential treatment of agreements, with different rules for consortia and conferences, and no provision for discussion agreements to receive block exemptions.

Pricing discussion and/or price setting are part of discussion agreements and conferences, and there are 33 of these agreements on 14 of Australia's 18 trade routes. On all but three of those routes, they encompass significant operational agreements that could continue to provide service and cost-saving benefits to Australian shippers. In other cases, carriers would be free to respond by developing new operational agreements if considered necessary.

Option 2: exclude discussion agreements together with the introduction of confidential individual service contracts

A number of participants, particularly those representing shipper interests, proposed that discussion agreements be explicitly excluded from registration under Part X. As discussion agreements do little or nothing in the area of providing liner cargo shipping services, because this service provision is predominantly undertaken by the operational agreements or conferences included under them, any benefits to shippers are unclear. At the same time, by bringing together previously competing liner service groups and independent carriers, discussion groups can result in a substantial lessening of competition to the detriment of Australian shippers. It is by no means clear that the existence of discussion agreements is necessary for the provision of competitive and reliable scheduled services. For example, there is no evidence that the level of service is inferior, or the level of freight rates higher, on routes to and from the European Union where no discussion agreements operate as a result of not receiving block exemption from their antitrust law.

The Commission considers that discussion agreements are not necessary for the provision of scheduled liner cargo shipping services on Australian trade routes but, by bringing together competing parties to discuss market conditions, services and freight rates, they increase the likelihood of carriers acting in an anticompetitive manner. Excluding discussion agreements alone would carry a risk of allowing some agreements with strongly anticompetitive provisions that might not provide a net public benefit. This is because 'automatic' registration and carrier immunity would be provided to conferences which include price setting and route capacity

management provisions that could result in anticompetitive detriment, especially on routes where they have a high market share. The provision for, and protection of, confidential individual service contracts would reduce, but not eliminate, the extent of such anticompetitive detriment.

There are currently 20 discussion agreements registered under Part X and these occur on 12 of Australia's 18 trade routes. On all but two of those routes, they encompass significant operational agreements that could continue to provide service and cost-saving benefits for Australian shippers.

One of the most influential changes introduced recently by both the United States and the European Union for promoting competition in liner shipping has been provisions providing for, and specifically protecting, individual service contracts between carriers and shippers. In the United States, this effectively precludes formal price fixing under conferences, though it does allow for informal price setting through permitting the joint discussion and development of non-binding guidance on rates for members. Making such a change in Australia was supported by Shipping Australia Limited, representing ocean carriers, as well as by representatives of many individual shippers.

Option 3: introduce confidential individual service contracts

In the Commission's view, even if no selective registration process were introduced into Part X, it would still be worthwhile to modify Part X to provide for and protect confidential individual service contracts. This would involve making ineligible for registration those agreements that specifically limit the ability of carriers to enter into confidential individual contracts, or require that the terms and conditions of such contracts be disclosed to other agreement parties or otherwise be made public. Whether such contracts are entered into should remain a matter for negotiation between the individual parties involved. They would not be mandatory but, if entered into, confidentiality provisions would need to be respected. Part X should clearly state that carriers shall not discuss or otherwise disclose, directly or indirectly, the provisions of individual service contracts to other carriers, whether they are members of the registered agreement or not.

Other possible modifications to Part X

Other possible modifications to Part X proposed by some participants in this inquiry include:

- requiring all-in freight rates to be offered as an alternative for shippers;

- requiring freight rates to be offered in Australian dollars as an alternative for shippers;
- requiring the provisions of agreements between parties to a registered conference agreement and a designated shipper body to be binding (while not restricting the ability to enter into confidential individual service contracts, and consistent with the regulation of Australian's trading partners); and
- requiring that a code of practice be developed to cover negotiations between parties to conference agreements and designated shipper bodies to maximise the opportunities for negotiations to be conduced in good faith.

Those proposed modifications, which seek to increase government intervention in the outcome of market negotiations, are partly a response to the current tight shipping market. Adding extra regulation is unlikely to address issues which are better left to commercial negotiation. Any additional requirements would involve carriers in added cost, or increased risk, and it could be expected that they would be reflected in higher freight rates.

In relation to enforcement, Ministerial discretion to deregister an agreement should be removed and financial penalties introduced for procedural breaches of Part X.

Findings

Chapter 2 The market for liner cargo shipping

Global trends in liner shipping

FINDING 2.1

The trend has been away from the provision of direct liner services and towards the establishment of networks centred on regional hub ports. As a result, carriers who previously serviced only major routes have joined networks servicing secondary routes. While larger ships service hubs, smaller second-generation vessels are deployed on feeder routes.

FINDING 2.2

Since the advent of containerisation in the 1960s, the average size of container ships has increased dramatically. Average vessel size will continue to increase, although limitations may ultimately be imposed by port capacity limits and draught restrictions on sea channels.

FINDING 2.3

Concentration of ownership has increased appreciably in the market for international liner shipping over the past two decades, although, in comparison with other transport industries, concentration is still not high.

FINDING 2.4

Reported profitability of liner shipping has been low. However, investment in additional capacity remains strong.

The Australian liner shipping market

FINDING 2.5

As with other international trade routes, Australian trade routes are subject to imbalances in container requirements. Typically, more containers are required for

imports than are required for exports. Issues in the management of Australia's liner shipping requirements include different densities of export and import cargoes, the relatively high proportion of Australia's exports requiring refrigeration and the seasonality of some exports.

FINDING 2.6

Most of Australia's container trade involves long voyages along north-south trade routes. Traditionally, these routes — which may carry comparatively low cargo volumes — have been described as 'long and thin'. However, developments in the market for liner shipping, including the expansion of global networks and the growth of the Asian region, have increasingly integrated Australian container trade flows with those of the rest of the world.

FINDING 2.7

Freight rates on Australian trade routes have diverged, reflecting supply and demand conditions on individual routes. Since 1999, there have been notable increases in freight rates on general exports to Europe; on refrigerated exports to Japan and on imports from China. Substantial declines have occurred on the trans-Tasman route; exports to the United States; and refrigerated exports to Europe.

Agreements between shipping lines

FINDING 2.8

Conferences are the traditional form of cooperation designed to fix freight rates. Over recent years, conferences have declined in importance.

FINDING 2.9

Discussion agreements have become more important as a mechanism for influencing freight rates on most major trade routes. Where they occur on Australian trade routes, the capacity share of discussion agreement members is generally high. On European trade routes, discussion agreements are not granted block exemption and do not occur.

Chapter 3 Economics of international liner shipping

Characteristics of supply and demand

FINDING 3.1

The importance of economies of scale in liner shipping makes a policy of charging a single price to all shippers inefficient. Price discrimination — between cargoes and/or between shippers — can be an efficient mechanism for recovering high fixed costs.

FINDING 3.2

Surcharges can be a means of passing on unavoidable costs associated with container shipments to shippers. However, they can also enable carriers collectively to impose price increases on the market. On Australian trade routes, surcharges appear to be largely imposed by carriers and not be subject to negotiation with shippers.

Stability and competition in the market for liner shipping

FINDING 3.3

Concern about 'destructive competition' has been a powerful argument used in support of allowing ocean carriers to confer and form conferences to control the supply of shipping capacity and set freight rates on trade routes. However, there is a lack of evidence to support that concern. In response to conditions in the industry, other less collusive market arrangements have emerged to ensure continuity of supply.

Comparisons with other industries

FINDING 3.4

Parallels exist between the international liner shipping market and airline travel, particularly in large domestic markets such as the United States and Europe where there are few regulatory barriers to entry by domestic carriers. Despite the lack of an exemption from competition laws for price setting agreements, there is no evidence that these markets have experienced a lack of supply.

Chapter 4 Competition in the market for liner shipping

Rationale for cooperation between shipping lines

FINDING 4. 1

A number of business strategies have emerged as means of dealing with conditions in the market for liner shipping. The most important of these are cost reduction, service differentiation, market development and limiting competition. Carriers typically enter into operational agreements to achieve any or all of the first three objectives. Operational agreements have the potential to benefit carriers and shippers through cost reductions and greater flexibility in service delivery. Discussion agreements and conferences are primarily means of limiting or regulating competition on capacity and price.

Limits to competition in the market for liner shipping

FINDING 4.2

Entry costs to a new route are not especially high. Though costs are involved in establishing a liner trade route (specifically, those associated with assigning a number of vessels, marketing and administration), these will typically not be a large proportion of total costs. A number of factors — including high worldwide demand for capacity, the desire to maintain networks and predatory behaviour by incumbents — may raise these costs and reduce the degree of route contestability.

FINDING 4.3

While the liner shipping market, like any market, needs to be well informed to function properly, the exchange of commercial information on price and quantity among carriers can be a means of enforcing collusive agreements and may result in a limiting of competition.

FINDING 4.4

The evidence on whether conferences raise freight rates above levels necessary to sustain industry equilibrium is mixed. Conferences with high market share appear to have more success in raising freight rates. Where the confidentiality of service contracts are protected by law — such as on US trade routes — conferences appear to have less success in fixing and raising rates.

FINDING 4.5

Exchange of information, particularly in regard to shipper demand, increases the influence of discussion agreements over prices. The ability of discussion agreements to influence rates increases with market share and is greater at times of strong shipper demand.

FINDING 4.6

The potential for operational agreements that do not include provisions for price fixing to reduce competition is less than those which involve collusion over rates. The potential for an operational agreement to reduce competition increases with market share.

Chapter 5 Key elements of Part X of the TPA

Agreements covered by Part X exemptions

FINDING 5.1

Part X of the TPA provides significant immunity for ocean carriers from key elements of Australia's competition law. Eligible agreements are very broadly defined and little limitation is placed on the range of provisions that can be included in those agreements. As a consequence, practically all types of shipping agreement are eligible for immunities under Part X. No such immunity from the TPA is provided for any other industry in Australia.

Obligations of ocean carriers under the Act

FINDING 5.2

The obligations placed on carriers are essentially procedural in nature. Consequently, registration of conference agreements under Part X is, to all practical purposes, automatic, with no assessment being made as to the costs and benefits of these agreements, and with no time limit placed on the immunities granted.

FINDING 5.3

Although the requirement to negotiate with peak shipper bodies prior to the registration of an agreement is viewed favourably by some shippers, it does not

appear to have any material impact on the level, or quality, of shipping services offered to Australia. The level of service appears to be determined by the commercial interests of carriers responding to demand in the market place, as would be the case in the absence of the requirement to negotiate.

FINDING 5.4

The negotiations with shipper bodies during the operation of an agreement required under Part X appear to have minimal impact on the service offered to Australia and on the commercial decisions of carriers. They can more accurately be described as 'consultations'.

Review and enforcement

FINDING 5.5

Deregistration is the penalty that applies for all breaches, from minor procedural failures to major anticompetitive behaviours. The requirement to seek undertakings before deregistration allows carriers to avoid penalty under Part X.

Chapter 6 International regulation of liner cargo shipping

Differences between Australian and major international conference regulations

FINDING 6.1

Part X of the TPA and the United States' Shipping Act make no distinction between different types of agreements, but the United States regulations now promote and protect individual service contracts. The European system is more restrictive, effectively not allowing discussion agreements.

Enforcement and penalties

FINDING 6.2

Australia differs from both Europe and the United States in allowing Ministerial discretion in the decision to impose penalties on carrier agreements. The regulation in the United States also provides for financial penalties to be imposed for procedural breaches, whereas Part X contains no such provisions.

International conflict of laws

FINDING 6.3

The removal of immunities from national competition laws for the liner cargo shipping industry should not give rise to a conflict in laws as no jurisdiction actually requires that carriers engage in anticompetitive behaviour.

Recent trend towards greater competition

FINDING 6.4

In recent years, both the United States and European Union have introduced greater competition within the regulation of the liner cargo shipping industry, including protecting confidential individual service contracts between shippers and carriers.

Chapter 7 Evaluation of Part X

Nature of Part X restriction on competition

FINDING 7.1

Part X restricts competition by limiting the pro-competition regulatory safeguards on the market conduct of ocean carriers and shippers.

Countervailing power

FINDING 7.2

The existing arrangements under Part X to promote the countervailing power of Australian exporters and importers do not appear to be working. This is because carriage of most cargo is now arranged individually between shippers and ocean carriers. A more effective way to deal with market power would be to promote more competitive forces in carrier negotiating circumstances.

Balance of benefits and costs

FINDING 7.3

The wide range of agreements registered under Part X have varying potential to provide a net public benefit to Australia, depending on the type of agreement and characteristics of the market in which it operates. While many operational agreements covering low shares of carriage on a trade route should be able to demonstrate that they provide a net public benefit, it would be much more problematic for agreements including price setting and capacity control provisions covering a high share of carriage on a trade route. Thus, the public benefit to Australia of carrier agreements could be enhanced if agreements providing a public benefit were identified and allowed and those not, were identified and prohibited.

Chapter 8 Alternatives to Part X

Authorisation under Part VII

FINDING 8.1

The authorisation process is sufficiently flexible to cater for the circumstances of the liner cargo shipping industry. In particular, not all existing carrier agreements may need authorisation under Part VII. Under the Dawson reforms, authorisation would be granted within six months. During this time, interim authorisation could be obtained. As well, authorisations can be framed so as to apply to other carriers which become members of an authorised carrier agreement at a time after it is made, or after it has been authorised, subject to the market impact of additional members.

FINDING 8.2

Authorisation under Part VII provides a rigorous system for evaluating whether carrier agreements seeking exemption from Part IV are in the public interest. Safeguards ensure authorised agreements continue to meet the test and that the ACCC does not arbitrarily revoke an authorisation where it would still provide a net public benefit, or where an amended authorisation would result in an overall net public benefit.

FINDING 8.3

Shippers and their representative organisations are able to seek protection for collective bargaining agreements through the authorisation process in Part VII.

This would enable shipper bodies currently registered under Part X to continue to represent the interests of their members and to negotiate individually and collectively with carriers.

International implications of preferred recommendation

FINDING 8.4

The anticipated effect of repealing Part X and relying on individual authorisation under Part VII of the TPA is unlikely to result in any practical inconsistencies with the regulations as currently applied in both the United States and the EU. Further, should the EU remove its block exemption for conferences, the Australian regulation of liner shipping under Part VII would, in practice, mirror the regulation in the EU.

Chapter 9 Options for modifying Part X

Differentiating between agreements on the basis of market share

FINDING 9.1

Introducing a market share threshold would involve a major change to the current arrangements, present significant transitional costs, and involve a much higher level of ongoing administrative and compliance costs.

Other modifications to Part X

FINDING 9.2

Encouraging greater competition in liner shipping markets would be more effective in helping shippers than further government intervention aimed at prescribing or influencing the outcome of commercial negotiation between carriers and shippers.

Chapter 10 Review and enforcement

FINDING 10.1

The review and enforcement processes under Part X are not very effective. As well, the range of penalties available under Part X is limited and relatively severe, despite a wide range of potential breaches, both minor and major.

Recommendations

The major recommendations

RECOMMENDATION 7.2

The regulation of liner shipping agreements be strengthened by adopting a selective approach aimed at allowing only those carrier agreements which are likely to provide a net public benefit to Australia.

RECOMMENDATION 8.1

Part X be repealed, thus making the liner cargo shipping industry subject to the general provisions of the Trade Practices Act.

RECOMMENDATION 8.2

Transitional arrangements be introduced. Such arrangements should provide deemed authorisation for operational Part X agreements (subject to certain conditions). These arrangements would entail:

- ***delay in the repeal of Part X for one year after the promulgation of an Amending Act;***
- ***authorise only agreements which are operational at the beginning of the transitional period;***
- ***deemed authorisation to continue for three years; and***
- ***the ACCC to provide advisory assessments of deemed authorised agreements, at the request of members of an agreement, so as to assist applicants in applying for Part VII authorisation at the end of the transitional period.***

Objectives of Part X legislation

RECOMMENDATION 7.1

If Part X is retained, its principal objectives should be to:

- ***facilitate efficient coordination and joint provision of liner cargo shipping services within a pro-competition framework; and***
- ***assist Australian exporters and importers to have access to liner cargo shipping services of adequate frequency, geographical coverage and reliability at freight rates that are internationally competitive.***

Differentiating between agreements on the basis of key characteristics

RECOMMENDATION 9.1

If Part X is retained, either:

agreements that contain the following provisions should be excluded (with appropriate transitional arrangements) from eligibility for registration under Part X:

- ***for the fixing or other regulation of freight rates;***
- ***for the setting of non-binding guidance on freight rates;***
- ***for freight rates to be discussed between members; or***
- ***that seek to limit the maximum level of capacity on offer.***

or

discussion agreements should be excluded from eligibility for registration under Part X, together with measures to protect confidential individual service contracts outlined in recommendation 9.2.

Provisions for confidential individual service contracts

RECOMMENDATION 9.2

If Part X is retained, and neither (or only the second) of the options in recommendation 9.1 are adopted Part X should be modified so that agreements should not be eligible for registration if they contain provisions that:

- ***prohibit members from engaging in negotiations for individual service contracts; or***

- ***require members to disclose negotiations or make public the terms and conditions of such agreements; or***
- ***adopt rules or requirements affecting the right of members to enter into individual service contracts; or***
- ***allow the discussion or development of non-binding guidelines that relate to the terms and procedures of a member's individual service contract.***

Part X should be amended to prohibit carriers from discussing or disclosing, directly or indirectly, the provisions of individual service contracts to other carriers.

Review and enforcement

RECOMMENDATION 10.1

If Part X is retained, the following changes should be made to the review and enforcement process:

- ***the parties to a registered agreement being reviewed in relation to section 10.45(1)(a)(viii) of the TPA be required to demonstrate that the conduct under review has resulted, or is likely to result, in a net public benefit;***
- ***Section 10.44 (1) be amended such that the Minister 'must' rather than 'may' direct the Registrar to cancel the registration of an agreement whether in part or in full;***
- ***a range of penalties, including fines, be introduced for breaches of the procedural provisions of Part X; and***
- ***the use of undertakings be limited to situations where deregistration is threatened, and not be available as a means of avoiding fines resulting from procedural breaches of Part X.***

1 Introduction

The Australian Government has asked the Productivity Commission to review Part X of the *Trade Practices Act 1974* (TPA). Part X gives ocean carriers exemptions from key parts of Australia's restrictive trade practices legislation, allowing them to form conference agreements to provide joint liner (regular scheduled) cargo shipping services to Australian exporters and importers (shippers).

In brief, the Productivity Commission's task in reviewing Part X is to consider:

- whether such industry-specific regulation is justified, that is, whether Part X should be retained;
- what would be the alternatives if Part X were to be abolished; and
- if Part X were to be retained, would there be any changes that could be made to improve its effectiveness.

The full terms of reference are presented at the front of the report.

When reviewing Part X of the TPA, the Commission has been asked to have regard to the requirements for the assessment of regulation agreed to by the governments of Australia under National Competition Policy and set out in the Competition Principles Agreement. Accordingly, assessments should:

- clarify the objectives of the legislation;
- identify the nature of the restrictions on competition;
- analyse the effect of the restrictions on competition and on the economy generally;
- assess the costs and the benefits of the restrictions; and
- consider alternative means for achieving the same result, including non-legislative approaches.

In addition, the Commission has been asked to identify the benefits and costs to different groups in the community, as well as to the community as a whole, and to consider recent technological and institutional changes to the international liner cargo shipping market since the Commission's last review in 1999. In that review, the Commission found that, on balance, Part X served Australia's national interest,

and recommended that it be retained with a number of amendments aimed at improving its operation.

The Australian Government's guiding principle for legislative reviews places the 'onus of proof' on those recommending retention of legislation with anticompetitive effects or costs for business. That is, the case must be made — and supported by evidence — that exempting, through Part X, carrier agreements from the anticompetitive provisions in the TPA is of net benefit to the Australian community as a whole, and that any net benefit could only be achieved through this method, rather than, say, selective authorisation under Part VII. If such a case can not be made, Part X should be repealed.

The inquiry process

The reference was received on 23 June 2004, and the Productivity Commission was asked to report within six months of receipt of the reference, that is, by 23 December 2004. The Commission initially planned to present a draft report by mid-September 2004, followed by public hearings at the end of October, but the calling of the Federal election meant a delay in publication of the draft report, and in the scheduling of public hearings. The draft report was published on 22 October 2004, and the hearings were conducted in Sydney on 1 December, and in Melbourne on 6 December 2004. The delay caused by the Federal election resulted in an extension of time being provided for the completion of the final report to 23 February 2005.

In preparing this report, the Commission has provided the opportunity for interested parties to contribute to its deliberations in various ways. The Commission advertised the commencement of the inquiry in the national press and invited public submissions. To help those preparing submissions, an issues paper was released in June 2004.

The Commission had also held informal discussions with interested parties in July and August 2004 and established a website (http://www.pc.gov.au/inquiry/partx) on which it has placed relevant inquiry material, including contact details for the inquiry team, and copies of public submissions received.

At the time the draft report was finalised, the Commission had received 24 submissions. Following the draft report, the Commission has received an additional 37 submissions. Eight organisations participated in the public hearings in Sydney and Melbourne. The Commission wishes to record its appreciation for all those who have contributed to the inquiry.

Report structure

The remainder of this draft report is structured as follows:

Chapter 2 presents information on the market for liner cargo shipping. It provides information on the trade pattern of Australian and international liner shipping, as well as the key economic features of the liner shipping industry.

Chapter 3 looks at the economics of liner cargo shipping, while chapter 4 looks at the economic arguments associated with the case for special legislative treatment of liner cargo shipping services.

Chapter 5 presents an outline of the key features of Part X, in particular, the nature of the exemptions provided, the range of behaviours exempted, the obligations placed on ocean carriers in exchange for these exemptions, and at the review and enforcement provisions of Part X.

Chapter 6 outlines the important features of the regulation of liner shipping by Australia's major trading partners. The focus of the chapter is on the difference between international and Australian regulation and recent developments in international regulation.

Chapter 7 evaluates Part X based on the National Competition Policy guidelines. In particular, it evaluates the rationale for the exemptions provided under Part X, whether Part X is necessary to address this rationale, and whether Part X does so in an appropriate manner.

Chapter 8 looks at the alternatives if Part X were to be abolished. This mainly involves the authorisation process available under Part VII of the TPA.

Chapter 9 presents options for modifying Part X, if it were to be retained, to improve its operation.

Chapter 10 looks at the review and enforcement process under Part X and at options to improve its effectiveness.

Appendix A lists the participants who have provided a written submission to this inquiry, and a list of the people and organisations visited by the Commission. Appendix B provides a summary of the views of participants contained in their public submissions. Appendix C presents a range of data collected by the Commission over the course of the inquiry. Appendix D outlines some of the economic issues relating to the nature of the shipping industry as a supplement to the discussion presented in chapters 3 and 4. Appendix E reproduces the checklist used for the provisional registration of conference agreements under Part X.

Appendix F presents in more detail the option of discriminating between agreements for registration under Part X on the basis of market share. Appendix G lists the range of proposals presented by participants to modify provisions of Part X.

2 The market for liner shipping

This chapter examines major trends and recent developments in the market for international liner shipping. While freight rates have risen recently on many trade routes, it is against the background of longer term declines. Investment in capacity remains strong, despite low rates of return being reported in the industry. Hub-and-spoke networks have continued to evolve as viable alternatives to direct services. These developments are reflected on Australian trade routes.

In common with firms in other transport industries, carriers enter into cooperative agreements. These agreements differ in terms of intended purpose and the obligations placed on individual members. A number of factors, including the nature of trade and the impact of national competition laws, influence the extent to which these agreements are entered into on a particular trade route. Currently, a wide variety of agreements are registered under Part X. Each is specific to an individual trade route. They operate on nearly all Australian trade routes and cover varying amounts of capacity on each route.

Longer-term structural trends in the liner shipping market, identified in the Commission's 1999 Review of Part X, have continued over the past five years. However, prevailing cyclical market conditions are fundamentally different. At the time of the previous review, demand for liner shipping services was subdued and freight rates had fallen in the wake of the Asian financial crisis of 1997. In contrast, current market demand is strong world-wide, capacity utilisation is at historically high levels and freight rates have risen sharply on many routes since 2002.

This chapter considers major trends and recent developments in global liner shipping and their impact on Australian trade routes. The local experience reflects international trends, although Australian conditions differ in several important respects. It also considers the types of cooperative arrangements entered into by carriers.

2.1 Global trends in liner shipping

Maritime trade is carried either as general cargo or in bulk. Liner shipping provides carriage for cargo, in regularly scheduled services, between specified ports[1]:

> A liner service is a fleet of ships, with a common ownership or management, which provide a fixed service, at regular intervals, between named ports, and offer transport to any goods in the catchment area served by those ports and ready for transit by their sailing dates. A fixed itinerary, inclusion in a regular service, and the obligation to accept cargo from all comers and to sail, whether filled or not, on the date fixed by a published schedule are what distinguish the liner from the tramp. (Stopford 2003, p. 343)

Liners typically transport goods in modular containers[2]. In contrast, bulk shipping operations use purpose-built vessels to carry homogeneous products — either unpacked dry commodities (such as coal, iron ore or grain) or liquid commodities (such as oil, liquefied gas or chemicals).

Goods carried in containers tend to be higher value/lower volume than other seaborne trade. Of the 5.9 billion tonnes transported by sea in 2002, a little over one-quarter was carried by liner (UNCTAD 2003, pp. 1, 14). In value terms, however, approximately 60 per cent of world maritime trade was shipped by liner (Stopford 2003, p. 343).

Major trade routes

Containerised cargo movements have assumed an increasing importance in world trade. International container port throughput increased from 36 million TEU in 1980 to 274 millionin 2003 (Talley 2000; Containerisation International 2004). The container share of the cargo trade is estimated to have grown from a little over 20 per cent in 1980 to more than half in 2000 (Brooks 2000a, p. 4).

World container trade moves along east-west trade routes — linking North America, East Asia and Europe; north-south trade routes — linking the northern and

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[1] The alternatives to liners as carriers of general cargo are breakbulk and tramp shipping. Breakbulk ships have large open hatches and are equipped with boom-and-winch gear or deck cranes. They are most commonly used as military transports or to service ports which lack the infrastructure or road and rail connections to efficiently handle containers. Breakbulk vessels have a larger crew requirement than container vessels which tends to make them a more expensive form of transport. Tramp vessels do not have a scheduled service and typically do not leave a port unless fully loaded.

[2] The standard size of a container is one TEU (twenty-foot equivalent) or 20 feet by 8 feet by 8 feet. The most common container size is 2 TEU (forty feet long). Containers can be loaded directly on to rail cars or truck chassis leading to considerable savings in handling costs.

southern hemispheres; and on intra-regional trade routes. Collectively, the three east-west routes (the trans-Pacific; the trans-Atlantic and Europe-Asia) carried 38 per cent of the 75.8 million TEU transported by sea in 2002. Trade on north-south routes is estimated to account for about 20 per cent of containerised cargo; while the largest intra-regional trade route, in Asia, accounted for 21 per cent of the total (UNCTAD 2003, p. 14).

The largest of the east-west routes, the trans-Pacific, transported 12 million TEU in 2002 (table 2.1). The Europe-Asia route carried about 10 million TEU. Trade on the smallest route — the trans-Atlantic — was estimated at 6.5 million TEU. Reflecting patterns of world economic growth, the focus of containerised trade has moved away from the Atlantic trade routes, where the first international containerised services were introduced, towards Asia. Container movements through Asian ports increased from 25 per cent of the world total in 1980 to 46 per cent in 2004; while European container port throughput declined from 32 per cent of international container movements to 23 per cent (Notteboom 2004, p. 86). Reflecting this trend, the six largest ports in the world, in terms of container movements, are in East Asia[3].

Trade route imbalances and container management

Logistics in liner shipping can be complicated by differences in the number and type of containers required to carry cargo on the inward and outward legs of a trade route. Differences in container requirements are a common feature in the industry and reflect trade imbalances between countries as well as differences in the amount of container space occupied by different types of cargo[4]. According to the OECD:

> Carriers argue that ... overcapacity is endemic to the industry since strong trade flows in one direction are not necessarily matched in the other — in order to provide for demand in the outward leg, carriers must necessarily oversupply capacity on the weaker return leg. (2002, p. 49)

While the extent of container imbalances can differ between trade routes (table 2.1), on average across all routes, a little over 20 per cent of container movements

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[3] In 2003, the ten largest container ports in terms of container throughput were: Hong Kong (20.4 million TEU); Singapore (18.1 million TEU); Shanghai (11.3 million TEU); Shenzhen (10.6 million TEU); Busan, Korea (10.4 million TEU); Kaohsiung, Taiwan (8.8 million TEU); Los Angeles (7.2 million TEU); Rotterdam (7.1 million TEU); Hamburg (6.1 million TEU); Antwerp (5.4 million TEU) (Containerisation International 2004).

[4] This is measured by the stowage factor. The stowage factor measures how many cubic metres one tonne of a cargo occupies, allowing for unavoidable stowage losses in packing and handling. Typically, the heavier a cargo, the lower its stowage factor and the less likely a container which carries it can be fully utilised.

represent the repositioning of empty containers (OECD 2002, p. 17). This ratio has remained unchanged over the past two decades (Dupin 2002; Stopford 2003, p. 362).

The costs of ensuring that available container capacity matches cargo flows (such as those associated with repositioning empty containers) are an unavoidable cost of providing liner services. As such, they will ultimately be passed on to shippers. Shipping lines practise price discrimination as a means of covering such unavoidable joint voyage costs (chapter 3). However, carriers have also developed means of reducing these costs, including alliances with other carriers, joint vessel operations and equipment sharing (chapter 4). According to the OECD:

> … many carriers are seeking alternative strategies to reduce the need to run unbalanced service strings. In particular, the increasing use of slot charter agreements across all trades and, increasingly, between conferences, alliances and independent operators, represents a less capital intensive way of responding to growth in demand. It is also telling that a growing proportion of the top 20 operators' fleets is made up of time-chartered vessels, indicating a trend away from self-ownership to more flexible asset management arrangements. (2002, p. 49)

Container leasing[5] is also widely used in the industry, both for financial reasons and to remedy container shortfalls. Carriers lease about half of the containers they use, a ratio that tends to be stable (*LLDCN* 21 June 2002). Internet-based exchanges have been developed to allow users to more efficiently find shipping space for empty containers (Cottrill 2000). The introduction of collapsible containers will also allow shipping lines to fit three collapsible twenty-foot containers into each standard container slot (Amoako 2002).

Table 2.1 **Selected liner routes and trade imbalances, 2002**

	Cargo flows	*Share of world container trade*	*Largest trade*	*Trade imbalance*	
	Millions of TEU	%		Millions of TEU	% of trade on route
East–West Trades					
Trans–Pacific	11.72	15.5	Asia to US	3.92	33.0
Trans–Atlantic	6.52	8.6	Europe to US	1.08	16.6
Europe–Asia	10.33	13.6	Asia to Europe	2.01	19.5
Total	**28.57**	**37.7**			

Source: UNCTAD (2003, p. 70).

[5] Container leasing may either take the form of a long-term lease (over one year) or a 'master-lease' under which containers are supplied only when needed at agreed ports.

Direct trade and transhipment services

Prior to the introduction of containerisation in the 1960s, most carriers operated 'out-and-back' shipping services between ports in two or more countries. While such services continue, opportunities for different types of service have emerged as a result of growth in the volume of cargo flows between the three major northern hemisphere regions of North America, Europe and East Asia.

'Round-the-world' services link these three major trade regions with vessels continually circling the globe in an eastbound or westbound direction. 'Pendulum' services typically operate from the east coast of North America via Europe and Asia to the west coast of North America, returning via the same route. Shipping companies which service the round-the-world and pendulum routes compete with out-and-back services provided by carriers engaged on the three major trade routes.

The most significant recent trend has been the continued growth of transhipment services which transport cargo through regional 'hub' ports. Hub ports connect east-west trade routes to destinations off the major routes, such as Australia, via feeder shipping or landbridging (overland transport). The proportion of international cargo which is transhipped has increased from around 5 per cent in the mid-1980s to, on some estimates, more than one-quarter now (Andriamananjara et al. 2004; Department for Transport 2000).

Under the standard configuration of a hub-and-spoke network, large vessels provide shipments between the hubs while smaller, faster vessels provide services to the final destination (the spoke). While direct services can be quicker, transhipment offers a cost-effective alternative to shippers. In particular, by better matching vessel capacity to route cargo volumes, hub-and-spoke networks can provide a more efficient means of servicing lower volume trade routes than direct services[6] (Baird 2002).

The development of hub-and-spoke networks in liner shipping has prompted carriers, which previously specialised in the major east-west trades, to enter the north-south trades. Participation in such networks offers the potential for realising cost savings as well as providing shipping services which might not otherwise have been provided through a series of direct services (chapter 3). Typically, entry has occurred by way of feeder (transhipment) services linking with round-the-world or pendulum services at major northern hemisphere hub ports. As the carriers employ larger vessels on the mainline east-west trades, older, medium-sized ships cascade

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[6] One view was that the additional cost of loading and unloading would render transhipment an uneconomic alternative to direct services. However, the strong growth in the volume of transhipped suggests this is not the case.

into secondary routes (Baird 2002). According to ACIL Tasman and Thompson Clarke, the growth in transhipment can be linked to increased vessel size:

> A further byproduct of this increase in vessel size is the fact that the operators of such tonnage will increasingly want to hub these extra large vessels on a minimum number of port calls. Singapore has for a number of years positioned itself as the premier hub port in SE Asia, with direct services to over 150 overseas ports and on major trade routes 2 or 3 sailings daily. 80% of its container throughput is transhipment traffic to/from regional services spanning Africa, the Middle East, South Asia, SE Asia and Australasia. It handles either as local trade or transhipment some 25% of all Australia's container imports and a typical mainline vessel will discharge and load containers to/from up to 50 different regional ports. (sub. 17, p. 22)

FINDING 2.1

The trend has been away from the provision of direct liner services and towards the establishment of networks centred on regional hub ports. As a result, carriers who previously serviced only major routes have joined networks servicing secondary routes. While larger ships service hubs, smaller second-generation vessels are deployed on feeder routes.

Increased vessel size

The size of container vessels has increased dramatically since the 1960s (table 2.2). The capacity of early container ships was less than 1000 TEU, and until the mid-1990s, vessel size was limited to the maximum capable of passing through the Panama Canal[7]. Since that time, carriers have introduced larger vessels specifically intended for the mainline east-west trades[8]. In 2003, 30 per cent of liner capacity was post-Panamax (Tozer 2004, p.1).

Two factors contributing to this increase in the size of container ships are the increase in worldwide demand for liner shipping and the ability of carriers to reduce unit costs by increasing vessel size (chapter 3). As yet, neither diseconomies of vessel size nor constraints on the use of large vessels (such as the inadequacy of land-based infrastructure to handle ships over a certain size and the cost of widening and deepening channels to accommodate larger vessels) have deterred the trend to larger tonnage. The largest container vessel afloat, at 8500 TEU, was launched by China Shipping Container Lines in July 2004 (*LLDCN* 8 July 2004). Maersk-

[7] A Panamax vessel is capable of carrying up to 4000 TEU (Alderton and Rowlinson 2002, p. 169).

[8] According to McLellan (1997) one constraint on the earlier introduction of vessels capable of carrying more than 6000 TEU was the lack of an engine powerful enough to drive such a vessel at 25 knots.

Sealand reportedly has a 11 000 TEU vessel on order which is due for delivery in 2007 (*LLDCN* 2 August 2004).

Table 2.2 **Growth of container ships**

Year	*Class or type*	*Capacity*
		TEU
1960 [a]	First generation	< 1000
1970	Second generation	1000 – 3000
1987	Third generation	3000 – 4000
1988	Fourth generation (post-Panamax)	4000 – 6000
1996	Fifth generation	6000 – 8000
1998	Sixth generation	> 8000

[a] According to Dr Tony Fletcher (sub. DR2, p. 2) the first container vessel in the Australian market was commissioned in 1964.

Source: Alderton and Rowlinson (2002, p. 168).

The majority of vessels currently on order will be capable of carrying in excess of 6000 TEU. Indeed, half the total capacity ordered by October 2003, for delivery in 2006, is accounted for by ships of 8000 TEU or greater (Containerisation International 2004, p. 5). These ships are intended for deployment on the trans-Pacific and Europe-Asia trades. Tozer (2004) forecast that vessels up to 12 500[9] TEU will be in service by 2010, at which point, port infrastructure constraints will limit further increases in vessel size. Wijnolst (2000) forecast that, ultimately, the maximum feasible capacity would be 18 000 TEU (the limit imposed by draught restrictions on the Straits of Malacca).

FINDING 2.2

Since the advent of containerisation in the 1960s, the average size of container ships has increased dramatically. Average vessel size will continue to increase, although limitations may ultimately be imposed by port capacity limits and draught restrictions on sea channels.

Industry capacity

The trend to larger ships has been accompanied by strong growth in available liner capacity. This is consistent with past trends in the industry which have frequently resulted in excess capacity, leading some commentators to suggest that excess

[9] A vessel with a capacity of 12 000 TEU would be the largest capable of passing through the Suez Canal (Baird 2002, p. 836).

capacity[10] may be a structural feature of liner shipping (Shipping Australia Limited, sub. 16, p. iv).

Excess capacity in liner shipping may be a result of a number of factors, including increased competition in the liner shipping industry. Increased competition has led to a quest by carriers for lower costs, which in turn has led to more and bigger ships (chapter 3). Establishing a new service typically requires the commitment of several vessels. Traditionally, this occured through new ship building rather than through slot exchange/charter or ship charter — although there is evidence that carriers are increasingly using these alternatives (OECD 2002, p. 47).

Excess capacity may also be encouraged by the provision by governments in some countries of industry assistance in the form of shipbuilding subsidies, vessel operating subsidies, special taxation provisions relating to investment in shipping and special taxation treatment for ship operators. Shipping Australia Limited (sub. 16, p. 21) provided a list of 57 countries that provide government assistance to building and operating ships. Subsidies have the effect of increasing the supply of ships relative to demand, such that at any given level of freight rates more ships are competing for a given volume of cargo.

However, despite the view that excess capacity is endemic in liner shipping, strong growth in ship numbers is anticipated to continue, prompted by strong demand for liner shipping services. As at June 2004, new capacity of 3.5 million TEU (or 50 per cent of the current world fleet) is scheduled for delivery through until 2007. By comparison, in 1999, new orders represented only 16 per cent of the fleet (*LLDCN* 30 June 2004). Low vessel retirement rates have contributed to the growth of the world fleet. Only around 30 000 TEU (or 0.5 per cent) of the world fleet was estimated to have been scrapped in 2003 (Containerisation International 2004, p. 5).

According to UNCTAD (2003, p. 47), surplus tonnage[11] in cargo vessels has declined over the 1990s, falling from a little over 2 per cent of the fleet in 1996 to 0.7 per cent in 2002. However, as discussed later in this chapter, this relatively small shift in surplus tonnage appears to have had a significant impact on the

[10] At the macro or industry level, excess capacity exists when the carrying capacity of the global liner fleet exceeds the volume of cargoes shipped. At the micro or trade level, excess capacity exists when vessels operate at relatively low levels of capacity utilisation. Liner shipping operators run regular services along a predetermined route and vessels sail according to a prearranged schedule whether or not they have full cargoes. Thus, liner vessels would not be expected to operate at or close to 100 per cent of capacity.

[11] Surplus tonnage is defined as tonnage that is not fully utilised because of 'slow steaming'or lay-up status. 'Slow steaming' occurs when a ship or fleet of ships is operated at less than design or maximum sustained operating speed. This may occur to take advantage to reduce operating costs or to lessen fleet overcapacity (Perakis 2002, p. 580).

pricing of liner services. Excess capacity appears to be less significant in cargo shipping than in either tanker or bulk shipping. Surplus tonnage was estimated to be 7.1 per cent of the world tanker fleet in 2002, and 0.9 per cent for bulk carriers.

Ship chartering

Ship chartering presents a viable alternative to purchasing newly constructed or secondhand vessels[12]. The significant financial commitment of purchasing a ship has grown along with the increasing size of container ships. Chartering a vessel enables a carrier to respond quickly to changes in demand and to have greater flexibility in matching vessel capacity with cargo volumes. Reflecting this flexibility, and unanticipated increases in demand on some routes, the trend in the liner shipping market has been towards vessel chartering. In the early 1990s, the top 30 container fleet operators leased 18 per cent of their capacity. By 2004, the figure had risen to 45 per cent (*LLDCN* 5 August 2004). Currently, almost 60 per cent of container vessels on order are intended for the charter market (ECDG 2004, p. 18).

Chartering is practiced to varying degrees across the industry. For example, P&O Nedlloyd currently charters about 80 per cent of its fleet; compared with 50 per cent in 1999 (*LLDCN* 5 August 2004).

Although ship charters may be entered into to avoid the financing costs and risks associated with purchasing a vessel, the financial commitments associated with a lease can still be considerable. While, traditionally, ship charters were entered into for periods of six to 12 months for vessels of 2500 TEU or less, more recently carriers have moved into longer term leases on significantly larger vessels. For example, P&O Nedlloyd recently entered into a 10 year leasing contract for three 8400 TEU vessels. Each vessel is leased at US$38 500 per day (*LLDCN* 5 August 2004). The European Commission noted the importance of vessel chartering in capacity management:

> There are two different charter markets: the long-term and short-term charter market. The latter market covers all time and voyage charter contracts of up to two years. It mainly serves to fill capacity gaps at short notice, comparable to a rental car in case of a breakdown or accident.
>
> The long-term charter market is of greater importance to carriers. Carriers may decide to own or charter a vessel. In the case of long-term charter, carriers enter into a legally binding contract of more than two years, typically between five and ten years, before the vessel is … built. A large number of shipowners that charter out vessels are

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[12] According to UNCTAD (2004, p. 64) the container ship charter market is dominated by German shipowners, in particular the Hamburg Shipowners Association which controls around three-quarters of the container ship charter tonnage.

benefiting from tax incentives and are not active in the liner shipping market. Hence, long-term charter can be seen as a flexible way of vessel financing.

However, when a carrier is able to obtain a long-term charter contract over a relatively limited period of five years, it can substantially mitigate its investment risk. Thus, carriers with a well-balanced portfolio of owned vessels and long-term charter contracts of different durations are not bearing a great investment risk while at the same time these carriers are able to react independently (i.e. outside of conference co-ordination) to capacity imbalances at relatively short notice. (ECDG 2004, p. 18)

This longer term trends towards chartering, as well as the recent strong demand for capacity, have increased vessel chartering costs. According to ACIL Tasman Pty Ltd and Thompson Clarke Pty Ltd, industry trends have been

… accompanied by a dramatic rise in charter rates for container vessels of all sizes. The day rate for a traditional Australian trade vessel size of around 1700 TEUs more than trebled in the last two and a half years, from just over US$5,000 per day to around $22,500 per day in Q2 2004. This implies a massive impact on costs — increasing vessel hire from under US$2m p.a. to over $7m per vessel. While most operators charter vessels for periods of more than 12 months, and so this impact is delayed, when their charter comes up for renewal there is no escape from such market forces. (sub. 17, p. 19)

Changes in industry concentration

The increase in average vessel size has been accompanied by a clear move toward consolidation of carriers[13]. In 1999, at the time the Commission last reviewed Part X, no single line controlled more than 6 per cent of the world's total container capacity. However, as table 2.3 indicates, two leading carriers now exceed this threshold. As another measure of consolidation, the top 20 carriers account for about 60 per cent of world liner vessel capacity in 2004, compared with 35 per cent in the mid-1980s (table 2.4).

Besides mergers, the industry has experienced a complex pattern of alliance formation and dissolution.[14] Strategic alliances offer carriers an opportunity to:

---

[13] Over the past decade, major mergers, takeovers and shareholding agreements include: the purchase of Sea-Land by Maersk; the acquisition of APL by NOL; the merger between P&O and Nedlloyd; the purchase of CGM by CMA; the acquisition of Lykes and Ivaran Lines by CP Ships; the purchase of Blue Star by P&O Nedlloyd; and the majority shareholding of Hanjin Shipping Company in DSR Senator Line (Hanjin itself was formed through the merger of Hanjin and the Korea Shipping Corporation) (Hoffmann 1998; Notteboom 2004).

[14] Alliances covering the world's three major trades routes (trans-Pacific, trans-Atlantic, Europe–Asia) include the Grand Alliance (NYK, Hapag-Lloyd, MISC, OOCL, P&O Nedlloyd), the New World Alliance (Hyundai Merchant Marine, MOL, American President Lines) and the

aggregate cargo volumes; increase service frequencies; improve asset utilisation through the sharing of vessels, terminals, equipment and containers; and employ their collective financial strength for long-term asset procurement and replacement (Hoffmann 1998). Alliances are discussed further in chapter 3.

However, despite this trend towards consolidation, liner shipping does not appear highly concentrated compared with other industries. One measure of industry concentration is the 'four–firm ratio' which measures the market share of the four largest firms in the industry. According to the US Department of Justice and Federal Trade Commission Guidelines, a four firm ratio of less than 50 per cent is regarded as 'unconcentrated', while a ratio of over 70 per cent is regarded as 'highly concentrated' (1997, p. 15; Hoehn et al., 1999, p. 21).

In the United States, the average industrial four-firm concentration ratio is a little over one-third. In some industries, such as breakfast cereals and cigarettes, the ratio is over 80 per cent (Gilligan 2004). A high degree of concentration is not unusual among industries in the transportation sector. The US domestic airline industry also appears to have a high degree of concentration with 15 major routes having a single airline with more than 70 per cent of the market (Cooper 2001, p. 3).

Table 2.3 indicates that the capacity share of the four largest firms in international liner shipping is around one-quarter. While capacity shares and market shares are not necessarily the same, and differ according to the capacity utilisation rates of individual firms, the data do not suggest a highly concentrated international industry. The data presented above are an average across all routes. Concentration ratios vary on a route-by-route basis.

FINDING 2.3

Concentration of ownership has increased appreciably in the market for international liner shipping over the past two decades, although, in comparison with other transport industries, concentration is still not high.

Trends in international freight rates

Abstracting from volatile short-term movements, trend freight rates declined over the 1990s (OECD 2002, p. 35). This reflected cost savings associated with industry consolidation and increases in vessel size, together with increased competition on many trade routes (PC 1999). Substantial declines in trade volumes in the Asia-

United Alliance (Hanjin, Cho Yang, DSR-Senator, United Arab Shipping Co.) (Brooks 2002, p. 10; Notteboom 2004).

Table 2.3 **Ten leading carriers by capacity**
as at 11 August 2004

Operator	*Country*	*Number of ships*	*Capacity*	*Share of world capacity*
			TEU	%
Maersk/Sealand	Denmark	300	812 225	9.3
MSC	Switzerland	238	613 395	7.0
P&O Nedlloyd	UK/Netherlands	146	402 178	4.6
Evergreen Group	Taiwan	126	349 916	4.0
CMA CGM Group	France	125	326 265	3.7
NOL/APL	Singapore	89	288 530	3.3
Hanjin	Republic of Korea	70	275 824	3.2
Coscon	China	126	253 326	2.9
NYK	Japan	69	228 697	2.6
CSCL	China	96	212 813	2.4
World fleet		**7 447**	**8 744 549**	

Source: Containerisation International online database accessed 12 August 2004.

Table 2.4 **Twenty largest carriers' share of total liner shipping capacity, 1986 to 2004**

Year	*Share of world fleet capacity*
	Per cent
1986	35
1990	39
1992	42
1993	44
1994	46
1998	53
2001	60
2002	62
2004	62

Source: PC (1999, p. 13); UNCTAD (2003, p. 63); Containerisation International (2004).

Pacific region following the 1997 Asian financial crisis also contributed to the downward trend. However, since mid-2002, freight rates[15] have risen on most major international maritime trade routes (figure 2.1). These recent increases can be traced to extremely strong — and largely unanticipated — demand for Chinese exports (Containerisation International 2004, p. 5)[16].

On the trans-Pacific route, freight rates from Asia to the United States rose by 28 per cent in the two years to the June quarter of 2004, while those on the return leg increased by 10 per cent. On the Europe-Asia routes, rates for shipment from Europe averaged an increase of 13 per cent; while inbound services from Asia recorded average increases of 57 per cent. Rates declined on the United States to Europe route by a little over 1 per cent, while increasing on the return leg by 23 per cent (UNCTAD 2004, p. 67).

Despite cooperative arrangements between carriers, partly aimed at moderating volatility (chapter 4), international freight rates demonstrate considerable instability. For example, from 1999 to 2004, quarterly changes in average rates on the Asia to Europe route varied between a decline of 12 per cent and an increase of more than 9 per cent. On the United States to Asia route, average quarterly changes ranged between a decline of 10 per cent and a rise of 8 per cent. Whether freight rates would have been more or less volatile in the absence of such arrangements is not clear.

Carrier profitability

There is a general view that profitability in liner shipping is low (ACIL Tasman and Thompson Clarke, sub. 17, p. 34; Haralambides et al. 2003, p. 82). The OECD concluded:

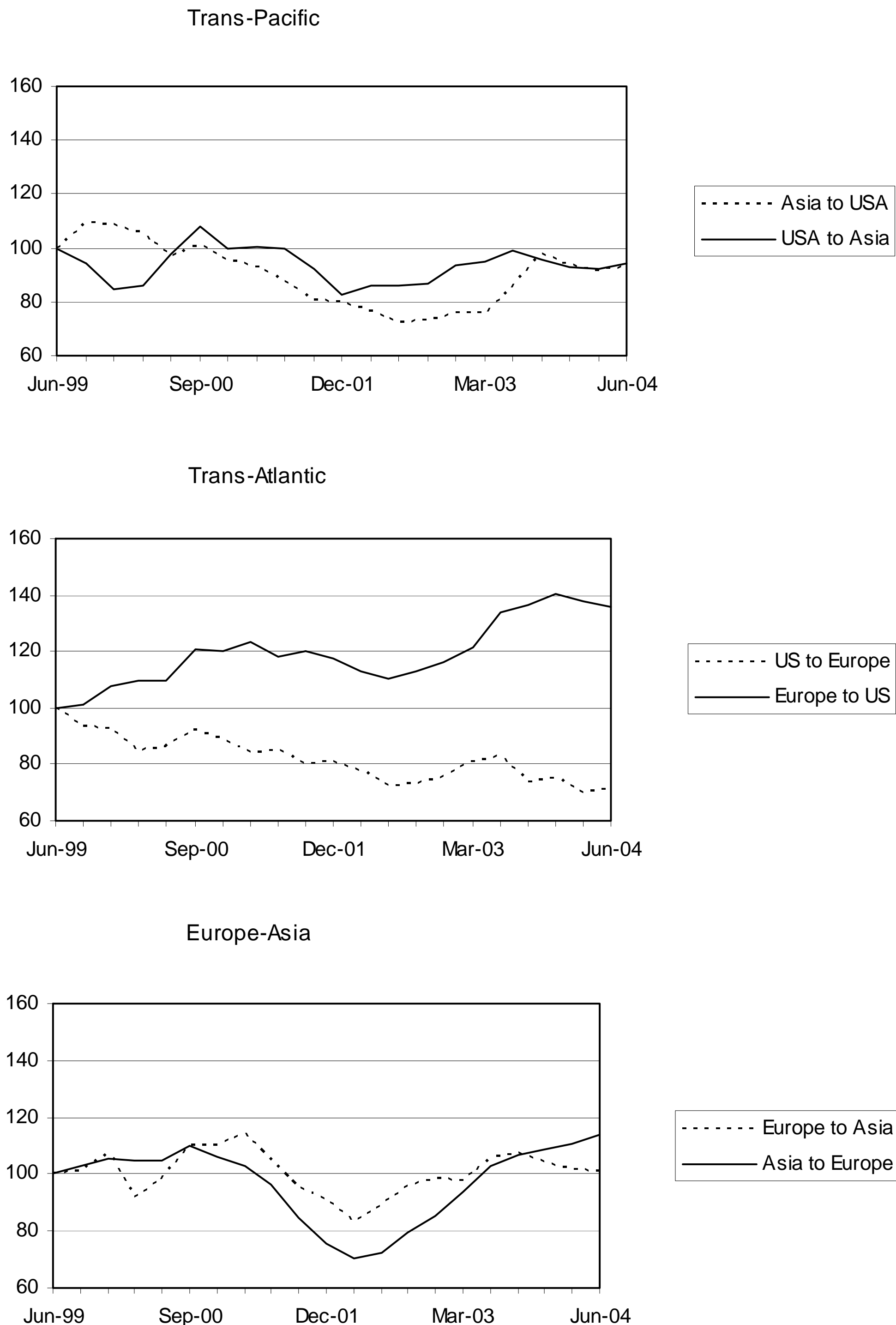
> Carriers often point out that theirs is an industry characterised by poor economic performance. The measurement of economic performance of an industry is notoriously difficult and fraught with problems. Nevertheless, the evidence in this report suggests that the liner shipping industry is a poor performing one, as are many other transport

---

[15] Movements in average freight rates should be interpreted with caution. Carriers charge different rates for different cargoes and discriminate between shippers (chapter 3). Movements in average rates can therefore reflect compositional changes in cargoes.

[16] UNCTAD commented: 'China is by far the world's largest exporter of containerized cargo, with 14.4 million TEUs in 2003. This is expected to grow further to 18.6 million TEUs in 2005, assuming an annual growth rate of almost 18 per cent, which is also the region's highest. China will then account for 24 per cent of the world's containerized exports. In fact, globally, the largest bilateral containerized trade flow is that of Chinese exports to the United States. In 2003, these increased by 13 per cent to 4.6 million TEUs' (2004, p. 99).

Figure 2.1 **Liner shipping freight rates[a] on three major trade routes**
June quarter 1999 = 100



a Market averages. $US per TEU. All-in rates, including the inland intermodal rate where relevant. Rates to and from the US refer to the average for all three coasts. Rates to and from Europe refer to the average for North and Mediterranean Europe. Rates to and from Asia refer to the whole of South-East Asia, East Asia and Japan/Republic of Korea.

Source: UNCTAD (2004, p. 67).

service provider industries. However, there is no evidence that average returns in the liner shipping industry have been significantly *worse* than returns in many other sectors of the transport service industry. Furthermore, it would be wrong to believe that all liner operators are faring so poorly. Like in any other industry, carriers have come and gone and many have changed in response to historical circumstances, yet most of the top 20 carriers have been in business for over 20 years – detracting from carrier claims that industry losses are unsustainable over the long run. [emphasis in original] (2002, pp. 45–6)

In reaching this conclusion, the OECD observed that the average return on equity for leading carriers in the ten years to 2000 was 10.55 per cent; while the average return on equity in the rail and freight transport sectors was 9.16 per cent. Rates of return for major liner shipping companies are shown in table 2.5.

Table 2.5 **Return on equity for a cross-section of liner shipping companies**

Company	*1999*	*2000*	*2001*	*2002*	*2003*
	%	%	%	%	%
Maersk [a]	10.4	11.2	15.8	14.3	16.5
P&O Nedlloyd	0.2	9.3	3.9	-12.1	4.3
NOL/APL	6.1	12.6	6.4	4.6	na
CGM-CMA	3.9	11.4	2.3	5.2	9.6
Evergreen	3.9	4.3	3.1	1.5	4.0
Hanjin	4.9	7.5	4.4	0.2	8.1
NYK	4.9	5.0	6.3	4.9	5.4

a Return for the entire A.P.Moller group, not simply liner operations. Profits for the entire group are higher than those for liner shipping operations (OECD 2002, p. 46). **na** Not available.

Source: Containerisation International online database, accessed 11 February 2005.

The volatility of freight rates is mirrored in carrier profitability. Returns can vary for a company substantially over time and also between shipping lines. The OECD (2002, p. 47) provide evidence that cost structures vary considerably between carriers, suggesting that shipping companies implement efficiency improvements to varying degrees. Another view is that profitability of liner carriers is generally poor because of intense competition rather than lack of efficiency (ACIL Tasman and Thompson Clarke, sub. 17, p. 36). In turn, low profits may be a force driving carriers toward strategies involving alliances, mergers and building larger ships in an effort to capture economies of scale and scope.

However, profitability also depends on the business strategies pursued by individual carriers. According to the OECD:

Carriers put forward many reasons for the industry's propensity for poor economic returns. These include the investment necessary to implement liner shipping services, the vagaries of international trade, the fact that unsold slots are forever lost and the general commoditised nature of the liner shipping product. Despite these factors, it is clear that some carriers are able to generate a reasonable return on their investments. Why this should not be the case for more carriers may be more linked to management and accounting practices than to industry-specific characteristics. (2002, pp. 46–7)

FINDING 2.4

Reported profitability of liner shipping has been low. However, investment in additional capacity remains strong.

2.2 The Australian liner shipping market

Shipping is the primary form of transport for Australia's exports and imports. Many of Australia's major exports and imports are bulky or dense and carriage by sea is the only viable mode of transport. In 2003, 80 per cent of Australia's merchandise exports and 70 per cent of Australia's merchandise imports were transported by sea.

In common with international experience, Australia's liner exports and imports tend to be high value/low volume. In 2003, by value, liners carried 47 per cent of Australia's seaborne exports and 80 per cent of imports (table 2.6). By weight, the liner trades accounted for only 3.5 per cent and 27 per cent of Australia's seaborne exports and imports, respectively. Major commodity exports such as coal, iron ore and wheat are usually shipped by bulk carrier.

Table 2.6 **Australian sea freight, 2003**

	Exports		*Imports*	
By value	**$ billion**	**% of total carried by sea**	**$ billion**	**% of total carried by sea**
Total carried by sea	87.1	–	92.7	–
Liner shipping	41.3	47.4	74.0	79.8
Non-liner shipping	45.8	52.6	18.8	20.2
By weight	**Million tonnes**	**% of total carried by sea**	**Million tonnes**	**% of total carried by sea**
Total carried by sea	538.5	–	62.4	–
Liner shipping	18.8	3.5	17.0	27.2
Non-liner shipping	519.7	96.5	45.5	72.8

Source: BTRE (2004).

Major liner cargoes

Australia's major liner export and import cargoes have different characteristics and shipping requirements. Exports tend to be commodities (such as meat, cereals and dairy products) whereas imports are largely manufactured goods (such as machinery, vehicles and chemicals). Australia's exports tend to comprise denser cargoes[17] than its imports. Some export categories, such as fruit and cereal products, are subject to seasonal variability. In contrast to many export cargoes, import cargoes generally do not require refrigeration.

By weight, in 2003, the most important liner exports were meat (6.7 per cent of the total); cereals (6.5 per cent); animal feedstuff (6.4 per cent); aluminium and aluminium alloys (5.1 per cent); vegetables and fruit (4.7 per cent); and dairy products (4.4 per cent). The largest categories of liner imports were machinery (8.9 per cent); paper products (8.4 per cent); non-metallic mineral manufactured products (8.4 per cent); chemicals (7.2 per cent); and road vehicles and other transport equipment (6.1 per cent).

Data on the composition of Australian cargoes are presented in appendix C.

Given that Australia's exports are denser cargoes than its imports, and because of vessel deadweight limitations, a larger number of empty containers are carried on outward journeys compared with inward journeys. The Department of Transport and Regional Services (sub. 9, p. 33) provided data suggesting that 35 per cent of export containers are empty, while 15 per cent of import containers are empty. As noted in section 2.1, repositioning empty containers is a standard feature of container cargo routes. Ultimately, the cost of shipping empty containers is passed onto shippers.

Within this overall trend, there are specific container requirements which differ between Australia's imports and exports, and which can complicate container logistics. Australia's dense export cargoes can limit the use of forty foot containers, since the weight of a forty foot container filled with dense cargo can exceed the capacity of cargo handling equipment. Twenty foot containers are more often used for denser, agricultural exports, while forty foot containers are used to import manufactured products (ACIL Tasman and Thompson Clarke, sub. 17, p. 30; DTRS, sub. 9, p. 33).

The high proportion of refrigerated container slots required to carry Australia's exports of meat, dairy products and other refrigerated cargoes may increase vessel

[17] A dense cargo is one with high weight relative to volume (ACIL Tasman and Thompson Clarke, sub. 17, p. 30).

and container capital and operating costs. It also increases the need to carry empty refrigerated containers to Australia, since some of Australia's imports cannot be carried in refrigerated containers. Empty dry containers must then be carried from Australia for subsequent use in other trades.

FINDING 2.5

As with other international trade routes, Australian trade routes are subject to imbalances in container requirements. Typically, more containers are required for imports than are required for exports. Issues in the management of Australia's liner shipping requirements include different densities of export and import cargoes, the relatively high proportion of Australia's exports requiring refrigeration and the seasonality of some exports.

Australian trade routes

As a result of the country's relative distance from major trading partners and the size of its economy, Australian liner trades have been described as 'long and thin' (DTRS, sub. 9, p. 33; Shipping Australia Limited, sub. 16, p. 8). 'Long and thin' trades are characterised by low volume cargo traffic and long voyages. Australia is not located on the major round-the-world or east–west trade routes — its major trade routes run north–south. In 2003, Australia ranked sixteenth in the world in terms of the number of container movements through ports. According to the Department of Trade and Regional Services (sub. 9, p. 33), Australia accounted for 4.7 per cent of seaborne containerised trade in 2003[18]. Data on the value of liner shipping services, provided to Australian importers, can be obtained from the Australian balance of payments. However, an estimate of the value of liner services utilised by exporters is more difficult to obtain since it requires knowledge of the import values, inclusive of freight charges, for the countries that Australia exports to. In 2003-04, the value of liner shipping services associated with Australian

[18] Both Shipping Australia Limited (sub. DR20, p. 3) and ACIL Tasman Pty Ltd and Thompson Clarke Pty Ltd (trans., p. 85) disputed this figure. They estimated Australia's share of world container trade at less than 2 per cent. However, this estimate appears to be based on container movements through ports, not on the transport of full containers. Port throughput overstates cargo trade since, in addition to international cargo movements, it includes domestic movements of containers, movements of containers from one ship to another, movement of partially filled containers and re-positioning of empty containers. Throughput data also counts transhipped containers twice — as both a 'landed' and 'shipped' movement (Containerisation International 2003, p. 9). Notteboom (2004) reports that world container throughput in 2002 was 266 million TEU. By comparison, UNCTAD (2004, p. 14) estimated that seaborne container trade was 76 million TEU in 2002. The use of port throughput data could be expected to understate the relative importance of Australia compared to regions such as the United States and Europe with significant inland waterways and transport systems.

imports was $3.7 billion[19]. Given that the value of Australian liner imports exports was around 80 per cent higher than the value of liner exports in 2003 (table 2.6), and on the assumption that prices charged by carriers on exports are approximately the same as those charged for imports, the value of liner services provided on Australian trade routes would be close to $6 billion.

In volume terms, over 60 per cent of liner exports were shipped to Asia in 2003. The most important export destination was South-East Asia (23.4 per cent). Other export markets were Japan and North Asia (19.3 per cent); East Asia (18.4 per cent); Europe (9.8 per cent); North America (8.3 per cent) and New Zealand (9.3 per cent).

By volume, about half Australia's liner imports were sourced from Asia in 2003 — East Asia (20.7 per cent); South-East Asia (18.4 per cent) and Japan and North Asia (12.3 per cent). Europe provided a further 20.7 per cent of the total. 10.2 per cent of imports originated from North America while 9 per cent were sourced from New Zealand (BTRE 2004).

There can be substantial route trade imbalances. For example, on the Japan and North Asia trade, the ratio of import volumes to export volumes was 1.7 in 2003. On the Europe trade, the ratio was 0.5. This has implications for the number of containers required on each leg of the voyage. There are approximately 1.75 full export containers to every full import container on the Japan and North Asia trade. Conversely, on the Europe trade, the ratio of full export to import containers is only one-third (ACIL Tasman and Thompson Clarke, sub. 17, p. 27).

The imbalances between import and export tonnages have narrowed on some routes. In 1997, the ratio of exports to imports to Japan and North Asia was 3.5 (compared to 1.7 in 2003); for South East Asia it was 2.0 (compared to 1.4 in 2003); and, for East Asia, the ratio was 2.2 (compared to 1.0 in 2003).

Data on cargo trade routes are presented in appendix C.

It has been argued that the characteristics of Australian trade routes make some cooperation between carriers necessary. For example, the Department of Transport and Regional Services commented that the 'long and thin' nature of Australian routes, together with imbalances in container requirements:

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[19] This figure was derived for the Commission by the Australian Bureau of Statistics from balance of payments data. It is calculated as the difference between the CIF and FOB value of merchandise imports which were transported by sea. The CIF (cost, insurance and freight) value measures the landed value of a good at its first port of arrival. The FOB (free on board) value includes the cost of loading a cargo on to a vessel but does not include insurance or further freight charges. Commodity groupings which would not normally be transported by container were excluded.

> … would appear to militate against efficient and economical liner services by lines operating independently. Collaboration between lines allows an effective combination of high regular service frequency and/or the service of a wider range of ports with the use of relatively large and economical vessels. (sub. 9, p. 33)

However, the view that Australia is vulnerable at the end of 'long and thin' trade routes is not universal. The European Union classified Australian trade routes, along with mainline east-west trades, as 'thick' (ECDG 2004a, p. 41; DTRS, sub. 9, p. 15).

Moreover, a number of structural developments in the market for liner shipping have strengthened Australia's integration into world container trade routes. Major carriers are increasingly moving towards establishing integrated global networks (section 2.3). The growth in the importance of networks centred around hubs, such as Singapore, also increases the viability of feeder trade routes, such as those to and from Australia. Australia is also geographically close to Asia, a region which is accounting for an increasing proportion of world containerised trade[20]. An indication of this trend are the recent major investments by carriers in vessels with substantially greater reefer (refrigerated container) capacity, with the express purpose of servicing Australian trade routes (chapter 4).

One characteristic of a 'thin' trade is that it is serviced by a small number of carriers (ECDG 2004a, p. 41). Across Australian routes, there are significant differences between the number of carriers. However, on major routes there are typically in excess of ten carriers (chapter 5). Many of these are major international carriers. This is a trend which appears to be increasing over time. In 1996, only three of the twenty largest carriers were represented on the Australia/North American trade routes (Brooks 2000a, p. 25). By 2004, this number had doubled. According to Shipping Australia Limited (sub. 16, p. 77), the number of carriers entering Australia/North East Asia trade routes between 1999 and 2004 exceeded those leaving.

In commenting on Australia's trade routes, the ACCC noted that:

> … not all of Australia's principal liner trades are long and thin. Indeed several Australian trades are sufficiently 'thick' enough to support frequent sailings by several groups and independent lines. The Australia–South East Asia trade is such an example. There are also alternative routes via Singapore to the direct routes between Europe and Australia (the longest Australian liner trade route). Since Singapore does not represent a significant diversion (in distance) for carriers, it is not significantly slower to ship

[20] According to UNCTAD (2004, p. 99) eleven major South and East Asian countries collectively accounted for almost half of the world's containerised exports in 2003 — a ratio which is forecast to increase. The countries were China (including Hong Kong), Indonesia, India, Japan, Malaysia, Philippines, Singapore, Republic of Korea, Taiwan, Thailand and Viet Nam.

goods via Singapore to Europe rather than directly. The relative volumes that are carried by carriers on either the direct or indirect route between Australia and Europe depend on the relative freight rates earned by carriers operating on each route. In the late 1990s the freight rates for shipping boxes via Singapore was less than that for direct carriage. However in the past few years direct shipping has become cheaper than transhipment via Singapore. (sub. 21, pp. 46–7)

Increased capacity on major routes will also enable a greater number of services to be provided on secondary routes. The impact of developments in the international market for liner shipping on Australian trade routes was noted by several participants. For example, ACIL Tasman and Thompson Clarke observed the:

> … massive surge in containership capacity is bound to lead to a somewhat disorderly 'trickle down' to Australia as the bulk of new vessels will be placed in the major East-West trades between Asia and North America, Asia and Europe and Europe and North America. Some of the displaced vessels currently on those routes will be reallocated to the much smaller North South trades. MSC has already deployed 15 vessels in their European service with Australia/New Zealand in response to the two Round the World services introduced in late 2002, and has announced plans to progressively upgrade the vessel size in their service to as large as 6,700 TEUs, beginning with the progressive early introduction of vessels over 3,500 TEUs. (sub. 17, pp. 19–20)

UNCTAD also noted that '… the influx of larger containerships on the main routes heralds the deployment of larger vessels in feeder routes too' (2004, p. 61).

FINDING 2.6

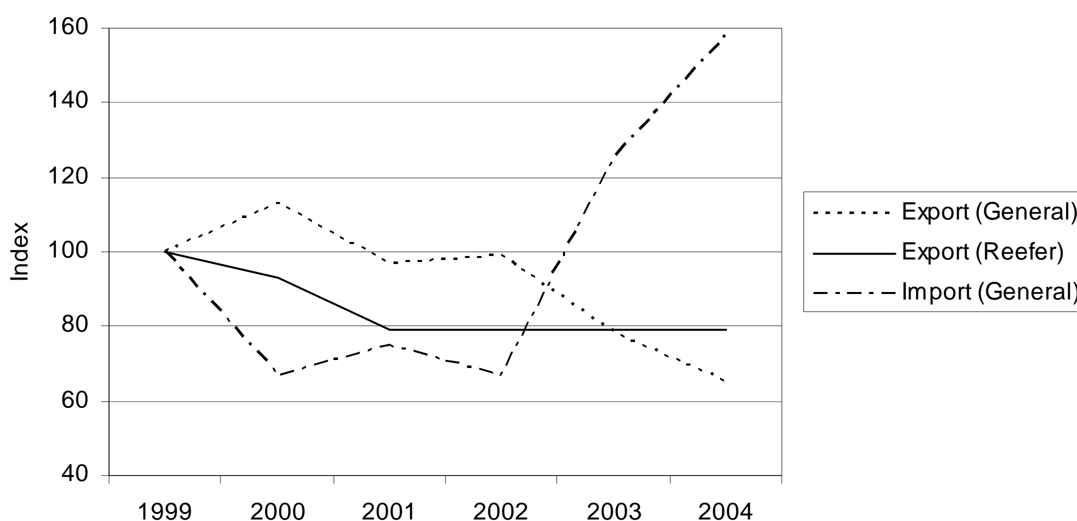
Most of Australia's container trade involves long voyages along north-south trade routes. Traditionally, these routes — which may carry comparatively low cargo volumes — have been described as 'long and thin'. However, developments in the market for liner shipping, including the expansion of global networks and the growth of the Asian region, have increasingly integrated Australian container trade flows with those of the rest of the world.

Freight rates on Australian trade routes

Figures 2.2 to 2.6 show movements in average 'blue water' freight rates on Australian trade routes since 1999. In general, these rates have followed different trends, reflecting route specific demand and supply pressures. Trade volumes grew substantially on Asian regional trade routes in 2004, resulting in port delays and capacity limits. In some regional ports, container throughput increased by 30 per cent over the year to June (*LLDCN* 15 July 2004). In response, rates on transporting imports from the region increased by an average 26.4 per cent (figure 2.2).

Reefer rates have increased on north Asian trades as a result of an unanticipated increase in meat exports to Japan and Korea (figure 2.3). This followed a ban on US meat exports to those countries (ACIL Tasman and Thompson Clarke, sub. 17, p. 17). Reflecting this shift in demand, refrigerated container rates have fallen on European and US trades.

Figure 2.2 **Average freight rates[a]: Australia–South East Asia**
1999 = 100



[a] Average blue water rates (includes cargo transported under contract).
Source: Shipping Australia Limited.

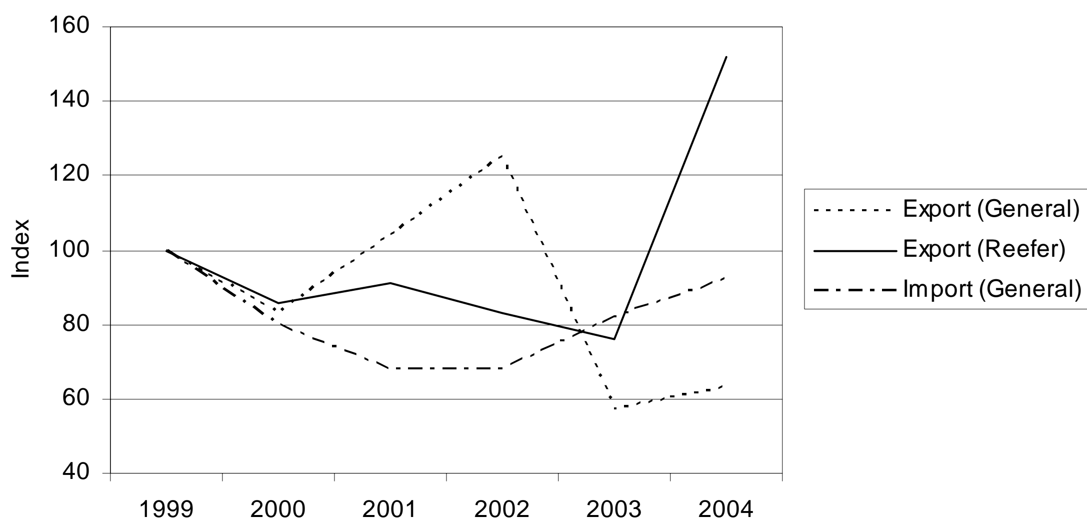
Chinese trade has grown rapidly over the past two years, particularly with the United States. Exports from China to the United States rose by 27 per cent in volume terms in the year to the March quarter 2004, while exports from the United States to China rose by 36 per cent. Trade volumes have also grown substantially on Asian–Europe trade routes. The volume of exports from China to Europe rose by 17 per cent in the year to June 2004. These developments have impacted significantly on freight rates. Average import container rates rose by 22 per cent on the Australia–China trade in 2004 (*LLDCN* 12 August 2004). However, for individual importers, rate increases may have been considerably higher than this. Gift and Homewares Australia, who represents small shippers, noted:

> Approximately 80% of our Members import into Australia and of these nearly 95% of members have faced increases. In some instances, increases have been up to 300% in the cost of shipping a container from north east Asia since June 2003. (sub. DR15, p. 4)

Developments on Chinese trade routes have impacted on the availability of international capacity. According to ACIL Tasman and Thompson Clarke (sub. 17,

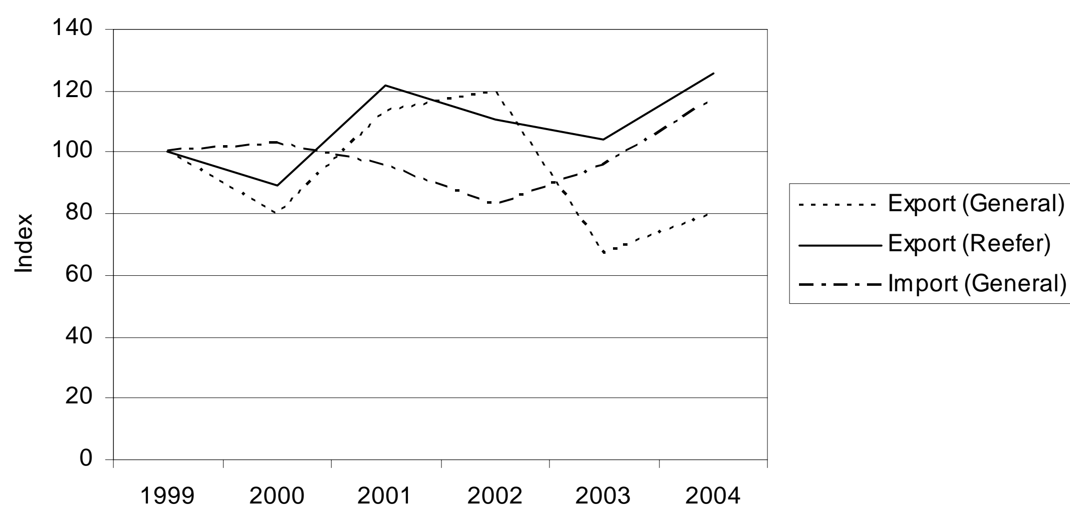
p. 24), a near fourfold increase in the cost of chartering a container ship since 2002 can be largely attributed to Chinese economic growth.

Figure 2.3 **Average market freight rates[a]: Australia–Japan**
1999=100



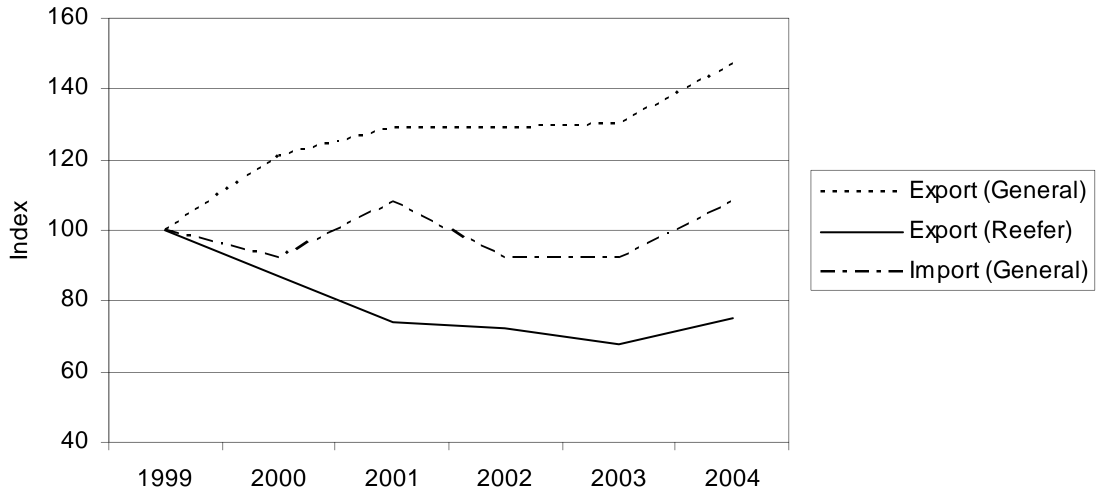
[a] Average blue water rates (includes cargo transported under contract).
Source: Shipping Australia Limited.

Figure 2.4 **Average market freight rates[a]: Australia–China**
1999=100



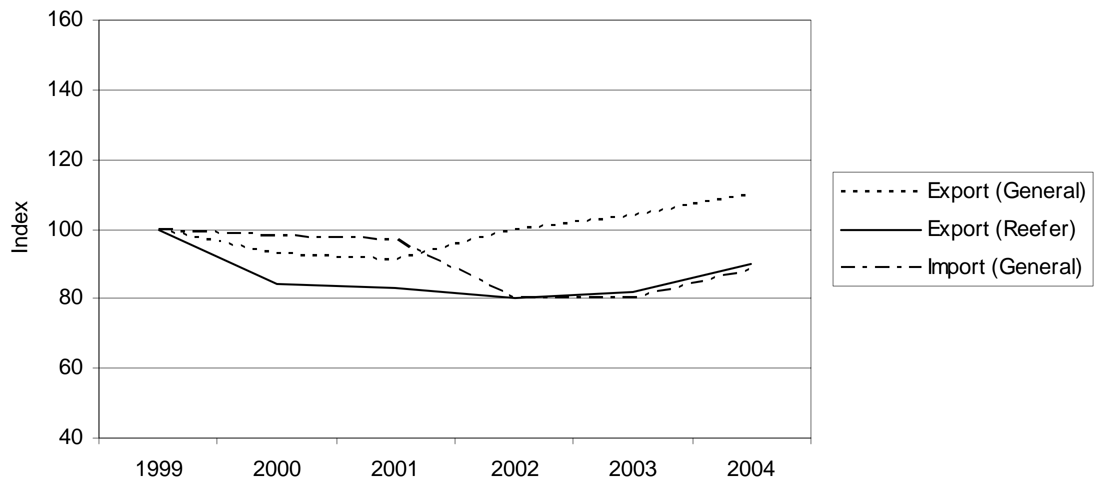
[a] Average blue water rates (includes cargo transported under contract).
Source: Shipping Australia Limited.

Figure 2.5 **Average market freight rates[a]: Australia–Europe**
1999=100



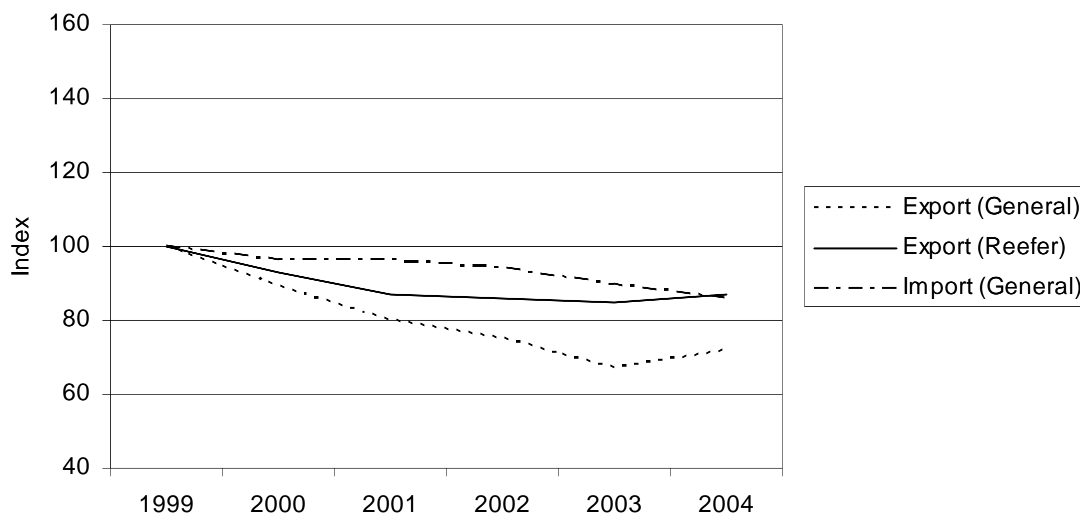
[a] Average blue water rates (includes cargo transported under contract).
Source: Shipping Australia Limited.

Figure 2.6 **Average market freight rates[a]: Australia–United States (West Coast)**
1999=100



[a] Average blue water rates (includes cargo transported under contract).
Source: Shipping Australia Limited.

Figure 2.7 **Average market freight rates[a]: Australia–New Zealand**
1999=100



[a] Average blue water rates (includes cargo transported under contract).
Source: Shipping Australia Limited.

FINDING 2.7

Freight rates on Australian trade routes have diverged, reflecting supply and demand conditions on individual routes. Since 1999, there have been notable increases in freight rates on general exports to Europe; on refrigerated exports to Japan and on imports from China. Substantial declines have occurred on the trans-Tasman route; exports to the United States; and, refrigerated exports to Europe.

2.3 Agreements between shipping lines

In common with other industries in the transportation sector — such as airlines, rail and road haulage (chapter 3) — suppliers in the liner shipping market enter into cooperative agreements. These agreements fall into three broad categories[21]:

- agreements to fix price (conferences);
- agreements to exchange commercial information (discussion agreements);
- agreements for the joint provision of services (operational agreements).

[21] The distinction between conferences, discussion agreements and operational agreements was also made by the Federal Maritime Commission (2001, pp. 24–5), Shipping Australia Limited, (trans., p. 22), and the ECDG 2004a, p. 12.

These categories are not mutually exclusive and agreements between carriers may attempt to achieve more than one of these objectives. More fundamentally, these agreements can either be viewed as attempts to cooperate on freight rates (conferences; discussion agreements) or to cooperate on operational matters (consortia and other vessel sharing agreements) (Ryoo and Lee 2002, p. 348).

This distinction between operational cooperation and cooperation with respect to market conditions was also made by Shipping Australia Limited:

> … there are really only three types [of agreement] in essence: you have the operation agreements which you can source through a joint service and they have their economic rationalisation reasons of sharing large capital assets and so on … They operate under the umbrella of either a discussion agreement, which is the more common form of conference … We believe that — or what we contend is — that it's the ability to discuss supply and demand within a discussion agreement, particularly how you see it going in terms of demand collectively and how we see the capacity being provided, but not controlling capacity — that also seems to be a misapprehension — but that helps the ability at times to set, as I said, certainly not account rates or individual account rates, but simply across-the-board rates or surcharges, that gives confidence for those agreements to hang together. (trans., p. 22)

Agreements vary in terms of the obligations placed on members and the extent of interdependence between lines. There have also been significant mergers and acquisitions in the industry as lines have attempted to capture the benefits of coordination through more formal company structures.

Operational agreements are commonly entered into with a view to reducing the number of vessels deployed by individual carriers. Given the importance of capital costs in the industry (chapter 3), strategies which minimise the capital requirements of an individual carrier have the potential to significantly improve profitability. Operational agreements may also facilitate the provision of services to shippers which might otherwise not have been supplied. Ryoo and Lee (2002) have undertaken a study of the commercial motives of carriers in entering agreements (chapter 4). Based on their findings, table 2.7 categorises agreements into demand-side (cooperation on rates) or supply-side (operational cooperation).

Conferences

Conferences are the traditional form of cooperation between carriers. A conference is a route specific agreement between carriers to charge common freight rates, pool revenue and costs, pool profits and engage in capacity management. These agreements also establish the sailing schedules, ports of call and minimum service levels. The aim of conferences is to limit competition between members with a view

Table 2.7 **Types and nature of liner shipping cooperation**

Objective	*Agreement type*	*Nature of cooperation*	*Example*
Cooperation on rates	Conference	Agreement to regulate or restrict competition in order to achieve rate stability, and regularity and reasonable frequency of sailings while maintaining services to less remunerative ports.	Australia and New Zealand/ Eastern Shipping Conference
	Discussion (stabilisation) agreement	Voluntary agreement to reduce the level of capacity with the ultimate objective of raising rates to cover costs.	Australia/United States Discussion Agreement
Operational cooperation	Consortium	Operational/technical agreements of varying degrees of closeness in which the shipping companies involved operate under one name by pooling all or some of their activities on a single trade route. The activities covered could include rationalisation of sailings; slot exchanges or vessel sharing.	Asia/Australia Services Slot Exchange Agreement; Contship/P&O Nedlloyd Vessel Sharing Agreement
	Pooling agreement [a]	Agreement to pool revenue and/or costs with the objective of rationalising operations and limiting service competition.	ANSCON/ANZESC Pooling Agreement (no longer operating)
	Joint service	Agreement to establish a new and separate line or service to be jointly operated by partner companies. The service fixes its own rates, published its own tariffs, issues its own bills of lading, and acts generally as a single carrier.	MISC/MOL/OOCL/PIL Joint Service Agreement
	Slot charter	Operator leases slots on another line's vessels and markets the slots as its own.	NEAX Member Lines and APL Slot Charter Agreement
	Joint venture	Agreement in which each party has a share of ownership as shareholders, in one separate and legally autonomous venture and the participants jointly own or lease vessels, equipment and terminals. The venture has its own management.	Chief Container Service (New Guinea Australia Line and Australia West Pacific Line)
	Alliance	Agreement between carriers cooperating on a global trade route basis (usually involving provision of multimodal and logistics services).	Grand Alliance
	Merger and acquisition	Combination of lines to form a single company.	Merger between P&O and Nedlloyd; Purchase of ANL by CMA CGM

[a] Can also take the form of a trade share agreement (Shipping Australia Limited, sub. 16, p.16). According to Shipping Australia Limited (sub. DR4, p. 13) pooling agreements no longer operate on Australia trade routes. There are two trade share agreements operating on the Europe-Australia routes.

Source: Ryoo and Lee (2001); agreements registered with the Registrar of Liner Shipping.

to stabilising market freight rates. Conferences monitor members to ensure compliance. Discipline can be enforced by fines for non-compliance levied out of membership bonds or expulsion[22].

Conferences may engage in differential pricing structures (typically rates are higher on higher valued cargoes). They may also offer various forms of customer loyalty agreements such as deferred rebates and dual rate contracts under which shippers are charged a lower price if they ship exclusively with the conference. Carrier pricing policies are discussed in greater detail in chapter 3.

According to the OECD (2002, p. 19), 150 conferences operate around the world, with membership ranging between two and 40 carriers. Some carriers operate independently of conferences. Carriers may also participate in conferences on some trade routes while choosing to act independently on others (Sjostrom 2002).

The proportion of container trade carried by conference ships has decreased over the past two decades. On Australian trade routes, the share of conference capacity declined from 74 per cent in 1984 to 55 per cent in 1999 (OECD 2002, p. 7). In the late 1990s, conference ships represented approximately 60 per cent of worldwide liner capacity (although the share represented by conference shipping varied across individual routes).

FINDING 2.8

Conferences are the traditional form of cooperation designed to fix freight rates. Over recent years, conferences have declined in importance.

Discussion (capacity stabilisation) agreements

Discussion agreements facilitate the exchange of commercial information between carriers about freight rates, costs, capacity and conditions of service on a particular route. Unlike conferences, discussion agreements do not attempt to bind members to mutually agreed capacity levels or freight rates. Originally, discussion agreements were intended to facilitate the exchange of information between conference and non-conference members. However, in many trades, discussion agreements have increasingly replaced conferences as the preferred means of cooperation (Federal Maritime Commission 2001, p. 26; World Shipping Council 2001a, p. 13). The aim of discussion agreements is to provide an overall limit on route capacity to prevent instability in freight rates. On some Australian trade routes, those running between Australia and North America, discussion members account for more than 90 per

[22] Prior to 1998, the Federal Maritime Commission in the United States fined members for non-compliance.

cent of route capacity (chapter 5). Carriers can also be members of more than one discussion agreement and also be members of conferences and operational agreements.

Regulation determines the routes on which discussion agreements operate. Discussion agreements are allowed on United States, Canadian, Australian, Japanese, and New Zealand routes. In the European Union, discussion agreements do not benefit from the block exemption for anticompetitive behaviour (chapter 6). As a consequence, discussion agreements do not operate on European trade routes.

FINDING 2.9

Discussion agreements have become more important as a mechanism for influencing freight rates on most major trade routes. Where they occur on Australian trade routes, the capacity share of discussion agreement members is generally high. On European trade routes, discussion agreements are not granted block exemption and do not occur.

Operational agreements

In addition to conferences and discussion agreements, which are largely intended to directly influence market activity, carriers may also enter into operational agreements. The primary purpose of these agreements is to achieve operational efficiencies or better target shipper requirements by sharing assets and/or coordinating service provision.

Operational agreements vary according to the degree of cooperation between members. Agreements can take the form of route-specific agreements (consortia); agreements covering several routes (alliances); and agreements which involve the complete integration of ownership and management between two or more firms (mergers and acquisitions).

Over time, the degree of operational cooperation between carriers has increased. Prior to 1991, the most common forms of agreement were route specific slot charters and vessel charters. From 1991, several alliances were formed on major routes between well-established shipping lines. These alliances enabled members to achieve greater route coverage. From the mid-1990s, a number of significant mergers and acquisitions occurred in the industry (Brooks 2000a).

Consortia

Consortia are agreements to provide joint services through the sharing of vessels, port installations or marketing organisations. They are means by which lines can

provide services to shippers across a number of routes without investing in additional vessels or other assets. Consortia may allow vessels to be repositioned more easily in response to changes in demand than could occur if a single carrier were committed to servicing the route. Consortia can also minimise the costs associated with transporting empty containers.

Under a slot charter agreement[23], a carrier undertakes to provide a competitor with a minimum number of slots per sailing, for a specified period of time, at a fixed price. The line offering the slots achieves greater revenue stability; while the carrier chartering the slots is able to offer shippers greater route coverage. Slot charter agreements are often accompanied by agreements between carriers to coordinate sailings in order to jointly offer fixed-date sailing schedules (Brooks 2000a, p. 78).

In Australia, Canada, Japan, New Zealand and the United States, consortia benefit from general exemptions from collusion contained in competition law, whether or not the operators apply uniform freight rates. In the European Union, consortia are not granted price fixing authority unless they receive an individual exemption (chapter 6).

Alliances

Alliances are agreements under which carriers attempt to achieve global coverage without committing large amounts of capital (Brooks 2000a, p. 76; Cariou 2000). These agreements typically cover at least two of the major east-west trade routes (Europe–Asia, Asia–United States, or United States–Europe) served either by combined services on each route or round-the-world services. Alliances tend to be formed between larger carriers and dominate some major routes (Federal Maritime Commission 2001, p. 26). For example, in 2002, the five major alliances[24] accounted for almost three-quarters of capacity on the trans-Pacific route (UNCTAD 2003, p. 70).

The characteristic that sets alliances apart from other operational agreements is that they extend cooperation beyond a single trade route. Alliance members coordinate vessel utilisation, including joint vessel route assignments, itineraries, sailing schedules, the type and size of vessels to be employed, additions and withdrawal of capacity, ports and port rotations on a global scale. Alliances have arisen as carriers have attempted to exploit cost advantages from hub-and-spoke operations linked to the mainline east-west routes. The agreement typically covers vessel sharing and

[23] Similar to codeshare agreements in airline travel (section 3.5). Codesharing occurs when the airline marketing a flight and the airline operating a flight differ.

[24] New World Alliance; Cosco/K Line/Yangming; Grand Alliance; Evergreen/Lloyd Triestino; United Alliance (Hanjin, Senator Lines).

slot charters, use of joint terminals and containers, pooling of containers, establishment of container stations, vessel feeder routes, co-ordination (where permitted) of intermodal transport services and information exchange (Brooks 2000a, p. 20). According to the Department of Foreign Affairs and Trade (sub. 4, p. 3):

> Liner operators have also increasingly formed Global Strategic Alliances in order to share space and services and thereby capture additional efficiencies on a global basis. These cover the use by various liner operators of many carriers over different trade routes. These Alliances are therefore operationalized through route agreements which cover the entire operation of the liner trade, and involve close cooperation on matters such as the employment and utilization of vessels, itineraries, sailing schedules, the type and size of vessel to be employed, port rotations and use of terminal facilities. Global Strategic Alliances are distinct from Conference Agreements in that their members do not engage in common marketing, establish common tariffs or share profits and losses. However, the close cooperation entailed by those Alliances usually limits competition on freight rates.

Alliances are viewed as a more flexible cooperative arrangement than formal mergers or acquisitions, particularly since carriers can have business interests beyond liner shipping. For example, Mitsui OSK Lines receives only 40 per cent of its revenue from liner shipping, the remainder comes from bulk shipping and oil and gas transport (Panayides and Gong 2002).

Mergers and acquisitions

A number of mergers and acquisitions between shipping lines have occurred since the mid-1990s. Between January 1996 and November 1997, there were 21 major mergers and acquisitions in the liner shipping industry (Brooks 2000a, pp. 81–3). The most significant merger was between P&O from UK and Nedlloyd from the Netherlands in 1996. In 1999, Maersk Lines purchased the US carrier Sea-Land to form the world’s largest shipping line.

A merger or acquisition involves the complete amalgamation of the carriers involved and therefore requires some compatibility in business strategies. A merger or acquisition can follow a period of cooperation through less formal ventures. The acquisition of Sea-Land by Maersk followed a longstanding alliance partnership between the two lines (Brooks 2000a, p. 81).

Typically, national competition regulatory agencies have not objected to mergers or joint ventures between lines. This may reflect the fact that, compared with other industries, the international liner shipping industry is not highly concentrated (section 2.1).

2.4 The significance of different types of agreements on Australian trade routes

With the exception of alliances[25], which operate on the major east-west routes, all the agreements discussed in the previous section — ranging from operational agreements such as consortia and vessel-sharing agreements to conferences and discussion agreements — have been registered under Part X to operate on Australian trade routes.

An examination of the membership of individual agreements (appendix C) reveals a complex pattern of interaction between shipping lines. A carrier may be in several agreements on a particular route and choose to operate independently — or participate in few agreements — on another. Some shipping lines participate in more agreements, on average, than others.

There is a clear hierarchy of agreements reflecting the different purpose of each type of agreement. At the most basic level, decisions on the deployment of capacity are made by carriers who are independent or members of consortia (Shipping Australia Limited, sub. DR4, p. 27; ACCC, sub. 21, p. 27; ACIL Tasman and Thompson Clarke, sub. DR9, p. 4). In turn, the consortia may be linked together through membership of conferences (for the purpose of setting a common tariff) or discussion agreements (for the purpose of exchanging commercial information). Shipping Australia observed that this hierarchical structure, of consortia operating under the 'umbrella' of a discussion agreement or conference, was typical:

> They operate under an umbrella mostly. I can't think of any [operational agreements] that don't. They operate under the umbrella of either a discussion agreement, which is the more common form of conference, and there are still a few conferences left … (trans., p. 22)

It is also unusual for a carrier to be a member of a discussion agreement or conference without first being a member of an operational agreement. The exception is Maersk-Sealand — the world's largest shipping company — which, while participating in discussion agreements on the North American trades, is not a member of an underlying operational agreement (appendix C).

The share of capacity supplied by consortia varies, but is usually below 50 per cent. However, there is considerable overlap between the members of operational agreements on any one trade route. For example, PONL and Contship are in five of the six different operational agreements on the Australia to Europe trade route, and are members of the dominant conference (appendix C).

[25] However, alliance members do provide services on Australian trade routes and may be members of other types of agreements registered under Part X.

Operational agreements typically involve two or three carriers. These agreements are essentially commercial in nature and may involve a substantial financial commitment[26]. They may also be entered into following a prior history of successful cooperation between the carriers (Ebsworth & Ebsworth 2002). Discussion agreements and conferences, on the other hand, can incorporate all the carriers on a particular trade, reflecting their primary purpose of regulating, to some extent, price and capacity. Typically, membership of these agreements does not require the same level of commitment as membership of an operational agreement. As a result, capacity shares of operational agreements tends to be lower than those of conferences and discussion agreements (although, there are some notable exceptions).

Agreements by trade route

Table 2.8 provides information on the share of capacity on Australian trade routes represented by the different types of agreements. The Commission's analysis of Australian trade routes and agreements indicates that there were 130 agreements registered under Part X in 2003-04. Only 52 of those agreements were active. They operated on 14 of Australia's 18 trade routes. When adjusted for the many agreements that operate on more than one trade route (such as to and from a destination) to reflect the separate markets involved, some 92 agreements may be identified as influencing the supply of liner cargo shipping services to Australia.

The nature of cooperation between carriers differs significantly between routes — varying according to the nature of trade on the route and the impact of national competition laws. Typically, routes on which carriers co-operate are serviced by a number (ranging from one to eight) of operational agreements.

Discussion agreements operate on 12 of Australia's 18 trade routes. With the exception of those to and from Europe, they operate on all of the other main routes. On European routes conferences remain the overarching type of agreement as the EU provides no block exemption for discussion agreements. Discussion agreements represent large shares of the available capacity on a number of routes. For example, on the North American (west coast) routes they cover 100 per cent of capacity, while on the Asian routes they cover in excess of 70 per cent. This may reflect the non-binding nature of discussion agreements which lowers the cost of membership (this point has also been noted by the FMC 2001, p. 25).

[26] For example, the Contship/P&O Nedlloyd Vessel Sharing Agreement, registered in 2002, was expected to involve a joint financial commitment of US$800 million (Ebsworth & Ebsworth 2002).

Independents — carriers who provide a scheduled service but are not members of any agreements on that route — exist on almost every trade route but their significance varies considerably. Independents provide a quite high share of the capacity on offer on a number of routes. On four of the smaller routes they supply all the capacity, while they account for over 80 per cent on another. However, carriers that operate as independents on some routes may also be members of agreements on others.

There is a tendency for routes with lower cargo volumes and a small number of operators to be serviced primarily by independents. This is the case for long routes (to and from Africa and Central and South America) and those involving considerably shorter distances (to and from Papua New Guinea). Routes with higher trade volumes, and a large number of operators, such as to and from Asia, the west coast of North America, and New Zealand and the South Pacific, tend to have a low level of capacity represented by independents. This may reflect the intensity of competition on those routes and that demand-side agreements, such as conferences, provide for competition to be regulated by common agreement among members (chapter 4). This is particularly evident on the Asian trades. On these routes, consortia, which are intended to allow carriers to realise operational efficiencies, have a relatively low share of capacity on offer. However, discussion agreements, which are entered into with the objective of influencing market outcomes, have a very high capacity share.

On European trades, there are several operational agreements and a single conference, with shares of between roughly 40 per cent and 50 per cent of market capacity. The number of independents is low, although compared with routes with a similar number of agreements, the capacity share of these independents is high.

The reverse pattern emerges with respect to Asian trades where a relatively large number of independents have a low share of route capacity. On the North Asia route there are eight operational agreements, a conference and a discussion agreement in current use, on both the inwards and outwards trades. A similar situation exists on the routes to and from South East Asia; although conferences do not operate. On all the Asian trades, discussion agreements have a capacity share in excess of 70 per cent.

On routes linking Australia with New Zealand and the South Pacific there is wide variation in the market share of individual agreements. There are discussion agreements, conferences and operational agreements with less than 10 per cent of market capacity; there are also discussion agreements and an operational agreement with more than 50 per cent of route capacity.

Table 2.8 **Estimated share of capacity[a] on trade route to and from Australia: 2003-04 (per cent)**

	Route size	*Independents[b]*		*Operational agreements (consortia and vessel sharing agreements)*								*Conferences[c]*		*Discussion agreements*		
Route	*TEUs '000*	*No*	*Share*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*1*	*2*	*1*	*2*	*3*
To Africa and Indian Ocean	296	2	100													
From Africa and Indian Ocean	301	2	100													
To Central and South America	357	4	63											29	37	
From Central and South America	299	3	80											3	20	
To Europe	457	2	53	41	39	39	41	46				47				
From Europe	586	3	46	52	45	45	46	52				52				
To NZ and South Pacific	822	7	22	32	51							6		6	54	56
From NZ and South Pacific	902	12	22	4	13	47						6		2	59	41
To North America east coast	252	1	49	16	20	20	28	21				14		35		
From North America east coast	273	2	69	2	4	3	6	4				5		29		
To North America west coast	115	-	0	94								74	21	100	94	
From North America west coast	179	-	0	94								74	21	100	94	
To North Asia	659	9	8	23	16	25	23	29	5	23	23	33		72		
From North Asia	945	9	10	25	15	16	25	27	4	21	20	31		90		
To South east Asia	988	11	14	17	17	19	7	11	16	9	7			75		
From South east Asia	1081	9	11	22	22	25	10	15	11	11	8			78		
To Papua New Guinea	70	6	100													
From Papua New Guinea	91	6	100													

a Shares on a route may sum to more than 100. Member of consortia and vessel sharing agreements are usually members of discussion agreements or conferences on the same route. There is also significant overlap in membership of consortia and vessel sharing agreements. Common agreements have been consolidated to reflect trade routes as markets. **b** Independents are carriers that are not members of consortia, vessel sharing arrangements, or other operational agreements, conferences or discussion agreements on the relevant route. **c** Capacity for the Australia to Middle East conference, which sails to the Middle East via Singapore, has not been reported. This conference handles 9 per cent of trade from Australia to the Middle East and less than 1 per cent of the trade to Singapore.

Source: Commission estimates.

A very different picture emerges with respect to containerised trade carried between Australia and the North American west and east coasts. West coast trade is covered by a small number of agreements with very large capacity shares. No independent carriers operate on these routes. On the other hand, east coast trade routes contain a number of agreements with low market shares. On the route from the east coast of North America to Australia, five operational agreements, a conference and a discussion agreement operate. The operational agreements and the conference have a capacity share of 6 per cent or less. The discussion agreement has a share of capacity of 29 per cent, which is low in comparison with that of discussion agreements on other routes.

How the capacity shares were calculated

Capacity shares[27] were estimated for agreements lodged with the Registrar of Liner Shipping[28]. Shipping Australia Limited provided information on which of those agreements were operational. The vessels and sailing schedule for each agreement member was obtained from the Lloyds List schedule of weekly arrivals and departures. From this information, the Commission identified which vessels sailed under a particular agreement. Data from Containerisation International (2003) was then used to calculate the capacity of the vessels covered by each agreement.

As means of gauging market share, the estimates should be interpreted with caution. In deriving capacity shares, the Commission has allocated vessel capacity according to the operator of the vessel and ports served. For example, if a vessel sailed from

[27] The Commission was unable to obtain reliable data on cargo carried by agreement members. The Australian Bureau of Statistics does collect unit data on the cargo carried by container vessels. But, confidentiality would require aggregation across carriers before the data was provided to the Commission. Such aggregation is problematic because a vessel may operate under an agreement on one route while operating independently on others. The Commission identified that this was the case for around one-third of container ships in the March quarter of 2004. Previous estimates of conference versus non-conference trade assumed that where a vessel was an agreement member on one route it was a member on all routes. However, given the propensity for vessels to move between trade routes (and out of agreements) this raises the potential for substantial inaccuracy.

[28] Agreements are registered by trade route and the ports of loading and discharge are specifically identified (including allowance for transhipment). In calculating capacity shares, the Commission has consolidated the Mediterranean and European trades and the Middle East and South East Asian trades. This reflects the fact that all of the scheduled sailings to the Mediterranean also service the European ports and all of the scheduled sailings to the Middle East also service South East Asian ports. The only effect of this consolidation on agreement capacity shares, is that the Australia to Middle East Gulf Conference, which carried 9 per cent of the Middle East trade, is not reported. If included, this conference would have represented less than one per cent of the total capacity on the combined South East Asian/Middle East trade.

Australia to Europe, the capacity of the vessel is allocated to an agreement according to whether the operator is in an agreement on the European trade and whether the vessel serviced at least one port covered by that agreement. If this condition is met, the full capacity of the vessel is allocated to that agreement. There is considerable overlap between members of agreements on individual routes, and some agreements clearly operate as sub-groupings within a particular agreement. Calculation of the capacity shares is discussed further in appendix C.

3 Economics of International Liner Shipping

It has been argued that the liner shipping industry has economic characteristics which differentiate it from other industries, particularly in relation to cost structures. These characteristics are said to render the industry susceptible to instability. This chapter examines the economic features of the liner shipping industry, focussing on cost and pricing structures. It considers the extent to which these characteristics can promote market instability. While there are theoretical arguments in favour of 'destructive competition', the empirical evidence is not compelling. The experience of other industries with comparable cost and demand conditions suggests that the potential for 'destructive competition' may be overstated.

3.1 Characteristics of supply and demand

Liner shipping costs

The liner shipping industry is characterised by significant economies of scale and scope. Economies of scale occur when average costs decline as the amount of cargo carried increases. Economies of scope occur when a firm lowers average costs through the provision of more than one type of service.

There is general agreement regarding the existence of economies of vessel size arising through capital, crew and fuel costs (Stopford 2002; Haralambides et al. 2002; Notteboom 2004). Though evidence relating to economies of fleet size is less well documented, operators of larger fleets may benefit from organisational, information technology and/or marketing economies (Perakis 2002; Heaver 2002).

Larger fleet size may also lead to improved container logistics and give shipping lines greater leverage in dealing with shipyards, ship repairers and suppliers of bunker fuel. There may also be economies of scope, for example, in the sense that direct service operators offer several port combinations. In other words, they combine multiple direct services so as to serve several sub-markets within one

voyage. Network economies may also be achieved if cargoes are channelled to increase density on particular routes. Scale, scope and network economies in liner shipping are discussed in more detail in appendix D.

The existence of economies of scale and scope implies that a firm which charges a single price, in a competitive market, will incur losses. Under these circumstances, price will tend to be competed down to marginal cost[1] which, in the presence of economies of scale, will be insufficient to cover overheads. Moreover, most costs in liner shipping are non-separable[2], meaning that they cannot be accurately attributed to individual customers or cargoes. This further reduces the practicality of cost-based pricing. As an alternative, shipping lines have developed pricing policies based on demand characteristics — shipper attributes and the nature of the cargo shipped.

Economies of scale also imply that, up to the point at which a single vessel is full, it can provide a given service at lower cost than two competing vessels. Such economies may therefore provide an economic rationale for different liner operators to cooperate in the provision of a single service (chapter 4).

Capacity management can be further complicated by the fact that, as a service provider, ocean carriers cannot store their product. The service, in this case capacity on a scheduled journey, must be consumed when it is offered, or it is lost. This contrasts with the output of a manufacturing firm which can be potentially stored and sold at a time when demand is higher. Where the service cannot be stored, capacity must be set at a level sufficient to meet peak demand. This implies that there will be excess capacity in off-peak periods which may limit the operator's ability to recover fixed costs. Excess capacity can be reduced by operating smaller vessels. However, the operator risks losing custom if capacity offered is not sufficient to ensure that reliable, scheduled services are offered at peak times. Under these circumstances, long-term contractual relationships with customers may provide the certainty needed to ensure that sufficient capacity is committed to provide adequate and reliable service.

The combination of high fixed costs, inability to store output, and consumer demand for reliability (and, hence, potentially high cost in failing to have capacity

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[1] Short-run marginal costs are the additional operating and maintenance costs associated with an incremental increase in cargo carried without any increase in physical capacity. In the long-run, marginal costs also include the capital costs associated with an increase in carrying capacity.

[2] The issue of non-separability is considered in appendix D. Non-separability may arise through costs which are common to all users and are incurred before the service is offered (for example, administration costs) or costs which are jointly incurred as a result of service provision (for example, fuel costs on the return leg of a journey). It is the feature of non-separability which largely distinguishes liner shipping costs from the costs of a charter service.

available in periods of high demand), is by no means unique to liner shipping. For example, similar pressures are faced in the electricity supply industry. Despite the high costs of doing so, electricity generators have traditionally tended to keep substantial reserve margins, or high levels of spare capacity, in an attempt to ensure that peak demand can be met. Similarly, it has been argued that liner operators need to have a high level of excess capacity to ensure that they can meet the demands for a reliable service (Davies 1986).

To some extent, the price mechanism has been used to manage excess capacity. For example, freight rates are often set higher on the leg of the journey where demand is relatively high, and lower if there is excess capacity that would otherwise be wasted. The issue of capacity management is considered further in appendix D.

Pricing strategies

The nature of costs in the industry (in particular, the need to cover fixed costs) and demand characteristics of shippers, have led to the development of complicated pricing strategies. According to Brooks:

> … liner pricing is highly complex with each box moved possibly charged a different price for a similar service. The ocean portion of the price quoted depends primarily on whether the move is a conference or non-conference move, the direction of trade (due to trade imbalances) and, most importantly, the commodity moved (as higher value commodities cross-subsidize the carriage of lower value ones). Beyond this, there are price adjustments for special container needs (such as reefers, half heights, high cubes and so on), 'discounting' off conference tariffs, service contracts and independent action as well as currency and bunker adjustments. Finally, there are terminal handling charges and inland transport costs. (2000a, p. 209)

Route-specific attributes, such as trade imbalances, can also complicate the apportionment of joint or common costs since many of these must be recovered on the dominant leg.

Demand characteristics may enable carriers to differentiate between users on the basis of price and service offered. In contrast to bulk or tramp shipping, liner companies undertake to provide maritime transportation services for a diverse range of customers with many different shipping requirements. Some shippers require a 'priority' service while others are content to receive a discount and allow their cargo to be shipped on 'stand-by' status (Butz 1993). Others may require the use of port storage facilities or the arrangement of intermodal transport. Some cargoes may require refrigeration or other forms of special handling. According to the Department of Transport and Regional Services:

> There are a multiplicity of rates for different commodities, with different rates for cargoes involving special equipment (such as refrigerated containers, atmosphere-controlled containers, fan-tainers etc), different bases of carriage (port-to-port or

terminal-to-terminal, or combinations of these, or door-to-door, and whether centralisation arrangements apply), many different origin and destination combinations, including inland destinations, different rates negotiated with larger shippers that may be substantially less than the tariff rates that small shippers may pay, etcetera. (sub. 9, p. 17)

Carriers may charge different rates for different commodities on the same voyage, different rates for similar commodities on different legs of a voyage, and different rates for similar commodities on the same voyage. Typically, higher rates are charged on more valuable cargoes. Such pricing can be an efficient means of recovering fixed costs since it involves charging mark-ups on marginal cost which are inversely related to the user's sensitivity to price. The largest mark-ups apply to those cargoes where the shippers are less sensitive to price changes. The aim in doing this is to raise the revenue needed to cover fixed costs with minimal disruption to the pattern of demand that would emerge under marginal cost pricing[3].

While there do not appear to be published estimates of price elasticities of demand for shipping services for different cargo types, it is reasonable to expect that responsiveness to changes in freight rates would be lower for relatively valuable freight. The NSW Road Transport Association identified the importance of the cargo's value in determining a customer's willingness to pay for transport services:

> To a degree I think that's commodity based, because I think there are low value commodities that move in and out by container, that there is no specific time target, and that tends to be the ones that are more price sensitive and people who aren't in a hurry and have got a never-ending flood of containers coming in of low value goods always take the cheapest price. It's when you get upmarket — people importing machinery, people importing high-value goods that there are security issues or other factors — they will pay a bit more for a particular service level. That part of the market tends to stay stable. It's the bottom end of the market that bounces around a fair bit. (trans., p. 12)

The common practice in liner shipping of setting higher freight rates for more valuable commodities — despite the fact that they may cost basically the same to carry as less valuable commodities — could therefore be an efficient response to the requirement to raise revenue to cover fixed costs. According to the United Nations:

> Liner vessels transport many different types of cargo of widely differing values. Since marginal costs associated with some specific cargoes can be very low, liner operators practice price discrimination, or ad valorem pricing to cover total costs. Often the same service is sold to different shippers at different freight rates, according to the principle of 'what the traffic will bear' … High value cargoes tend to pay higher unit charges than low value ones, thereby contributing relatively more to the fixed costs of the service than cargoes with lower unit values. It is sometimes suggested that this may amount to cross-subsidization. However, since fixed costs cannot be allocated to

[3] This is known as Ramsey-Boiteux pricing and is discussed further in appendix D.

specific cargoes in a rational manner, this argument is difficult to sustain. Indeed, it is argued that price discrimination, as operated by liner firms, tends to reduce welfare losses to society as a whole. Without it, probably less cargo would be transported. (2001, pp. 128–9).

Given this differential pricing, the impact of freight rates on the final price of the good to the consumer can vary considerably. According to Shipping Australia Limited:

> Shipping contributes around 50 per cent of the transport cost associated with imports/exports, which in turn ranges from 2 per cent to 25 per cent of the value of the cargo. The remainder of the transport cost is incurred once the cargo is landed, in costs associated with intermodal operations and land transport. (sub. 16, p. 35)

FINDING 3.1

The importance of economies of scale in liner shipping makes a policy of charging a single price to all shippers inefficient. Price discrimination — between cargoes and/or between shippers — can be an efficient mechanism for recovering high fixed costs.

Surcharges

Surcharges are costs paid by shippers in addition to the 'blue water' freight rate. They may reflect costs incurred by carriers which are anticipated to be 'once-off' in nature or they may be levied to recoup charges imposed on carriers by government or port authorities. Shipping Australia Limited (sub. 16, pp. 33–4) provided a list of surcharges commonly applied on Australian trade routes. These include bunker surcharges to cover variations in the price of bunker fuel; currency adjustment factors to compensate carriers for exchange rate movements; terminal handling charges; peak season surcharges; equipment handover charges; and documentation fees.

The use of surcharges has been criticised by shippers because they can be imposed with very short notice periods and an apparent lack of transparency in relation to the real costs incurred by the carriers. Indeed, there is a view among shippers that surcharges may be a means of indirectly increasing prices. According to the European Shippers' Council (2003, p. 3) '[o]cean carriers continue to extract cost elements from their basic operations costs and roll them into surcharges without valid justification'.

The OECD (2002, p. 43) found evidence that surcharges were typically the same among members of the same discussion agreement or conference. It concluded that '[w]hile some surcharges (e.g. bunker or currency adjustment factors) can

reasonably be seen to apply across all carriers, it is more difficult to understand why others such as equipment repositioning and paperwork filing charges should be identical in firms operating at different levels of efficiency'. Even on US trade routes, where confidential contracting between shippers and carriers is enforced by law, contracts contain provisions for surcharges, agreed to within discussion agreements or conferences, to be passed on to shippers.

Surcharges may be an effective means of increasing carrier revenue and dealing with unanticipated demand changes since they are presented to shippers as unavoidable costs and therefore not subject to negotiation (unlike 'blue water rates'). Moreover, unless stipulated in the contract between the carrier and the shipper, surcharges may be increased during the life of the contract. The view that surcharges are an important source of revenue generation may be supported by their increased use by carriers (OECD 2002, p. 44).

While observing that surcharges were appropriate in some circumstances, the Australian Peak Shippers Association (trans., p. 65) noted that, unlike freight rates, surcharges were typically not subject to negotiation with carriers.

Surcharges may also play a role in increasing cohesion between carrier agreement members. This point was acknowledged by Shipping Australia Limited (trans., p. 22) in relation to discussion agreements. Surcharges are made publicly available by carriers and therefore may be one mechanism by which discussion agreements and conferences enforce any agreements made on price, particularly as an increasing proportion of container trade is moving under confidential contract (chapter 4).

Terminal handling charges are becoming increasingly prevalent, particularly in the Asian region. Fung et al. (2003) examined the impact of separating 'blue water' freight rates from terminal handling charges on Hong Kong shippers. Both are set by conferences, but the authors concluded that terminal handling charges are easier to enforce because, unlike freight rates, they are not affected by haulage distance or the type of commodity shipped. The authors also found that the separation of 'blue water' rates from terminal handling charges had increased overall shipping costs. The Chinese Ministry of Communications has launched an investigation into the legality of terminal handling charges (UNCTAD 2003, p. 68).

Many shippers believe that the use of surcharges reduces flexibility in freight rate negotiations. According to the Department of Transport and Regional Services:

> Shippers in Australia and elsewhere have long opposed the widespread use of surcharges to the ocean freight rate in liner shipping, preferring instead an 'all-in' freight rate.

> Carriers have argued that the use of surcharges makes for greater transparency. Shippers believe surcharges render only the ocean freight component readily negotiable, leaving a significant proportion of freight costs non-negotiable when making shipping arrangements, as they are set by formulae negotiated separately with shipper bodies.
>
> An all-in freight rate can be a fully negotiable market rate. Surcharges are either set by formula negotiated periodically with shippers, or else imposed by the shipping lines, and only the ocean freight rate component may be fully negotiable in the market. Shippers have argued that, while the carriers can segment their charges on invoices, the total freight cost must be negotiable at the time of arranging transport, and the use of surcharges prevents this. (sub. 9, p. 42)

There is also a view that surcharges are a means of transferring risk away from shipping lines:

> Shippers have said that the widespread use of surcharges in liner shipping effectively transfers financial risk from the liner operator to the shipper. Shippers who have contracted to sell or buy overseas for a period on the basis of a certain level of freight rate changes may find the profitability of these transactions eroded or eliminated by increases in surcharges during the period of their sales contracts. (Department of Transport and Regional Services, sub. 9, p. 42)

The Australian Peak Shippers Association:

> … has repeatedly rejected surcharges suggesting that shipping lines have at their disposal various hedging options, for example, to cover movements in currencies and fuel prices. However, the standard response from lines is that it is too difficult and at the end of the day the shipper carries the risk. (sub. 5, p. 20)

Ultimately, in a competitive industry, increased fuel costs and costs associated with adverse exchange rate movements will be passed on to final users of the service. However, some of these costs can be defrayed by using financial markets to hedge against adverse oil and currency movements. It is difficult to see why these financial instruments are not used more widely in the liner shipping industry, particularly given the fact that carriers are large, financially sophisticated corporations.

FINDING 3.2

Surcharges can be a means of passing on unavoidable costs associated with container shipments to shippers. However, they can also enable carriers collectively to impose price increases on the market. On Australian trade routes, surcharges appear to be largely imposed by carriers and not to be subject to negotiation with shippers.

3.2 Stability and competition in the market for liner shipping

'Destructive competition'

Traditional arguments supporting the use of collusive agreements, such as conferences, are based on a view that competition will be 'destructive' in the sense of leading to prices below costs (in other words, marginal cost pricing is inadequate to recover large fixed costs) and thus generate market instability. Theoretical developments in game theory have added some weight to this view (Telser 1987; McWilliams 1990; Pirrong 1992; Sjostrom 1988, 1989, 1992).

The 'theory of the core' suggests that markets characterised by uncertain and/or periodic demand, large capital capacity relative to demand, increasing returns to scale, fixed capacity and output which is costly or impossible to store, may have no stable competitive equilibrium. The essence of the problem is that if suppliers, who have made optimal (large-scale) investments, compete there may be excess capacity with prices too low to cover costs. In other words, competition would lead to instability with optimal-size, low-cost capacity. Under these conditions, some form of industry coordination or concentration is considered necessary to generate an efficient equilibrium. The theory of the core is discussed in more detail in appendix D.

Shippers ideally want fast, reliable shipping services on demand. However, few shippers have sufficient demand to charter an entire vessel. The provision of a regular 'bus service' is a way of accommodating shippers' diverse demands for frequency and reliability while allowing various operational economies to be captured by carriers.

However, in order to reduce the risk associated with 'destructive competition', it is argued that a carrier may commit smaller vessels, reduce sailing frequency and/or scheduled ports of call. A single shipping line may be reluctant to commit several large vessels — and incur correspondingly large fixed costs — in order to provide a comprehensive, regular, scheduled service where demand is uncertain and where that uncertainty is exacerbated by the possibility of rivals encroaching on the trade. Smaller ships may mean higher costs and reduced service level or frequency. According to the Australian Peak Shippers Association:

> … international liner shipping is a unique industry and in recognition of its uniqueness warrants special treatment … Marketing experiments are much more risky for international liner shipping than for manufacturing; manufacturing industries are better able to accommodate variations in the pattern of demand than are shipping lines. (sub. 5, p. 8).

The ACCC discussed the consequences of ‘destructive competition:

> … from a reasonably balanced condition, a fast or unanticipated rise in demand will cause the market price to rise; a slump in demand will cause price to fall. These movements will be more or less efficient as price rations capacity to those that value it the most or, during slumps, price falls to the avoidable cost at which liners are willing to supply. The latter case is the point of departure for long-held arguments that the consequences can be ‘destructive’ or ‘cutthroat’ competition. The argument is that price will fall to marginal cost as carriers maximise profits, but at that price losses are incurred. Faced with financial losses, some carriers will exit. When demand rises, price rises above average cost and some carriers (re)enter and earn profits, but the cycle would continue when demand falls relative to supply. (sub. 18, p. 18)

Cooperation with potential rivals offers an alternative way of reducing demand uncertainty. A lower risk premium will mean that larger ships can be utilised (thus capturing economies of scale) while a large, jointly-organised fleet may generate additional economies while providing the coordinated scheduling valued by shippers. In this sense, cooperative arrangements can provide an efficient mode of service delivery. It is feasible, of course, that conferences serve to generate a stable equilibrium but simultaneously give member lines market power. This possibility is discussed below.

By allowing carriers to cover the capital costs of operating a liner fleet, it is argued that conferences prevent such ‘destructive competition’ which would result in incumbent carriers making losses at times of low demand. It is further argued that such destabilising competition could engender instability in freight rates and result in greater industry concentration and the possibility of monopoly pricing:

> Shipping lines need to form alliances such as Conferences and Consortia, to be able to share assets and spread the cost of the enormous capital infrastructure necessary to provide comprehensive liner services to Australian ports, where volumes are relatively low on a global scale and do not justify the investment alone. (Australian Horticultural Exporters Association, sub. 13, p. 12)

However, the ability of conferences to deliver market stability depends on their ability to completely regulate competition on the route. Should conferences prove successful in stabilising rates and reducing uncertainty, this may act as a signal to entry, raising the possibility of excess capacity on the route and ‘destructive competition’ may re-emerge. As noted by the OECD (2001a, p. 24), conferences are increasingly unable to make their prices ‘stick’ — particularly in the face of individual service contracts — raising doubts about their ability to prevent ‘destructive competition’.

Moreover, the ability of conferences or discussion agreements to encourage a more efficient deployment of capacity must be questioned given their route specificity. As noted above, efficient asset management techniques (such as consortia and joint

ventures) have evolved to allow carriers to redeploy vessels across several routes and benefit from network economies. Price setting by conferences may also distort investment signals and contribute to market instability. According to the European Commission:

> Carriers attempt to mitigate their investment risk through their participation in conferences. This might however lead to the so-called 'moral hazard' phenomenon: a carrier might invest in 'too much capacity' which is not in accordance with supply and demand projections on the market. In this case a carrier relies on the conference price-setting system which ensures that freight rates are only partly or with a certain time-lag reflecting supply and demand conditions on the market. While such a strategy could be profitable for a single carrier, it might lead to overcapacity in the market when a larger number of carriers follow this strategy. Under these circumstances conferences would systematically provide poorer market results than free competition. (ECDG 2004a, p. 18)

Is there evidence for 'destructive competition'?

There is little empirical support for the existence of an 'empty core' in the liner shipping market. In part, this is because of the difficulty in establishing what a market with an empty core would look like. By definition, such a market has no equilibrium, so there is no benchmark against which to assess market outcomes. The theoretical literature suggests that a market with an empty core would have more volatile prices than one with a stable equilibrium (appendix D); but, again, there is no objective benchmark against which to assess such volatility. Similarly, such a market may experience problems with service frequency, adequacy and reliability as shipping lines constantly exit and re-enter trade routes in response to changing demand conditions.

Furthermore, there is no clear evidence that rate-fixing agreements among carriers reduce rate volatility or improve service delivery.

Rate volatility

The European Liner Affairs Association (ELAA), representing the interests of carriers in the current review of European regulations, proposed its own definition of rate stability:

> … rate stability does not require that a liner conference … must have the effect of preventing any and all changes in freight rates. More accurately, the Association suggests that the avoidance of rate volatility, namely the reduction of sharp, dramatic or explosive changes, or exaggerated rate fluctuations in the face of supply/demand imbalances, is sufficient to satisfy the requirement of a 'stabilising effect' … Put simply, so long as the rates are sufficiently stable over time to enable customers to

> know reasonably far in advance the cost of transporting their products and, therefore, their selling price on the market of destination, whatever the time, vessel or conference ship-owner involved, the requirement of 'stabilising effect' is met. (ELAA 2004, p. 21)

While the definition of 'exaggerated rate fluctuations' necessarily remains open to interpretation, the ELAA's definition of rate stability appears to require a consensus on the part of shippers that price setting by carriers is both relatively transparent and information on price changes is transmitted in a timely fashion. On both these grounds, shippers have found cause to criticise carriers servicing Australian trade routes. For example, according to the Australian Horticultural Exporters Association (AHEA):

> All-in rates are a problem because, again, there's no stability. They can impose surcharges, currency or bunker or whatever, without any requirement for previous negotiation.
>
> I think the most important one is the US dollar rate that has now been imposed on us without negotiation, some years ago, whereby the shipping line will set an exchange rate seven days before the first day of loading. (trans., p. 107)
>
> All we want is the ability to quote and forecast further out. The lines we deal with — and we deal with most of the lines at some stage through the year — won't give us a fixed or maximum rate for a period, which is very frustrating. It just means we simply can't quote our clients without taking some sort of protection. Although you can protect against currency, you can't protect against capital increases, which are still imposed, even though we are paying in US dollars. (trans., p. 108)

International evidence suggests that conferences do little to reduce rate volatility. Indeed, the OECD (2002, p. 46) provides evidence that greater competition in liner shipping might promote more, not less, rate stability. The OECD notes the relative stability of rates on routes, such as the Europe-Mediterranean trade, where carriers face unregulated competition from tramp shipping and land-based transport. The instability may be a result of distortions to investment signals, and possible over-commitment of capacity, produced by conference price fixing.

The Japanese Government disagreed and argued that conferences were necessary to promote stability. It observed that, on the Japan–China trade, where no carrier agreements were filed with authorities, the market appeared to be unstable:

> Unlike in the liner trades in Europe and the U.S., in the liner trade between Japan and China, where no liner conference or other agreement among shipping operators is filed to the authorities, shippers in Japan have been forced to negotiate with shipping operators individually with the limited information they have and their own ability of negotiation. In this situation, the Japanese shippers confront difficulties in that the shipping operators set individually the freight rates and service level, and they change them suddenly, frequently in short terms and largely without a rational reason and explanation. In addition a surcharge is imposed which is set individually by the

> shipping operators and does not comply with the world import/export business practices.
>
> It is a real fact that the Japanese shippers experienced an unstable and unreliable liner shipping services in the liner trade between Japan and China where no liner conference or other agreement among shipping companies is filed with authorities. Moreover, the shippers in Japan also confront difficulties in that they are not able to find a proper counterpart who is able to consult with shippers collectively to set up a transparent and fair business rule in liner markets between Japan and China, aiming at formulating constructive relations between shippers' associations and the liner conference or discussion agreement. (sub. DR25, pp. 3–4)

However, the complaints of Japanese shippers on this route are similar to those of some Australian shippers, who deal with members of agreements registered under Part X. In particular, as noted above, there was a view expressed by a number of participants in this inquiry (for example, AHEA, trans., p. 107; Gift & Homewares Australia, sub. DR15; Bunbury Port Authority, sub. 1; Importers Association of Australia, sub. 19) that there is a lack of transparency in rate and surcharge setting and an inability to successfully conclude negotiations with carriers.

Moreover, the conditions described by the Japanese Government may not be reflective of 'destructive competition' but of strong market demand associated with Chinese economic growth. As noted in chapter 2, the entire region has experienced strong demand for containerised services prompting volatile freight rates, port bottlenecks and capacity shortages.

Service levels

In addition to rate volatility, the other criteria for assessing the impact of 'destructive competition' are service adequacy and reliability. Reflecting the chaotic nature of a market experiencing such competition, services could be expected to be infrequent, unreliable or inadequate. However, the European Commission has dismissed the view that rate-setting agreements among carriers are necessary to ensure reliable services. It points to the importance of negotiated agreements between individual shippers and carriers in determining efficient service provision:

> … it is doubtful whether it can be maintained today that the provision of reliable services result directly from conference price fixing. In this regard, it should be recalled that conference members increasingly offer services on the basis of service contracts. It is not excluded that under the current market conditions price stability and reliability of services are mainly brought about by such contracts. Moreover, the increase of both internal price competition within conferences and external cooperation by independent operators have not changed significantly the overall reliability of liner shipping services. It would therefore appear that the alleged causal link between the restrictions (i.e. price fixing, supply and market regulation) and the claimed efficiencies (reliable

> services) is too tenuous to meet the first condition of Article 81(3) of the Treaty [of Rome; namely, economic efficiency]. (ECDG 2004d, p. 11)

Support for this view is given by the fact that, despite the presence of conference agreements on Australian trade routes, Australian shippers have expressed significant concerns about service levels. According to Gift and Homewares Australia (GHA):

> … GHA Members have voiced significant concerns that they do not have continued access to inwards liner cargo shipping services of adequate frequency and reliability. Moreover, Members are being charged exorbitant prices that are clearly not internationally competitive. In addition our Members are also faced with regular price increases with minimal or no notice being communicated. (sub. DR15, p. 4)

In a survey conducted in August 2004, the shippers represented by GHA — who are largely small importers — expressed a number of concerns about service levels. Forty-one per cent of GHA members surveyed experienced the late arrival of cargo; 28 per cent had shipped cargo which had missed the connecting vessel; 36 per cent had difficulty securing space on ships; and, 26 per cent had experienced a lack of commitment from shipping lines. Almost two-thirds of those surveyed thought the standard of service was fair or poor and disagreed or strongly disagreed with the proposition that service levels had improved with price increases (sub. DR15, p. 5).

The Australian Importers Association (sub. 19, p. 2) also expressed dissatisfaction with service levels, citing a number of problems frequently encountered by its members: late arrival of containers; containers missing the connecting vessel; difficulty in securing space on a vessel; lack of container tracing at transhipment ports; late invoicing for container detention and poor customer service.

There are few recent studies on the reliability of conference versus non-conference shipping. A survey by Lloyd’s List (2003) of transit times from Northern Europe to Australian and New Zealand ports provided mixed results. Maersk Sealand, which operated as an independent on that route, had consistently lower delays than conference members. In turn, the conference operators had consistently faster transit times than MSC, another independent on the route.

Another indication of ‘destructive competition’ may be a reduction in port coverage, particularly on routes where cargo volumes are relatively low. Some participants expressed concern that, in the absence of conference agreements between shipping lines, services might be reduced to smaller, regional ports. However, there is no clear evidence that the presence of rate-fixing agreements has ensured the retention of services to smaller ports. For example, in acknowledging that services had been reduced to Adelaide, APSA noted that the decision reflected the ‘market situation’. APSA continued:

> It's a worldwide trend in all continents that a number of ports are being culled. I don't believe shippers are disadvantaged in Adelaide by having to come through Melbourne. Rail rates are pretty competitive. They've got daily frequencies into North Asian markets and almost daily into the US, which they couldn't have got out of Adelaide. They always like to have their own shipping line. Tasmania is still comfortable with the triple-A service. I'd be concerned that, if Part X disappeared, triple-A might disappear too from Tasmania. That would be a real worry, because the cost of crossing Bass Strait is not cheap. (trans., p. 61)

Similarly, the Western Australian Shippers Council and the Chamber of Commerce & Industry of Western Australia believed that commercial viability, and not cooperative agreements among carriers, would determine which ports were serviced:

> There has been a concentration of shipping in the last few years involving the world's major shipping lines forming alliances. These alliances now virtually control the shipping on the major east-west trades into and out of Europe the USA and Asia and massive new building programmes are underway to service them. As there are no plans to our knowledge for significant demolition of existing vessels on the east-west routes it is realistic to expect that there will be a flow on effect of larger vessels moving out to other routes providing greater capacity all round and more competitive freight rates. We therefore believe that market forces, which already dictate the level of service provided to and from Australia, will continue to do so and not provisions provided under Part X of our Trade Practices Act. (sub. 6, p. 3)

Indeed, it is possible that the group decision making of conferences may actually reduce services. The Bunbury Port Authority (sub. 1) argued that, by reducing competition among carriers and limiting incentives for carriers to respond to shipper demand, conference agreements had actually reduced services to regional ports.

Do international studies support the existence of an empty core?

The tests which have provided some support for the existence of an empty core in liner shipping (Sjostrom 1989; Pirrong 1992) have approached the issue by examining the role of conferences. They consider whether market conditions support the view that conferences act as cartels in order to increase the profits of members. If not, the authors surmise, their existence must be a rational response by carriers to impose competitive discipline on the market. They conclude that there is sufficient freedom of entry to trade routes to prevent conferences from acting as fully-fledged cartels and, therefore, that conferences are the means of preventing 'destructive competition'.

However, the evidence is mixed on whether conferences enable their members to earn higher profits. Certainly, while freedom of entry on to most trade routes is probably sufficient to prevent conference members from earning significantly

higher returns than independents, there is evidence that conferences charge higher prices (chapter 4). Moreover, most conferences are effectively open (OECD 2002, p. 21), implying that the costs of joining are low. It is conceivable that carriers might join conferences even if their ability to raise rates is limited.

Another argument made to support the argument that conferences are not cartels is that the conference system has been extremely long-lived. Cartels, by their nature, are unstable as members attempt to increase market share by cheating on each other (Stigler 1964). However, while the conference system has had a long history, supported by general exemptions from oversight by competition authorities, individual conferences frequently collapse and membership changes as carriers reorientate their business strategies (OECD 2002, p. 62; Shashikumar 1995). Furthermore, changes to the regulatory environment, such as the introduction of confidential contracting on US trade routes, have seen a trend away from conference membership on many major trade routes (the exception is European trade routes where conferences are the only price-fixing agreements provided with a general exemption from competition laws (chapter 6)).

As argued below, even in the presence of an empty core, price fixing is not the only means of ensuring market stability.

Are conferences the only means of preventing 'destructive competition'?

Strategies employed by carriers, outside traditional forms of collusive agreements such as conferences and discussion agreements, eliminate many of the pre-conditions for 'destructive competition'. As noted above, 'destructive competition' is more likely when capacity has to be added to a route in large, indivisible units and when individual demand is small relative to capacity deployed (increasing the prospect of excess capacity). Cooperative ventures, such as slot-chartering and vessel sharing, enable carriers to spread risk and reduce the possibility of the over-commitment of capacity to a route. Indeed, as discussed in chapter 4, the operational cooperation involved in these agreements may be necessary to ensure that carriers capture economies of scale while retaining sufficient flexibility to respond to changes in shipper demand. On the demand-side, uncertainty can be reduced by entering into contractual relationships with shippers.

Dealing with indivisibilities in capacity

The 'lumpy' nature with which capacity is added to a route may contribute to market instability by promoting excess capacity. However, aside from cooperative

asset sharing arrangements between lines, individual carriers have methods of managing capacity to improve the efficiency of deployed vessels. According to Butz (1993, p. 72):

> … carriers can take many measures to alleviate capacity problems. First, they can increase ship speeds during peak demand periods and at some expense they can reduce turnaround times at each port of call … Second, carriers can alter their ports of call as demand rises and falls. When demand is high, individual ships can call at fewer ports and yet sail at full capacity. Third, peak-load pricing and rapidly evolving hub-and-spoke route systems provide carriers with numerous opportunities to shift cargoes among ships and better manage capacity. Fourth, round-the-world sailings reduce the need for ships to sail half-empty on low-demand return legs. For example, ships often sail full on the east-bound U.S.–Europe trade but on average sail only two-thirds full on the westbound return leg. As a consequence, some carriers no longer sail their ships back to the United States from Europe but instead send them on to Asia and then back to the United States to begin again. Fifth, shippers and freight consolidators can package more cargo into smaller volumes. If the price mechanism works well, they have appropriate mechanisms to do so when capacity is scarce.

Dealing with demand conditions

It is often argued that the demand for liner shipping is relatively inelastic — implying that any price competition which does occur will involve relatively large discounts in order to elicit a significant response from consumers — and, somewhat contradictorily, that carriers supply a homogeneous product — implying that carriers would be driven into strong price competition.

However, in analysing the market influences on individual firms it is important to distinguish between the elasticity of market demand and the elasticity of demand faced by individual firms. While market demand may be inelastic, reflecting the lack of cost-effective substitutes to maritime transport, the demand for the services of individual carriers will become more elastic as the number of competitors on a trade route increases. In the face of such conditions, firms can adopt alternative strategies. For example, rather than seeking to expand market share through price discounts, a firm facing effective price competition could follow a margin strategy and seek to improve profitability through cost reductions. Alternatively, a market share strategy could be adopted by a firm which both priced competitively and sought to differentiate the service it provides from that of competitors. The role of the elasticity of market demand is discussed further in appendix D.

Service contracts and market based means of encouraging customer loyalty may also be mechanisms for dealing with demand variability. As Sjostrom (2003) notes, loyalty agreements, including the use of deferred rebates, have been a feature of liner shipping for almost as long as conferences. While it has been argued that

negotiating with shippers may be costly (PC 1999, p. B4) an increasing proportion of trade is moved under service contracts. According to ACIL Tasman Pty Ltd. and Thompson Clarke Shipping Pty Ltd (sub. 17, p. 33), 80 to 90 per cent of cargo, transported by liners serving Australia, is carried under contract. Shipping Australia Limited (sub. 16, p. 119) reported that the same proportion of trade was carried under service contract on European trade routes. Ultimately, the most important determinant of customer loyalty may be the provision of reliable and timely service.

In expressing its opposition to the continuation of the European block exemption for conferences, the United Kingdom Government noted:

> Destructive competition theories are not regarded as especially realistic by most economists. As the [European] Commission itself summarised, the theories of instability and destructive competition rely on the 'impossibility of adjusting capacity in accordance with demand and suicidal conduct of shipowners in setting their own prices'. Firstly, because most shipping firms are global in scope, capacity can be adjusted across the different trades. The use of leasing and chartering also enhances liners' supply flexibility. There is also no evidence that liner companies would be motivated to set prices at an unsustainably low level, especially as they are also able to compete on quality as well as price. In sum, it does not appear to be the case that the liner shipping sector has the unique characteristics which would result in the suggested negative consequences. (2004, p. 2)

FINDING 3.3

Concern about 'destructive competition' has been a powerful argument used in support of allowing ocean carriers to confer and form conferences to control the supply of shipping capacity and set freight rates on trade routes. However, there is a lack of evidence to support that concern. In response to conditions in the industry, other less collusive market arrangements have emerged to ensure continuity of supply.

3.3 Comparisons with other industries

It has been argued that the 'unique' nature of costs and demand in the liner shipping industry warrant its exemption from competition law as applied to other industries. Historically, transport providers have been accorded special treatment under competition rules and regulation has been directed at limiting competition. Prior to the deregulation of the sector, the European Union imposed minimum freight rates to limit 'destructive competition' and imposed maximum freights to prevent abuse of market power (Button 2004). Airlines were regulated in the United States in the 1930s to limit competition. Until recently, mergers in the airline industry in that country were approved by the Department of Transportation not, as with other industries, the Department of Justice (Button 2004).

The Commission considers there are strong parallels between transport industries such as airlines, road transport and rail freight which offer regularly scheduled services and have relatively high fixed costs. In many OECD countries, moves to deregulate these industries have been opposed on the grounds that it would give rise to 'destructive competition'. Yet deregulation of these industries has typically been successful. The argument might also be made that the preconditions for 'destructive competition' would be more likely to exist in these industries than in liner shipping since, on domestic markets, road, rail and air freight can be close substitutes, suggesting competition between modes of transport, as well as between suppliers within the same industry.

The view that liner shipping is not unique has received support from a number of commentators. According to the OECD:

> The cost structure of the industry is not significantly different from that of other transport industries and returns in liner shipping are similar to those of other scheduled transport providers. While it is true that ships cost considerably more than say, a new lorry or locomotive, each ship can also earn significantly more revenue. Seasonal and directional trade imbalances are not unique to the liner sector and must be faced by most transport service providers — in some cases these imbalances pose much more of a problem since some vehicles are not as standardised as container ships. In the end, liner shipping is about as 'different' from other industries as, for example, trucking is to freight air services or freight air is to rail freight — with the exception that price-fixing is allowed in liner shipping and nearly universally disallowed in these other industries. (2002, p. 75)

The ACCC agreed with this perspective:

> … there is nothing unique to the liner shipping industry about fluctuations in prices and constrained available capacity.
>
> Many industries face lumpy capacity that cannot be quickly changed and sharply rising marginal costs near capacity, a large fraction of costs that are fixed (in the short run) and fluctuating demand. In transport: — rail, airlines and road haulage; in other sectors: hotel accommodation, oil refining, aluminium smelting, automobile manufacturing and power generation. Some of these industries can be oligopolistic and yet can experience substantial price fluctuations but rarely is this deemed 'instability' — as it is in liner shipping. (sub. 18, p. 19)

According to Button, it is a 'myth' that transportation is a sector warranting special treatment under competition law:

> There are certainly fixed costs associated with the provision of many components of transportation, although certainly less than was traditionally believed. This can lead either to monopoly power or, when there are few barriers to entry, of an empty core emerging with associated instability and under supply (although not both at the same time). But this is not a problem unique to transport. It is handled elsewhere within standard institutional frameworks of competition policy. This may involve regulation of

> power or, conversely in the empty core case, relaxation of certain laws. In some service sectors, self-regulation has been adopted. But the point is that these situations are not unique to transport. (2004, p. 1)

The following sections compare competition in the market for liner shipping with competition in other industries.

Air transport

There are many similarities between air passenger transport and liner shipping, particularly in relation to costs and demand (Sjostrom 2002, p. 115; Button and Nijkamp 1998, p. 17). Airlines maintain a scheduled service irrespective of the number of seats filled and often operate with excess capacity. Fixed costs are extremely high, and operating costs are low, which gives rise to similar load factor management issues to those in liner shipping. Airlines practice price discrimination (for example, business versus tourist travel) and peak load pricing (based on the season travelled and the time of day). Deferred rebates and other incentives to customer loyalty offered by carriers are similar to airline frequent flyer programs. The industry is also said to be subject to low rates of profitability (Deustche Bank 2004, p. 5). Finally, airlines can benefit from economies of network size and scope.

Alliances and joint ventures are a prominent feature of the airline industry. In 2002, the three largest alliances accounted for 55 per cent of the world market[4]. The basis for alliances between airlines, particularly as a result of government imposed limits on airline mergers, is the codeshare agreement (Deutsche Bank 2004, p. 1). A codeshared flight is identified by the airlines own flight number, but is actually operated by an agreement partner[5].

Codeshare agreements allow an airline which does not provide a direct flight to a location to provide transit for its customers through a number of interconnecting flights provided by agreement partners. Codeshare agreements allow an airline to benefit from network economies, and differentiate their service, without committing a large amount of capital. Most studies have concluded that codeshare agreements have resulted in lower fares and higher passenger traffic in international aviation markets with cost savings as high as 30 per cent (Ito and Lee 2004; Brueckner 2002).

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[4] Measured by revenue passenger kilometres registered by member airlines of the International Air Transport Association. The three alliances were: Star Alliance, One World and Sky Team (Deutsche Bank 2004, p. 8).

[5] For example, Qantas codeshares with American Airlines and Alaska Airlines to provide transit between US cities without the necessity of Qantas committing its own planes.

Despite the similarities in cost and demand conditions, there are some regulatory differences between airline travel and international liner shipping. While most countries allow free competition on domestic airline markets, there are significant barriers to entry from airlines from other countries. Market access is established through bilateral air services agreements which establish conditions of entry and behaviour for airlines of the contracting countries. Traditionally, these agreements defined market access, routes, size of aircraft, flight frequencies and limits on price determination on a reciprocal basis between signatory nations. However, over the past two decades, airlines have been given greater scope to compete on price and service, and deploy planes of their own choice (Brooks 2000a, p. 143).

It has been argued that limits to market access remove the potential for 'destructive competition' and reduce the usefulness of comparing liner shipping and air transport. However, there have been moves to introduce more 'open skies' into international aviation. In June 2003, the European Commission commenced negotiations to establish an 'open aviation area' in the world's largest aviation market between the United States and Europe (Button 2002; Deutsche Bank 2004). According to Button (2002), approximately half of the world's air traffic moves in deregulated markets. Moreover, while bilateral air services agreements may restrict entry, they do not completely eliminate competition. While operational agreements between airlines, such as joint ventures, are common in international aviation markets, there are no equivalents to conferences or discussion agreements which attempt to fix prices or capacity.

Domestic airline markets are substantially free from entry or exit restrictions. Entry requirements to domestic airline routes (passenger reservation system, route planning, obtaining airport slots) are comparable to those involved in servicing an international cargo liner route. From the late 1970s, domestic air markets in OECD countries were deregulated. According to Brooks (2000a, p. 144) the experience of deregulation was generally positive. Fares fell by between one-quarter and one-third in the United States and the United Kingdom, labour productivity rose substantially, and capital productivity improved as load factors increased. Moreover, there was no evidence that service provision was reduced — service frequencies and passenger traffic increased.

On US domestic markets — which include a number of 'mainline' routes, as well as secondary regional routes — operational agreements have followed a pattern similar to that observed in international liner shipping. The notable difference is the absence of agreements in airline travel which explicitly attempt to regulate or limit competition. While codesharing agreements between major and regional airlines have been a feature of the US domestic airline market since the 1970s, there has been a strong trend recently towards marketing alliances and codesharing

agreements directly between the major airlines. United Airlines and US Airways entered into a codesharing agreement in January 2003; while Continental, Delta and Northwest Airlines formed an alliance in June 2003. The three largest US alliances[6] collectively account for almost two-thirds of US domestic origin and destination passenger traffic. Airlines which are based in a specific region — such as Alaska or Hawaii — and whose markets are therefore geographically concentrated, enter into alliances with a number of partners (Ito and Lee 2004).

Despite their prevalence, alliances on domestic routes are not necessarily viewed benignly from a competition perspective:

> Unlike international alliances, which largely extend domestic airlines' route networks into areas they could not enter by themselves, the networks of the domestic airlines generally overlap to a much greater extent, and therefore the proposed alliances pose a greater threat to competition. (US General Accounting Office 1998; quoted in Ito and Lee 2004, p. 2)

Nonetheless, alliances between airlines have been allowed by US competition authorities, with conditions that prohibit price fixing or other explicit anti-competitive behaviour. The marketing alliance and codeshare agreement between Northwest, Continental and Delta airlines was approved by the US Department of Justice subject to a number of conditions to prevent airlines from colluding on fares or otherwise restricting competition. These conditions included a prohibition on codesharing on an alliance partner's flight whenever members of the alliance offered a competing non-stop service (such as between hubs). The requirement was also imposed that airlines act independently when setting award levels or other benefits of frequent flyer programs and when competing for corporate contracts. The alliance involved no pooling of revenue so individual airlines could continue to compete for passengers (Majoras 2003).

While a large number of airlines have exited the industry or merged[7] and two large US airlines (United Airlines and US Airways) have filed for Chapter 11 protection as part of a restructure, it is not clear that the industry is subject to 'destructive competition'. Charges of predatory pricing have not been upheld by US Courts and many airlines which entered as low-fare competitors have been successfully established in the industry for over a decade (Lee 2003). Button (1996) found no evidence of market instability in the European aviation market; although he noted that some of the preconditions for an empty core existed. He also observed that the European Commission had been relatively pragmatic in handling merger

[6] Continental/Delta/Northwest; United/US Airways; and American/Alaska.

[7] Between 1978 and 1997, 246 airlines were certified to operate on US domestic routes. Of these, 168 left the market or merged (Button 2002, p. 11).

applications in aviation and allowing frequent flyer programs as means of retaining customer loyalty in periods of fluctuating demand.

In advocating the removal of the European block exemption for conferences, the European Shippers' Council — who, in addition to representing shippers, also represents users of air and other freight services — identified strong parallels between liner shipping and air transport:

> The air transport industry is a highly comparable industry with the liner shipping industry. The airline industry has high fixed costs, suffers trade imbalances and experiences seasonal fluctuations in demand. In addition, in common with the liner shipping industry the air transport industry is cyclical and is subject to sharp changes in supply and demand.
>
> Like the liner shipping market the aviation industry provides scheduled air transport services (for passenger and freight services) and, in common with shipping, utilisation of capacity is the key to profitability.
>
> However, unlike the liner-shipping industry airlines are not allowed to fix prices or set air cargo rates … Airlines are only allowed to consult with each other on the interline segment of air fares, and are only permitted to consult with each other for the express purpose of facilitating interlining. Such interlining amounts to a very small proportion of air passenger and air cargo journeys…
>
> The aviation market, both for passengers and freight, is a highly competitive international market. The absence of price fixing and rate setting has provided no evidence of ruinous prices or destructive price competition. Indeed, deregulation of the aviation industry has resulted in significant innovation, market growth and the introduction of new and innovative services for customers. There is no reason to believe that exactly the same kind of benefits will not be enjoyed by the liner shipping industry as soon as Regulation 4056/86 is repealed and the EC competition rules are applied normally. (2004, pp. 13–14)

The UK Government also considered that the experience of airline deregulation was relevant to liner shipping:

> For example, a useful comparison might be the development of low cost air travel on short-haul journeys, although the markets involved here are of course are mostly intra-European rather than international … Deregulation has been a huge enabler for the majority of people. It has created massive growth in passenger numbers and injected prosperity to many regions/regional airport locations, which were effectively off the beaten track for the national carriers. Perhaps the most telling observation has been that even the national carriers have had to reduce their economy fares on routes where they face direct competition from 'no-frills' carriers meaning that the consumer has benefited hugely from deregulation.
>
> To put this into the liner shipping context and specifically the tariff setting point, what the short-haul air passenger transport example illustrates is how, when the industry was deregulated, fares came down. Efficiency was also improved, as airlines could no longer operate undersubscribed flights on a viable basis as they had been able to do

previously, when prices were guaranteed. If a similar effect were to occur in the liner shipping industry, any inefficient use of shipping would diminish, once that industry became subject to fluctuating and competitive changes. Prices or tariffs, if calculated on the basis of the most recent load transported, would better reflect actual costs. There is of course the possibility that consolidation would take place, if the block exemption were repealed. This might result in fewer players being left in the industry, perhaps eventually resulting in an oligopolistic market. But again, the air transport example has shown that, once deregulation has taken place, more not fewer operators have entered the market. However, the overall benefits may not be as large for the liner shipping industry as the no-frills airline market, as the former lacks the harsh levels of competition seen in the latter due to the large number of new entrants. (2004, p. 5)

FINDING 3.4

Parallels exist between the international liner shipping market and airline travel, particularly in large domestic markets such as the United States and Europe where there are few regulatory barriers to entry by domestic carriers. Despite the lack of an exemption from competition laws for price setting agreements, there is no evidence that these markets have experienced a lack of supply.

Road transport

Similar to liner shipping, economies of scale and scope are important in the operation of road freight networks (OECD 2001b, p. 271) and barriers to entry are low. The NSW Road Transport Association (NSWRTA) noted the similarities between road transport and liner shipping. It also identified ways in which capacity management, in both industries, could occur without the need for price-fixing agreements:

NSWRTA's view is that the principles that apply to the movement of containers by ship also apply to the movement of containers by road. The owner of the transport equipment wants to achieve maximum asset utilisation by minimising turnaround time and maximising payload. This can occur amongst other ways by allocating space to competitors where the market determines there are advantages for both parties and, ultimately, the client. Operators in both industries are also driven by the desire to ensure consistency in operations. Benchmarks are set to achieve a complete turnaround in service within a specified time frame, irrespective of whether this involves a regular shuttle between two or more points, which is more characteristic of shipping or the more unstructured arrangements that apply to road transport. (sub. DR7, p. 1)

Historically, road freight has been a heavily regulated industry in many countries. Some of these regulations were introduced to limit competition with government-owned rail operations (Boylaud and Nicoletti 2001, p. 234). However, in the last two decades most OECD countries, following the lead of the United States, the United Kingdom and Australia, have deregulated the sector. There are few

remaining controls on prices or service provision. Deregulation has led to significant falls in prices — by between 15 and 25 per cent — and an increase in service frequencies. Productivity has improved as a result of better vehicle capacity utilisation and an improvement in backhaul load rates (OECD 2001b, p. 10). According to the OECD, '[f]ears of destructive competition or a drop in safety standards have not materialised'.

Boylaud and Nicoletti (2001) surveyed the experience of deregulation in the industry across 16 OECD countries. They found a consistent pattern of price falls (in one case as high as 75 per cent), service improvement and traffic increases. These developments were associated with productivity improvements and, where measured, with carrier profitability.

There has been a history of allowing collusion in the sector to prevent 'destructive competition'. Prior to 1980 in the United States, regional associations of trucking companies — known as 'rate bureaux' — set haulage rates. The antitrust immunity for these associations was progressively reduced. The only remaining immunity is for 'general' (industry-wide) rate increases (OECD 2001b, p. 272). This immunity has been opposed by the US Department of Justice and is currently under review by the US Department of Transportation.

4 Competition in the market for liner shipping

Shipping lines enter into agreements for the purpose of limiting competition and/or realising operational efficiencies. This chapter compares the likely benefits to carriers and shippers of various agreement types against the potential for competition to be reduced. While some agreements — those involving the rationalisation of asset use — may be appropriate responses to industry cost structures and characteristics of shipper demand, agreements to limit competition appear less justifiable on efficiency grounds.

Opinions are divided as to the benefits of cooperation between carriers in the provision of liner shipping services. Some argue that explicit collusion between shipping lines — through conferences or discussion agreements — enables the carriers to operate as cartels and earn monopoly profits. Others contend that cooperation between carriers will produce efficiency gains and lowering of costs through the joint provision and/or organisation of shipping services.

In practice, both views could be correct. Cooperative agreements between carriers may promote productive efficiency while enabling shipping lines to exercise market power. Much depends on the type of agreement and the extent of competition in the trade on which the agreement operates.

This chapter explores the nature of collusive arrangements between carriers and the arguments used to justify them. These arguments primarily relate to cost conditions in the liner shipping industry, although demand characteristics and restrictions on market entry are also relevant. Specifically, the existence of economies of scale suggests that the liner shipping market may be efficiently serviced by a small number of carriers. However, a small number of competitors raises the prospect of exploitation of market power. Freedom of entry and exit with respect to trade routes may effectively curtail any market power but, at the same time, potentially engender market instability.

Supporters of collusive arrangements between carriers argue that such agreements are necessary to prevent such market instability. However, the potential for market instability can be reduced by arrangements which are not necessarily

anticompetitive — in particular, those agreements that rationalise the deployment of vessels or service provision. Stability can also be enhanced by individual service contracts and customer loyalty agreements. Moreover, market developments have rendered traditional collusive agreements, such as conferences, less potent as mechanisms for preventing market instability.

4.1 Rationale for cooperation between shipping lines

Liner business strategies

The nature of costs and demand in liner shipping favour particular business strategies which focus on the efficient deployment of capital. Following Ryoo and Lee (2002), these can be classified into four broad categories:

- cost reduction;
- service differentiation;
- market development, and;
- limiting competition.

The authors examined the motivations behind carriers entering into various types of agreements. They concluded that operational agreements, such as consortia, may be entered into to achieve any or all of the first three objectives. Discussion agreements and conferences are principally designed to limit competition.

Cost reduction strategies

Given the importance of capital costs in the industry, carriers can derive considerable cost savings through more efficient asset utilisation. From an industry perspective, the cost structure implies that this more efficient utilisation will generally arise out of cooperation between firms which involves a rationalisation of vessel use (Brooks et al. 1993; Ryoo and Lee 2002). Cost savings can also be realised through rationalisation of port calls to take advantage of network externalities. Slot charters and vessel sharing agreements may be means of lowering financing costs and risk of stand-alone investments in containerships. Agreements to share containers can reduce the costs associated with the movement of empty containers. Agreements to share common marketing and logistics networks can provide additional benefits through mergers, alliances and joint ventures.

Chartering slots and coordinating sailing schedules with another carrier have the potential to realise significant cost savings. Brooks (2000, p. 72) provides an

example, based on industry data, in which a carrier achieves a 50 per cent reduction in unit costs by jointly providing route capacity instead of servicing the route independently. The decision to cooperate in servicing the route enables the shipping lines to replace their outdated vessels, thereby saving on fuel and maintenance costs. Each provides three new vessels to the route — instead of the six each would have to provide if the route was independently serviced — and is able to divert older vessels to alternative routes.

Greater efficiency in vessel deployment has been a motivation behind operational agreements registered under Part X. For example, in registering a vessel sharing agreement in 2002, P&O Nedlloyd (PONL) and Contship (CS) argued that cooperation would enable both companies to jointly provide 10 new purpose-built vessels with reefer capacity to service the Australia/North American East Coast and European trades. In doing so they would also be able to retire the outdated vessels previously serving those routes (Ebsworth & Ebsworth 2002, p. 2). The large joint financial commitments involved in such agreements are entered into on the expectation of an ongoing commercial relationship between the carriers. In turn, this may promote greater stability for shippers:

> Whilst PONL/CS have agreed that they wish to have a fairly long commitment period to provide adequate security against their investments, they also believe that this provides the shippers (particularly in Australia and New Zealand) with a significant degree of stability in that the Lines are committed to a long term direct service. (Ebsworth & Ebsworth 2002, p. 3)

Alliances can generate substantial cost savings and achieving efficiencies through productivity improvements and scale economies is a major motivation for entering into alliances, mergers and joint ventures (United Nations 1998, p. 24). In the main, these efficiencies occur through reduced labour costs, although savings in vessel and container costs are also important.

A study conducted by Hapag-Lloyd in the mid-1980s, estimated that capacity utilisation on the trans-Atlantic route would rise from 68 per cent to 85 per cent if services were coordinated and that costs would decline by 20 per cent. Hapag-Lloyd reached an agreement with ACL to rationalise services on two routes between North America and Europe. As a result of this agreement, the two lines were able to remove four vessels from the route while maintaining the same level of service and achieve cost savings through sharing containers, port facilities and inland transport equipment (United Nations 1998, p. 12).

Mergers can also be important sources of operational efficiencies. Two-thirds of the cost savings from the merger between P&O and Nedlloyd were expected to be generated by reductions in the combined labour force of the two companies. Savings also accrued through a reduction in the number of containers used;

rationalisation of the agency network; a decline in the volume of empty container movements; economies from vessel sharing; integrated computer systems and discounts on bulk purchases of equipment such as bunkers and containers (United Nations 1998, p. 24).

The ability of operational agreements to deliver cost savings to carriers, and ultimately shippers, has been noted by competition authorities. The Directorate General for Competition of the European Commission observed:

> Liner consortia are industrial co-operation agreements between liner shipping companies aimed primarily at supplying jointly organised services by means of various technical, operational or commercial arrangements. Thanks to consortia agreements, ship owners can organise jointly the services they supply (in particular container liner shipping) and thus provide users with a better service while rationalising their maritime transport activities and securing economies of scale and cost reductions. (ECDG 2004a, p. 12)

Moreover, market trends appear to reflect the benefits of operational cooperation:

> It is however common ground between the US and EU authorities that the decline of the conference agreement has been accompanied by a commensurate increase in the number and scope of consortium agreements, mainly because the latter agreements provide clear benefits to carriers and shippers alike in the form of cost-savings and improved services. (Pons 2002, p. 12)

Similarly, the ACCC identified the potential benefits of operational cooperation as lower costs and, as discussed in the following section, greater choice for shippers:

> *Prima facie*, most of the benefits claimed to flow from the various forms of liner agreements appear attributable to consortia agreements.
>
> Consortia agreements allow for liner companies to minimise their vessel investment and scale of involvement on a particular trade but still partake in providing a liner service that may require up to five vessels. It could also enable the selection of the optimal choice of vessel size to realise inherent economies of scale by spreading the risk of chartering or investing in vessels. Consortia agreements facilitate carriers' initial entry into a trade by significantly reducing the required scale and cost of entry. There are numerous examples of liner companies entering Australian trades with minimal investment and then gradually expanding their market presence. When significant excess capacity and poor returns persist, lines may decide to enter into a consortium with other lines to reduce their market exposure and costs.
>
> Consortia agreements also allow lines to enter into complementary markets and expand their market reach with minimal investment. This may increase the network density efficiencies generated by the shipping lines regional or global networks (to the extent that lines that are party to consortia also belong to the same global alliance groupings).
>
> Finally, the use of slot share arrangements may use up spare reserve capacity, thus improving overall vessel utilisation and possibly leading to greater competition

> between carriers and greater brand proliferation and choice for shippers. (sub. 21, pp. 37–8)

However, while operational agreements have the potential to create cost savings for carriers, market conditions will determine the extent to which these are passed on to shippers. As noted by Brooks (2000a, p. 72), cost savings less likely to be passed on to shippers by conference members or in the absence of individual service contracts.

Service differentiation strategies

It has been argued that the homogeneous nature of containerised transportation makes it difficult for carriers to differentiate their product. However, a number of studies have found that carriers have successfully adopted service differentiation strategies, with significant variations in the type of services offered (Williams 1991; Brooks et al. 1993; Ryoo and Lee 2002). These studies found that shipping lines were able to differentiate their service on the basis of several attributes which are important to shippers: frequency of service; directness of sailings; port coverage; door-to-door service; intermodal service; cost of service; transit times; reliability of delivery; and, logistics service and information technology (Ryoo and Lee 2002, p. 348).

A service differentiation strategy involves more closely aligning services with shipper demand. This could occur through extending port coverage; providing more frequent sailings; providing intermodal transport services[1]; or providing a total container logistics service[2]. According to Nottebomm (2004, p. 97), there has been a recent trend towards shipping lines developing dedicated container terminals at major ports[3]. Shipping lines have tended to enter into long-term contractual relationships with inland haulage companies in preference to investing in inland transport networks. One exception is Maersk-Sealand which, in an attempt to offer complete door-to-door services, operates: a logistics subsidiary; dedicated terminals (through APM Terminals) which are open to other carriers; and, the European Rail Shuttle in partnership with P&O Nedlloyd (Notteboom 2004, p. 93)[4].

[1] For example, the European Rail shuttle is owned by Maersk Sealand and P&O Nedlloyd (von Hinten-Reed et al. 2004).

[2] Carriers may own and operate cargo handling equipment at ports (von Hinten-Reed et al. 2004).

[3] These terminals may also offer stevedoring services to other carriers.

[4] The European Commission has prevented the extension of the block exemption for rate fixing to inland haulage.

The agreements most suited to a service differentiation strategy are slot charters, (where economies of scale can be exploited through shared capacity) and joint service agreements.

Market development strategies

Market development strategies are designed to increase a carrier's share of an existing market or to develop new market opportunities. This could occur through linking into a partner's established marketing network; having the capacity to expand into a new trade route; or targeting a niche market (for example, concentrating on a regional market rather than participating in a global network).

An alliance of large carriers who were previously servicing smaller individual routes allows the establishment of a global network and the realisation of associated economies of scale and scope. According to Fremont and Soppe (2003) major alliances deploy 90 per cent of their capacity on routes between East Asia, North America and Europe. The carriers can also share marketing and logistics networks while at the same time reducing the financial risk to any one carrier of developing the vessel capacity[5] to service the global network on its own (Ryoo and Thanopolou 1999; Ryoo and Lee 2002).

Within alliances, members may concentrate on particular routes. For example, Asian carriers such as APL, Hanjin, NYK and Hyundai focus on intra-Asian trade, trans-Pacific trade and Europe–East Asia trade (Notteboom 2004, p. 96). Mitsui OSK Lines is an exception and also services routes to Africa and South America. However, alliance membership provides access to a larger network that includes the Atlantic trades.

Maersk-Sealand has attempted to achieve a balanced coverage of world trade routes. Other carriers, while having a presence on major trade routes, may also specialise in secondary routes. CMA-CGM and MSC have a network centred around a number of hub ports (which are not among the world's largest container ports) and selective servicing of secondary routes such as Africa, the Caribbean and the East Mediterranean. Evergreen has remained outside the alliance system and provides services to South American and Africa (Notteboom 2004, p. 96).

Similar cost advantages from sharing joint capacity and marketing and logistics networks can be obtained through mergers or joint ventures. Slot charter agreements may provide some of the cost advantages of sharing capacity.

[5] Notteboom (2004, p. 89) gives estimates of the number of vessels required to ensure a weekly departure from each port of call: 12 vessels for a pendulum service Europe–East Asia–US West; 8 vessels for a Europe–East Asia service; and 4 to 5 vessels for a trans-Atlantic service.

According to the United Nations (1998, p. 24), in addition to seeking cost savings, carriers enter into alliances, mergers and joint ventures with the intent of increasing market share (through the ability to extend port coverage and offer more frequent sailings) and reducing risk by spreading the services they offer over a range of routes. These agreements also provide a means of reducing the impact of route trade imbalances.

Strategies to limit competition

Shipping lines may reach agreement over a number of issues of mutual interest including 'blue water' rates, intermodal haulage rates, schedules of sailings and commitment of capacity. While such agreements might be viewed as partly an attempt to rationalise service provision (so as to ensure that services are provided at regular intervals commensurate with the needs of shippers), carriers have incentives to limit competition for the purpose of raising profits. However, as with any other form of cartel behaviour, individual members retain incentives to capture market share by reneging on collective agreements to reduce capacity and raise price. The success of any agreement to limit competition will therefore depend on the ability of firms to reach consensus on the terms of collusion, and on the ability of the group to monitor the activities of individual firms and prevent any non-compliance.

There are a number of factors which will undermine the ability of the agreement to coordinate members and monitor their behaviour. Coordination and monitoring becomes more difficult as the number of members of a cartel increases[6]. Variable market conditions, in particular price, can reduce the chance of cheating being detected. Similarly, the chances of detection are reduced if firms enter into confidential agreements with customers[7]. Incentives to deviate from agreements may also depend on the variability of demand — firms may be more tempted to renege on an agreement at times of low demand — and whether sales can be stored as inventories in order to smooth unforeseen downturns in demand.

The ability to punish members who deviate from agreed behaviour will largely depend on the nature of the relationship between members. If the members have established, on-going relationships — in the same market or across markets — there

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[6] A rule of thumb in the theory of industrial organisation is that agreements become unworkable when membership rises above '10 or 12 firms' (Scherer and Ross 1990, p. 277; von Hinten-Reed et al. 2004). In markets with a larger number of firms, individuals are more likely to act in a highly competitive way and ignore their own impact on price.

[7] The caveat to this is if the firm is party to another type of agreement which facilitates the monitoring of behaviour. For example, in liner shipping, consortia members may have information on the amount of cargo transported by each other (von Hinten-Reed et al. 2004, p. 11).

is a greater chance that any deviation from agreed behaviour can be punished by retaliatory pricing or output decisions. Issues relating to the behaviour of firms in a cartel are examined further in appendix D.

The traditional form of limiting competition between individual carriers for the purpose of limiting competition on a trade route was the conference (which could either be closed or open to new membership). However, as conferences have faced increased competition from independent operators, looser discussion agreements have evolved to include conference and non-conference lines.

While alliances may provide an opportunity for cost savings, the benefits derived may be reduced by coordination costs as the number of members increases and the alliance becomes more complex (Midoro and Pitto 2000). If an individual member faces financial difficulty and has to exit the market, this reduces the network benefits for the remaining members (Deutsche Bank 2004).

Why do carriers cooperate?

Ryoo and Lee (2002) surveyed 15 Korean shipping lines to establish the motivation for carriers to enter into various types of agreements. Korean lines feature prominently in the world market — two companies, Hanjin and Hyundai Merchant Marine, are among the twenty largest carriers — and are important suppliers of shipping services to Australia. Ryoo and Lee distinguished between agreements which allowed cooperation on freight rates (such as discussion agreements and conferences) and those which facilitated cooperation on purely operational matters (such as slot-charter agreements).

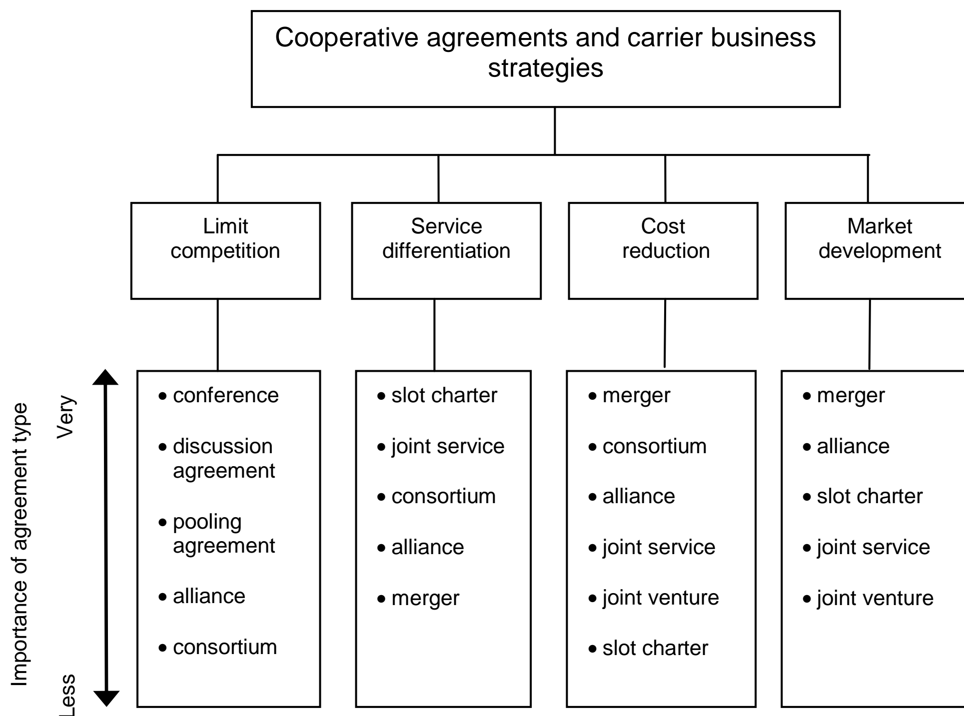
Respondents were given the option of choosing whether the motivation for entering an agreement was ‘not important at all’; ‘important’; or ‘very important’. In the case of discussion agreements and conferences, the objectives of stabilising freight rates and limiting external competition rated as the most important motivations (on average, rating between ‘important’ and ‘very important’). Technical or operational reasons for participating in a discussion agreement or conference were less highly rated (in all instances, the average rating for all respondents was below ‘important’).

In the case of discussion agreements, cooperation to achieve operational efficiencies (such as, benefit from economies of scale; reduce firm’s financial burden; provide more frequent sailings; provide intermodal service; provide total container logistics service and gain access to general management skills) was rated as ‘not important at all’ by every respondent. Similar outcomes were recorded with respect to conferences.

Conversely, achievement of operational efficiencies rated as the primary objective for entering into consortia (including slot charters); joint ventures and mergers. In the case of slot charters, joint service agreements, and mergers, stability of freight rates and limiting competition rated at, or close to, 'not important at all'.

Figure 4.1 outlines the importance of agreement types to various business strategies.

Figure 4.1 **Agreements and carrier objectives**



Source: Ryoo and Lee (2002, p. 370).

In following a cost reduction strategy, mergers and acquisitions were viewed as the most effective agreements for achieving economies of scale and other operational cost savings. Alliances were formed primarily to rationalise service routes and to increase the use of containers. Slot charters were employed primarily to share the risk of providing new services. Joint ventures and consortia were viewed as the most effective mechanisms for reducing capital vessel costs.

Slot charters were the most favoured agreement for a service differentiation strategy of providing greater service coverage and more frequent sailings. Joint service agreements were the second most important type of cooperation for achieving these objectives.

In terms of market development strategies, the carriers surveyed regarded merger and acquisition as the most important in increasing market share, entering new trade routes and accessing the established marketing network of another carrier. Slot charters were viewed as the most effective vehicles for targeting a particular market niche.

FINDING 4. 1

A number of business strategies have emerged as means of dealing with conditions in the market for liner shipping. The most important of these are cost reduction, service differentiation, market development and limiting competition. Carriers typically enter into operational agreements to achieve any or all of the first three objectives. Operational agreements have the potential to benefit carriers and shippers through cost reductions and greater flexibility in service delivery. Discussion agreements and conferences are primarily means of limiting or regulating competition on capacity and price.

4.2 Limits to competition in the market for liner shipping

The issue of whether cooperative arrangements between carriers, in particular conferences and discussion agreements, are necessary to ensure market stability or whether they enable carriers to operate as a cartel is largely unresolved in the economic literature. In assessing whether liner shipping should receive an exemption from penalties for anticompetitive behaviour, governments have balanced the perceived need for market stability against the potential for market exploitation.

Definition of the market

The limits of a market are defined by the existence of substitutes. Thus, while the demand for cargo liner services depends on the overall demand for maritime transport services, it will also be influenced by the existence and attractiveness of substitutes — bulk shipping or chartered cargo vessels. For most cargoes however, particularly in the case of small shippers, these alternatives represent a poor substitute for liner transport. Substitutability is also relevant for the commercial decisions made by carriers. Shipping lines commit capacity on the basis of anticipated rates of return. If higher returns can be earned on the charter market, for example, vessels may be utilised there rather than committed as part of a liner service.

There are limited alternative forms of transportation for most containerised cargoes (OECD 2002, p. 21; Brooks 2000a, p. 201). Some high value/low volume cargoes may be transported by air. Bulk transport may represent an alternative for a limited range of commodities.

While overall conditions in the market for maritime transport services impact on all shippers and carriers, demand and supply conditions at the individual route level will have the greatest impact. The demand for liner services is derived from the underlying demand for exports and imports. In turn this underlying demand is typically market specific, suggesting that there are few alternatives to using established trade routes. Shippers do have a limited range of choices, for example whether to ship cargo direct or have it transhipped through a port. But in the main, substitutes are offered to shippers not through the existence of alternative routes, but through the existence of more than one carrier to service the route.

Thus, in transportation industries, the standard definition of a market is a route, or a combination of routes, which provide comparable services to a consumer[8]. The location where the shipping contract was entered into will also be crucial in defining market boundaries. According to Wood:

> … the purchaser of the service may be located in a different place to where the service is provided. Since the notion of geographic market is used for delineating the area in which market power is exercised, it follows that in some service markets the geographic market is the place where the consumer is located. This is not necessarily the place where the service is supplied. The geographic market is in fact the identification of those consumers against whom market power is exercised … Thus, a shipper in Australia may telephone a shipping line in Singapore to arrange the transport of a container from Munich to Pittsburg. The market power of the service supplier is not exercised in Munich, Pittsburg or Singapore but in Australia. (2001, p. 6)

Similarly, the OECD (2002, p. 21) argued that the ability of shippers to substitute between trade routes and ports may be a useful means of defining the boundaries of a market in liner shipping. In turn, this may depend on the availability of intermodal transport facilities.

Limits to market power

Some studies have pointed to the difficulty in sustaining cartel arrangements in a competitive market (Sjostrom 1989, 2002; OECD 2001a). Individual members of an agreement designed to limit market competition retain important incentives to undercut agreed price or expand beyond agreed capacity. By doing so, they can

[8] According to Wood (2001, p. 6) competition authorities focus on substitutability with respect to consumer choice, not substitutes for the supplier, in determining market boundaries.

capture market share from members of the agreement. However, the motivation to do so depends on the ability to keep such deviations secret and the penalties imposed for breaching the agreement (Stigler 1964; Sjostrom 1989).

In addition to the ability to impose discipline on members for non-compliance, the extent to which the agreement itself faces competition on the route will be important.

Over time, increasing demand will increase the scope for further competition while changes in technology may erode the need for conferences. For example, computer technology may reduce the transaction costs involved in contracting between shippers and carriers (or promote freight forwarding activities) and thus reduce demand uncertainty. Transhipping directly exploits network economies together with economies of scale and thus may provide shipping services at lower cost than direct services by conferences.

The Australian Peak Shippers Association (APSA) expressed the view that discussion agreements had substantially lessened competition on Australian trade routes:

> It is the strong view of shippers generally that discussion agreements are formed to limit or even eliminate competition on price and capacity by combining Conference members and independent carriers in any particular trade where they can discuss issues such as the level of freight rates that each is charging. Discussion agreements have been the chief target of Australian shippers who seek to end such agreements by taking away their right to operate with anti-trust immunity for these agreements. APSA has no problems with cost-savings and efficiency enhancing agreements such as vessel sharing agreements or space chartering agreements all of which operate in Australia's trades. Although issues discussed by members of discussion agreements are said to be voluntary or non-binding on agreement members, there is a view that voluntary guidelines may not be truly voluntary and whether they actually interfere with individual carriers' behaviour, especially that of independent carriers or non Conference carriers. Additionally, shippers have had great difficulty in endeavouring to finalise freight negotiations because of the non-binding nature of these agreements. (sub. 5, p. 18)

Contestability in liner shipping

Market power can be limited by the threat of entry by potential competitors. This threat could be from carriers who operate vessels on other routes or new start-ups. It has been argued that entry to the market may be made easier by the fact that potential entrants and incumbents have access to the same technology and provided the market is not affected by a distortion (such as a cargo reservation system) all carriers are equally placed with respect to access to cargo. Unlike international

aviation markets where bilateral agreements restrict landing rights and market entry, there are few regulatory or institutional constraints on entry to liner shipping markets[9]. However, despite the ability to transfer ships to alternative routes and the existence of an active second-hand market, the high capital costs associated with operating a containership suggest there are high entry costs to the industry. According to Brooks:

> The largest barrier to entry is the requirement for matched or nearly matched ships in order to serve a particular route. To mount a credible service on the longest of the routes, the Europe–Far East trade, nine or ten similar or matched ships are required. The capital cost of providing this injection of capacity is both uneven and massive. Although it is possible to find a few similar ships in the charter market, generally speaking the cost of entry is extremely high. The need for matched ships has led in part to the growth of slot charters over the past decade. In addition, the specialization of the asset (container ship) serves as a barrier to exit. The existence of more tonnage than demanded makes exit difficult as vessel salvage value is often related to the value of the mill's steel as opposed to the value of the asset on the books or in the second-hand market. (2000a, p. 58)

Effective competition depends on the ease of entry and exit on to individual trade routes. The frequent entry and exit on certain maritime trades has been cited as evidence of the contestability at the route level (Davies 1986). However, while entry to trade routes may be easier than entry at the industry level, carriers must also incur costs in establishing themselves on a route. Building up goodwill represents a substantial sunk cost and lines cannot enter and exit markets with complete disregard of the effect this has on their reputation (Pearson 1987; Jankowski 1989). Advertising and agency costs expended to establish regular liner services are also examples of intangible sunk costs. According to Brooks:

> It is important to remember that the new entrant also needs to have credibility in the market so shippers will have confidence that using the carrier will not result in their containers being delayed or, worse, arrested. Such credibility will be more difficult for a new start-up rather than an existing firm as it is likely the existing firm already has an experienced sales force and established image, albeit not associated with the new trade lane. (2000a, p. 58)

The ACCC commented on the contestability of liner trade routes:

> *Liner shipping markets are likely to be 'substantially contestable'*. In general the majority of a carrier's costs are in vessels and are largely avoidable. Some sunk costs (such as shipping corporate infrastructure, route establishment, marketing and possibly some terminal facilities) can be expected to be incurred but these are not usually high relative to total costs. Therefore *competition in and for the market is likely to be 'reasonably workable' but may be susceptible* to attempts at tacit and possibly clandestine collusion, unless threat of prosecution on anti-competitive conduct is highly

9 Some developing countries have sought to impose national flag cargo reservation schemes.

credible and the penalties under the Act are significant compared to the gains from collusion. (sub. 21, p. 46) [emphasis in original]

In some circumstances, servicing a route may require the deployment of relatively specialised vessels which can limit the degree of contestability. For example, in 2002, P&O Nedlloyd and Contship entered into a vessel sharing agreement with the intention of providing 10 new vessels to service routes between Australia and Europe and the US east coast. Given the high proportion of refrigerated cargo carried on the route, the carriers were proposing to invest US$800 million to construct vessels with the capability of carrying around twice as many reefer containers than any other vessel. The parties also made substantial investments in refrigerated containers. At the time, the P&O Nedlloyd order for refrigerated containers (of US$200 million) was the largest ever placed (Ebsworth & Ebsworth 2002).

Decisions on the transfer of vessel capacity across routes depends on the overall state of the market and on demand conditions across all routes. In circumstances where demand is strong, there may considerable opportunity costs in redeploying a vessel from a particular route. Similarly, where a shipping line has constructed a network (to benefit from economies of scope and/or to meet shipper demand) it will not be costless to divert vessels.

Contestability is reduced if incumbents have the ability to engage in 'predatory' pricing[10] to discourage effective competition or to engage in practices which undermine the ability of new entrants to capture market share. There is evidence that conferences have developed quick price-response mechanisms to respond to entry, including the use of action committees vested with the power to match rates offered by outsiders (Fink et al. 2000, p. 89). To be effective, a policy of predatory pricing requires the existence of barriers to entry (such as through the existence of sunk costs) to prevent firms who have been driven out of the industry from re-entering once prices have be increased to generate above normal rates of return.

In 2000, the European Court of Justice[11] found that predatory pricing had been used by a conference to eliminate the competition provided by two independent carriers. There was evidence that, whenever one of the independents announced a new sailing, the conference would deploy a vessel to match it at prices that represented a

[10] 'Predatory' pricing involves incumbent firms charging loss-making prices in order to force exit (or discourage entry) by a competitor. It requires the incumbents to have the capacity to endure losses for a greater period than the potential entrant. Sjostrom (2002, p. 14) provides some historical evidence of predatory pricing. In the case of liner shipping, predatory pricing is known as engaging 'fighting ships'.

[11] Compagnie Maritime Belge Transports SA v Commission (2000), 4 CMLR 1076.

substantial discount to normal freight rates. The resulting losses were shared between the conference members.

Ultimately, frequency of entry and exit may not be convincing evidence of contestability; after all, at least in equilibrium, a contestable market would have no entry. Discipline is imposed on incumbents by the mere threat of entry. Frequent entry and exit may either represent the outcome of predatory pricing (or other anti-competitive behaviour) or it could be indicative of destabilising competition.

FINDING 4.2

Entry costs to a new route are not especially high. Though costs are involved in establishing a liner trade route (specifically, those associated with assigning a number of vessels, marketing and administration), these will typically not be a large proportion of total costs. A number of factors — including high worldwide demand for capacity, the desire to maintain networks and predatory behaviour by incumbents — may raise these costs and reduce the degree of route contestability.

Collusive agreements and the role of information exchange

While information exchange can improve the ability of a market to allocate resources — for example, common knowledge of sailing frequencies and port calls can improve service provision — it can also facilitate collusion between firms and increase the anticompetitive effect[12] of an agreement. The cost of achieving and coordinating an agreement can be reduced when members provide information on future capacity commitments or prices; while the exchange of information on current price and capacity decisions can improve the chances of detecting any cheating.

Concerns over the prospect of information exchange limiting competition have led economists to suggest that competition authorities should not allow the exchange of firm-specific information. For example, Kuhn and Vives (1995) recommended that firms not be allowed to exchange individual price and quantity data, although, in the absence of evidence of any explicit collusion in the industry, aggregated market data could be exchanged.

The potential for information exchange to be anticompetitive has also been recognised by carriers. Typically, in operational agreements registered under Part X — such as consortia, vessel sharing agreements, slot charters and slot exchanges — the parties request that certain commercial information be kept confidential. This information could relate to slot fees or slot allocations under the agreement or

[12] In the terminology of the TPA, this is known as anticompetitive detriment (box 7.2).

capacity deployed by individual lines. The standard reason given for requesting confidentiality is that knowledge of competitors' capacity could be used to 'manipulate the market'[13].

Shipping Australia Limited claimed the '[e]xchange of market information which, in turn, leads to better forecasts of demand (and therefore eventually the required capacity); more stable prices than would occur without this exchange and it also assists future investment decisions'. However, such market intelligence can be gathered without the need to exchange firm or customer-specific information. In its recent submission to the European Competition Directorate-General, the European Liner Affairs Association (ELAA), proposed that discussion agreements be permitted which would allow the exchange of aggregated, and essentially historical, market data. The exchange of forward-looking data would not be permitted under the ELAA proposal and, importantly, neither would price discussions (ECDG 2004c).

In liner shipping there is a great deal of publicly available information on the scheduling of services through the weekly publication, *Lloyd's List*. This information covers scheduled arrivals and departures in the immediate past and the near future (sometimes three months in advance). Capacity data on the vessels deployed by carriers on routes is also publicly available through publications such as *Containerisation International.*

FINDING 4.3

While the liner shipping market, like any market, needs to be well informed to function properly, the exchange of commercial information on price and quantity among carriers can be a means of enforcing collusive agreements and may result in a limiting of competition.

To what extent are carrier agreements anticompetitive?

As noted above, discussion agreements and conferences have the explicit purpose of limiting competition. Their ability to do so depends on a number of factors, including: the ability to limit competition from current or potential competitors; ability to influence the behaviour of agreement members; and market share. These

[13] Specifically, where confidentiality is requested, the standard reason is given as: 'In some sections of the trade areas served, slots are limited and this could be used to advantage by the Member Lines' competitors in persuading exporters and importers to use their own service rather than run the risk of having their cargo shut out. These other shipping Lines could manipulate the market by warning shippers to avoid using the Member Lines' services in those trade sectors where slot allocations are more limited.'

types of agreements may impact on market activity in a number of ways. Tariffs set by conferences may act as a benchmark against which market rates are set. Surcharges may be a means of passing on price increases to shipper and enforcing discipline amongst agreement members. The exchange of confidential price information among carriers may act as a deterrent to the offering of discounts. Operational agreements, while primarily intended to deliver operational efficiencies, may also reduce competition. The potential for such a reduction in competition will depend on market share and the nature of the agreement (for example, whether it includes joint price-fixing provisions).

Attempts to establish that agreements enable carriers to exploit market power and earning above normal rates have been hampered by a lack of reliable data. For example, the OECD concluded:

> The difficulty in assessing the validity of the pro- or anti-exemption position has always been the availability (or lack thereof) of the detailed information necessary regarding actual negotiated freight rates, terms and provisions of service contracts, relationships between operating costs and freight rates and the nature of arrangements among carriers. (2002, p. 11)

Conferences

Many conference practices appear consistent with classical cartel or monopoly behaviour — that is, they have the objective of restricting supply in order to raise prices and profits above competitive levels. However, the discipline imposed by competitors, or by the threat of entry by potential competitors, prevents conferences from earning rates of return significantly above those earned by independents. Carriers also practise complex pricing strategies as a means of covering high fixed costs. These strategies involve charging different rates for different cargoes (chapter 3). The statistical studies, discussed below, which have investigated whether conferences act as cartels and earn excessive profits have examined average market freight rates rather than rates paid by individual shippers. This approach ignores the potential for rates to vary between individual commodities and between shippers. In an industry where price discrimination is practised, the test of abuse of market power may not be whether average rates are excessive, but whether market supply is kept artificially low (Levine 2002).

Clyde and Reitzes (1995) report no significant correlation between conference market share and freight rates. They interpreted this result as implying that conferences were not able to act as 'perfect cartels'. However, there was also evidence that rates were significantly lower on routes where conference members were free to negotiate directly with shippers. Clyde and Reitzes conclude that this 'provides some support for the conclusion that some aspects of the conference

system may contribute to higher shipping rates, particularly when the conference has a sizable market share'. Fox (1992) finds that freights rates are directly correlated with the market share of a conference: when the market share declines, so do freight rates. Fox also finds evidence that freight rates fall as the number of conference members rises, suggesting that coordination costs may limit the ability of conferences to enforce rates.

Carriers have also noted the importance of market share in determining the ability of a conference to influence rates. The World Shipping Council (2001c, p. 8) claimed that entry of rival shipping lines led to a decline in the market share of the Trans Atlantic Conference Agreement (TACA) from 63 per cent to 53 per cent resulted in a 10 per cent decline in freight rates and, ultimately, to a restructuring of the agreement.

Fink et al. (2002) examined price data on US trade routes and found that conferences increased freight rates. They concluded that the removal of price-fixing carrier agreements would reduce liner transport prices by one-third; while the removal of operational agreements would lead to less substantial price falls[14]. Hummels (1999) also found evidence that conferences may have contributed to higher transportation costs. He found that, despite the introduction of cost-saving technology and declines in other freight costs (including that for bulk transport), international liner freight rates had not declined. The cost of transporting goods via tramp shipping had also not risen to the same extent as liner shipping costs.

Enabling greater competition between carriers appears to undermine the ability of conferences to determine market rates. The OECD surveyed shippers on major trade routes. They found little variation between the prices charged by conferences on European trade routes. However, on US routes, where confidential contracting between shippers and carriers is protected by legislation, not only were there greater differences between the rates charged by conference members but the rates charged by conferences tended to be closer to those charged by independent operators. In other words, the use of confidential contracting substantially undermines the ability of conferences to set market rates. In providing an explanation for this change, the OECD noted that '[s]ince confidential contract terms can no longer be shared among carriers [on US trade routes] liner operators now find themselves having to set rates closer to their real costs in order to remain competitive'(OECD 2002, p. 43).

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[14] The World Shipping Council (2001c) has disputed these findings. It claimed that the industry is substantially competitive, calling in question whether price falls of this magnitude are possible, and that the introduction of confidential individual service contracts had undermined the ability of conferences to determine prices on US trade routes.

However, the enforcement of confidential contracting has not completely removed the ability of conferences to influence rates. Tariffs published by conferences are now used as 'benchmarks' for conference negotiations. According to the US Federal Maritime Commission (2001, p. 20), 90 per cent of contracts are linked to tariffs published by conferences. This could take the form of passing on surcharges as specified by the conference or, in 36 per cent of contracts, as a General Rate Increase clause, which passed on increases in the conference's general tariff through to the contracting shipper. Shipping Australia Limited also acknowledged the role of conference tariffs in establishing a benchmark for individual carriers:

> Whilst rate levels tend to follow business cycles, the ability to discuss rates trends and collate information confidentially on revenues and costs (ie., collated by an independent secretariat thus protecting the confidentiality of individual members) assists in determining a collectively agreed price rise if warranted. In addition, the main tariff can act as a benchmark and it should be noted that collectively agreed surcharges have remained relatively stable. (sub. 16, p. 19)

Some studies have found no evidence of cartel behaviour on the part of conferences. A study conducted by academics from Erasmus University (Haralambides et al. 2003) found no evidence that conferences raised rates on major east-west trades, although their results were statistically insignificant. They interpret their results as indicating that conference tariffs may serve as '… starting point for negotiations of service contracts, even for non-conference members [but it] is questionable whether this benchmark has any direct effect on the final price that is agreed between parties' (p. 105).

Von-Hinten-Reed et al. (2004) found evidence that conference carriers receive higher prices than non-conference lines on North Asia–Europe trade routes. The authors hypothesise that this price difference must reflect better service on the part of conference lines as any systematic price difference would be competed away on the route. However, they do not provide any direct evidence to support this hypothesis. Their results could also be consistent with conferences servicing different segments of the market (for example, smaller shippers with more inelastic demand) than independent operators.

The impact of a conference may depend on whether membership is open to all carriers. The ACCC (sub. 21, p. 32) notes that all conference agreements operating on Australian trade routes are closed, with the exception of those with the United States (where closed conferences are not permitted). However, under section 10.45(1)(a)(ix) of the TPA, entry to a conference cannot be reasonably refused and such a refusal may be subject to investigation by the ACCC. According to the OECD (2002, p. 21), international experience suggests that 'in practice entry has not been difficult, and since the early 1980s there have been few cases where membership to closed conferences has been refused to applying parties'.

The ability of conferences to earn higher rates of return is limited when entry to the conference is open to other carriers. Under these circumstances, any excess profits may be dissipated by competition between members. However, while an open conference reduces the likelihood of excess profits being earned, it also can lead to operational efficiencies. In an open conference, in which excess profits are earned, the entry of new firms and expansion of capacity by firms within the cartel are freely permitted. Service competition leads to overtonnaging, increased costs and higher freight rates. While a closed conference is able to control service competition and rationalise fleet operation, an open conference may be unable to exert the required discipline (Devanney et al. 1975; Jansson and Shneerson 1978). These issues are discussed further in appendix D.

The extent to which conference members are exposed to effective competition therefore depends on the interaction of a number of factors, principally the market share of the agreement and the nature of the relationship between agreement members. While greater effective competition between members reduces the risk of competition being curtailed, it also calls into question the alleged rationale for such agreements — that is to reduce or eliminate the effects of 'destructive' competition. The various influences which determine the degree of competition between agreement members is a strong argument in favour of assessing agreements on an individual basis. According to the Competition Directorate General of the European Commission:

> … given the increasing number of links between carriers (i.e. consortia, alliances, vessel-sharing arrangements and slot-charters) determining the extent to which a particular conference is subject to effective, internal and external, competition can be a very complex exercise, even if the conference in question does not have a substantial market share. In any event, such an assessment would necessarily have to be made on a trade by trade basis. (ECDG 2004a, p. 13)

FINDING 4.4

The evidence on whether conferences raise freight rates above levels necessary to sustain industry equilibrium is mixed. Conferences with high market share appear to have more success in raising freight rates. Where the confidentiality of service contracts are protected by law — such as on US trade routes — conferences appear to have less success in fixing and raising rates.

Discussion agreements

Discussion agreements may reduce competition by providing a forum for the exchange of firm-specific information and for the limiting of market supply. As noted previously, conferences have declined in relevance as scheduled tariffs have become more difficult to enforce (OECD 2002, p. 21). On the other hand, as noted

by the ACCC (sub. 21, p. 29), the loose membership structure, the lack of a need to commit capital to the agreement and the ability to freely exchange market information have contributed to the increased market share of discussion agreements. Similarly, the US Federal Maritime Commission identified the attraction of discussion agreements to carriers:

> With the demise of the conference system, the discussion agreement, by default, became the sole forum for collective carrier pricing activity in most US liner trades. In the major trades, it is able to attract key players by being less bureaucratic and autocratic than the traditional conference. Members are not bound to specific rate levels, and among the variety of their features found attractive, the ability to exchange information and the ability to agree voluntarily on pricing policy are paramount. Although a discussion agreement's ratemaking may not be on the rigid, enforceable scale of the traditional conference, the ability of the members to share commercial information and formulate pricing policy can have a considerable demand-side influence under certain economic conditions. (2001, p. 25)

Despite their loose membership structures, discussion agreements appear to have the ability to influence freight rates: 'While the rates set by discussion agreements are non-binding, in practice most of the members to the discussion agreements seem to follow them, at least when they are dealing with small and medium sized shippers' (ECDG 2004d, p. 24). As in the case of conferences, the ability of a discussion agreement to influence market rates will rise with its market share. Discussion agreements may be able to deter entry by potential competitors through committing additional capacity to a route (Spence 1977; Fusillo 2003). However, the ACCC (sub. 21, p. 29) questioned whether this strategy would be applied on Australian trade routes[15] and noted that decisions relating to the commitment of vessels are normally made through an operational agreement.

The ability of a cartel to influence market price may be greater when firms are operating at or near capacity (Scherer and Ross 1990, p. 278). Similarly, the ability of discussion agreements (and conferences) to exert market power appears to be greater when demand is high (Brooks 2000a, p. 210). According to the ACCC:

> In periods of significant demand growth, parties to discussion agreements cease price competition between each other, discounts to all but the largest shippers are withdrawn and contract terms tend to shorten as they expire. In a growing market, carriers have no incentive to cheat on each other by offering discounts in the short term as they are already experiencing high load factors.

[15] The ACCC notes that, in 1999, a conference operating on the route from Australia to North East Asia route established a new service in response to entry by several new competitors. This new service was withdrawn five months later when the conference's market share fell. More recently, in mid-2004, members of the Asia-Australia Discussion Agreement did not significantly increase capacity in response to the entry of new competitors onto the Australia–North East Asia trade.

> Given that discussion agreements tend to have larger market shares, this behaviour in a tight market means that often shippers are forced to absorb freight rate hikes or switch to inferior shipping alternatives such as transhipment with slower transit times and greater possibility of delay through double handling. Also, given the ability of discussion agreement members to exchange confidential market data and to signal to each [other] their pricing intentions, the speed of rate increases following an increase in cargo demand may be more rapid than in a competitive market. (sub. 21, p. 30)

The ACCC cited evidence from two of its investigations of discussion agreements instituting '… a series of rapid price increases, taking advantage of significant increases in cargo volumes on the respective trades' (sub. 21, p. 30).

The US Federal Maritime Commission (FMC) found evidence of the exercise of market power by discussion agreements during periods of high capacity utilisation in an investigation of carrier behaviour on trans-Pacific trade routes (Won 1999). This study examined the period immediately before the introduction of the US Ocean Shipping Reform Act and found evidence of refusing to carry lower valued cargoes in preference to high value cargoes; 'opting-out' of service contracts entered into with shipper associations; discriminating against cargo booked through freight fowarders[16]; and 'the imposition of significant and sudden increases in rates and charges'. In assessing the evidence, the FMC concluded:

> In view of the significant level of abuse of the shipping public documented in this Report, the [Federal Maritime] Commission must carefully examine the extent of its authority and resources to protect the public under circumstances where the various layers of antitrust immunity (slot charters, alliances, conferences and … discussion agreements) combine with unusual economic conditions to permit carriers to extort price increases that would not otherwise be possible under competitive market conditions. Many of the documents contained in the appendices to this Report reflect a high degree of disregard on the part of carriers for the customers which they are in business to serve as well as for the laws administered by the Commission. The cavalier sharing of confidential shipper information is but one example of this attitude, and one that potentially forebodes much larger problems when the Ocean Shipping Reform Act ("OSRA") takes effect in a few short months, with confidential contracts as its centrepiece. (Won 1999, p. 4)

Brooks concluded that discussion agreements should continue to receive antitrust immunity provided they did not engage in price fixing or capacity management. Moreover, confirmation of the behaviour outlined in the Federal Maritime Commission investigation would suggest that '… the role played by discussion agreements should be revisited, strictly regulated and monitored to prevent participants from engaging in predatory practices in a rising market' (2000a, p. 256).

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[16] In the United States, these are known as non-vessel operating common carriers (NVOCCs).

Submissions from Shipping Australia Limited (sub. DR4, p. 23) and ACIL Tasman and Thompson Clarke (sub. DR9, p. 1) questioned the ability of discussion agreements to impose any form of collective decision making on individual members. They noted that these agreements have no formal mechanism for ensuring that any consensus reached by the majority of members is undertaken by all members. However, agreements between firms do not require explicit enforcement mechanisms to ensure that decisions are enforced. The threat of retaliatory action against members who do not abide by the collective decision (for example, by the deployment of additional capacity) may be sufficient to ensure that discipline is maintained. If discussion agreements have no ability to enforce decisions, it would also appear that the minimum service levels written into such agreements are of little value to shippers.

One industry participant, representing horticultural exporters, noted that, in his experience, members of discussion agreements appeared to have limited scope to offer individually negotiated prices:

> If one of the lines has given us a slightly better deal, in terms of something free or dropping a documentation fee, and you tell another line that that line has in fact done that, they are berated at the next meeting. They ring you up and say, 'Look, we've given you something, tried to help you out and we've got to withdraw it because it has been made public'. (Australian Horticultural Exporters Association, trans., p. 108)

Shipping Australia Limited also acknowledged that the exchange of information about shippers could be means of raising prices and providing stability to discussion agreements:

> … it's the ability to discuss supply and demand within a discussion agreement, particularly how you see it going in terms of demand collectively and how we see the capacity being provided, but not controlling capacity — that seems to be a misapprehension — but that helps the ability at times to set, as I said, certainly not account rates or individual account rates, but simply across-the-board rates or surcharges, that gives that confidence for those agreements to hang together. (trans., p. 22)

FINDING 4.5

Exchange of information, particularly in regard to shipper demand, increases the influence of discussion agreements over prices. The ability of discussion agreements to influence rates increases with market share and is greater at times of strong shipper demand.

Operational agreements

Treatment of operational agreements under competition law differs between jurisdictions (chapter 6). In general, the characteristics of operational agreements that would most likely reduce competition are joint price fixing and a high market share. In the European Union, consortia are defined to be operational agreements without price fixing. They have a block exemption from European competition law, subject to market share criteria. Consortia with a market of more than 50 per cent do not benefit from the exemption. In the United States, consortia with joint price setting provisions are classified as joint ventures and are subject to individual review to determine their potential for reducing competition on a route (Brooks 2000a, p. 19). Although, operational efficiencies generated by such agreements would be considered in any assessment of net benefit. Around 90 per cent of all new agreements registered with the Federal Maritime Commission in 2003 were vessel sharing agreements (which do not include joint price fixing provisions)[17]. According to the FMC, these agreements range 'from agreements that involve a high degree of operational cooperation with respect to space and services, down to the simple swap of container slots … The objective of these agreements is to provide a high-quality service, while reducing individual operating costs' (FMC 2004, p. 51).

Typically, competition authorities have regarded consortia as more benign than agreements which attempt to set market rates or limit market capacity. An analysis of operational agreements registered under Part X indicates that, while a number of agreements provide for joint price fixing by members, many are either silent on the issue or explicitly state that marketing will be separately undertaken by members. This suggests that joint price fixing is not an indispensable requirement for achieving operational efficiencies. According to the ACCC the 'potential anti-competitive detriment of consortia agreements is generally not regarded as pernicious as those agreements involving some form of rate fixing' (sub. 21, p. 36). On balance, the ACCC concluded that the potential for competition to be reduced by operational agreements was likely to be outweighed by the benefits. While these agreements might forestall:

> … competition between rival carriers that would otherwise operate individual services in the absence of consortia agreements … This potential competitive detriment has to be balanced by the likelihood that the cost of providing an entire liner service with five vessels by one carrier would be prohibitive. Thus, there may be limited net competitive

[17] While 37 vessel-sharing agreements were filed with the FMC in 2002-03 only two new joint service agreements (which enable members to set common rates and effectively operate as a single carrier on that route) were filed. At the end of 2002-03, there were 145 vessel-sharing agreements filed with the FMC compared with only seven joint service agreements (FMC 2004, p. 51).

> detriment of a consortium with respect to service provision. In terms of marketing/sales and freight rate setting, it appears that consortia bodies do not impede upon their individual liner parties' decision making. Absent discussion and conference agreements, the basic competitive medium with respect to freight rate setting appears to be the carriers themselves.
>
> Another possible source of competitive detriment accorded to consortia agreements relates to prohibitions placed on parties to charter third party lines. However, the overall competitive impact depends on the prevalence of this practice and the amount of capacity (typically about 10 per cent of a given vessel) in a liner trade. (sub. 21, pp. 36–7)

FINDING 4.6

The potential for operational agreements that do not include provisions for price fixing to reduce competition is less than those which involve collusion over rates. The potential for an operational agreement to reduce competition increases with market share.

5 Key Elements of Part X of the TPA

Part X provides exemptions for ocean carriers providing liner cargo shipping services from key provisions of Australia's regulation of restrictive trade practices. In particular, it allows them to group together to coordinate the provision of their shipping services to and from Australia through a wide variety of formal agreements (conference agreements). It also provides exemptions to Australian exporters and importers (shippers) to negotiate collectively with ocean carriers.

To receive the exemptions, carriers must register their agreements. They must negotiate (but are not required to come to an agreement) with designated peak shipper bodies representing Australian exporters and importers over minimum service levels to be provided on specific routes by the agreement parties. Carriers are not required to demonstrate that there is a net public benefit from their potentially anticompetitive agreements, and there is no time limit on, or review of, the individual exemptions provided.

While an agreement is in operation and when requested by designated shipper bodies, carriers are required to negotiate (but are not required to come to an agreement) on service conditions, including freight rates.

The Minister for Transport and Regional Services has the power to deregister an agreement, in part or in full, following an ACCC review However, the Minister must provide carriers with an opportunity to give undertakings as to future behaviour if doing so would make deregistration unnecessary. No agreement has been deregistered since Part X provisions were introduced in 1966.

In outlining key elements of Part X of the *Trade Practices Act 1974*, (TPA), this chapter first sets out the objectives stated for Part X, and the intentions of Parliament as to how those objectives are to be achieved. It then sets out the extent of the immunities granted to providers of liner cargo shipping services, and to Australian shippers to cover their negotiations with ocean carriers. This is followed, in sections 5.3 and 5.4, by an outline of the activities and agreements covered by Part X, respectively. Section 5.5 sets out the obligations imposed on ocean carriers in order to receive the exemptions provided by Part X. Section 5.6 lists the

designated shipper bodies recognised under Part X, and section 5.7 outlines the provisions for review and enforcement.

5.1 Objectives of Part X of the TPA

The TPA (s. 10.01) specifies four principal objectives for Part X:

- to ensure that Australian exporters have continued access to outwards liner cargo shipping services of adequate frequency and reliability at freight rates that are internationally competitive;
- to promote conditions in the international liner cargo shipping industry that encourage stable access to export markets for exporters in all States and Territories;
- to ensure that efficient Australian flag shipping is not unreasonably hindered from normal commercial participation in any outwards liner cargo shipping trade; and
- as far as practicable, to extend to Australian importers in each State and Territory the protection given by this Part to Australian exporters.

The last objective was added as part of the amendments to Part X introduced in 2000 which, among other things, extended the provisions of Part X to include conference agreements on inwards trades as well as those handling Australia's exports.

Section 10.01 also states that it is the intention of the Parliament that the principal objects of Part X should be achieved by permitting continued conference operations while enhancing the competitive environment through the provision of safeguards against abuse of conference power, particularly by:

- enacting additional restrictive trade practice provisions applying to ocean carriers;
- requiring conference agreements to meet certain minimum standards;
- making conference agreements generally publicly available;
- permitting only partial and conditional exemption from restrictive trade practice prohibitions; and
- requiring conferences to take part in negotiations with representative shipper bodies.

Parliament also intended that the objects of Part X be achieved through increased reliance on private commercial and legal processes and a reduced level of government regulation of routine commercial matters.

5.2 The exemptions from trade practices provisions provided under Part X

Part X exempts ocean carriers providing liner cargo shipping services from key sections of Part IV of the TPA regulating restrictive trade practices. The exemptions allow ocean carriers to, among other things, collaborate through registered conference agreements to provide coordinated, joint, regular scheduled services, share capacity and agree on freight rates.

Without the exemptions contained in Part X, ocean carriers involved in some types of agreements would be in danger of contravening the following sections of the TPA:

- section 45 which prohibits contracts, arrangements or understandings (anticompetitive agreements) that restrict dealings or affect competition. Anticompetitive agreements include market sharing arrangements (which have the purpose or effect of substantially lessening competition), exclusionary provisions that limit or exclude dealings with particular suppliers or customers, or agreements that fix prices; and
- section 47 (other than subsections (6) and (7)) which prohibits exclusive dealing. Exclusive dealing involves agreements which impose restrictions on one party's freedom to choose with whom, or in what, it deals.

Ocean carriers remain subject to:

- the prohibition on third line forcing in subsections 47(6) and (7) — that is, to the prohibition on supplying goods or services on the condition that the buyer also purchases goods or services from another person;
- the misuse of market power in section 46; and
- the provisions in section 50 governing mergers and acquisitions which substantially lessen competition.[1]

Australian importers and exporters are also provided with exemptions from the same provisions of the TPA as is provided to ocean carriers to enable them to negotiate collectively with carriers in relation to the provision of scheduled liner

[1] Parliament of Australia. Parliamentary Library. Bills Digest No. 29, 2000-01. Trade Practices Amendment (International Liner Cargo Shipping) Bill 2000, pp. 1–2.

cargo shipping services. The extension to importers was included in the amendments to Part X of the Act in 2000 (box 5.1).

Box 5.1 **Recent extension of Part X to include importers**

Until 2000, inward shipping conference agreements had the same exemption from Australia's competition law as agreements on export trades, but Part X provided no complementary exemptions for Australian importers.

The amendments to Part X in 2000 extended to Australian importers the same protection given by Part X to exporters, in particular, the right to negotiate collectively with inward conferences without otherwise seeking authorisation under Part VII, and the placing of obligations on inward conference agreements to be registered and negotiate with designated inwards shipper bodies. The Department of Transport and Regional Services noted:

> Regarding imports, Part X has a more restricted role and more limited objectives, in line with the traditional approach (USA excepted) that the country of export has the primary interest in regulating liner shipping. While inwards conference agreements must, since the 2000 amendments, now be registered, and the designated peak import shipper body has the right to negotiate minimum levels of service to be provided under the agreement, shipper bodies can only call for negotiations in respect of arrangements contracted in Australia, or to which Australian law is to apply, and in respect of land-side activities in Australia. In practice, most inwards shipping arrangements are contracted in the country of export. (sub. 9, p. 14)

To avoid possible conflicts with the legal systems of other countries, a system of exemption orders has been adopted. Certain Part X provisions may be suspended in relation to an inwards conference agreement, by the Minister, when it can be shown to conflict with overseas regimes.

5.3 Activities covered by Part X

The Part X exemptions are limited to liner cargo shipping services, being the transport of general cargo by sea on scheduled routes, stevedoring services and activities that take place outside Australia (s. 10.14). This is predominantly trade by container but also covers break-bulk transport[2], as well as roll-on, roll-off vehicular transport. It does not apply to the transport of bulk cargo in bulk carriers, nor to general cargo carried on non-scheduled vessels.

As well as the 'blue-water' component of the shipping service, a range of ancillary services are also covered. These are:

[2] Non-containerised cargo of unusual mass or shape that is difficult to pack in containers.

- inter-terminal transport services[3];
- stevedoring services; or
- services provided outside Australia that:
  - relate to the cargo transported, or to be transported, on the scheduled cargo shipping services; and
  - provided by, or on behalf of, providers of scheduled cargo shipping services (s. 10.02(1)).

The 2000 amendments specified that contracts between a stevedoring operator and an ocean carrier (s. 10.24A) would be covered by the Part X exemptions. Essentially, it clarified the right of shipping conferences to negotiate with stevedores, as stevedoring operations are traditionally part of the terminal-to-terminal services provided by shipping conference lines.

Part X also includes provision (s. 10.02A) for the Minister to declare a facility that is outside a designated port area as an inland terminal. Such facilities are used for assembling export cargo by, or on behalf of, ocean carriers for delivery to a port, or delivering cargo to importers.

5.4 Agreements covered by Part X exemptions

The registered collaborations between ocean carriers are referred to in the Act as 'conference agreements'. The Act defines a conference very broadly as '… an unincorporated association of 2 or more ocean carriers carrying on 2 or more businesses each of which includes, or is proposed to include, the provision of outwards liner cargo shipping services or inwards liner cargo shipping services' (s. 10.02(1)).

Section 10.08 specifies that conference agreements may include only certain restrictive trade practices provisions specified as follows:

- the fixing or other regulation of freight rates;
- the pooling or apportionment of earnings, losses or traffic;
- the restriction or other regulation of the quantity or kind of cargo to be carried by parties to the agreement;

[3] An inter-terminal transport service means a service for the transport of various types of general cargo from: an inland terminal to a port terminal; a port terminal to an inland terminal; or a port terminal to another port terminal, and includes the handling of the cargo within any of those terminals.

- the restriction or other regulation of the entry of new parties to the agreement; or
- provisions that are necessary for the effective operation of the agreement and of overall benefit to Australian exporters or importers.

This list is quite broad, and the last provision means that there is little effective limit to the range of restrictive trade that can be included in an agreement eligible for registration under Part X.

Agreements can take a number of forms (chapter 4) and, because of the very broad definition of a conference agreement under the Australian legislation, all are equally permitted on Australian trades. Shipping Australia Limited identified four broad types of agreements, saying:

> Whilst there are over 60 Agreements presently registered under Part X as mentioned at the hearing, they all fall into four broad categories and within each category there are more similarities than differences between each Agreement:
>
> - Discussion Agreements (DAs) that provide for some rate (price) setting but only on a non-binding consensus basis.
> - Conferences which provide for binding rates on the members but they have declined in number.
> - Consortia or Operational/Technical Agreements that provide for rationalised, economic services with the sharing of space on the vessels of individual carriers party to the arrangement.
> - Joint Service Arrangements often between two parties only which are also technical or operational in nature. (sub. DR20, p. 2)

In its analysis, the Commission has grouped the last two types of agreements together as 'operational agreements' (chapter 2).

Internationally, and in the literature, a 'conference' is thus just one of the types of agreements that ocean carriers can enter into. In this report, when referring to the broad Australian definition used in Part X of the TPA, the Commission uses the term 'conference agreement' or 'Part X agreement', leaving the term 'conference' to refer to the particular type of agreement identified in international usage.

FINDING 5.1

Part X of the TPA provides significant immunity for ocean carriers from key elements of Australia's competition law. Eligible agreements are very broadly defined and little limitation is placed on the range of provisions that can be included in those agreements. As a consequence, practically all types of shipping agreement are eligible for immunities under Part X. No such immunity is provided for any other industry in Australia.

Non-ocean carriers with substantial market power

Division 9 of Part X provides for the declaration of non-conference carriers with substantial market power. The effect of a declaration is to require the non-conference carrier to meet the same obligations that apply to registered conference agreements. The task of declaring carriers rests with the Minister acting on a report from the ACCC. To date, no non-conference ocean carrier has been declared.

5.5 Obligations of ocean carriers under the Act

In order to receive the exemptions under Part X, providers of liner cargo shipping services are required to register their agreements with the Registrar of Liner Shipping (in the Department of Transport and Regional Services) and to meet certain obligations towards designated Australian export and import shipper bodies, notably, to provide information and negotiate on certain matters. In particular:

- a conference agreement must contain provisions specifying the minimum level of shipping services to be provided under the agreement (s. 10.07);
- parties seeking the registration of a conference agreement must negotiate a minimum level of shipping services with a relevant designated shipper body (representing the interests of Australian exporters or importers) before an agreement can be finally registered (s. 10.29);
- parties to a conference agreement must negotiate with a relevant designated shipper body on the terms and conditions applicable to that shipping service if reasonably requested to do so during the operation of the agreement (s. 10.41(1)); and
- ocean carriers who provide liner cargo shipping services must have a registered agent resident in Australia (s. 10.68).

Registering an agreement

The Registrar of Liner Shipping is the first point of contact for enquiries and for ocean carriers seeking immunity under Part X for their proposed agreement. The registrar administers the registration process and keeps the various registers (such as that of conference agreements, ocean carrier agents, and designated shipper bodies.) that are required to be maintained under Part X.

Registration of an agreement occurs in two stages, provisional and final. Provisional registration allows agreement parties and shipper bodies to negotiate on minimum

levels of service prior to final registration, without contravening the TPA. To facilitate those negotiations, the agreement parties must give a copy of the agreement to the outwards, or inwards, peak shipper body as soon as possible after applying for provisional registration. If the Registrar is satisfied with the application, the agreement will be provisionally registered within 14 days of receiving the application (s. 10.28).

With provisional registration, parties to the agreement are required to negotiate and provide information to a designated shipper body in relation to minimum levels of service that they propose to provide. After negotiations have been held, or declined by the shipper body, the parties to the agreement can apply for final registration. If the Registrar is satisfied that the processes have been followed, final registration will be provided within 14 days of receiving the application.

Agreements between outward conferences and shippers are required to provide expressly for questions arising under the agreement to be determined in Australia under Australian law, unless otherwise agreed by the parties and the Minister (s. 10.06). This provision gives protection to shippers by ensuring that their contracts with carriers are dealt with in their own jurisdiction.

The registration process for Part X agreements differs markedly from the standard authorisation process available to other industries under Part VII of the Act. Part VII requires parties to an agreement to demonstrate that the agreement would provide a net public benefit, that is, that the public benefit outweighs the anticompetitive detriment (see box 7.2) from operation of the agreement, before approval to engage in potentially anticompetitive behaviour is granted. In addition, agreements authorised under Part VII have a specified time limit attached to them, ensuring that the expected benefits and anticompetitive risks are subject to review. Agreements registered under Part X, on the other hand, are not required to demonstrate that any public benefit will result from that agreement, nor is there any time limit on the immunities granted and, thus, no review of the benefits and costs of these agreements.

At the hearing and subsequently, Shipping Australia Limited asserted that there is a public benefit test in operation under Part X:

> Part X contains an ongoing and substantive test of public benefit by requiring the services offered by these types of agreements to be adequate, economic and efficient and for that test to be applied by those who pay and require such shipping services. (trans., p. 7)

And that:

> The provisions of Part X do provide for an ongoing public interest test. Section 10.45 (1)(a)(iv), for example, provides that parties to the Agreement need to have due regard

> to the need for outwards liner cargo shipping services or inwards liner shipping services provided under the Agreement to be:
>
> a. efficient, economical and
>
> b. provided at the capacity and frequency reasonably required to meet the needs of shippers who use, and shippers who may reasonably be expected to need to use, the services.
>
> This is an important test which is regularly monitored by not only the peak shipper bodies but the secondary designated shipper bodies and individual shipper groups/shippers. (sub. DR4, p. 3)

The 'requirement' that agreements be economic and efficient and so on, is not an express requirement for registration under Part X. No information is either provided or sought on which such an assessment could be based, while failure to come to an agreement with Australian shippers does not limit the ability of an agreement to be registered. The section in the Act referred to in Shipping Australia Limited's comments is about the conditions under which the Minister may order the *deregistration* of an agreement. The Minister may do so if the parties to the agreement apply or propose to apply the agreement without due regard to the need of shippers, for the services to be efficient and economical and provided at the capacity and frequency reasonably required to meet the needs of shippers who use the services. However, the ACCC commented that:

> The ACCC has formed the view that, due to the current structure of Part X, there is little incentive for the lines to provide evidence to the ACCC during investigations to demonstrate that liner agreements provide public benefits to Australia. Indeed, prior to the amendment of Part X in 2000, shipping lines were not required by the legislation to even address the issue of public benefit during a Part X investigation. Furthermore, shipping lines are not required to demonstrate *ex-ante* evidence of public benefits prior to gaining Part X registration. A *prima facie* assessment of the ACCC's investigation history indicates that it is difficult to recommend deregistering a liner agreement. (sub. 21, p. 6)

As no agreement has ever been deregistered, either in full or in part, this 'condition', and the 'ongoing and substantive test of public benefit' referred to by Shipping Australia Limited, would seem to be of limited practical relevance. A more serious assessment of net public benefit is likely to be provided if an evaluation were to be undertaken before an agreement is put in place.

The requirements placed on a Part X agreement for registration are essentially 'technical', involving such things as:

- specifying minimum service levels;
- offering negotiations to designated shipper bodies;

- ensuring that questions arising under the agreement be determined in Australia in accordance with Australian law;
- providing for parties to be able to withdraw with reasonable notice without penalty; and
- ensuring that the agreements only relate to areas where exemptions from the TPA are provided (see appendix E for the checklist for provisional registration).

Earlier, the Commission had expressed the view that the registration of agreements was essentially automatic. The Department of Transport and Regional Development did not agree with this view saying:

> While registration under Part X is a far less exacting and time-consuming process than authorisation under Part VII, it is not fair to say that registration is automatic. It would be fair to say that agreements may be registered provided that they meet certain minimum standards.
>
> The most common defect in agreements is an unsatisfactory withdrawal clause in outwards agreements, usually where the notice period is not reasonable (s10.06) in the view of the Registrar. In such cases, registration does not occur until a satisfactory provision is inserted in the agreement to replace the original provision. While not a frequent occurrence (there have been two cases in 2004 to date), the most notable example in recent times involved one of the central agreements in the counter-rotating round-the-world services in the Europe and US trades. Although the agreement had already been lodged with the FMC [Federal Maritime Commission], the Department refused to register the agreement in the form proposed for registration under Part X. The Department eventually accepted a revised agreement, with a much shorter withdrawal notice period, for registration. (sub. DR18, p. 22)

While there is an assessment process under Part X, this is essentially is an assessment as to whether technical and procedural matters such as withdrawal notice periods, have been addressed and adhered to. It does not involve an assessment of the nature of the agreement itself nor of the service provided, nor whether the agreement provides a net benefit to Australia. The obligations placed on carriers in order to obtain exemptions for their agreement are minimal and, as far as the Commission can ascertain, do not limit their ability to act, either individually or collectively, in response to market conditions, or to provide a non-preferred level of service.

The Commission considers that it remains an accurate conclusion that, as long as these 'technical' and procedural requirements are met, registration of agreements is essentially automatic.

FINDING 5.2

The obligations placed on carriers are essentially procedural in nature. Consequently, registration of conference agreements under Part X is, to all practical purposes, automatic, with no assessment being made as to the costs and benefits of these agreements, and with no time limit placed on the immunities granted.

Requirements to negotiate with Australian shippers

The major obligation imposed on parties to a conference agreement is to negotiate with a designated peak shipper body (representing the interests of Australian shippers generally) or designated secondary shipper bodies representing particular trades, goods or areas. Two sections of Part X relate to the requirement to negotiate.

Negotiation of minimum service levels at the time of the registration of an agreement

As part of the registration process, parties to a conference agreement are required to negotiate minimum levels of shipping services after provisional registration of the agreement and before final registration can be granted (s. 10.29). The minimum levels of shipping service include the frequency of sailings, cargo carrying capacity, and ports of call of liner cargo shipping services provided or proposed to be provided under the agreement (ss. 10.02 (2) and (2A)).

When an agreement seeks registration, or amendment, the schedule of minimum levels of service is provided to either the Australian Peak Shippers Association (APSA) or the Importers Association of Australia (IAA). If the shipper organisation is satisfied about the level of the services provided, they inform the Registrar by statutory declaration and negotiations are not entered into. Where the shipper organisation is not satisfied with the minimum service level offered they may undertake negotiations with the conference agreement parties. If agreement is reached, the Registrar is informed by way of a statutory declaration. If agreement is not reached with the designated shipper body, the agreement may still be registered, provided that it does specify a minimum level of service, with the failure to come to an agreement over that level being noted.

In practice, negotiations over minimum service levels are rarely entered into. APSA informed the Commission that, in 1991, it had reached an agreement with the carriers that minimum service levels would be 80 per cent of the service the carriers planned to operate on Australian routes. APSA said:

> In 1991 APSA proposed 80% as being a realistic and practical level for the minimum obligations that Shipping Conferences must provide in space levels and this has worked well since then. There have been no cases where Conferences have not provided the minimum and in many cases the space provided has been close to the maximum possible. (sub. DR14, p. 1)

Consequently:

> In 90 per cent of the cases, the minimum levels of service proposals they are putting forward to us we assess as being adequate or not and in nearly all cases, when we've done our mathematics, they are. The only ones where we have to negotiate are those services which are not managed by SAL [Shipping Australia Limited] and are perhaps new to the trade. (APSA, trans., p. 57)

Similarly, Shipping Australia Limited commented:

> It is acknowledged that over time Lines now understand the type of information they have to provide to satisfy the Australian Peak Shippers' Association's (APSA) MSL [minimum service level] requirements both in terms of what has to be covered by the MSLs as well as the background information that has to be provided to satisfy APSA that they meet the minimum standards. For the other 10% of cases additional information was requested and eventually agreement was reached. (sub. DR4, pp. 12–13)

The practical impact of the requirement to negotiate with peak shipper bodies levels is difficult to gauge. In relation to the level of shipping services offered to Australia, it appears that carriers establish the level of service they wish to provide, essentially in response to their assessment of market demand and their commercial interest. There is no negotiation with peak shipper bodies at the stage where the nature and level of the service is decided upon, nor is negotiation required under Part X until after a proposed agreement, including the proposed schedule of services, is submitted to the Registrar.

The West Australian Shippers Council and the Chamber of Commerce and Industry of Western Australia commented:

> ... it is now our belief that market forces will determine the level of service to and from Fremantle and whether Part X remains or not, shipping lines will continue to provide service purely on the commercial viability. (sub. 6, p. 2)

The key result of the Part X requirements is the guarantee that the overall service level will not fall below 80 per cent of the level that the carriers plan to provide. This guarantee, to the extent that it is effective, would provide a degree of certainty over the level of service provided and over its variability — reliability of service being a characteristic ranking high on the factors considered important by Australian shippers.

However, the practical effectiveness of the minimum service levels is unclear.

First, scope exists for 'gaming' by the members of a conference agreement seeking registration. There is an incentive to submit a lower service level than actually planned, resulting in the minimum service level being potentially less onerous. For example, the minimum level of service commitment given can be as low as 50 per cent of that actually provided (see box 5.2 which provides information relating to the Asia–Australia discussion agreement).

Box 5.2 **Asia–Australia minimum service level**

For an agreement to be registered under Part X, it needs to outline a minimum level of service — typically a minimum quantity of TEUs to be provided by the agreement. The Asia–Australia Discussion Agreement covers inward trade from North Asia and East Asia (including China (PRC), Japan and Korea) to Australia and provides approximately 86 per cent of the total trade on that route (see ACCC 2004a). The minimum level of service for this Agreement is 456 746 TEUs per year.

The total capacity for 2003 on the North and East Asia routes[4] was 1 969 537 TEUs. This represents total TEU on both the inward and outward legs. Using the ratio of exports to imports (chapter 3), TEUs on the inward leg was 871 477, while the outward leg was 1 098 060. For 2004, it is estimated that total TEU will be 2 333 294.[5] Using the same ratio, inward TEUs will be 1 032 431, while outward TEUs will be 1 300 863.

The guaranteed minimum level of service represents only 52 per cent of the inward trade of 2003 and only an estimated 44 per cent in 2004.

Source: Containerisation International; and Asia–Australia Discussion Agreement.

A consequence of this behaviour is that, when the actual service level is increased beyond any 'artificially low' initial level, shippers are likely to be pleased by the outcome.

Second, the minimum service level cannot be seen as being particularly onerous as it can be varied by giving the required notice to shippers and offering to negotiate. Failure to reach agreement with shippers as a result of those negotiations does not, however, preclude carriers from introducing their planned changes.

FINDING 5.3

Although the requirement to negotiate with peak shipper bodies prior to the registration of an agreement is viewed favourably by some shippers, it does not

[4] North East Asia–Australia (121), East Asia–Australia (103); and Australia–PRC (122) routes.

[5] To estimate the total 2004 TEU, the first six months have been doubled.

appear to have any material impact on the level, or quality, of shipping services offered to Australia. The level of service appears to be determined by the commercial interests of carriers responding to demand in the market place, as would be the case in the absence of the requirement to negotiate.

Negotiation while an agreement is in operation

Parties to a registered agreement are required to take part in negotiations (in relation to negotiable shipping arrangements) with a relevant designated shipper body whenever reasonably requested by the shipper body (s. 10.41). In addition, the parties to an agreement must notify each relevant designated shipper body of any changes in negotiable shipping arrangements.

Negotiable shipping arrangements (cover the terms and conditions applicable to the shipping services provided, or proposed to be provided, under the conference agreement (including, for example, freight rates, charges for inter-terminal transport services, frequency of sailings and ports of call) (s. 10.41(3)). Freight rates include base freight rates, surcharges, rebates and allowances.

The definition of negotiable shipping arrangements applying to an inwards conference agreement has an additional element, being that they include activities that take place on land in Australia (including, for example, terminal handling charges and charges for inter-terminal transport services).

Typically, negotiation while an agreement is in operation covers such things as freight rates and surcharges, and any changes that the carriers seek to make to the service offered. However, there is no obligation on carriers to reach agreement with shippers, only that negotiations are entered into if asked to do so. Nor is there an obligation on the part of carriers to abide by any agreement reached. Negotiations do not limit the ability of the carriers to implement any of the changes that they propose to introduce.

The ACCC, in recent reviews of Part X of the TPA, considered that:

> … the negotiation provisions under Part X represent a weakness and provide minimal countervailing power to shippers. While Part X talks about negotiation, there is no obligation on parties to actually agree on proposals. (ACCC 2001, p. 7)

The limited practical effectiveness of negotiations to take account of the interests of shippers was evident in the inquiry. For example, at the hearings, APSA commented that:

> Lines seem to believe that they can just impose a surcharge. The outwards terminal handling charge is a good example, which came in in June 2000. We had 10 of our members sit down with them; they kept stating our opposition to them. The minister's

> representative was there and, no matter what we said, they were imposed a couple of months later. (trans., p. 65)

And in a later submission that:

> The concern of APSA for many years has been that the representatives of shipping lines that attend negotiations do not have the power to make decisions on behalf of their Conference. (sub. DR11, p. 6)

The requirements of Part X and the practical experience of 'negotiations' between carriers and designated shipper bodies indicate that shippers collectively have limited influence over the level of shipping services provided to Australia. This appears to be largely driven by the commercial decisions of carriers in response to their assessment of the market — a desirable outcome in markets not characterised by market power. The contact between carriers and designated shipper bodies would be better described as 'consultations' rather than 'negotiations' with the implication of an agreed, commercial outcome that this latter term implies. Such consultations can, nevertheless serve a useful purpose in maintaining information links between carriers and shipper bodies.

While collective consultations can serve a useful, if limited, role in the presence of collusive market arrangements, the provision of immunity for shippers to participate in such activity is not dependent on Part X. They are also eligible to seek authorisation for such collective action under Part VII of the TPA.

FINDING 5.4

The negotiations with shipper bodies during the operation of an agreement required under Part X appear to have minimal impact on the service offered to Australia and on the commercial decisions of carriers. They can more accurately be described as 'consultations'.

5.6 Designated shipper bodies

As outlined above, designated shipper bodies are exempt from key provisions of Part IV of the Act to enable them to negotiate collectively without first seeking authorisation under Part VII.

There are two designated peak shipper bodies — the Australian Peak Shippers Association (APSA) representing exporters, and the Importers Association of Australia (IAA) representing importers. There are 13 designated secondary shipper bodies:

- Australian Dried Fruit Shippers Association;

- Australian Federation of International Forwarders (AFIF);
- Australian Horticultural Exporters Committee (Australian Horticultural Exporters Association);
- Australian International Movers Association;
- Australian Malt Exporters Committee (Shipping);
- Australian Onion Industry Association;
- Australian Prawn Promotion Association;
- Dairy Industry Shippers Association;
- Federated Chamber of Automotive Industries (FCAI);
- Meat Industry Shippers Association;
- South Australian Shipping Users Group (SASUG);
- Western Australian Shippers Council Inc; and
- Wool Industry Shippers Group.

SASUG, AFIF and FCAI have been designated in respect of both outwards and inwards shipping — the others, for outwards shipping only. Other shipper bodies, such as the Australian Cotton Shippers' Association, have not been designated, but conduct negotiations using powers delegated by APSA to certain of its members (DTRS sub. 9, p. 8).

The exemption for designated shipper bodies to negotiate collectively, together with mandated requirement to negotiate, are based on the presumption that it provides some countervailing power to Australian shippers in their dealings with the members of a conference agreement, thereby limiting 'conference' carriers' ability to exploit any additional market power that Part X may give them (DTRS 2001, p. 6). APSA acknowledged that the conference system confers considerable power on the carriers, saying:

> On the other hand, the carriers have considerable power through their conference arrangements, which have enabled them to develop an international overview of shipping arrangements and is the means by which they coordinate their conduct in dealing with Australian shippers. In other words, the carriers are in a powerful position and with this in mind the imbalance in their favour needs to be addressed towards a more balanced position. (trans., p. 55)

The position of the smaller shippers was the particular focus of argument, with APSA saying:

> We have the powers to negotiate the tariff rates which are the ceiling rates, which are not as important as they were, because in a lot of trades these days the market rates rule the day, but they still provide a ceiling for those very small shippers who wouldn't

> know where to start if they had to ship some goods and go along to a shipping line agent and say, "What's the price to Hong Kong?" They now have the tariff, which is a guide for them. Without any of those guides, heaven knows what might happen in the way of rates to some of these smaller shippers. (trans., p. 63)

Designated secondary shipper bodies undertake more focused negotiations than the peak bodies, but are less involved in the area of price, in many cases leaving this to the individual shippers (Australian Meat Industry Council, sub. DR24, p. 1; Tasmanian Freight Logistics Council, trans., p. 51).

There is a widespread view that the negotiating position of designated shipper bodies, particularly the secondary shipper bodies, has become considerably more difficult with the rise of Discussion Agreements. The Australian Horticultural Exporters Association said:.

> Once discussion groups came into existence and started to exert their influence the competition between conferences was reduced and increasingly negotiations between conferences and designated shipper bodies became a rubber stamp for the discussion agreements. There was then increasingly less evidence that conference members were breaking ranks and competing in the open market with lower freight rates to attract additional business as had been the experience for many years in the past. (sub. DR8, p. 13)

They also said that that their ability to go to another carrier to ask for particular conditions is limited:

> No, we can’t, [go to another carrier and ask for a fixed price] because of the discussion groups; there’s conference and non-conference combined. It becomes a little bit anticompetitive in that light.
>
> If one of the lines has given us a slightly better deal, in terms of something free or dropping a documentation fee, and you tell another line that that line has in fact done that, then they are berated at the next meeting. They ring you up and say, “Look, we’ve given you something, tried to help you out and we've got to withdraw it because it has been made public”. (trans., p. 108)

Despite these problems, the secondary shipper bodies argued strongly for the continuation of their right to negotiate collectively with carriers, and for the obligation that Part X places on carriers to enter into such negotiations if requested.

Even in the absence of any effective countervailing power, the secondary shipper bodies do provide useful services to members in coordinating negotiations for their small and medium size members and maintaining a useful flow of information for shippers. The question, however, is whether such services could only be provided by way of the designated shipper bodies, or whether there are market mechanisms and service providers who would do so in their absence.

In a market situation, small to medium shippers members would approach a freight forwarder to do this work (gather information and negotiate scheduling and rates). The Tasmanian Freight Logistics Council commented that this occurred in relation to exports from that State, whereby forwarders and brokers arrange for the entire shipment to destination on behalf of the exporter (including transhipment via Singapore) and negotiate rates with the carriers. Similarly, the Australian Federation of International Forwarders said that:

> … we see our industry as a "buffer" for smaller shippers to gain better price stability by utilisation of the service contracts for the freight forwarders. (sub. DR22, p. 1)

Indeed, it would be reasonable to expect that freight forwarders would have a strong incentive to be informed, provide a good service to shippers and seek out the best rates available because their livelihood depends on it. Moreover, they may have more effective bargaining (countervailing) power than a designated shipper body because they would have contracts with shippers and can realistically threaten to move cargo between carriers. Designated shipper bodies have no such control over cargo.

Were industry bodies to be dissatisfied by the services offered by freight forwarders, the option is still open to them to seek authorisation for collective negotiations with carriers under the existing mechanisms contained in Part VII of the TPA.

5.7 Review and enforcement

Registration may be cancelled (and the exemptions withdrawn) at the direction of the Minister, if the Minister is satisfied that the parties have not met their obligations under the Act (s. 10.45). An agreement may be cancelled in part (particular provisions) or in full, or the registration may be withdrawn in relation to an individual party to the agreement (s. 10.44). Such action would render the parties to that agreement liable to all provisions of the TPA, and thus open to prosecution if they continued to act in ways that would be in breach of the restrictive trade practices provisions of the Act. The Department of Transport and Regional Services noted that 'Deregistration by the Minister has not yet been found necessary, and in only one case has the threat of deregistration been necessary to achieve a settlement' (sub. 9, p. 9).

The Minister may direct the Registrar to cancel the registration of a conference agreement when the Minister is satisfied that one or more of the following matters applies (s. 10.45):

- an outwards agreement does not provide for the application of Australian law or does not provide for reasonable withdrawal of parties to the agreement;
- minimum levels of shipping services are not specified in the agreement (except for inwards agreements already in existence at the time the 2000 amendments were introduced);
- an agreement does not comply with the requirement that only certain restrictive trade practices may be included in agreements (except for existing inwards agreements);
- parties to the agreement do not negotiate with a designated shipper body when reasonably requested to do so;
- parties fail to notify the Registrar of events, or of any agreement with other ocean carriers, affecting the operation of a registered conference agreement;
- parties do not apply to register any variation to the agreement;
- an agreement is not implemented in a way that had due regard for the need for services to be;
  - (a) efficient and economical; and
  - (b) provided at the capacity and frequency required by shippers;
- parties to an outwards agreement hinder an Australian flag shipping operator;
- final registration of the agreement was based on false or misleading information; or
- parties to the agreement breach an undertaking given to the Minister.

Following the 2000 amendments to Part X of the TPA, there are two further grounds on which the Minster may direct the Register to deregister a conference agreement. These are where:

- an agreement substantially lessens competition without benefit to the public, and there are exceptional circumstances that warrant the Minister giving such a direction (s. 10.45 (3)); and
- parties to an agreement unreasonably prevent the entry of a new party to the agreement (s. 10.45 (4)).

Other than in special circumstances (s. 10.45(1)(c)(ii)), procedures for deregistration would only begin after the Minister receives a report from the ACCC in relation to an agreement. An ACCC investigation may occur after referral by the Minister to the ACCC of a complaint by a person affected by the agreement, or after such a person complains directly to the ACCC.

Following the 2000 amendments, the ACCC has been given the power to initiate an inquiry but, in such a situation, the ACCC may only do so in relation to the additional grounds for deregistration introduced in 2000 (s. 10.48(2A)). The first of these additional grounds (s. 10.45(1)(a)(viii)) requires that the ACCC demonstrate that there are exceptional circumstances before it can recommend deregistration, and that the agreements substantially lessens competition without benefit to the public (s. 10.45(3)).

Exceptional circumstances are not specified in the TPA, but in the second reading speech to the Bill introducing the legislation, the Minister stated that examples of exceptional circumstances include where:

- an agreement has the effect of giving its parties a substantial degree of market power;
- the conduct of the parties to the agreement has led to or is likely to lead to an unreasonable increase in freight rates or an unreasonable reduction in services;
- an agreement covers a substantial majority of shipping lines and capacity in a trade; and
- the anti-competitive detriment of the agreement outweighs the benefit to shippers flowing from the agreement (ACCC 2001, p. 9).

Exceptional circumstances will also be taken to apply where the agreement in question is substantially similar to one that has previously been deregistered pursuant to section 10.44 of Part X (DTRS 2001, p. 14).

The second of these additional grounds (s. 10.45(1)(a)(ix)) relates to reviews into whether the parties to an agreement unreasonably prevent the entry of a prospective party to the agreement (s. 10.45(4)).

Undertakings

The deregistration of an agreement is at the discretion of the Minister, irrespective of the findings of an ACCC investigation. Section 10.44 only says that the Minister *may* direct the registrar to cancel the registration of a conference agreement. In addition, before directing the Registrar to cancel the registration of an agreement, the Minister must first consult (or attempt to consult) with the parties to the agreement to determine if any action or undertaking by them would make cancellation unnecessary. Such undertakings are enforceable in court (s. 10.49A), and breaches of undertakings are grounds for deregistration of the agreement.

While no agreement has been deregistered, undertakings have been accepted. The Department noted in relation to undertakings that, '… the Minister accepted

undertakings in 2 of the 5 cases of TPC/ACCC investigation and report that have been necessary since 1989' (sub. DR18, p. 20).

Essentially, this means that parties to a registered agreement can avoid penalty for any past behaviour by giving an undertaking not to engage in that behaviour in the future.

Review of decisions

Various decisions taken by the Registrar, the ACCC or the Minister are reviewable.

Persons may apply to the Administrative Appeals Tribunal for a review of any decision of the Registrar (s. 10.84) other than:

- a decision to provisionally or finally register a conference agreement; or
- a decision as to the form of a register.

A designated shipper body or a person whose interests are affected by a reviewable decision made by the ACCC may apply to the Australian Competition Tribunal for a review of the decision. The Tribunal may affirm, set aside or vary the decision of the ACCC. Reviewable decisions by the ACCC (s. 10.82(A)) are:

- a decision to refuse to hold an investigation; or
- a decision to exclude or refuse to exclude a document; or the particulars of a submission, from the register of ACCC investigations.

A designated shipper body or a person whose interests are affected by a reviewable decision made by the Minister may apply to the Australian Competition Tribunal for a review of the decision (Division 14B). The Tribunal may affirm, set aside or vary the decision of the Minister. A reviewable decision by the Minister may involve a decision to:

- give or refuse to give a direction to the Registrar or the ACCC;
- accept an offer or refuse to accept an offer by ocean carriers;
- revoke a reference or refuse to revoke a reference to the ACCC;
- revoke or refuse to revoke a direction to the ACCC;
- make or refuse to make an order in relation to an ocean carrier; or
- revoke an order or refuse to revoke an order in relation to an ocean carrier.

FINDING 5.5

Deregistration is the penalty that applies for all breaches, from minor procedural failures , to major anticompetitive behaviour. The requirement to seek undertakings before deregistration can occur allows carriers to avoid penalty under Part X .

Chapter 7 evaluates Part X based on National Competition Policy guidelines, in particular the rationale for Part X, and whether Part X, as currently structured, is necessary to achieve the objectives. Chapter 9 looks at a range of options to modify Part X, while Appendix F presents a range of other proposals put forward by participants for change. Chapter 10 evaluates the review and enforcement provisions under Part X and presents some recommendations aimed at improving their effectiveness.

6 International regulation of liner cargo shipping

Different countries provide differing levels of immunity to carrier agreements from competition laws. Europe favours distinguishing between the various types of agreements. The United States, like Australia, applies the same obligations to all forms of agreement. Both Europe and the United States provide for, and protect, confidential individual service contracts. Australia does not provide specific legislative protection for the confidentiality of these contracts. Australia is one of the few jurisdictions which allows Ministerial discretion in the application of its regulatory regime. Since 1999, there have been moves in Europe and the United States towards promoting greater competition in the regulation of carrier agreements. The OECD recently suggested the use of three principles to help guide member countries in reviewing current legislation, including the use of confidential individual contracts. The European Commission is currently in the process of reviewing its block exemption for conferences, having formally extended its block exemption for consortium agreements. While specific changes have not been released, the European Commission concluded that the block exemption for conferences was no longer justified under EU law.

The international nature of the liner shipping industry means that carriers and shippers can be affected by the regulations of several different nations. This chapter outlines the application of competition laws to the liner cargo shipping industry by the major trading partners of Australia. While most jurisdictions have an exemption allowing for carrier collaboration in the provision of liner cargo shipping services, the precise nature of the arrangements differs significantly between jurisdictions.

The first two sections outline the current regulation operating within Australia's major trade partners and highlights the main differences in the arrangements of the United States and European Union (EU) from the Australian approach. The remainder of the chapter outlines recent developments in the regulations of the two major jurisdictions (the United States and the EU) which influence the industry worldwide.

6.1 Outline of current regulations in major trading partners

In recent years, there have been several significant international developments in competition policy as it relates to liner shipping. In the main, these changes — which include greater public availability of conference tariffs and increased freedom for conference members to negotiate individual service contracts with shippers — have been designed to increase competition in liner shipping. This section outlines the current application of competition laws to liner shipping within the United States, the EU, New Zealand, Japan, China and the Republic of Korea. Other major trading hubs, such as Singapore, Hong Kong and the Philippines, do not regulate liner shipping.

United States

Liner shipping carriers are granted exemptions to the United States' antitrust laws under the Shipping Act of 1984, which was significantly modified by the Ocean Shipping Reform Act of 1998 (OSRA).

The exemptions apply to agreements between carriers which discuss, fix or regulate freight rates, cargo space accommodation and other service conditions; pool revenues, earnings or losses; limit or regulate the amount or type of cargo to be carried; restrict or allocate sailing schedules and ports of call; and engage in preferential or exclusive dealings among members or marine terminal operators. Agreements must be filed with the Federal Maritime Commission (FMC).

Carrier agreements must provide for commercial dispute resolution processes, and consultation and cooperation with shippers. Agreements must allow for reasonable entry and exit of carriers as well as the ability for members to take independent pricing action after five days notice. Agreements must also allow the use of confidential individual service contracts (ISC) between carriers and shippers. Carrier agreements cannot:

- prohibit member carriers from engaging in negotiations for ISCs with one or more shipper;
- require member carriers to disclose negotiations or make public the terms and conditions of such agreements (excluding those publicly listed with the FMC, but including the freight-rate and service commitments); or
- adopt mandatory rules or requirements affecting the right of member carriers to enter into ISCs.

However, carrier agreements are permitted to adopt non-binding voluntary guidelines that relate to the terms and procedures of a member carrier's ISC, providing that such guidance specifically states that carriers have the right not to follow such guidance.

While some elements of the contracts must be filed with the FMC, under section 8 of the Act certain strategic terms must remain confidential. These terms are:

- the freight rate;
- any service commitments;
- the liquidated damages for non-performance, if any; and
- the origin and destination areas in the case of inter-modal movements.

The FMC can, at any time, seek an injunction against a carrier agreement if it finds that the agreement is likely, 'by a reduction in competition, to provide an unreasonable reduction in transportation service or an unreasonable increase in transportation cost' (s. 6(g)). The burden of proof lies with the FMC to establish that the carrier agreement reduces services or increases costs. An injunction has the effect of removing antitrust immunity for the members of the agreement. However, immunity still applies to actions of members prior to the injunction. Violations of the procedural aspects of the Shipping Act of 1984 can attract a fine not exceeding US$5000, unless it is a wilful breach, in which case the fine cannot exceed US$25 000. Every day of the violation is a separate offence (Brooks 2000a, p. 238).

Canada

The Shipping Conference Exemption Act exempts inbound and outbound liner conferences from certain aspects of Canadian antitrust legislation. The exemptions are broadly similar to the provisions in the United States, but Canada imposes 'fewer administrative burdens on conference carriers' (Shipping Australia, sub. 16, p. 65).

Following a review in 1999, the Canadian Government introduced measures similar to those adopted in the United States' OSRA. In November 2001, the Shipping Conferences Exemption Act was amended to allow individual conference members to negotiate confidential service contracts directly with shippers. The amendments also reduced the amount of notice that conference members are required to give before undertaking independent action. Conference freight rates are no longer required to be filed with the Canadian Transportation Authority, but must be made available to shippers and other interested parties in an electronic form. The fine for non-compliance with the Act increased from C$1000 to C$10 000 per day.

The European Union

Under Article 81[1] of the European Community Treaty, restrictive agreements and practices in general are prohibited, but exemptions are allowed — either on an individual or a block basis — under strictly defined conditions. Conference and consortium agreements, in relation to liner shipping, are exempted under different regulations. However, these agreements are not exempted from Article 82, which relates to abuse of a dominant position[2].

Conference block exemption

Agreements between carriers are exempted from Article 81 of the European Community Treaty by way of a block exemption[3] applying to conferences (Regulation 4056/86) and individual exemptions modelled on the 'revised Trans-Atlantic Conference Agreement' (TACA) decision (2003 OJ L 26; see also Monti 2003, p. 4). The block exemption covers the price fixing activities of liner conferences for an indefinite period.

Conferences cannot discriminate between ports or transport users. Conferences must also apply a uniform and common tariff rate for all goods carried (for rates not determined under an ISC). Any capacity regulation programs under which a coordinated capacity withdrawal is undertaken only in circumstances where they are needed to address short-term fluctuations in demand.

The European Commission (EC) also requires that conferences do not include:

- a prohibition on ISCs;
- restrictions, either binding or non-binding, on the contents of such contracts;
- a prohibition of independent action on joint service contracts; and
- the terms of ISCs are to remain confidential, except where the shipper consents to such disclosure.

Conferences can only provide voluntary guidelines dealing with technical and non-commercial matters. Guidance cannot be provided on the actual terms of the contract.

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[1] Article 81 is similar to s. 45 of the TPA.

[2] This is similar to s. 46 of the TPA.

[3] The block exemption only applies to agreements which *do not* allow individual service contracts between shippers and member carriers. That is, conferences which mandate and enforce all goods are carried under the common conference tariff rate. Agreements which do not qualify generally receive individual authorisation in line with the TACA decision.

Conferences must also provide for: consultation between the conference and shippers concerning rates, conditions and quality of service; loyalty arrangements; services other than those covered by the freight charges; availability of tariffs; and notification to the Commission of awards at arbitration and of recommendations made by conciliators (Gardner 1997, p. 318).

Consortia block exemption

The second block exemption applying to liner cargo carriers is provided for in Regulation 823/2000 concerning consortia. A consortium agreement is defined as a cooperative agreement, which aims to improve the services that would be offered individually, by allowing member services to be rationalised by way of technical operation and/or commercial arrangement, with the exception of price fixing. Examples include: provision of joint services through coordination of timetables, exchange and sale of space on vessels and pooling of vessel and port facilities. The block exemption continues for five years before it is reviewed. At every review, it is up to the carriers and shippers supporting the exemption to demonstrate it still provides a net benefit.

The exemption applies automatically to consortia with market shares not exceeding 35 per cent or, if the consortium operates within a liner conference, 30 per cent. For consortia with a market share above this, but below 50 per cent, an opposition procedure is provided for in the Regulation. In such a case, the EC can disallow the agreement up to six months after notification. If the market share is greater than 50 per cent, consortia need to seek an individual exemption.

In addition to the ban on price fixing, consortia must not seek to freeze capacity utilisation. Members must also be allowed to offer individual service arrangements and be free to leave the agreement without penalty on reasonable notice. Further, the exemption is dependent on one or more of the following conditions being fulfilled: that consortia operating within a conference are allowed to compete with the other conference members on freight rates or services; or that consortium members are subject to effective competition from non-consortium lines.

Carrier agreements that are not covered by a block exemption or an individual exemption are subject to the general penalty provisions for breaches of competition laws (that is, carriers could be liable for fines of up to 10 per cent of turnover in the previous year if they breach the EC's competition laws)[4]. For example, in 1998, the

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[4] Examples of such cases include the TAA case [Commission decision of 19 October 1994 in Case No IV/34.446 – *Trans-Atlantic Agreement* (OL J 376, 31.12.1994)]; the FEFC case [Commission decision of 21 December 1994 in Case No IV/33.218 – *Far Eastern Freight Conference* (OL J 378, 31.12.1994)]; the TACA case [Commission decision of 16 September 1998 in Case No

EC fined the 15 member carriers of TACA a total of €273 million for inland price fixing, the fixing of brokerage and freight-forwarder remuneration, and collusion and abuse concerning the terms and availability of ISCs (Pons 2000).

New Zealand

New Zealand's Shipping Act 1987 states that Part II (restrictive trade practices) and Part IV (control of prices) of the Commerce Act 1986 (equivalent to Australia's TPA) does not apply to outward shipping. New Zealand does not require the registration of carrier agreements or the filing of a tariff rate. There is no regulation of entry or exit into agreements, loyalty agreements, discussion agreements or ISCs (DTRS, sub. 9, p. 24).

The Minister of Transport may initiate investigations and provide directions to carriers if they have conducted any unfair practices and the Minister is satisfied that such behaviour will disadvantage any New Zealand shipper. Carriers can be directed to provide details of an agreement, give reasonable notice to New Zealand shippers, or provide evidence that a carrier has entered into reasonable negotiations with shippers (DTRS, sub. 9, p. 24).

Japan

The Japanese Marine Transportation Law exempts conferences and other agreements between carriers from the general provisions of the Anti-Monopoly Law (similar to the approach by the United States' Shipping Act). In order to 'further promote fair and free competition among carriers as well as to secure a stable supply of ocean going shipping services', the Japanese Government amended the application of competition laws to liner shipping in June 1999. Under the Marine Transportation Law (Article 28), registered agreements are exempt from Japan's anticompetitive laws except where:

- unfair trade practices are used; or
- users' interests are unduly impaired by practically restricting competition in certain fields of trade.

Conference agreements have to be filed in advance with the Ministry of Land, Infrastructure and Transport, which notifies the Fair Trade Commission. The

IV/35.134 – *Trans-Atlantic Conference Agreement* (OL J 95, 9.4.1999)]; and the EATA case [Commission decision of 30 April 1999 in Case No IV/34.250 – *Europe-Asia Trades Agreements* (OL J 193, 26.7.1999)].

Minister may not grant approval to an agreement unless it meets the following criteria:

- users' interests are not unduly impaired;
- no undue discrimination arises;
- participation in, or withdrawal from, the agreement is not unduly restricted; and
- contents of the agreement are at the minimum level judging from the purpose of the agreement.

The Ministry may issue orders to revise or abolish individual agreements that do not meet these criteria. Outward conferences must include details of freight rate tariffs (DTRS, sub. 9, p. 23). Carriers which fail to obey orders to amend agreements could face a fine of up to ¥1 million.

People's Republic of China

China's Regulations on International Marine Transportation impose requirements on carriers engaged in trade through Chinese ports. The freight rates for both carriers and freight forwarders need to be registered with the Ministry of Communications. Freight rates include both the published tariff rate and the actual negotiated tariff rate. Copies of both inward and outward agreements also need to be supplied to the Ministry, within 15 days. There is no requirement to include minimum service levels.

Article 27 of the Regulations specifically bans any carrier or freight forwarder from conducting the following acts:

- providing service at lower freight rates than normal and reasonable;
- offering secret rebates to shippers;
- arbitrarily taking advantage of a dominant position to impose discriminatory freight rates or other restrictive terms; or
- committing any other acts that are detrimental to other parties or to the order of international liner shipping (Shipping Australia, sub. 16, pp. 69–70).

The Republic of Korea

Korea's Maritime Law grants a block exemption to conference agreements which have been notified to the Korean Maritime and Port Administration, subject to conditions regarding unfair provisions and hindering Korean shipping. The

government may take action to suspend agreements or alter offending provisions (DTRS, sub. 9, pp. 23–4).

In an attempt to encourage greater independence in rate setting by individual carriers, the Korean Government amended the Maritime Transport Act in 1999. Shippers and carriers are allowed to exchange information and discuss service arrangements, but can no longer discuss freight rates. Only freight rates for major commodities are required to be published and the carrier is not required to update its published rate information unless the tariff changes by more than 20 per cent.

6.2 Differences between Australian and major international conference regulations

The regulatory regimes of the United States and the EU exert a major influence on the international liner cargo industry due to their effects on the major east–west trade routes. These regulations also influence the behaviour of carriers worldwide as many carriers operate on several routes around the world.

Regulation of agreements

The regulation of carrier agreements under Part X of the TPA imposes the same obligations and protections on all forms of agreements. This is broadly similar to the approach in the United States (although different obligations are imposed) but is markedly different from the position of the EU.

The EU only grants exemptions to strictly defined conferences or consortia. For example, the EU exemption permits conferences to engage in behaviour which restricts competition (similar to Part X). However, because the exemption is for 'hard-core' anticompetitive behaviour, it has been interpreted very narrowly by the European courts[5]. Agreements (or parts thereof) that do not fall within the exemption could be granted individual exemptions under certain circumstances.

The European system also differs from both the Australian and United States systems by providing a separate block exemption for consortia. Immunity under the block exemption is dependent on the level of market share covered by a consortium's individual members. The exemption either applies automatically upon notification, can be disallowed by the EC up to six months after notification, or consortia have to rely on an individual exemption.

[5] See the TAA, FEFC and TACA decisions.

Discussion agreements

As a result of using type-specific exemptions for conferences and consortia, discussion agreements are not exempted from European competition laws. The European view is reflected in the following quote:

> The Commission has generally objected to discussion agreements under EC competition law because by grouping together conferences and their main competitors, they tend to the elimination of effective competition on the trade in which they operate. Moreover the Commission has at this stage not received any information as to which benefits discussion agreements can pass on to the consumers. (ECDG 2004a, p. 29)

The regulation in the United States also differs from Part X — specifically on the use of individual service contracts and the ability for agreements to provide guidelines on such contracts. As a result, conference-type agreements do not use the published tariff rate but rather individual contracts. With the published rate being little more than guidance, discussion agreements, where allowed, have replaced conferences on United States routes.

FINDING 6.1

Part X of the TPA and the United States' Shipping Act make no distinction between different types of agreements, but the United States regulations now promote and protect individual service contracts. The European system is more restrictive, especially in not allowing discussion agreements.

Enforcement and penalties

The administration and enforcement of the immunity from competition laws differs between the United States, Europe and Australia. The penalties provisions also differ between each jurisdiction. However, all jurisdictions include the power to remove the immunity granted to agreements.

In the EC, the Competition Directorate (DG IV), which administers and enforces the competition laws, is responsible for granting exemptions for liner shipping. By comparison, under the Australian system, the exemptions for liner shipping contained are within Part X the TPA and the Department of Transport and Regional Services administers and enforces them — the ACCC only has an advisory and investigative role. Similarly, in the United States, the FMC administers and enforces the exemptions rather than the Department of Justice (which administers the United States antitrust laws).

Australia also differs from both the United States and Europe through the use of Ministerial discretion in deciding whether to deregister a conference agreement

which has been found to have breached Part X. In both the EU and the United States, it is an independent body (DG IV and the FMC, respectively) that determines whether breaches have occurred, and whether to pursue penalties. However, all three jurisdictions allow for judicial review and/or judicial determination of whether the obligations imposed on carrier agreements have been breached and, if so, the level of penalties.

In all three jurisdictions, the ultimate penalty applicable to exempted carrier agreements is deregistration. After deregistration, the agreement is subject to full enforcement of each jurisdiction's competition laws. No registered agreement has been deregistered in Australia, and the Commission is aware of only a few European cases where carrier agreements have been subjected to general competition laws. For example, European courts found that the Trans-Atlantic Conference Agreement was not covered by the EU block exemption and was fined €273 million for price and supply fixing (see above).

The United States regulation differs slightly from Part X to the extent that the FMC is able to impose fines for carrier agreements which do not comply with the administrative requirements imposed under its Shipping Act. Under Part X, the Minister can request undertakings under certain circumstances, but if these are not complied with, the Minister can only resort to deregistration. There are no provisions in the Australian regime to impose fines for procedural breaches.

FINDING 6.2

Australia differs from both Europe and the United States in allowing Ministerial discretion in the decision to impose penalties on carrier agreements. The regulation in the United States also provides for financial penalties to be imposed for procedural breaches, whereas Part X contains no such provisions.

International conflict of laws

An often used argument for the retention of Australia's Part X regime is that it is consistent with other international regimes, hence any conflict of laws is avoided. This was raised in the Productivity Commission's 1999 review of Part X and has also been raised in submissions to this inquiry.

However, international laws only conflict where one jurisdiction demands certain behaviour which another expressly forbids. The OECD Maritime Transport Committee considered that:

> … a conflict of law occurs when a particular agreement or particular conduct is required by one competition regime and is at the same time prohibited by another competition regime. (OECD 1998)

For example, there would be a conflict of laws between the United States and Australia if Australia banned conferences but the United States demanded that all carriers be members of a conference. This is not the case with respect to the removal of immunity from competition laws. Jurisdictions either exempt conferences from their competition regulations or they do not — no jurisdiction requires that carriers engage in anticompetitive behaviour.

The EC also commented that:

> No country with jurisdiction over liner conferences operating to or from the EU actually requires those lines to engage in horizontal price fixing and capacity regulation and it is not likely that any jurisdiction ever will. The removal of EU authorisation to engage in those activities would therefore not create a conflict of laws … (ECDG 2004a, p. 37)

Professor Crawford (providing advice to Shipping Australia) criticised such a view, stating that it is:

> … a narrow and formalistic view of what amounts to a conflict of laws or regulations. If Asia, Australasia and North America maintain their existing positions—for example on discussion of forward rates—there would be a practical conflict: EU law would prohibit in its inward trades what the law of the exporting State specifically permits and envisages in its export trade. (sub. 16, p. 122)

However, 'practical' conflicts between liner shipping antitrust-exemption laws have been occurring between jurisdictions for some time, without significant detrimental effects upon the industry. Such conflicts are seen on the Australian–European route where discussion agreements are not used, or on Australia–United States routes where confidentiality is enforced on ISCs. In both cases, Australian law (being the more permissive) is usurped by the more 'demanding' jurisdiction. Conflicting laws become problematic where they are mutually exclusive of one another — that is, the adherence to the laws in one jurisdiction leads to the breaching of laws in the other jurisdiction. Where this does not occur, the need to adhere to different (or more rigorous) laws in a foreign jurisdiction is an added cost of transacting with that foreign jurisdiction (akin to the need to obey different labelling laws).

FINDING 6.3

The removal of immunities from national competition laws for the liner cargo shipping industry should not give rise to a conflict in laws as no jurisdiction actually requires that carriers engage in anticompetitive behaviour.

However, differences in the immunities from competition laws would involve carriers incurring additional compliance costs where they wish to exploit the full range of immunities provided by different countries.

6.3 Recent trend towards greater competition

The above sections outlined the current regulation of liner conferences by Australia's main trade partners and the main differences between the Australian regulation and those of the jurisdictions that most influence the global behaviour of conferences — Europe and the United States.

Within these two jurisdictions, there has also been a recent trend away from blanket protection of conferences towards encouraging the adoption of pro-market behaviour within the industry. This has been achieved through the OSRA and the 'revised TACA' decision which forced conferences to allow the use of confidential ISCs between carriers and shippers. These two reforms are outlined below.

Ocean Shipping Reform Act of 1998

In 1999, the Ocean Shipping Reform Act (OSRA) came into force and facilitated the use of ISCs between carriers and shippers. OSRA provided for increased confidentiality in negotiations between individual carriers and shippers and removed direct penalties for conference members who enter into ISCs. It also removed the requirement that contracted freight rates be made publicly available and removed the right of similarly situated shippers to be given the same essential contract terms (the 'me-too' clause). In addition to negotiating contracts individually, or through associations, shippers were also given the right to enter into contracts through a group of unrelated shippers. Contracts may now be negotiated for a percentage of a shipper's cargo instead of a fixed quantity. The authority to offer joint service contracts was also extended to any agreement among carriers, not simply conferences.

The impact of OSRA has resulted in a shift away from conference carriage on United States routes towards carriage under ISCs:

> The marked shift towards contract carriage and the increase in individual service contracting resulting from the OSRA reforms has been a significant factor in altering the structure of the liner industry in US trades, as it has led to the termination or suspension of major conference agreements in many trades. This is because where only a small volume of cargo in a trade moves under tariff rates or conference service contracts, there is little incentive for carriers to belong to a conference if a discussion agreement that covers the trade exists or could be established. (Gardner et al. 2002, p. 338)

In evaluating the reforms, the FMC concluded:

The major regulatory changes made by OSRA were aimed at promoting a more market-driven, efficient liner shipping industry. After two years of operation under this statute, indications are that it generally is achieving this objective.

Numerous pro-competitive reforms enacted under OSRA to increase industry market responsiveness focused on service contracting. The ability to deal with individual carriers, the elimination of the 'me-too' requirement for similarly situated shippers, and the confidentiality of certain commercially sensitive contract terms have fostered a shift to contract carriage — carriers generally report that 80 per cent or more of their liner cargo currently moves under service contracts … Most shippers presently are negotiating one-on-one with individual carriers, instead of negotiating with rate-setting conferences or groups of carriers.

The emergence of global markets, the improved service of non-conference carriers, and the deregulatory nature of OSRA are catalysts that have contributed to the restructuring of the liner shipping industry. This has led to a de-emphasis of traditional conferences and a dramatic increase in efficiency-enhancing operational types of agreements, such as vessel-sharing and space charters. (FMC 2001, p. 2)

Similarly, Stewart et al., through interviews and surveys with shippers, found that the main implications of the OSRA were:

- Carriers and shippers are increasing their use of private contracts. Although such contracts were not uncommon prior to OSRA, they are playing a greater role in current regulatory regime.
- While carriers always charged lower rates for large-volume, recurrent-service freight, OSRA has increased the incentives for carriers to negotiate such pricing schemes since annual (long-term), large-volume contracts have become vital to carrier profitability.
- Collusive agreements among carriers have ceased to be significant determinants of rates. Carriers may still collude in the current regime but lack significant incentives to stick to the agreements. Consequently, carriers rely more on contracts to set rates than on collusive agreements.
- Small and medium-sized shippers can obtain lower rates to the extent that they effectively use third party agents like freight forwarders, non-vessel operating common carriers, and shippers' associations. (2003, p. 207)

The 'revised Trans-Atlantic Conference Agreement' decision

The scope of the conference block exemption (Regulation 4056/86) has been the subject of several confrontations between the EC and conferences. Between 1994 and 1998, there were several cases where the EC sought to limit the application of the block exemption. The EC objected to the collective fixing of tariffs for the inland leg of multimodal transport operations, attempts to limit the availability to shippers of individual and confidential service contracts, and to capacity freezes with the obvious purpose of increasing freight rates by limiting supply.

Following these confrontations, conferences and the EC entered into discussions with a view to ending the cycle of litigation and establishing a consensus on the way forward. These talks resulted in the revised TACA decision requiring conferences to:

- refrain from inland price fixing;
- place no restrictions on member carriers to enter into confidential ISCs with shippers, including: a prohibition on ISCs; restrictions (either binding or non-binding) on the contents of such contracts; a prohibition of independent action on joint service contracts; and the terms of the contract are to remain confidential, except where the shipper consents to such disclosure; and
- only regulate available capacity where it is necessary in order to adapt to a short-term fluctuation of demand without combining it with rate increases.

The European Commission is of the view that:

> … [the] features of the Revised TACA are unequivocally pro-competitive and, as complemented by the guidance provided by the European Court of First Instance, *should be immediately emulated by all conferences operating on EU liner shipping trades*. (Benini 2003, pp. 5–6) [emphasis in original]

FINDING 6.4

In recent years, both the United States and European Union have introduced greater competition within the regulation of the liner cargo shipping industry, including the use of confidential individual service contracts between shippers and carriers.

6.4 Recent regulatory reviews

Since the 1999 Productivity Commission report on Part X, there have been two major reviews of the treatment of liner conferences by the OECD and the EC. The EC review, if adopted, would remove the block exemption for conferences. The OECD recommended ways to liberalise the sector by acknowledging common ground between shippers and carriers.

The OECD

In April 2002, the OECD released its final report on *Competition Policy in Liner Shipping* (OECD 2002). The report examined:

- the positive and negative impacts on both carriers and shippers of uniform freight rates under antitrust exemptions;

- the impact of various forms of carrier cooperation on both carriers and shippers; and
- the possible effects resulting from the removal of antitrust exemptions.

The OECD concluded that it 'had not found convincing evidence that the practice of discussing and/or fixing rates and surcharges among competing carriers offers more benefits than costs to shippers and consumers' (2002, p. 2). It recommended that limited antitrust immunity not be allowed to cover price fixing and rate discussions. It also considered that capacity agreements should be carefully scrutinised to ensure that they do not distort the markets in which they are present.

The OECD recognised the high degree of polarisation in the longstanding debate on these issues. However, it also proposed three principles, based on elements which had received support from both carriers and shippers. The OECD recommended that member countries could use these principles to guide further reassessments of the validity of antitrust immunity for price fixing, rate discussions and capacity agreements between competitors in the liner shipping sector.

These principles are:

- *freedom to negotiate* — shippers and ocean carriers should always have the option of freely negotiating rates, surcharges and other terms of carriage on an individual and confidential basis;
- *freedom to protect contracts* — shippers and ocean carriers should always be able to protect contractually key terms of negotiated service contracts, including information regarding rates, and this confidentiality should be given maximum protection; and
- *freedom to coordinate operations* — ocean carriers should be able to pursue operational and/or capacity agreements with other carriers as long as those do not confer undue market power to the parties involved (OECD 2002, pp. 77–80).

European Commission's current review of the conference block exemption

The EC is currently reviewing its block exemption for liner cargo shipping conferences (Regulation 4056/86). The EC released, in early 2004, a Discussion Paper which was informed by consultations with interested parties. In October 2004, the EC released its White Paper on the review of Regulation 4056/86. The paper came to the conclusion that there were no valid justifications for the continuation of the block exemption, as it did not meet the conditions set out under the Treaty of Rome for the granting of a block exemption.

In order to grant a block exemption for an agreement, it must be shown that the agreement meets four requirements (this is required by Article 81(3) of the Treaty of Rome). These requirements are that the agreement results in economic efficiencies; consumer benefits; is indispensable (that is, cannot be achieved through other means); and is still subject to effective competitive constraints.

The EC rejected the claim that the block exemption results in economic efficiencies. It stated in the White Paper that it is doubtful that the 'provision of reliable services result directly from the conference price fixing' (ECDG 2004c, p. 11). The EC also commented that none of the benefits identified by carriers which flow from the exemption appear to negate the negative effects for consumers of conference price fixing. Under Article 81(3), even if consumer benefits outweighed the detriments, the proposed agreement would have to be the only way to achieve the outcome. The EC noted that:

> The alternatives already available on the market [ie consortia, alliance, slot-sharing] show that shipping lines do not need any longer to engage in price-fixing, supply and market regulation to provide reliable shipping services. (ECDG 2004c, p. 13)

On the question of whether the block exemption meets the requirements of Article 81(3) under the current environment, the EC concluded that:

> The four cumulative conditions to justify an exemption for liner conference price fixing, supply and market regulation would appear to be no longer fulfilled. There is no conclusive economic evidence that the assumptions on which the block exemption was justified at the time of its adoption in 1986 are, in the present market circumstances and on the basis of the four cumulative conditions of Article 81(3) of the Treaty, still justified. (ECDG 2004c, p. 13)

The EC analysed the expected impact of removing the block exemption on the liner shipping industry. It concluded that, while some of the effects are hypothetical, it is incorrect to argue that removal of the exemption is a 'leap in the dark', as claimed by certain carriers. The EC stated:

> Although an assessment of the impact of repealing the present block exemption on liner services on trades to and from the EU remains to some extent hypothetical, it would go too far, as some carriers have suggested, to speak in this regard of a "leap in the dark". Economic theory, facts and developments on the liner services market as well as examples from other industries provide sufficient information to weigh the various pros and cons of repealing the block exemption. Also the position of consumers should be taken into account. Shippers, for example, have explicitly stressed that they are willing "to take the risk" of a competitive liner shipping world. Overall, the available evidence shows that, although less efficient carriers are likely to be affected the most, there are no indications that the liner shipping operators on trades to and from the EU, or European carriers as such, will be worse off without price fixing in the long term. (ECDG 2004c, pp. 22–3)

Following the analysis in both its Discussion Paper and White Paper, the EC has proposed to (among other things):

- consider repealing the substantive provisions of Regulation 4056/86, in particular the block exemption for liner conferences and exemption for technical agreements;
- examine what type of instrument would be needed to replace Regulation 4056/86 and make an appropriate proposal in that regard; and
- examine the European Liners Affairs Association (ELAA) proposal for an alternative regulatory system in light of submissions from third parties, as well as any other proposal that might be made by industry or other interested parties (ECDG 2004c, p. 10).

The ELAA-proposed alternative regulatory system, noted above, refers to a proposal presented to the EC in response to its Discussion Paper of early 2004. This proposal would exempt the following types of information exchanges (including discussions) between carriers:

- aggregated capacity utilisation and market size data by trade —historical data with one month's delay prior to release;
- commodity developments by trade — aggregated data with one month's delay prior to release;
- aggregate supply and demand data by trade and commodity, as well as forecast of demands — this information would be published and publicly available;
- price index, differentiated by type of equipment (eg reefer, dry) and/or trade — made publicly available with a quarterly delay; and
- surcharges and ancillary charges based on publicly available and transparent formulae; details of which will be discussed with shippers (ELAA 2004, pp. 3–4).

Shipping Australia (sub. DR4, p. 15) argued that the ELAA proposal is broadly similar to the discussion agreements prevalent on Australian routes. However, there are some important structural differences between the ELAA proposal and discussion agreements. Under the proposal, the information which is to be shared would be provided by individual carriers to a trade-specific industry body or committee. The trade-specific body would aggregate the information so no individual carrier could detect other carriers' data. Importantly, there would be no discussion of individual carriers data during these meetings. The ELAA has also proposed that the trade-specific trade body or committee be subject to EC competition compliance rules (ELAA 2004, pp. 6–11).

7 Evaluation of Part X

This chapter assesses Part X against the analytical framework provided by the Competition Principles Agreement. It reflects the guiding principle that legislation should not restrict competition unless the benefits of the restriction to the community as a whole outweigh the costs and the benefits can only be achieved by restricting competition.

The overriding objective of Part X is to facilitate the efficient provision of liner cargo shipping services for Australian exporters and importers. By providing immunity from key sections of Part IV of the TPA, Part X allows ocean carriers to enter into agreements that potentially restrict competition. It also provides immunity to exporters and importers to negotiate collectively with ocean carriers through designated shipper bodies.

Part X provides all types of carrier agreements with immunity irrespective of the balance of benefits and costs they are likely to provide on a trade route. However, the impacts on ocean carriers, shippers and the Australian community of agreements allowed under Part X depend on the types of agreement registered and the market influence gained on trade routes on which they operate. Generally, public benefits derive from supply-side cost savings that carriers achieve by coordinating their activities, while anticompetitive detriments result from the demand-side ability of carrier agreements to manipulate prices and to control supply on a trade route.

The Commission recommends that a more selective approach to the approval of carrier agreements should be adopted aimed at allowing only those which are likely to provide a net public benefit to Australia.

The analytical framework for evaluating Part X is set out in the next section. This is then followed by sections which individually evaluate each of the first four key areas to be reviewed under that framework, namely: objectives of the legislation; nature of the restriction on competition; effects of the restriction on competition; and balance of benefits and costs. The fifth area, alternative means of achieving the same result, is considered in chapters 8 and 9, which deal with alternatives to Part X and modifications to Part X, respectively.

7.1 Analytical framework

Legislation reviews

The Competition Principles Agreement sets out principles to be followed for reviews of legislation (and associated regulations) (box 7.1). As indicated, reviews are to address five key areas using the guiding principle that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction outweigh the costs, and the objectives can only be achieved by restricting competition.

Box 7.1 **Legislation review principles set out in the Competition Principles Agreement of National Competition Policy**

The governments of Australia have agreed to apply the following principles to their reviews of legislation:

5.(1) The guiding principle is that legislation (including Acts, enactments, Ordinances or regulation) should not restrict competition unless it can be demonstrated that:

(a) the benefits of the restriction to the community as a whole outweigh the costs; and

(b) the objective of the legislation can only be achieved by restricting competition.

…

5.(9) Without limiting the terms of reference of a review, a review should:

(a) clarify the objectives of the legislation;

(b) identify the nature of the restriction on competition;

(c) analyse the likely effect of the restriction on competition and on the economy generally;

(d) assess and balance the costs and benefits of the restriction; and

(e) consider alternative means for achieving the same result including non-legislative approaches.

Source: Competition Policy Reform Act 1995, Competition Principles Agreement.

While restrictions on competition, or in the case of Part X allowing anticompetitive behaviour, may be necessary to achieve certain economic and social objectives, they can also impose costs, reduce choice, and impede innovation and efficiency. Reflecting these potential costs, the guiding principle effectively means that legislative restrictions (or exemption from the general provisions of the TPA in the case of Part X) are to be removed unless the restrictions confer a net benefit on the

Australian community and restricting competition in that particular way is the least-cost way to achieve the objective of the legislation.

As specified in the terms of reference and in keeping with legislation reviews more generally under National Competition Policy, the 'onus of proof' is on those who seek to retain Part X to demonstrate that it is essential to achieve the four principal objectives stated in Part X of the Act (chapter 5 and below).

Notwithstanding this well-established policy and legal framework, Shipping Australia Limited argued '… that it is important that those seeking withdrawal of the exemption have a responsibility to prove that this would result in a net public benefit' (sub. DR4, p. 4). Some support for this view was provided by ACIL Tasman and Thompson Clarke which argued that any cancellation of Part X would be '… proposing an extension of economic regulation (through Part VII authorisations) into an area where it does not now apply … [and that this] … should not be contemplated unless these costs would clearly be outweighed by benefits – and no such benefits are established' (sub. DR9, p. 2). Similar arguments were raised and considered when the existing policy and legal framework for legislation reviews was developed and they do not provide a sound basis for setting that framework aside in this particular case.

In addition to the requirements of the Competition Principles Agreement, the terms of reference specifically ask the Commission '… to have regard to the analytical requirements for regulation assessment by the Commonwealth … as well as recent technological and institutional changes in the international liner shipping market since the last review of the industry in 1999'. The technological and institutional changes in the liner shipping industry that have occurred since the last review are outlined in chapters 2, 5 and 6.

The Australian Government's analytical requirements for regulation assessment are as set out by the Office of Regulation Review in its 1998, *A Guide to Regulation*. These are designed to assist government officials working on the review and reform of existing, new or amended legislation. They emphasise identifying the benefits and costs to different groups in the community as well as to the community as a whole, and using quantitative measures, where ever possible.

The Commission's general policy guidelines, which are consistent with the National Competition Policy guiding principles and the Australian Government's analytical requirements, stress the need to: improve the overall economic performance of the economy; reduce regulation of industry; and encourage the growth and development of Australian industries.

7.2 Objectives of Part X legislation

The inclusion of Part X in the TPA reflects views about the uniqueness of the liner cargo shipping industry that make general trade practices regulation of carrier agreements inadequate. Features of the industry said to contribute to this include:

- collusive agreements are necessary to prevent 'destructive competition' that would cause market instability;
- there are efficiency benefits from coordination in the provision of regular scheduled services, such as economies of scale and spreading of risk; and
- it is a competitive industry and most agreements provide benefits such that it would not be cost effective to assess them individually under the alternative Part VII process simply to identify a few agreements that might not generate a net public benefit.

Testing these views is an important part of the Commission's assessment.

The four principal objectives given in Part X of the TPA for the separate regulation of liner cargo shipping are:

1. to ensure that Australian exporters have continued access to outwards liner cargo shipping services of adequate frequency and reliability at freight rates that are internationally competitive; and
2. to promote conditions in the international liner cargo shipping industry that encourage stable access to export markets for exporters in all States and Territories; and
3. to ensure that efficient Australian flag shipping is not unreasonably hindered from normal commercial participation in any outwards liner cargo shipping trade; and
4. as far as practicable, to extend to Australian importers in each State and Territory the protection given by the Part to Australian exporters (s. 10.01).

In reviewing those objectives, it is necessary to consider the provisions of Part X that give effect to those objectives and the provisions of the TPA more generally.

The first objective explicitly recognises the demand by exporters for liner (regular scheduled) cargo shipping services to transport their goods to overseas customers and that important aspects of those services are frequency, reliability and internationally competitive freight rates (prices). Part X provides that, for contracts made in Australia for the supply of those services, ocean carriers may, either individually or collectively, enter into collusive arrangements (under a Part X agreement) with other carriers and for those arrangements to be given immunity

from key sections of Part IV of the TPA regulating restrictive trade practices — namely, section 45 which prohibits agreements that restrict dealing or affect competition and section 47 which prohibits exclusive dealing.

The immunity is specific to the supply of liner cargo shipping services and applies to both ocean carriers and shippers. It does not extend to the supply of land-based transport services from the site of manufacture to ports or from ports to markets. It reflects the presumption that the exemption provided by Part X is necessary, in some manner, for the provision of adequate liner services to Australian shippers. In return for the immunity, carriers accept certain obligations to provide information and engage in negotiations with designated shipper bodies.

The fourth objective is similar to the first and applies to the demand by importers for liner cargo shipping services to get their overseas-purchased goods transported to Australia. The 'as far as is practicable' clause is explicit recognition of the limitations to the jurisdictional reach of Australian law in relation to the shipment of imports and that the international transport of goods is typically (but not exclusively) arranged and paid for by exporters. It is international practice for countries to recognise that the law applicable to the transport of goods is that of the country where the contracts are entered into. In most cases, this is the country of export.

The second objective is largely symbolic. Nonetheless, it may be important for regional shippers as under Part X they can be explicitly recognised as one of the types of designated shipper bodies that conferences are obliged to negotiate with while an agreement is in operation. As with the first objective, the presumption is that the exemptions provided under Part X are necessary to ensure a level of regional liner shipping services that would not otherwise be provided. However, the evidence from participants on its importance is not clear cut.

The South Australian Shippers' Users' Group, a member of the Australian Peak Shippers Association, considered that '… over the years Part X has been essential in maintaining services to South Australia' (sub. DR12, p. 1). However, it also considered that their '… negotiating position was undermined by the Carriers' introduction of illegal "non-binding discussion agreements"' (sub. DR12, p. 1).

In contrast, the Western Australian Shippers Council Incorporated, a designated secondary shipper body, and the Chamber of Commerce & Industry of Western Australia, when considering the risk that the level of services would be reduced if Part X was repealed, concluded that:

> … it is now our belief that market forces will determine the level of service to and from Fremantle and whether Part X remains or not shipping lines will continue to provide service purely on the commercial viability. (sub. 6, pp. 1–2)

The Port of Bunbury, while arguing that Part X '… is an anachronism and should be abolished', also considered that, if it were to be retained, then there should be requirement for authorisation that at, '… a minimum, one regional port must be serviced in each State in addition to the capital city port' to encourage regional development (sub. 1, p. 3).

The third objective, that Australian flag shipping is not unreasonably hindered from participation in outward conferences, is in effect no more than an explicit safeguard to limit the immunity for collusive conduct provided by Part X. This is so that carriers cannot use their immunity to collude to engage in anticompetitive behaviour at the expense of an Australian flagged carrier. It is provided for by being specified as one of a number of grounds on which the Minister may exercise his power to deregister a Part X agreement, or part of such an agreement (s. 10.45(1)(v)). More generally, however, if there were no Part X, then the objective would be safeguarded by the general anti-discrimination provisions of the TPA, notably section 46 which proscribes the misuse of market power such as by preventing entry to a market of a competitor.

If retained, the Commission considers that the objectives specified for Part X should reflect that competition in the supply of liner shipping is generally beneficial and that the demand of shippers throughout Australia is for regular scheduled shipping services that are adequate, reliable and internationally competitive. Support for the redefinition of the principal objectives of Part X was given by the Australian Horticultural Exporters Assn Inc. (sub. DR8, p. 11), the Australian International Movers Assn (sub. DR21, p. 1), the Department of Transport and Regional Services (sub. DR18, p. 6) and Shipping Australia Limited (sub. DR4, p. 1). The Commissions recommends that:

RECOMMENDATION 7.1

If Part X is retained, its principal objectives should be to:

- ***facilitate efficient coordination and joint provision of liner cargo shipping services within a pro-competition framework; and***
- ***assist Australian exporters and importers to have access to liner cargo shipping services of adequate frequency, geographical coverage and reliability at freight rates that are internationally competitive.***

7.3 Nature of Part X restriction on competition

The nature of the restriction on competition provided by Part X derives from the immunity from aspects of trade practices regulation given to ocean carriers. Trade

practices regulation presumes that competition in the provision of goods and services best services the interest of the community and regulates anticompetitive conduct (box 7.2). Part X allows carriers to form collusive agreements for the carriage of goods for Australian shippers.

Box 7.2 **Trade practices regulation of market conduct**

Trade practices regulation presumes that competition in the provision of goods and services best serves the interests of the community as a whole (Hilmer et al. 1993). As a consequence, anticompetitive market conduct is identified and regulated. The core criterion used for this is whether or not the conduct has the purpose, or has or is likely to have the effect of, substantially lessening competition in the relevant market. The TPA and its subsequent judicial interpretation have developed workable rules for applying that core criterion.

The principal part of the TPA that regulates market conduct is Part IV — Restrictive Trade Practices. This contains provisions which proscribe and regulate agreements and conduct that would otherwise limit the benefits of competition to the community. As outlined by Miller:

> Broadly speaking, those provisions either control or proscribe the making of certain contracts or arrangements or the reaching of certain understandings, the giving or extracting of certain covenants in relation to land, the engaging in conduct involving a secondary boycott, engaging in the practices of monopolisation, exclusive dealing or resale price maintenance, engaging in predatory price discrimination, and the increasing of market share by means of takeover or merger. (2004, p. 247)

Trade practices regulation also recognises that, in some circumstances, anticompetitive market conduct can have beneficial effects for the community as a whole. It provides for those situations to be identified and specifically authorised on a case-by-case basis under Part VII — Authorisations and Notifications in Respect of Restrictive Trade Practices. (Part VII also provides, through notification, for statutory protection, within limits, of exclusive dealing arrangements which would otherwise breach section 47, which proscribes such arrangements.) Authorisation requires there to be a public benefit from the conduct and that there is sufficient public benefit to outweigh any likely anticompetitive detriment. While 'public benefit' and 'anticompetitive detriment' are not defined in the TPA, legal clarification of the concepts has been developed by case law and an interpretation of that case law is available from commentators on competition policy such as Miller (2004). In general, anticompetitive (or public) detriment is the opposite of public benefit and refers to the costs to the community from anticompetitive behaviour, including losses of efficiency and reductions in competition. The Act is administered by the ACCC.

As outlined in chapter 5, the immunity is provided by specific exemptions from key sections of Part IV (restrictive trade practices) of the TPA, namely section 45, which deals with constraints, arrangements or understandings that restrict dealings or affect competition, and section 47 covering exclusive dealing (except subsections

47(6) and (7) which prohibit third-line forcing). These sections prohibit collusive market conduct that would otherwise limit the benefits of competition.

The TPA does not define competition other than to make it clear that competition from imports and overseas service providers is to be taken into account when assessing competition in markets (s. 4). As Miller has put it, 'It has been left to the courts, applying well-established principles of economics to define the term' (2004, p. 64). He draws attention to the courts adopting and applying the formulation of it made by the Trade Practices Tribunal in *Re Queensland Co-operative Milling Association Ltd* (1995) ATPR 41-438: *Re Defiance Holdings Ltd* (1976) 25 FLR 169. As part of its formulation, the Tribunal quoted the following from the United States Attorney General's National Committee to Study the Antitrust Laws in its report of 1995:

> The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new potential entrants into the field, would keep this power in check by offering or threatening to offer effective inducements. (Miller 2004, p. 65)

Effective competition in liner shipping can come in a number of forms. On individual trade routes, it involves the threat of other ocean carriers entering the market and from carriage through third-country hubs, as well as through competition among the existing carriers. Conversely, there are a number of ways in which agreements among carriers can limit competition, as noted in chapters 2 and 3. However, the ability to act in competition-limiting ways derives from ocean carriers having immunity from the pro-competition regulation of market conduct under Part IV to form such agreements.

Shipping Australia Limited did not regard Part X as a restriction on competition. While noting that the TPA seeks to promote competition as a means of enhancing efficiency, productivity and the welfare benefits it can bring, Shipping Australia Limited considered that:

> In the case of Part X, the light-handed system of regulation seeks to achieve a similar result but it also recognises that the complexity of the industry requires special treatment. The end objectives are similar and over any reasonable period of time, observance of the results of the application of such regulation in this industry can only lead one to the view that a high level of competition prevails but there is a balance between meeting the requirements of Australian liner exporters and those providing the service. (sub. DR4, p. 2)

In essence, Shipping Australia Limited appears to regard Part X as fostering competition that provides a balance between the interests of ocean carriers and

shippers. However, if agreements registered under Part X resulted in a high level of competition in trade routes, then the inclusion of liner cargo shipping industry under the general provisions of the TPA should present little difficulty. The agreements would either not trigger anticompetitive concerns under Part IV, or would be able to receive authorisation under Part VII.

FINDING 7.1

Part X restricts competition by limiting the pro-competition regulatory safeguards on the market conduct of ocean carriers and shippers.

7.4 Effects of Part X restriction on competition

The effects of the Part X restriction on competition depend on two key factors:

- the nature of the agreement; and
- the impact of the agreement on competition on a particular trade route.

In the absence of Part X immunity, all the agreements currently registered would be subject to scrutiny under Part IV of the TPA, unless an authorisation or notification was obtained under Part VII (chapter 8). Part VII exempts anticompetitive agreements from Part IV scrutiny where it can be demonstrated that the public benefits of the agreement outweighs any anticompetitive detriments (box 7.2 above).

The nature of the agreement is crucial because it determines the issues on which carriers can make joint decisions and therefore the potential extent of anticompetitive effect. As discussed in chapter 4, these issues range from operational matters involving coordination of shipping assets through to setting freight rates and controlling carrier capacity on a route. Who derives financial benefits from such joint decision making and what costs there might be in terms of anticompetitive detriment depend largely on the market power that the agreement members are able to exercise in individual routes. The market share they represent provides an indication of this.

The prevalence of the different types of agreements on Australian trade routes is given in chapter 2 and appendix C, and their economic effects indicated in chapter 4 and appendix D. Agreements permitting collective discussion or setting of freight rates and route capacity are prevalent among the agreements registered under Part X. Many agreements also cover a large share of the markets on which they operate.

In 2003-04, there were some 92 agreements registered under Part X that influenced the provision of liner cargo shipping services on 14 of Australia's 18 trade routes (table 2.8). On the other four routes, carriers independently provided liner services. These were the smaller volume routes to and from Africa and the Indian Ocean, and to and from Papua New Guinea.

Of the 92 agreements, 59 could be classified as *operational agreements*. These operated on 12 of the trade routes. They typically operate under the 'umbrella' of a discussion agreement or conference (Shipping Australia Limited trans., p. 22). Some 45 of the agreements individually covered less than 35 per cent of the capacity provided to a route. Of these, 16 operated on the Australian trade routes to and from North Asia, 16 on the routes to and form South East Asia, with a further 10 operating on the routes to and from the east coast of North America. There were five routes where there was an operational agreement that covered greater than 50 per cent of route capacity.

A total of 20 *discussion agreements* also operated on 12 of Australia's trade routes. Discussion agreements did not operate on the two European routes where no block exemption is available (chapter 6). In 2003-04, there were eight routes where the capacity share of an individual agreement accounted for more than 50 per cent of route capacity and further two routes where an agreement covered between 35 per cent and 50 per cent of capacity. The routes where over half of the capacity was covered by a discussion agreement were to and from the west coast of North America, North Asia, South-East Asia, and New Zealand and the South Pacific.

In total, 13 *conferences* operate on 11 of Australia's trade routes. On three of those routes, the capacity share of an individual conference exceeded 50 per cent of route capacity and, on a fourth, the capacity share was just under 50 per cent. On the other seven routes, the capacity share of individual conferences was less than 35 per cent. Conferences covered the majority of capacity on the trade routes to and from the west coast of North America and Europe.

In addition to the four trade routes on which all capacity was provided by carriers operating independently, there were a further four routes on which they provided over 50 per cent of route capacity. On a further two routes they provided between 35 per cent and 50 per cent and on the other eight routes they provided less than 35 per cent of route capacity.

While carriers operating independently do have significant market shares in a number of Australian routes, there may also be constraints on their ability to act independently. For example, some carriers provide an independent service on some Australian routes and are linked to their 'competitors' through agreements on other Australian routes.

In the absence of an assessment of the benefits and costs of individual agreements, it is not possible to determine which of the current agreements would be assessed as providing a net public benefit. Nevertheless, 'in principle' benefits and costs for key groups affected can be identified from the economic analyses of chapters 2, 3 and 4. These 'in principle' effects, together with information from participants and the Commission's own investigations, have enabled the following qualitative assessments to be made of the effects of Part X.

The three main groups affected by the provision of the immunity are ocean carriers, shippers and the community as a whole.

For carriers, agreements have the potential to provide members with two distinct types of benefit — supply-side and demand-side. On the supply side, carriers can benefit from making cost savings by achieving efficiencies through coordinating their investment, scheduling and the use of shipping assets in the joint provision of liner shipping services on particular trade routes. Also, by coordinating their assets and joint provision over a number of trade routes, as opposed to concentrating them on one, or a few, trades, carriers can reduce their market risks and benefit from increased scale and scope of their operations.

On the demand side, carriers can benefit from exercising their collective market power to control freight rates in, and/or the supply of shipping services to, a market. The degree of collective control exercised depends on market characteristics such as the share of the trade route the members control, the degree of competition from other carriers and carrier groups, and the ease with which other carriers and carrier groups could enter particular trade routes. In addition, the degree of control exercised depends on the cohesiveness of the agreement among the carriers — that is, the degree of 'internal competition'.

As the agreements are entered into voluntarily by carriers, such supply-side and demand-side benefits are presumed to offset any costs from constraints on individual freedom to differentiate the service they provide, grow their businesses and develop individual long-term trading relations with shippers.

For shippers, carrier agreements offer a mix of benefits and costs. On the one hand, there are likely to be benefits to shippers from carriers realising supply-side efficiencies if they are passed on in lower freight rates and a better level and quality of service. Also, there may be benefits from being able to consult and negotiate collectively about service levels through designated shipper bodies. On the other hand, there are likely to be costs where carrier agreements provide substantial market power and this is used by carriers to obtain higher freight rates and/or restrict the level and quality of service. There may also be costs associated with collective consultation and negotiation, such as loss of individual flexibility and the

need to compromise with other shippers to reach a common position. Essentially, however, the level of benefit, or cost, to shippers depends on the willingness of carriers to pass on their cost savings through lower freight rates and a better level and quality of services, and this depends on their ability to exercise market power.

For the community as a whole, agreements among carriers offer a mix of public benefits and anticompetitive detriments. The public benefits derive from carriers making supply-side cost savings and providing better services, whereas the anticompetitive detriments derive from carriers obtaining demand-side benefits through the exercise of market power.

In determining public benefit, an important component is the degree to which carriers pass on the benefits of cost savings to Australian shippers. This is because the carriers are overseas-based corporations. As a result, in the Australian situation, the benefits and costs to shippers closely align with those of the community as a whole. For ensuring that carriers pass on cost savings to Australian shippers, the most effective means would be to ensure competition among carriers in the provision of liner shipping services.

In determining anticompetitive detriment, market share is an important indicator of the ability of an agreement to substantially lessen competition. (Other important indicators are barriers to entry and expansion, contestability of the trade route and any flow-on effects to other markets.) Agreements which provide a dominant market share are likely to pose a significant risk of anticompetitive detriment, irrespective of whether or not they involve binding commitments to common prices and control of supply to a trade route. Conversely, agreements setting common prices and controlling joint supply of shipping services are likely to have a lower risk of anticompetitive detriment if their market share is small. For example, in the airline industry, an anticompetitive agreement involving Qantas and British Airways has been authorised under Part VII on the basis that the benefits from cost saving, which are likely to be passed on to consumers, outweigh the detriment of substantially lessening of competition in the UK business passenger market.

A summary of the risk of anticompetitive detriment outweighing the potential for net public benefit from different types of carrier agreements is illustrated in figure 7.1. Where agreements provide significant public benefit, but substantially lessen competition on a trade route (for example, the north-east quadrant of figure 7.1), evaluations would be required to determine where the balance of the net public benefit lay. Also relevant for regulatory approval of such agreements is whether or not there are alternative means of obtaining the public benefit without the same anticompetitive detriment. For example, traditional conference agreements involve a mix of supply-side cost savings and demand-side lessening of competition, whereas operational agreements offer supply-side cost savings with

little risk of demand-side lessening of competition where they cover only a small share of the trade on a route.

Figure 7.1 **Risk of anticompetitive detriment from carrier agreements**

		Market share	
		Low	High
Agreement provisions	Supply-side: provisions for joint scheduling and supply of services (eg consortia)	Lowest anticompetitive risk	Medium anticompetitive risk
Agreement provisions	Demand-side: provisions for route pricing and capacity (eg discussion agreements and conferences)	Medium anticompetitive risk	Highest anticompetitive risk

Countervailing power

The immunity allowing shippers to collude and form designated shipper bodies, and the requirement under Part X for carriers to negotiate with these bodies over the provision of liner services, have been seen as providing for the exercise of countervailing power by shippers that safeguard the public benefits from carrier agreements. As indicated in chapter 5, some have regarded this provision of countervailing power as one of the central benefits of Part X. For example, the Department of Transport and Regional Services submitted:

> Part X is probably unique among liner regimes in that it places certain obligations on conference members towards shipper bodies that have been designated by the Minister to exercise countervailing powers on the behalf of shippers. (DTRS sub. 9, p. 9)

However, most participants considered the outcome of existing arrangements which promote countervailing market power by shippers to be unsatisfactory. While Shipping Australia Limited considered that the countervailing power of shippers can work under Part X and referred to the successful negotiation with the Australian Peak Shippers Association of a General Rate increase in the Australia to Europe trade, it also pointed out that:

> There have been no face-to-face meetings with the Australian Peak Shippers Association (APSA) to negotiate minimum service levels under umbrella [discussion] agreements let alone consortia agreements and not once since its formation has the Importers Association of Australia (IAA) sought to negotiate minimum service levels. (sub. 16, p. 11)

The ACCC, in recent reviews of behaviour under Part X, commented that:

> While Part X talks about negotiation, there is no obligation on parties to actually agree on proposals. The Commission considers that the negotiation provisions under Part X represent a weakness and provide minimal countervailing power to shippers. (Fels 2001, p. 7)
>
> The Commission considers that negotiation provisions of Part X should be strengthened to improve the countervailing power available to shippers. (ACCC 2000, p. iv)

The Australian Horticultural Exporters Association submitted:

> The foreign multi national carriers remain in a powerful and advantageous position and with this in mind the negotiating imbalance in their favour needs to be redressed towards a more balanced position. (AHEA sub. 13, p. 5)

Similarly, the Australian Peak Shippers Association, while noting that exporters are a diverse group who are largely uncoordinated and who are direct competitors with each other in foreign markets, also submitted that:

> … carriers have considerable power through their conference arrangements which have enabled them to develop an international overview of shipping arrangements, and is the means by which they coordinate their conduct in dealing with Australian shippers.
>
> <u>In other words, the carriers are in a powerful position and with this in mind the imbalance in their favour needs to be redressed towards a more balanced position</u>. (sub. 5, p. 2) [emphasis in original]

Evidence of countervailing power being exercised by shippers to enhance the public benefits provided by Part X is difficult to deduce when consideration is made of the nature of the negotiations that actually occur and of the effects of existing arrangements on service levels and freight rates. In relation to minimum service levels, as outlined in chapter 5, negotiations rarely occur and in those that do occur it is difficult to portray what occurs as any real exercise of countervailing power by shippers. Shipping Australia Limited and the Australian Peak Shippers Association explained that, after years of dispute, in 1991, agreement was reached between the parties that certain data would be provided and the minimum service levels would be set at 80 per cent of the service that carriers to a conference agreement collectively planned to operate on Australian routes (trans., p. 20; sub. DR14, p. 1). This has been adhered to since then and the only instances where the Australian Peak Shippers Association has been involved in negotiations over minimum service levels are when there are '… services which are not managed by SAL [Shipping Australia Limited] and are perhaps new to the trade' (trans., p. 57). As a result, minimum service levels are viewed as adequate by the Australian Peak Shippers Association in 90 per cent of the cases without any negotiation.

The level, quality and ports covered by a scheduled service are determined by carriers, based on their assessment of the market. The only 'concession' to

Australian shippers is the 'guarantee' of a minimum service level. There is little likelihood of carriers being committed to providing an 'uneconomic' level of service. Moreover, the notification processes under Part X allow carriers to vary their minimum service level commitments with short notice.

Of use in promoting the collective interests of shippers is the ability, under Part X, for common interest groups, such as industries and regions, to be recognised as designated shipper bodies for purposes of consulting and negotiating with carriers, either individually or collectively, on terms of carriage relevant to them. However, as outlined in chapter 8, Part X is not essential for this. Authorisation is available under Part VII. This carries the added benefit that approval is dependant on testing that there will be a net public benefit from permitting such collusion.

In relation to freight rates, the Commission understands that negotiations between conferences and designated shipper bodies under Part X typically result in 'open offer' or 'ceiling rates' being discussed which then may be used in subsequent negotiations between individual shippers and carriers (AHEA sub. 13, p. 12). Shipping Australia Limited considered this an accurate statement in relation to some commodity groups and noted that '… more generally the negotiations involve general rate increases if tariff rates are being increased or surcharges applied' (sub. DR4, p. 17).

Small shippers

Negotiated rates tend to hold among carriers and apply only to small and medium, or irregular, shippers. ACIL Tasman and Thompson Clarke considered that 'Small and irregular shippers can increase their bargaining power by operating through freight forwarders' (sub. DR9, p. 11). This view was endorsed by the Australian Federation of International Forwarders, which said '… we see our industry as a "buffer" for smaller shippers to gain better price stability by utilisation of the service contracts of the freight forwarders …' with specific lines that provide rate stabilisation in exchange for reasonable secure quantities of TEUs (sub. DR22, p. 2).

Also of relevance for small or irregular shippers is the experience in the United States following their 1998 reforms. The introduction of confidential individual service negotiations between shippers and carriers, which has, in effect, reduced the price-setting powers of conferences from binding agreements to non-binding advice, has led to the development of a more effective intermediary sector and this has benefited small to medium, or irregular shippers (Stewart et al. 2003).

As noted in chapter 4, collectively agreed prices tend to hold among carriers more generally when the market is tight than slack, and for surcharges than for general rates.

Large shippers

More generally, large shippers typically negotiate their shipping requirements directly with individual ocean carriers, irrespective of any affiliations the carriers may have to conferences, consortia and the like and without reference to any designated negotiating shipper body. The results of negotiations under Part X arrangements may form one element of the information base they use for their negotiations, but they do not restrict the ability of either party to negotiate quite different levels of, and prices for, shipping services. Likewise, the shipping requirements of the local subsidiaries of multinational corporations are part of global negotiations between the corporation and individual carriers overseas. Typically, both involve annual contracts and ongoing trading relationships.

Countervailing power

The countervailing power arrangements of Part X are of little relevance to large shippers. More generally, they are of little relevance to the some 80 per cent of trade that is transported under individual contracts (ACIL Tasman and Thompson Clarke Shipping sub. 17, p. 16). Thus, the provision of countervailing power appears to be relevant mainly to small shippers. However, even here, negotiated freight rates appear to be of limited value as they are effectively offered freight rates on a ‘take-it or leave-it’ basis. Small shippers also appear to be the ones most affected when capacity problems arise. Many of them expressed dissatisfaction with the services provided under current arrangements (see, for example, Gift & Homewares Australia sub., DR15).

This apparent failure in the provision of countervailing power currently brings into question whether the policy of promoting countervailing power as a means of improving the public benefit from Part X could be improved. As indicated in box 7.3, which outlines the theory of countervailing power, it is very much a ‘second-best’ policy approach. To be effective it would require not only the stronger organisation of shippers into monopsonies (single blocks), but also a ‘turning back of the clock’ to ‘traditional’ monopolistic conferences — a type of conference that is no longer permitted on US routes and has been largely replaced by ‘TACA-compliant’ conferences on European routes (chapter 6).

Box 7.3 **Theory of countervailing power**

The theory of countervailing power states that the power of a monopoly producer (for example, liner conference) can be effectively controlled through the use of a monopoly buyer (for example, shippers' association). Galbraith (1952) argued that the real constraints on a firm's market power lies with its customers and suppliers, not its competitors. Supporters of this theory argue that the threat of 'costly withholding' by a monopoly buyer encourages the monopoly supplier to price more cautiously (Engle-Warnick and Ruffle 2002).

However, the introduction of countervailing powers — essentially creating two monopolists bargaining with one another — can lead to vertical collusion, or coalescence of power. In this case, both parties recognise that their individual benefits are maximised when both monopolies are guaranteed. It is in their interests to support 'government protection from competition in the form of … immunity from antitrust laws … etc' (Adams 1987, p. 706).

For these reasons, the introduction of countervailing powers is seen as a second-best policy option. Schwartz addresses this point with respect to competition-reducing mergers being allowed to countervail existing market power of its suppliers. He states:

> Suppose that a merger is likely to reduce price to suppliers. Is it an acceptable defense to argue that the merger will countervail preexisting selling power of suppliers and, thus, is likely to reduce price towards the competitive level rather than below it?
>
> There are arguments to be made on both sides. Under the assumed facts, the countervailing merger may improve welfare, at least in the short run. Countervailing power, however, is unlikely to duplicate the competitive outcome and raises its own risks. Instead of trying to combat one distortion by allowing an opposite one, an alternative approach is to resist any merger that increases market power, and rely on market forces to erode market power on the other side or, in those cases where competition is deemed incapable of doing so (perhaps because of exclusionary practices or formidable structural barriers to entry), consider tackling such market power through government intervention, be it antitrust or regulation as the case may warrant. (2004, p. 3)

The Australian Peak Shippers Association rejected the view that the countervailing powers provided under Part X are not effective. It held that:

> These powers have been used extensively and successfully by APSA and others in many instances. Areas that need addressing though [to make them more effective] are the powers of Shipping Conferences to impose surcharges and a review of Discussion Agreements. (sub. DR11, p. 5)

In general, the more effective way to deal with market power is to promote competition. This has been the experience in the United States, which found that confidential individual contracting produces a more efficient and flexible liner carrier industry, resulting in lower freight rates and increased services (FMC 2001). Indeed, many participants have proposed that Part X be amended to protect confidential individual service contracts (Department of Transport and Regional

Services sub. 9; Australian Peak Shippers Association sub. 5; Australian Horticultural Exporters Association sub. 13). This proposal is considered further in chapter 9.

In short, countervailing power relies on collective negotiation and arguably runs counter to the freedom of shippers to contract individually and to the promotion of confidential individual service contracts and a competitive market.

The benefits of allowing shippers to consult and negotiate collectively with carriers, either individually or collectively, should be distinguished from that of promoting countervailing power as a condition of providing immunity under Part X. Procedures by which shippers could obtain regulatory approval for collective consultation and negotiation, in the absence of Part X, are given in chapter 8.

FINDING 7.2

The existing arrangements under Part X to promote the countervailing power of Australian exporters and importers do not appear to be working. This is because carriage of most cargo is now arranged individually between shippers and ocean carriers. A more effective way to deal with market power would be to promote more competitive forces in carrier negotiating circumstances.

As part of the range of changes proposed for Part X, participants have suggested a number of amendments, many of which seek to increase the countervailing power of shippers. These are outlined and discussed in chapter 9 and appendix G.

7.5 Balance of benefits and costs

The range of agreements between ocean carriers that have been provided with immunity under Part X is much wider than provided by similar immunity in many of Australia's trading partners, particularly in the United States and Europe. Registered agreements to and from those countries typically reflect the more restricted approvals of those countries. Part X is based on the assumption that so few agreements registered under it fail to provide a net public benefit that the added costs of individual authorisation are not warranted. For all practical purposes, automatic registration is provided for all types of agreement sought by carriers and permitted by Australia's trading partners.

As outlined above, agreements currently registered under Part X have varying potentials to provide a net public benefit for Australia. The balance between the likely public benefit and likely anticompetitive detriment depends on the type of agreement and on the characteristics of the market in which the agreement operates.

Agreements providing supply-side cost savings are likely to provide public benefits, especially if there is effective competition from other carriers and carrier groups to ensure the passing on of the cost savings to shippers. However, agreements including demand-side control over freight rates and/or supply of shipping to a market are likely to involve significant anticompetitive detriment, especially if the agreement has a high market share with the potential to substantially lessen competition on a trade route.

Having regard to the types of agreements currently registered under Part X and their potential for anticompetitive detriment on the trade routes on which they operate, the Commission's assessment is that, while many would be able to demonstrate that they provide a net public benefit, many of them also would be unlikely to be able to do so in their current form. Agreements between carriers with limited market share focussed on providing cost savings from the coordinated use of their assets for the provision of regular scheduled shipping services would appear to offer substantial public benefits with little risk of anticompetitive detriment. Such agreements should be allowed. As indicated above, the available information indicates that there are many of these agreements operating (broadly categorised as operational agreements) on Australian trade routes. For example, there were 45 operational agreements that individually provided less than 35 per cent of the capacity on a trade route in 2003-04.

Conversely, agreements between carriers with high market shares focussed on seeking to manipulate prices and control supply on routes would appear to offer little public benefit for Australia and involve substantial risk of anticompetitive detriment. Such agreements should be prohibited. As indicated above, many of these agreements (typically, discussion agreements and conferences) appear to be operating on Australian trade routes. For example, on half of Australia's trade routes there was either a discussion agreement or conference that covered over 50 per cent of the capacity provided to a route. In addition, there appear to be a number of agreements that would require detailed evaluations to determine where the balance of the net public benefit lies.

The public benefit to Australia of carrier agreements for the provision of liner services could be improved if those providing a net public benefit were identified and allowed and those providing anticompetitive detriment identified and prohibited. In this sense, by providing no meaningful distinction between agreements as to the net public benefit each is likely to provide, Part X as currently structured does not meet its primary purpose.

Shipping Australia Limited did not agree with this assessment. Consistent with its view that Part X was not a restriction on competition and that it provided an ongoing public interest test, Shipping Australia Limited held that the presumption

that all agreements registered would provide a net public benefit was '… not a flaw because Part X clearly sets out the types of restricted activities that will be allowed a limited exemption from Part IV … ' (sub. DR4, p. 16).

The Department of Transport and Regional Services explained that:

> … until the advent of discussion agreements, the approach currently adopted in Part X, of giving all types of agreement "the benefit of the doubt" until shipper complaint and ACCC investigation proves otherwise, had proved satisfactory to Australian shippers whom Part X is intended to benefit. This was reflected at previous reviews by general shipper support for the retention of Part X, and by continued shipper support for Part X modified to exclude discussion agreements.
>
> Rather than adopting a case by case approach to all agreements, the Department considers that such an approach should only apply to discussion agreements, an approach that would be supported by shippers generally. In reaching this conclusion, the Department notes, however, that precluding discussion agreements from receiving exemptions might result in such agreements being operated from overseas jurisdictions that still permit them (eg the US or Japan), so that the end result might be that Australian shippers lose their negotiating right under Part X. (sub. DR18, p. 6)

FINDING 7.3

The wide range of agreements registered under Part X have varying potentials to provide a net public benefit to Australia, depending on the type of the agreement and characteristics of the market in which it operates. While many operational agreements covering low shares of carriage on a trade route should be able to demonstrate that they provide a net public benefit, it would be much more problematic for agreements including price setting and capacity control provisions covering a high share of carriage on a trade route. Thus, the public benefit to Australia of carrier agreements could be enhanced if agreements providing a public benefit were identified and allowed and those not, were identified and prohibited.

Support for a more selective approach to the registration of agreements was expressed by the National Farmers' Federation (sub. DR29, p. 1), the Australian Peak Shippers Association Inc. (sub. DR11, p. 2); the Australian International Movers Association (sub. DR21, p. 2); and the Australian Horticultural Exporters Association Inc. (sub. DR8, p. 14).

In conclusion, the Commission considers that no compelling case has been made that all agreements currently registered under Part X operate to provide a net public benefit. Nor on the basis of evidence provided to it and from its own investigations could the Commission find sufficient evidence that so few agreements would fail to provide a net public benefit that the added costs of individual authorisation would not be warranted. On the balance of evidence now available about the types of agreements registered under Part X and the characteristics of the markets in which

they operate, it would appear that many agreements could pass a net public benefit test. Equally, however, many other agreements would be likely to have difficulty in demonstrating a net public benefit, and for many others detailed examination would be required to determine the balance of benefit and detriment.

The Commission considers that choosing between agreements is essential if Australia is to maximise the likely net public benefit of allowing otherwise anticompetitive arrangements to continue and that regulation should be designed to achieve this objective. Accordingly, the Commission recommends that:

RECOMMENDATION 7.2

The regulation of liner shipping agreements be strengthened by adopting a selective approach aimed at allowing only those carrier agreements which are likely to provide a net public benefit to Australia.

The best way of achieving this would be to repeal Part X and, as occurs with other industries, rely on the established authorisation and notification processes under Part VII. While opposed by the majority of participants, this option was supported by the Australian Competition and Consumer Commission (sub. 30, p. 1), the Australian Chamber of Commerce and Industry (trans., p. 117), the Chamber of Commerce & Industry of Western Australia and Western Australian Shippers Council Inc. (sub. DR10, p. 1), Trade Practices Committee of the Law Concil of Australia (sub. DR13, p. 1), Dr Tony Fletcher (sub. DR2, p. 2) and Bunbury Port Authority (sub. DR1, p. 1).

An alternative way of adopting a selective approach to the approval of carrier agreements would be to introduce some specific evaluation criteria into Part X. There are a number of options for more selective registration and review processes under Part X. Introducing simplified evaluation criteria could encourage beneficial agreements that might otherwise not occur because of the perceived difficulty of obtaining regulatory approval under Part VII. But, some agreements might be sanctioned that do not provide a net public benefit. The balance depends on the way in which the simplified evaluation criteria are specified.

A range of other modifications to Part X were raised by participants. Some sought improvements to competition in the provision of liner shipping services, some sought enhancement of the countervailing power provided to Australian shippers and others sought increased government intervention in the outcome of market negotiations in response to the current tight shipping market. These modifications are outlined and discussed in chapter 9 and appendix G.

8 Alternatives to Part X

The main alternative to Part X of the TPA is authorisation under Part VII. This provides similar immunity for carrier agreements and shippers from the application of Part IV of the TPA. Carrier agreements that can demonstrate a net public benefit would be authorised under Part VII. While carriers would incur costs in order to satisfy this legislative test, this is appropriate given that collusive agreements often have significant anticompetitive detriment. Carriers are also in a better position than the ACCC to demonstrate the benefits and detriments of an agreement. Shippers could also apply for Part VII authorisation. Since 1995 authorisations for collective bargaining agreements have generally been approved, with only two applications being rejected in that time. Several concerns were raised about the application of Part VII to the liner cargo shipping industry. The adoption of transitional arrangements that guarantee protection for registered agreements for four years in total, would ensure that a change in the regulatory system does not disrupt the provision of liner cargo shipping services. Repealing Part X and relying on authorisation under Part VII is the Commission's preferred option.

The terms of reference asks the Commission to consider relevant alternatives to Part X, including the authorisation process contained in Part VII of the TPA, other non-legislative approaches, and the extent to which these would achieve the rationale of Part X. Part VII contains two types of individual exemptions — authorisations and notifications. Carrier agreements and shippers' collective bargaining agreements can apply for, and may benefit from, authorisation. However, notification is likely to be of limited use for carriers and shippers.

In addition to Part VII options, shippers engaged exclusively in the export of goods from Australia may be able to rely upon the export agreement exemption under section 51(2)(g). This section exempts agreements which deal exclusively with the export of goods, or the supply of services, outside of Australia from certain elements of Part IV. However, there is uncertainty as to the application of this provision to the liner cargo shipping industry.

While there may be other alternatives to Part X, such as adopting a block exemption (similar to the European approach) or the adoption of an industry code, they are

either not possible within the framework of the TPA or not viable within the liner cargo shipping industry.

Section 8.1 looks at the operation of the authorisation process and the processes involved in seeking, reviewing and revoking authorisation decisions. Section 8.2 examines the notification process. Section 8.3 discusses the alternatives under Part VII for shipper bodies — some of which are currently registered under Part X. Section 8.4 outlines and addresses the main concerns raised over the application of Part VII to the liner cargo shipping industry. Section 8.5 analyses whether the alternatives outlined meet the rationale for Part X exemptions. Section 8.6 outlines the Commission's proposed transitional arrangements. Section 8.7 examines the international implication of the Commission's preferred recommendation.

8.1 Authorisation

Under Part VII of the TPA, any corporation wishing to engage in conduct that, in the opinion of the corporation, risks breaching the provisions of Part IV concerning restrictive trade practices, may apply to the ACCC for an authorisation. Authorisation provides immunity from most of the provisions contained in Part IV (it does not cover misuse of market power). It provides wider immunity than that provided under Part X, as it also covers primary and secondary boycotts, third line forcing, and resale price maintenance[1]. An authorisation grants immunity from prosecution for the applicant covering the proposed conduct. It is designed to provide a safeguard against breaching the prohibitions on anticompetitive conduct, where it can be shown that the public benefits of the proposed conduct outweigh any anticompetitive detriment.

Features of carrier agreements which need to be authorised

An erroneous assumption often made is that *every* carrier agreement would need to be authorised. While any party can apply for authorisation, it is only needed when the agreement would actually be likely to breach Part IV of the TPA. Chapter 7 argues that for the carrier agreements currently in existence, the provisions which would most likely breach Part IV are:

- price fixing;
- capacity management; and
- agreements with high market share.

[1] Applicants are required to use different forms, depending on the specific type of behaviour for which authorisation is sought — see s. 88 and the Trade Practices Regulations.

Other types of agreements — for example, supply-side agreements such as consortia, joint asset sharing or slot leasing — do not seem likely, by themselves, to contain provisions which would constitute a clear breach of Part IV, and may not require authorisation. However, some carriers may still wish to authorise these provisions in order to achieve certainty.

Obtaining an authorisation

The authorisation process requires those seeking legal immunity to demonstrate that the proposed conduct is likely to lead to a net public benefit. This is achieved under Part VII through the legislative requirement that the ACCC and the Australian Competition Tribunal assess applications for authorisation against prescribed tests. Namely, whether:

- the public benefits arising from the proposed conduct outweigh the 'detriments' constituted by any lessening of competition in the relevant markets; and
- the public benefit arising from the conduct is such that the conduct should be allowed (ss. 90(6)–(9)).

There is a broad view of what constitutes a public benefit and a public detriment. The classic judicial formulation states that it can include:

> … anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress. (*Queensland Co-op Milling Association Ltd* (1976) ATPR 40-012 at 17,242)

This definition of public benefit includes conduct which improves economic efficiency — either productive, allocative, or dynamic — as well as other behaviour unrelated to economic efficiency. The ACCC further noted that when assessing public benefits it takes into account the requirements under mergers to 'consider export enhancement and import replacement as public benefits and to take into account the competitiveness of any Australian industry' (sub. 21, p. 54).

Public detriment includes conduct which leads to any impairment to the community generally, including any harm or damage to the aims of society. A central element is the achievement of economic efficiency, hence, any damage to efficiency is seen as a significant public detriment. It is not always correct to equate anticompetitiveness with detriment. Anticompetitive behaviour may, in some circumstances, be beneficial (*Re 7-Eleven Stores Pty Ltd* (1994) ATPR 41-357).

In addition to accepting or rejecting an application, the ACCC may also seek to impose conditions and/or seek enforceable undertakings as a condition of

authorisation for applications which would otherwise not meet the net public benefit requirement. For instance, the ACCC may require the applicant to alter the proposed conduct or agreement in ways that the ACCC regards as necessary in order to satisfy the public benefit test (s. 91(3); also see Miller 2004, p. 926). Failure to comply with conditions imposed by the ACCC may lead to revocation of an authorisation. In addition, the ACCC may accept a written undertaking given by an applicant relating to an authorisation of one of its elements (s. 87B). These undertakings are enforceable by the courts.

Applying for authorisation

The processes to assess applications for authorisation are set out in the TPA and are designed to be rigorous, transparent and flexible. To this end, following receipt of an application for authorisation, the ACCC is required to:

- advertise receipt of the application and inform interested parties;
- invite submissions on the application from members of the public;
- release a draft determination outlining the ACCC's proposed decision and giving reasons;
- provide interested parties with an opportunity to hold a conference on the draft determination;
- publish a final determination; and
- maintain a public register of documentation relating to the matter.

The ACCC seeks comments and submissions from interested parties on an application for authorisation. Interested parties can include competitors, customers, suppliers, government bodies, industry associations, and industry experts. On implementation of the Dawson reforms (Trade Practices Amendment Bill 2004), the ACCC will be required to release its final determinations within a six-month timeframe or authorisation will be deemed to have been granted. This period can be extended up to 12 months if a draft determination has been issued, the ACCC determines the period has been extended *and* the applicant agrees to the extension (ACCC, sub. 21, p. 57). The application fee is $7500 (with a concessional fee of $1500 for the same, or additional applicants, engaged in similar behaviour) and most applicants typically employ specialist legal and economic consultants. In 2003 and 2004, the ACCC finalised 29 authorisation applications. Of these, three were granted with conditions, one was denied, and 25 were granted (ACCC, sub. DR30, pp. 9–10). The denied application was later allowed by the Australian Competition Tribunal. This means that, in 2003 and 2004, around 90 per cent of authorisation applications were granted.

Interim authorisation

The TPA enables the ACCC to grant interim authorisation while an application for authorisation is being assessed. As with authorisations, interim authorisation protects an applicant from prosecution under the TPA. Should the ACCC refuse or fail to grant interim authorisation, the Australian Competition Tribunal has the power to do so (Miller 2004, p. 882).

The decision to grant interim authorisation is based on several factors, and as noted by the Australian Competition Tribunal, 'are difficult to define as cases will be determined on their particular facts' (*Re International Air Transport Association* (1995) ATPR 40-537). The ACCC has indicated that interim authorisation is likely in cases where an application for authorisation maintains the status quo. It stated:

> … where the conduct the subject of an authorisation application has been engaged in for some time prior to the lodgement of the application, this would be an important factor the ACCC would take into account when assessing a request for interim authorisation. For example, in granting interim authorisation to the Royal Australasian College of Surgeons (RACS), the ACCC took into account the fact that these processes had been in place in various forms for many years prior to the RACS lodging the application. (sub. DR30, p. 3)

Decisions for interim authorisation are usually made within 30 days of the ACCC receiving a request. In 2003 and 2004, 16 out of 19 requests for interim authorisation were granted. The average time for approval was around 22 days (ACCC, sub. DR30, pp. 3–4).

Period of authorisation

The TPA allows for authorisations to be granted for a period of time and it is the practice of the ACCC to grant authorisations only for a set period (ACCC, sub. 21, p. 56). This allows the ACCC to review authorisations at the end of the period to ensure that the authorisation continues to provide a net public benefit to Australia (the review process is outlined below). The period of the authorisation depends upon the specific circumstances of the application. Examples include:

- a five year period due to constant technological changes in *Re Australasian Performing Rights Association* (1999) ATPR 41-701;
- a four year period for an advertising code in *Re Proprietary Medicines Association of Aust & NZ* (1997) ATPR (Com) 50-246;
- a three year period for the Franchising Code of Practice in *Re Franchising Code Council Ltd* (1996) ATPR (Com) 50-239;

- a three year period to assist the restructuring of marketing in the wool industry in *Re Australian Wool Exchange Ltd* (1994) ATPR (Com) 50-154; and
- a ten year period for a banking clearance system in *Re Australian Payments Clearing Association Ltd* (1998) ATPR (Com) 50-257.

Authorisation provides immunity from prosecution — by either the ACCC or private parties — for anticompetitive conduct under Part IV of the TPA. The immunity applies for the length of the authorisation, so long as parties behave as outlined in the authorisation and there has not been a 'material change in the circumstances'. The ACCC stated:

> Part VII offers greater certainty to liner agreements than Part X. The ACCC's obligation to investigate instances of 'unreasonable' increases in freight rates, regardless of market circumstances, gives rise to operating uncertainty for shipping lines. In contrast, liner agreements and shipper bodies would be given confidence that Part IV exemption is more certain over the term of authorisation. (sub. 21, pp. 64–5)

Changes in the membership of authorised agreements

Authorisations only apply to the parties nominated in the application, although under section 88(10) of the TPA, an authorisation can also apply to additional parties who become involved at a later stage in the conduct which is authorised. The ACCC (sub. 21, p. 56) noted that 'authorisation can apply to current and future parties to an arrangement'. This should enable carrier agreements to include new members without having to re-seek authorisation, provided that it does not result in a material change in circumstances.

The ACCC has indicated that the authorisation process would be flexible enough to deal 'effectively and efficiently' with changes to the membership of carrier agreements. The TPA allows an authorisation to be granted with conditions. Consequently, the ACCC is in a position to grant an authorisation subject to conditions which would allow the authorisation to apply to future members of a carrier agreement. The ACCC stated:

> … authorisation can apply to current and future parties to an agreement, meaning that the addition of new parties would not result in a loss of immunity for the arrangement. For example, the application for authorisation lodged by RACS was expressed to apply to "*the College, its officers, employees, current and future Fellows. The current and future members of the College's affiliated specialist societies and associations*" … (sub. DR30, p. 4) [emphasis in original]

It is anticipated that similar provisions could apply to an authorisation of a carrier agreement — subject to safeguards ensuring that new membership is not likely to increase the anticompetitive effect of the agreement. An example of such an

authorisation is the authorisation for Dairy Farmers to bargain collectively with milk processors subject to conditions, such as membership of dairy farmers not to comprise all farmers within specified regions (ACCC, sub. DR30, p. 4).

FINDING 8.1

The authorisation process is sufficiently flexible to cater for the circumstances of the liner cargo shipping industry. In particular, not all existing carrier agreements may need authorisation under Part VII. Under the Dawson reforms, authorisation would be granted within six months. During this time, interim authorisation could be obtained. As well, authorisations can be framed so as to apply to other carriers which become members of an authorised carrier agreement at a time after it is made, or after it has been authorised, subject to the market impact of additional members.

Anticompetitive agreements that have been authorised

To date, the ACCC has not undertaken a detailed examination of the public benefits and detriments of international liner cargo shipping arrangements (although there have been several investigations under Part X). However, the ACCC has looked at a variety of similar arrangements in domestic industries such as the airline industry.

According to Miller (1999, pp. 549–66), the ACCC has acknowledged that public benefits arise from arrangements such as: capacity allocation, cooperative buying, joint ventures, rationalisation agreements, and recommended and uniform pricing. Whilst not conclusive, this approach in relation to other industry arrangements is suggestive that a wide range of benefits of carrier and shipper arrangements could be considered in assessing authorisation applications.

The ACCC provided the Commission with examples of recent authorisations it had granted within the transport sector (see sub. 21). These examples provide some guidance on the likely approach the ACCC may take to authorisations within the liner cargo shipping industry.

Joint service arrangements between Qantas and British Airways

The joint service arrangements (JSA) between Qantas and British Airways have been authorised on two occasions in 1995 and 2000 and the ACCC has recently renewed it for a further five years.

The JSA provides for the coordination of airline services between Qantas and British Airways, primarily on routes between Europe and Australia. The

coordination involves scheduling, marketing, sales, freight, pricing and customer service activities (similar to a liner conference). The ACCC specifically noted that:

> The JSA provides for Qantas and BA to agree on prices. The Commission regards price fixing between competitors as one of the most serious forms of anticompetitive behaviour which can be highly detrimental to economic efficiency and consumer welfare. (2004b, p. ii)

However, even with the presence of price fixing, the ACCC determined that the JSA would still result in a net benefit to Australia. The ACCC noted that, while the agreement would result in a substantial lessening of competition for the United Kingdom business passenger market, it will provide significant cost savings for Qantas and British Airways and would not affect the other passenger markets.

Importantly, the market share of the JSA (combined Qantas and British Airways) had decreased in the United Kingdom market, and remained stable in the European and South East Asian markets — although on some legs (for example, Singapore to Heathrow) the market share had increased. The ACCC noted that due to the low market share of the both carriers in the relevant markets and the large number of competitors, there would not be a lessening of competition if the JSA were authorised. It stated:

> On the basis of the joint market shares for Qantas and BA of 37.8% in Europe and 25.1% in SE Asia it is unlikely that the JSA is currently having an anticompetitive impact in those leisure passenger markets. The Applicants' aggregate market share is at relatively low levels and the BA contribution to the aggregate share is small with a significant number of airlines in each market having greater market shares than BA. In other words there would not necessarily be significantly increased competition in the leisure passenger market if authorisation was not granted and as a result BA competed with Qantas. (2004b, p. 92)

Qantas–Air New Zealand strategic alliance

Qantas and Air New Zealand lodged applications seeking authorisation for Qantas to purchase up to 22.5 per cent in Air New Zealand and to form a strategic alliance (similar to the JSA with British Airways). The alliance would involve price, capacity and schedule coordination on nominated routes including trans-Tasman, North American and New Zealand domestic market.

The ACCC initially denied authorisation for this agreement. In the opinion of the ACCC, the agreement would be 'highly anticompetitive', would lead to fare increases, and lead to decreases in capacity and service levels on Australian routes and other routes which involve both airlines. The difference in outcomes between the two applications essentially turned on the level of contestability within the relevant market. The ACCC is of the view that it is through competitive pressures

that the benefits of efficiency gains are passed onto consumers through lower prices. The ACCC stated:

> The trans-Tasman route passenger market, where the Applicants currently have a joint share of around 90 per cent, would be particularly vulnerable to the Proposed Arrangements. The [ACCC] acknowledges that Virgin Blue has now been confirmed as entering the trans-Tasman market in the near future. However, the extent to which Virgin Blue might be able to be regarded as a *competitive constraint to the Applicants* under the Proposed Arrangements will depend on scale and timing of its entry and expansion, the routes on which it operates, and the market's response to its entry. (2003, p. iii) [emphasis added]

However, Qantas appealed to the Australian Competition Tribunal and the Tribunal unanimously overturned the decision of the ACCC (*Qantas Airways Ltd* [2004] ACompT 9). While the detailed reasons are yet to be released, the Tribunal was satisfied that the proposed coordination (pricing, scheduling, marketing and sales, and codesharing) would result in a net public benefit to Australia. The Tribunal granted authorisation for five years.

Variations, reviews and revocation of authorisations

The Act outlines specific requirements for variation, review and revocation of authorisations. These requirements ensure that any ongoing authorisation still provides public benefits that outweigh any anticompetitive detriment. The Act also protects parties to an authorisation from revocation where, even though the technical requirements for revocation are met, the agreement would still result in an overall net public benefit.

Minor variations and amending an authorisation

Parties to an authorisation can apply to the ACCC to allow minor variations to the authorisation (s. 91A). A minor variation is defined as 'a single variation that does not involve a material change in the effect of the authorisation' (s. 87D). The ACCC can approve minor variations after giving all interested parties an opportunity to make submissions about the proposed changes.

The ACCC must not vary an authorisation unless it is satisfied that, in all the circumstances, the variation would not result in a reduction in the net public benefit from the original authorisation (s. 91A(5)). In combination with the definition of 'minor variation', Miller (2004, p. 928) is sceptical about the use of this provision:

> The section's utility is also limited by the explicit requirement that, in order to move under this section, the ACCC must form the view that the variation would not result in lessening the public benefits. This factor … effectively means that the section can only

be used to correct minor errors or make minor changes in the form of the authorisation which have no effect on its scope or practical effect.

The Act also allows for amendments to authorisations which are more than minor, yet less than material, without the need to revoke and replace an authorisation (s. 91C). This allows authorisations with time limitations or ones where the basic protection is still required but the specifics have changed, to reformulate the details of the agreement. The process for amending an existing authorisation is similar to that for the granting of an authorisation. Further, the Act does not allow the ACCC to revoke and replace an existing authorisation unless the proposed amended authorisation would fail the net public benefit test (s. 91C(7)).

Review and revocation

The Act grants the ACCC limited power to revoke an authorisation. It can do so upon the request of a party to the authorisation, or by its own initiative. The ACCC can only initiate a revocation on the following grounds:

- it was granted on the basis of materially false or misleading information;
- a condition attached to the authorisation has been violated; and/or
- there has been a material change in circumstances (s. 91B(5)).

Considering if there has been a material change involves determining whether the change of circumstances causes a material detrimental change in the assessment of public benefits, due to the lessening of competition[2]. Under the Act, the determination of a 'material change' commences by an examination of the circumstances as they existed at the time of the original authorisation. Consideration must then be given to the circumstances as they exist at the time revocation is being considered. An overall assessment must be made on whether those changes should be regarded as significant enough to trigger the legislative requirement for the ACCC to revoke an authorisation[3]. Ultimately, the changes must result in a reversing of the original net public benefit assessment. Only where, under the current circumstances, the authorised behaviour would result in a net detriment can the ACCC revoke an authorisation[4].

Before revoking an authorisation, the ACCC must follow a formal process of review. This process must:

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[2] *Media Council of Australia* (1996) ATPR 41-497 and *7-Eleven Stores* (1998) ATPR 41-666.

[3] *Media Council of Australia* (1996) ATPR 41-497; *AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593; and *7-Eleven Stores* (1998) ATPR 41-666.

[4] *Media Council of Australia* (1996) ATPR 41-497. See also s. 91B(5)(b) of the TPA.

- inform all interested parties that revocation is being considered;
- inform those parties for what reasons revocation is being considered;
- invite submissions from interested parties; and
- consider any submissions (s. 91B).

As noted above, the ACCC cannot revoke an authorisation where an amended authorisation under section 91C would address the new causes of the detriment.

FINDING 8.2

Authorisation under Part VII provides a rigorous system for evaluating whether carrier agreements seeking exemption from Part IV are in the public interest. Safeguards ensure authorised agreements continue to meet the test and that the ACCC does not arbitrarily revoke an authorisation where it would still provide a net public benefit, or where an amended authorisation would result in an overall net public benefit.

8.2 Notification

In addition to the authorisation process, Part VII contains a further process for the granting of protection from elements of Part IV of the TPA — notification. The notification process (s. 93) provides protection from exclusive dealing provisions. A corporation can lodge a notification with the ACCC of the provisions in an agreement which risk breaching section 47 (exclusive dealings). Notification does not provide immunity from section 45 (anticompetitive arrangements). When a notification is lodged, the conduct is deemed not to have a substantial lessening of competition. The ACCC can only withdraw protection if it is satisfied that the provision is likely to have the effect of substantially lessening competition and that in all the circumstances either:

- no public benefit results from the conduct; or
- any public benefit would not outweigh the detriment (Miller 2004, p. 938).

However, the notification procedure typically would not apply to carrier agreements since they usually contain provisions which would risk breaching both ss. 45 and 47 (notification only applies to s. 47). For such agreements, carriers would most likely need to pursue authorisation.

8.3 Alternatives under Part VII for shipper bodies

Part X grants designated shipping bodies the authority to negotiate collectively with carriers on several issues — this is often referred to as granting countervailing powers to Australian shippers. However, should Part X be repealed such arrangements *may* risk breaching Part IV of the TPA. Shipping bodies may wish to receive Part VII protection for collective bargaining arrangements. There are several possible options available. These are:

- authorisation for collective bargaining;
- notification for collective bargaining; and
- export agreement exemption.

Authorising shippers' collective bargaining agreements

If Part X is repealed, shipper bodies which are currently registered under Part X, will be able to seek authorisation under Part VII. The authorisation process is outlined above in section 8.1. The ACCC submitted:

> If Part X is abolished, shippers and their representative organisations could retain their ability to collectively negotiate prices and/or services with shipping lines through the authorisation process, provided the conduct generates a net public benefit.
>
> Such authorisations could be designed to cover the process of collective negotiations between shippers and shipping lines generally (both individually and/or in grouping) for a period of time. This could allow immunity to apply to any agreement negotiated and put into effect with any individual or group of shipping lines during the authorisation period, without the need to seek authorisation for each agreement shippers may be entering into with particular shipping lines. (sub. DR30, p. 5)

Previous authorisations for such arrangements demonstrate that it should be relatively straightforward to receive authorisation. The ACCC has previously authorised collective bargaining for chicken growers, dairy farmers, sugar cane growers, lorry owner-drivers, TAB agents, newsagents and small private hospitals (sub. 21, p. 62).

The costs to shippers of applying for authorisation should not be too onerous. The Dawson review found that since 1995, only two authorisation applications for collective bargaining had been rejected by the ACCC, and conditions had been imposed in less than half the authorisations granted. Since 1995, the ACCC has not revoked any authorisation for collective bargaining (Dawson et al. 2003, p. 112). In saying that, however, the review acknowledged that some small businesses have faced an onerous task in seeking authorisation for collective bargaining (to achieve bulk buying or selling efficiencies) against larger businesses. But, the review did

not conclude that businesses which fall outside the small business definition should receive special treatment. Authorisation was seen as the most appropriate procedure for allowing collective bargaining between non-small businesses (Dawson et al. 2003, ch. 7).

The authorisation process contained under Part VII would provide shipper bodies and other groupings of individual shippers the ability to seek protection against prosecution under Part IV. This would enable shipper bodies to continue to negotiate collectively with carriers, as currently allowed under Part X.

Notification for collective bargaining

Following a review of the TPA (the Dawson review), the Trade Practices Legislation Amendment Bill 2004 was introduced into Parliament[5]. The Bill contains amendments which instigate a new notification process that enables small businesses to bargain collectively with big businesses.

The main effect of the change is that the applicant is no longer required to demonstrate the net public benefit. Under the new procedures, the onus is on the ACCC, in a limited time period, to provide notice that the conduct does not — or is unlikely to — benefit the public, or will not outweigh the detriment resulting from the conduct.

For these provisions to apply, a small business must:

- propose or make an initial contract with another small business with which it plans to collectively bargain about selling or acquiring goods and services from a third party (the target);
- reasonably expect that they will make at least one contract with the target in regard to selling or acquiring at least one of the goods and services; and
- reasonably expect that the total value of the transactions it will conduct with the target in any 12 month period in regard to the goods and services identified will not exceed $3 million or other amount prescribed by regulations. The regulations may vary the amount for different industries (Explanatory Memorandum, Trade Practices Amendment Bill 2004, p. 50).

The proposed collective bargaining notification process appears to be of little help for the majority of shippers as their contracts with carriers would typically exceed $3 million per year. Authorisation would therefore need to be sought for such collective bargaining arrangements.

[5] The progress of the Bill was stopped by the proroguing of Parliament in August 2004. It is expected that the Bill will be reintroduced into the new Parliament in 2005.

Export agreement exemption

The export agreement exemption contained in section 51(2)(g) of the TPA may be an alternative to the exemption under Part X for shippers to collectively bargain with carriers. The export agreement exemption applies to any provision in any understanding or contract that relates exclusively to the export of goods from Australia, or the supply of services outside of Australia. It applies to all conduct under Part IV, except secondary boycotts and resale price maintenance. Unlike Part X, export agreements are exempt from section 46 (misuse of market power).

To be eligible for the exemption, parties to the export agreement need to notify the ACCC within 14 days of the agreement being made. There are no forms to complete or fees to pay. Exporters need to provide the following information to the ACCC:

- a full copy of the export agreement;
- a copy of the actual relevant provisions of the export agreement; and
- details of the relevant provisions which may involve conduct prohibited by the TPA.

Exporters need to provide the ACCC with enough information to demonstrate that the agreement relates to the export of goods or the supply of services outside of Australia. The ACCC (2004c, p. 2) noted that information on prices of goods and services is not needed, but details of any method of fixing, controlling or maintaining prices are needed.

Exporters can request that the ACCC provide a certificate which can be presented in any subsequent court hearing as evidence that the contract was lodged with the ACCC on a specific date. Export agreements are lodged confidentially with the ACCC and are not available for public inspection (although details can be provided to the courts or Minister). The TPA does not prevent the ACCC from acknowledging that an export agreement has been lodged.

The export agreement exemption may enable shippers and shipping associations to form anticompetitive agreements. Unlike Part X, there is no requirement to be registered or for the exemption to apply only to government approved exporting bodies. Any individual, business, freight forwarder, or association which engages in exports can notify the ACCC and receive immunity.

The application of this exemption to the liner cargo shipping industry is untested, and there does not appear to be much precedence on the application of this provision to other industries. There is also legitimate debate over whether the term ‘exclusively’ for the export of goods relates only to the actual contract of sale, or whether it can apply to carriage, or other acts, in the course of the export of goods.

The ACCC (sub. DR30) advised the Commission that it believes the provision only applies to the actual contract of sale. The contract for carriage is, in the opinion of the ACCC, the acquisition of services from an Australian market.

However, there has been no clear judicial statement on whether the term 'provision for the export of goods from Australia' would or would not apply to agreements for the carriage of goods for export. The most direct quote comes from Justice Deane (in the Federal Court):

> There is plainly room for legitimate differences of opinion as to the precise meaning to be given to the words of s. 51(2)(g) … It also results, in part, from the difficulty in determining whether the reference to a provision relating "exclusively" to the export of goods should be restricted to a provision dealing with actual export as such or should be construed as embracing contracts for the carriage of goods in the course of their export. (*Refrigerated Express Lines v Australian Meat and Live-Stock Corporation* (1980) 29 ALR 333, at pp. 344–5)

As a result, the export agreement exemption may be of limited use to Australian outward shippers due to the uncertainties of its application. Shippers would need to apply for authorisation if they wish to receive protection from potential prosecution under the TPA for collective bargaining agreements.

FINDING 8.3

Shippers and their representative organisations are able to seek protection for collective bargaining agreements through the authorisation process in Part VII. This would enable shipper bodies currently registered under Part X to continue to represent the interests of their members and to negotiate individually and collectively with carriers.

8.4 Major concerns about alternatives

Several concerns about the application of Part VII to international liner cargo shipping were raised in the submissions received by the Commission — for example, see Department of Transport and Regional Services (sub. 9) and Shipping Australia (sub. 16). These concerns focused mainly on:

- whether the ACCC is likely to authorise core elements of some carrier agreements, particularly the price-fixing provisions;
- increased regulatory uncertainty arising from the ACCC's ability to revoke authorisations, and uncertainty about the process, the criteria the ACCC would apply and the conditions that would trigger reviews;

- how the ACCC would deal with the 'fluid' nature of membership to carrier agreements;
- relatively high compliance and government administration costs; and
- carriers refusing to service Australian ports.

The validity of each of these concerns is examined.

Would price fixing be authorised?

While the TPA explicitly permits price fixing to be authorised, several participants suggested that the ACCC would be unlikely to authorise price-fixing provisions of conference agreements, principally because under Part IV of the TPA, price fixing is a *per se* offence. For instance, the Department of Transport and Regional Services said:

> … it is by no means clear that joint price setting, a key factor in some conference agreements and one which is a *per se* offence under Part IV of the TPA, would be authorised [by the ACCC]. (sub. 9, p. 28)

The anticompetitive detriment of price fixing would typically be high, and as such, would require off-setting public benefits before it could be authorised under Part VII. While the public benefits would need to be larger than for other types of anticompetitive behaviour, there have been recent authorisations relating to price-fixing provisions. The Qantas–British Airways JSA (see above) involves price fixing and has been authorised three times since 1995. In addition, the Australian Competition Tribunal approved the proposed Qantas–Air New Zealand joint service (also containing price-fixing provisions). These two decisions demonstrate that price fixing is not a barrier to authorisation. It is only one factor in the assessment of whether the proposed behaviour would result in a net public benefit. The more pressing factor seems to be the level of competitive pressure and its ability to ensure the applicants pass on the cost savings through lower prices.

Submissions have stated that the liner cargo shipping industry is competitive. The central issue for authorisations would appear to be whether or not such competitive pressures are significant enough to ensure that carriers pass on their cost saving (or other benefits) to shippers. This can only be answered on a case-by-case basis. However, previous authorisations have indicated that joint service agreements (with price fixing) between carriers with relatively high market share could still be authorised.

Even if it were difficult to obtain authorisation for agreements that contain price-fixing provisions, there is increasing evidence that price fixing is not needed for

achieving operational efficiencies in the liner cargo industry. The diminishing significance of price fixing in carrier agreements is reflected by the move away from the use of common conference tariff rates since the Commission's 1999 report. This has been the experience in all major trades, especially in European and American routes (chapter 6). Further, most operational agreements currently registered under Part X are either silent on price fixing or state that parties will market separately (chapter 3). Even if the authorisation process reduced the incidence of price fixing in carrier agreements at the margin, it is noted that around 80 per cent of cargo on Australian routes is currently transported under individual service contracts.

Indeed, several participants have indicated that they have benefited from price competition among carriers that are members of the same agreement. For example, the Tasmanian Freight Logistics Council stated that shippers in Tasmania have access to five different carrier agents, even through they are all members of the same consortia. As a result, 'it makes it relatively easy for people to get the price they want' (trans., p. 53). The Australian Federation of International Forwarders also informed the Commission that they always try to negotiate prices with individual carriers, rather than use the common tariff (trans., p. 73). Similarly, a member of the Australian Horticultural Exporters Association (AHEA) commented that competition 'absolutely' helps shippers (trans., p. 114).

Uncertainty for industry

It has been submitted that reliance on Part VII authorisation would increase uncertainty for the industry. This is due to the time it takes to receive authorisation, the intensity of work needed to demonstrate a net benefit and the risk of revocation.

The Department of Transport and Regional Services stated:

> Of particular concern to liner shipping companies is uncertainty of the outcome of applications for authorisation under Part VII of the TPA. Shippers, as well as carriers, are concerned that authorisation can be protracted and expensive, requiring considerable inputs of management time and of legal and financial or economic advice. (sub. 9, p. 28)

Similarly, Shipping Australia is of the view that applications for authorisations would be lengthy and costly. It submitted:

> … the processes involved in authorisation decisions are lengthy, as the ACCC must have regard to all submissions put by any interested party (therefore a long review process is guaranteed). Such a process would be a major problem in administration, time and practicality to both shippers and conference members alike. (sub. 16, p. 37)

The ACCC informed the Commission that the average length of time for the 29 authorisations finalised in 2003 and 2004 was eight and a half months (sub. DR30, p. 3).

The length of time taken by the ACCC to reach a decision was also raised as a problem in submissions to the Dawson review of the TPA (Dawson et al. 2003, p. 112). In response, the review recommended that a time limit be imposed on authorisation decisions. Upon implementation of the Dawson recommendations, the ACCC must make a decision within six months. If it does not, the authorisation is deemed to have been approved (see Trade Practices Legislation Amendment Bill 2004). Shipping Australia argued that even when authorisations are granted within the six months time limit, the costs would be higher than under Part X. It commented:

> Whilst it is acknowledged that the authorisation time scale could be reduced to 6 months as a result of Government implementation of the recommendations of the Dawson review of the TPA, this is still considered by SAL to be inadequate … (sub. DR4, p. 19)

However, in practice, it is the time it takes to receive interim authorisation which is the most uncertain period for applicants. Once an interim authorisation is received, full immunity from prosecution under Part IV applies until the authorisation process is completed. In the past, most interim authorisations granted have resulted in final authorisations. The ACCC granted interim authorisation in 16 of the 19 requests in 2003 and 2004. The time taken to grant interim authorisation was also just over three weeks.

While authorisation under Part VII would result in greater uncertainty for carriers than currently applies under Part X, the Commission considers that this is not unreasonable given the potential for some carrier agreements to provide significant anticompetitive detriment. It could also be expected that agreements which provide clear cost savings with little anticompetitive risk would be authorised expeditiously.

Responsibility of demonstrating public benefits

The amount of work required to demonstrate a net public benefit from carrier agreements will vary greatly depending on the types of anticompetitive behaviour for which authorisation is sought. The cost associated with demonstrating a net public benefit would be high if authorisation was sought for highly anticompetitive behaviour (such as price fixing or supply control) — mainly because it would be more difficult to demonstrate that such behaviour could result in a net public benefit than if authorisation was sought for joint scheduling and asset sharing agreements that involve significant cost savings.

As outlined in chapter 5, currently, no examination of benefits and detriments is required prior to the registration of agreements. Reviews of agreements are limited to there being exceptional circumstances and the onus is placed on the ACCC to demonstrate that the agreement results in a net public detriment. The experience of investigations under Part X has demonstrated how difficult the ACCC has found it to gain the necessary information. The ACCC submitted that:

> The ACCC has formed the view that, due to the current structure of Part X, there is little incentive for the lines to provide evidence to the ACCC during investigations to demonstrate that liner agreements provide public benefits to Australia. (sub. 21, p. 6)
>
> The ACCC considers the removal of the Part X investigation function from Australia's liner shipping markets would be a significant benefit. The protracted and resource intensive process experiences over the last five investigations has not appeared to have been successful. Given the inherent difficulty in proving or satisfying Part X's investigation criteria with inadequate market data, the discontinuance of the investigation function is likely to enable resources to be saved, whilst achieving similar market outcomes. (sub. 21, p. 63)

The Commission is of the view that the costs of demonstrating that the anticompetitive behaviour results in offsetting public benefits *should* be borne by the party (or parties) claiming, and receiving, the benefit of authorisation for such behaviour. There are several reasons for this.

First, legal obligations should be placed upon the party which has the least cost of meeting them (Coase 1960, p. 2; Posner 1992, p. 52). This implies that the burden to prove the existence (or non-existence) of public benefits should be placed upon the party with the easiest access to the necessary information. In the liner cargo shipping industry, this is the carriers.

Second, the costs involved in seeking authorisation play an important rationing role. That is, a firm would only seek authorisation where the benefits of avoiding the risk of engaging in anticompetitive behaviour outweighs the cost of applying for authorisation. This can be compared to the current practice under Part X where many agreements are registered even though they are unlikely to be anticompetitive (chapter 7).

Third, such an approach is consistent with National Competition Policy and the treatment of other Australian industries. Currently, the liner cargo shipping industry is the only industry in Australia which does not have this responsibility.

There are, however, situations where the responsibility should be placed on the ACCC to show that the behaviour would result in no net public benefit. For example, situations which generally result in clear public benefits and do not give rise to risks of detrimental effects. Such a situation can be seen in the reversing of

the onus with respect to small business collective bargaining (see Dawson et al. 2003). However, the analysis in chapter 7 has shown that there is no guarantee that all, or even most, types of carrier agreements result in a net public benefit. Rather, the analysis indicates that many agreements (conferences and discussion agreements) could give rise to significant anticompetitive detriments. Hence, there appears to be a significant risk that leaving the responsibility on the ACCC would result in the authorisation of agreements which could cause significant anticompetitive detriment to the Australian economy as a whole. The ACCC submitted:

> A *prima facie* assessment of the ACCC's investigation history indicates that it is difficult to recommend deregistering a liner agreement. For example, the ACCC was unable to recommend deregistration of the AADA [Asia–Australia Discussion Agreement] despite concluding that the public benefits claimed by the AADA had not been substantiated. Therefore, the ACCC believes there is little incentive for shipping lines to provide evidence of public benefits under the current Part X arrangements, either prior to registration or during investigations. (sub. 21, p. 6)

However, Shipping Australia considered that placing the cost of demonstrating a net benefit on carriers is a:

> … misunderstanding of the significant public interest benefits to Australian exporters and to a lesser extent importers that arise from the operation of Part X. (sub. DR4, p. 20)

As stated in chapter 7, it is important that a process exists that distinguishes between agreements which provide net public benefits and those which do not. The relevant question is whether it is more efficient to place the responsibility of demonstrating the net benefit (or net detriment) on the applicant or the ACCC. With respect to liner cargo shipping, the most efficient outcome would occur where the carriers bear this responsibility. The Commission believes that Part VII would provide the appropriate incentives for the carriers to provide information demonstrating the benefits of such an agreement. This would enable a full and efficient assessment of carrier agreements.

Compliance and administration costs

Compliance costs incurred by business seeking authorisation include the costs of:

- preparing applications, which may include legal fees;
- preparing additional submissions to the ACCC (for example, responding to a draft decision or to submissions by other interested parties);
- appearing at a conference to consider an ACCC interim decision;
- preparing (or appearing as a party to) an appeal; and

- complying with notification requirements or enforceable undertakings (for example, to inform the ACCC of changes in conference membership).

While it is not possible to determine the likely magnitude of these costs for liner shipping carriers, and other interested parties, compliance costs to carriers, though significantly higher under Part VII than under Part X, would unlikely to be restrictive. The application fee is $7500 (with a concessional fee of $1500 for the same or additional applicants engaged in similar behaviour) and most applicants would also face the costs of specialist economic or legal consultants. However, there is no reason to believe that the compliance costs faced by the liner cargo shipping industry would be significantly higher than those incurred by other industries. The high compliance cost of Part VII was a concern addressed in the recent Dawson review. The review stated:

> The main expense involved in an application for authorisation would appear to be the legal costs associated with the preparation of the application and subsequent negotiations with the ACCC. The imposition of time limits for the consideration of applications for non-merger authorisations would, the Committee thinks, improve the process and reduce these costs. (2003, p. 113)

The costs of preparing an authorisation application need to be assessed against the benefits of the arrangements which are to be authorised. An example of the cost savings resulting from a conference-like arrangement is the savings Qantas expected to make through their joint service arrangement with British Airways. Qantas estimated that it will save around $43 million (ACCC 2004b, p. 106). If the cost of preparing authorisation was $1 million, this would only represent around 2 per cent of the expected cost savings.

The Department of Transport and Regional Services agreed 'that the costs of authorisation, although substantial, would not be the decisive deterrent for carriers from seeking authorisation for their agreements' (sub. DR18, p. 19). The ACCC further noted that in its experience, the cost of an authorisation application is much less than $1 million for the vast majority of cases (pers. comm.).

Carriers will stop coming to Australia

Several participants argued that repealing Part X would result in carriers refusing to service Australian ports. Responding to the draft report, Shipping Australia stated that repealing Part X:

> … puts at risk Australia's $120 billion international liner trade when the benefits to Australian exporters and importers from increased regulation under Part VII has not been justified. (sub. DR4, p. ii)

The Australian representative of Maersk Sealand stated that given the current market situation, Maersk might reconsider coming to Australia:

> As an agent down here, I'm under demand all the time to justify why we keep the ships in the Australian trade — because there is that much more money to be made in other trades … and certainly the fact if consortia will no longer be possible, there will be years where Australia can't come to market. (trans., p. 38)

The Australian Peak Shippers Association also warned that repealing Part X could result in carriers refusing to supply some Australian ports, since ships:

> … are mobile assets with high fixed operating costs. Left purely to market forces, carriers would concentrate on lucrative trades and abandon the not so lucrative ones. (trans., p. 56)

While it is difficult to test the veracity of such claims, *ex ante*, certain observations can be made. In the first instance, the existence of Part X has not prevented carriers from abandoning routes to particular ports. The Tasmanian Freight Logistics Council commented that the AAX consortium stopped servicing Tasmania because '[f]or the amount of containers they were able to pick up, it just wasn't perceived as worth their trouble'. The Council continued to note that that the 'nature of shipping, with faster vessels and larger vessels and a lot of north–south routes from Australia now, is that they are making fewer calls' (trans., p. 49).

More generally, the existence of Part X in Australia is unlikely to influence the rationalisation of existing services. For example, the Australian Peak Shippers Association commented that 'it's a worldwide trend in all continents that a number of ports are being culled' (trans., p. 61). Similarly, the Australian Federation of International Forwarders commented that moves towards rationalisation are a worldwide trend which is happening in Australia regardless of Part X (trans., p. 79).

Further, where it could be demonstrated that carrier agreements are a precondition for the supply of liner cargo shipping services to Australia, the ACCC has indicated that this will be taken into consideration in the authorisation process. The ACCC stated:

> Importantly, the provision of scheduled liner services to Australia is unlikely to be jeopardised by a change in the regulatory environment. The ACCC recognises there are strong arguments that the provision of scheduled liner shipping services to and from Australia constitutes a benefit to exporters and the community. Where the provision of a particular scheduled service is dependent upon an anticompetitive arrangement, the ACCC would take this into account in deciding whether to authorise the arrangement. (sub. DR30, p. 1)

The Commission does not view supply-side agreements, such as consortia and slot-sharing agreements, as being intrinsically anticompetitive. Both theory (chapter 4)

and the Australian experience (chapter 7) suggest that consortia play an important role in reducing costs and combining services so that carriers can jointly service trades which individually, they may be unable to do so. Shipping Australia submitted that it is the consortia and other supply-side agreements under umbrella agreements which arrange the supply of service. Shipping Australia noted:

> … you have the operational agreements which you can source through a joint service and they have their economic rationalisation reasons of sharing large capital assets and so on. They operate under an umbrella mostly. In fact, I can't think of any that don't. They operate under the umbrella of either a discussion agreement, which is the more common form of conference, and there are still a few conferences left … (trans., p. 22)

Consistent with the experience in other countries, it is likely that carriers would adapt to a new regulatory regime rather than move to withdraw services. Some reshaping of agreements may be necessary to obtain regulatory approval and, provided worthwhile commercial opportunities remain, this appears to be the more likely commercial response by carriers.

8.5 Do the alternatives achieve the rationale of Part X?

The proposed reformulated objectives of Part X are to:

- promote competition while facilitating efficient coordination and joint provision of liner cargo shipping services; and
- assist Australian shippers to have access to liner cargo shipping services of adequate frequency, geographical coverage and reliability, at freight rates that are internationally competitive (recommendation 7.3).

These objectives would be achieved primarily through agreements for the coordination of services (such as consortia, alliances, slot sharing and joint ventures). To be an effective alternative to Part X, Part VII should be capable of allowing for the provision of agreements for the coordination and joint provision of services. It should also ensure that agreements to coordinate on freight rates are allowed only where it can be demonstrated they result in a net public benefit.

The rationale of Part X would be met through the use of Part VII processes (such as authorisation). Experience with Part VII suggests that agreements that are needed to provide operational efficiency in other industries (and hence a public benefit) are generally authorised (or do not require authorisation). Agreements which include freight rate cooperation would only be authorised where it could be demonstrated that such cooperation resulted in a net public benefit; the degree of market power would be a key factor. While carriers would face greater compliance costs, these hurdles should not prohibit carrier agreements from seeking authorisation.

Jurisdictional issues

Some participants have questioned whether reliance on Part VII would result in agreements between carriers being made offshore, and hence, be beyond the jurisdictional reach of the ACCC or Australian courts. The Department of Transport and Regional Services stated:

> As liner shipping companies operating under conference agreements in Australia also operate in the countries of our major trading partners, if it became illegal for such companies to collaborate in Australia, consideration needs to be given to whether the issues of freight rates and levels of service could not be dealt with overseas, and to whether the extended application of Part IV of the TPA (s. 5) could deal adequately with such a situation. (sub. 9, p. 29)

Shipping Australia argued that jurisdictional problems would overshadow the objective of ensuring efficient liner cargo shipping services to Australia. It stated:

> Application of that regime [Part IV] would pit Australia against the strength of the regulatory regime in other countries and the focus of attention would be on resolving jurisdictional problems and the difficulties that arise with the seeking of the extraterritorial application of Australian law. The objectives set under the Australian Government's approach to international liner shipping policy could not be achieved under such a regime. (sub. 16, p. 43)

In contrast, the Australian Chamber of Commerce and Industry (representing Australian shippers in numerous States and Territories) noted that:

> If the carriers truly hold to that view [moving agreements offshore], then they would have no objection to the repeal of Part X; that is, they will get their legal protection somewhere else. (trans., p. 121)

The ACCC acknowledged there is a potential for jurisdictional conflict, but that there are international bodies and agreements set up to deal with such issues. It stated:

> The international nature of the liner shipping industry gives rise to a potential for jurisdictional conflict in its regulation. However, this problem is not unique to liner shipping and did not prevent the ACCC successfully prosecuting an international cartel of foreign firms that supplied vitamins to Australia.
>
> Working through organisations such as the International Competition Network (ICN) and the OECD, the ACCC will continue to develop the necessary relationships with regulators in foreign jurisdictions in order to ensure that anticompetitive activity affecting Australian markets can be investigated and prosecuted. (sub. 21, p. 65)

The TPA (and Part IV prohibitions on anticompetitive behaviour) applies not only to Australian corporations, but also foreign corporations which carry on business in

Australia (s. 5). The Federal Court in *Bray v Hoffman-La Roche Ltd*[6] clarified that an overseas business does not need a place of business within Australia in order for section 5 to apply. A foreign corporation may also be liable for its Australian subsidiary. Further, if the alleged anticompetitive conduct arises from sending a facsimile, e-mail, letter, or by telephone (or any other overseas communication) and the communication was directed to, and expected to be, and was received in Australia, such conduct can be considered as taking place in Australia (Miller 2004, p. 129).

The anticompetitive provisions of the TPA would apply to carriers engaged in liner cargo shipping services to any Australian port (whether inwards or outwards), irrespective of whether the organisation of such behaviour occurred offshore. A carrier would most likely be subject to the TPA if one or more of the following are present:

- the carrier has Australian customers;
- relevant negotiations regarding the provision of liner cargo shipping services occurred in Australia;
- the carrier has a place of business in Australia;
- the carrier advertised its business in Australia;
- any part of the payment transaction occurred in Australia; or
- the carrier has contracts with their customers which are enforceable under Australian law.

It would be more difficult, however, for the ACCC to gather evidence of agreements reached outside of Australia than if they were made in Australia. Although extra-territorial enforcement of competition laws is still an emerging and complex area, enforcement bodies are increasingly cooperating. This enables greater scope for enforcement. There can, however, be practical problems involved in the investigation and subsequent enforcement of judgments obtained. The ACCC finds it preferable to use its cooperation agreements with overseas agencies so that investigations are carried out by the country in which the company is based. An issue in this regard would be the extent to which foreign authorities would be willing to pursue investigations on matters which are in breach of Australian law but not in their own domestic jurisdiction.

The ACCC currently has agreements with the United States' Federal Trade Commission, the United Kingdom's Office of Fair Trading, and agreements with Taiwan, New Zealand, Canada, and Korea. In addition, the OECD agreed in 1995 to

[6] (2002) ATPR 41-865, at [63].

a set of principles which guide the notification, exchange and coordination of enforcement information and activities (OECD 1995). The OECD has also recommended that member countries cooperate in effective coordination and enforcement against hard core cartels (OECD 1998). The ACCC is also a member of the International Competition Network (ICN). In addition to cooperative agreements, the Australian Government in 1999 signed a treaty with the United States on Mutual Antitrust Enforcement Assistance.

In the past, it may have been correct to say that national boundaries were a barrier to the effective international enforcement of competition laws. But with the development of bilateral and multilateral agreements, the international recognition and enforcement of domestic competition laws has become more prevalent and should not be an obstacle to the application of Part IV to the international liner cargo shipping industry.

The Commission considers that the authorisation process would better ensure that only carrier agreements which result in a net public benefit receive immunity from Part IV of the TPA. This would address the main weakness of the current Part X regime (chapter 7). Shippers would also be able to seek authorisation for collective bargaining agreements. While the proposed small business notification process would not apply to the majority of shippers due to the size of their transactions, authorisation of these agreements should not pose a major impediment.

Some submissions raised concerns over the applicability of the authorisation process to the liner cargo shipping industry, including: the uncertainty of the authorisation process; the compliance costs involved in seeking authorisation; and the extra-territorial application and enforcement of the TPA. The Commission considers that the use of interim authorisations and changes contained in the Trade Practices Amendment Bill 2004 should reduce the uncertainty of the authorisation process. Further, through various international enforcement agreements, the risk of carriers avoiding the TPA while still servicing Australian shippers seems small and is not equivalent in other jurisdictions with differing regulatory systems. The Commission acknowledges that the potentially substantial costs of demonstrating a net public benefit will be borne by applicants for authorisation. However, this is appropriate as some carrier agreements involve significant anticompetitive behaviour and it is not clear that they would provide a net public benefit.

In summary, the Commission's preferred option is that:

RECOMMENDATION 8.1

Part X be repealed, thus making the liner cargo shipping industry subject to the general provisions of the Trade Practices Act.

8.6 Transitional arrangements

Repeal of Part X would involve a substantial departure from established practice in the liner shipping industry. Consequently, there would need to be suitable transitional arrangements put in place to minimise disruption and ensure continuity of service until ocean carriers gained familiarity with the new requirements and processes for seeking immunity for their agreements. The need for suitable transitional arrangements was supported by all participants who advocated repeal of (or major changes to) Part X.

The Department of Transport and Regional Services commented that should Part X be repealed it would be:

> … imperative that satisfactory transition arrangements should be put in place in order to minimise the disruption to services that could occur. A long transition period would minimise the effects of Australia's regime being out of step with those of its major trading partners. (sub. DR18, p. 18)

The Western Australia Shippers Council (a member of APSA) and Chamber of Commerce and Industry of Western Australia supported the introduction of a transition period (sub. DR 10). The National Farmers' Federation submitted that:

> As there are considerable anticompetitive risks associated with the Part X provisions, NFF is suggesting, as it did in previous submissions, that there should be a gradual and predictable movement towards the application of the general TPA rules. (sub. DR29, p. 1)

The Law Council of Australia suggested that any transitional period have a time limit of three years:

> Such a lengthy transition period should not cause any hardship to any parties to Part X agreements, and should also ensure that the ACCC completes its review of those agreements in a reasonable time. (sub. DR13, p. 2)

The National Farmers' Federation submitted that the transitional period run for a period of three to five years:

> In the context of previous submission NFF has suggested that those organisations which were using Part X of the TPA be guaranteed access to Part VII authorisation for a period of three to five years with such authorisation subject to revocation in the event that abuse of market power is proven. (sub. DR29, p. 2)

The ACCC, in its submission (sub. 21, pp. 58–60), suggested possible transitional arrangements to assist carriers in the move from blanket Part X exemptions to authorisation under Part VII. The ACCC suggested that:

- liner agreements registered under Part X would be *deemed* to be authorised pursuant to an Amending Act;

- deemed authorisation would give the same immunity as actual authorisation under Part VII; and
- deemed authorisation would continue to protect each liner agreement until that agreement was reviewed by the ACCC.

Deemed authorisation would be subject to two conditions: carriers continue to abide by the terms of registered carrier agreements; and carriers still abide by the obligations imposed by Part X. These conditions would ensure that carrier agreements would continue as if they were still covered by Part X, until they are reviewed. Non-compliance would trigger a revocation process as under sections 91B(3)(b) or 91C(3)(b).

Commission's proposed transitional arrangements

The Commission is of the view that, if Part X is repealed, transitional arrangements should be implemented. These arrangements could have the following features:

- delay the repeal of Part X for one year after the promulgation of the Amending Act to enable all operational agreements to be identified and deemed authorised by the ACCC;
- provide for all agreements deemed authorised to be provided with immunity for a transitional period of three years, at the discretion of ocean carriers (for carrier agreements) or shippers (for shipper collective bargaining agreements);
- during the transitional period, members to an agreement would be able to request the ACCC to provide advisory assessments as to the requirements for each agreement to be eligible for authorisation under Part VII — the advisory assessments would not be binding on the ACCC; and
- at the end of the transitional period, the general provisions of the TPA would apply and parties, who have not already done so, would need to apply for authorisation.

Certainty was a major concern for many carriers and shippers. The delayed start and three year transitional period would give carriers and shippers four years before Part VII becomes effective and allow them time to become familiar with Part VII processes. It should also ensure that carrier agreements (such as consortia) which provide for the scheduling of services are not disrupted. The delayed start should allow both regulators, carriers and shippers to identify those registered agreements which are in use and allow carriers to self-assess their agreements with an eye to the application of the Part VII process.

During the transitional period, minor variations to agreements that are deemed authorised (such as changes to membership that does not affect market share) would

not remove the agreement from the transitional arrangements. However, new agreements created after the start of the transitional period should not be covered by the transitional arrangements and would be subject to the general provisions of the TPA.

In addition to the certainty given by deemed authorisation, the ACCC would also undertake advisory assessments of relevant agreements, upon the request of members of an agreement. The advisory assessments could indicate the provisions which would likely breach Part IV of the TPA and, therefore, would require authorisation (in a similar manner to which informal discussions occur currently under Part VII). This advice should help carriers to identify agreements unlikely to require authorisation or likely to be authorised without amendment and to prepare authorisation requests. It would be in the carriers' interests to cooperate with the ACCC in providing relevant information in order to obtain more soundly based advisory assessments and therefore a better guide to final outcomes. These factors should also assist carriers and shippers to apply for authorisation at the earliest possible time, so that agreements which would pass the authorisation test could be authorised prior to the end of the transitional period (if the parties so wish).

Deemed authorisation should also be subject to certain conditions. Such conditions could include:

- carriers continue to abide by the terms of registered carrier agreements; and
- carriers still abide by the obligations imposed by Part X.

Agreements that have been deemed authorised would still be subject to misuse of market power provisions of the TPA (s. 46).

After the three year transitional period, agreements that have not already sought and received authorisation would become subject to the application of the general provisions of the TPA and would need to apply for authorisation. At the end of the transitional period, the flexible nature of the authorisation process should ensure that any remaining agreements which needed to be authorised would not cause an undue administrative burden on the ACCC.

The adoption of the transitional arrangements would initially result in little obvious change for the Australian liner shipping cargo industry. This should ensure the continuity of current liner shipping services. During the transitional period, the ACCC should be able to provide advisory assessments of agreements that would reduce the uncertainty of the authorisation process for carriers and shippers. These processes should result in carriers, shippers and regulators being prepared for the application of the TPA some four years after the promulgation of an Amending Act. The effects of the recommended transitional arrangements are summarised in box 8.1.

Box 8.1 **Effect of proposed transitional arrangements**

Conferences and discussion agreements

These agreements would be deemed authorised for three years, after which, they would be subject to the requirements under Part IV of the TPA. During this time, members of an agreement could request the ACCC to provide advisory assessments. During the deemed authorisation period, these agreements would continue to abide by the terms of the relevant registered agreement, and abide by the obligations imposed by Part X.

Operational agreements

Operational agreements would be deemed authorised for a period of three years, after which, they would be subject to the requirements under Part IV of the TPA. The ACCC would be able to provide advisory assessments of these agreements, although it would be expected that not many would require significant amendments in order to meet Part VII requirements.

Shipper bodies

Shipper bodies would be deemed authorised for a period of three years. After this period, the behaviour of such bodies would be subject to the requirements under Part IV of the TPA. The ACCC may also provide advisory assessment of these arrangements, at the request of shippers. However, it would be expected that most shipper collective bargaining agreements would meet the Part VII requirements.

In summary, the Commission considers that with the repeal of Part X:

RECOMMENDATION 8.2

Transitional arrangements be introduced. Such arrangements should provide deemed authorisation for operational Part X agreements (subject to certain conditions). These arrangements giving four years before Part VII became fully effective, would entail:

- ***delay the repeal of Part X until one year after the promulgation of an Amending Act;***
- ***authorise only agreements which are operational at the beginning of the transitional period;***
- ***deemed authorisation to continue for three years; and***
- ***the ACCC to provide advisory assessments of deemed authorised agreements, at the request of members of an agreement, so as to assist applicants in applying for Part VII authorisation at the end of the transitional period.***

8.7 International implications of preferred recommendation

This section outlines the international implications of repealing Part X and relying on Part VII authorisation. Any change to the domestic regulation of the international liner shipping industry would affect Australia's interaction with other jurisdictions' regulation of the industry.

The nature of agreements which would be authorised cannot be predicted accurately in advance of individual assessments as it would depend on each application's unique circumstances. However, likely approaches can be predicted based on an agreement's 'general' characteristics — that is, whether one type of agreement generally results in a net benefit or not. Using this approach, it is anticipated that adopting recommendation 8.1 would have the following effects:

- operational agreements would typically be authorised under Part VII, due to the low anticompetitive risk of such agreements (this would be subject to exceptions such as high market share or inter-membership between agreements); and
- conferences and discussion agreements which contain price-fixing or price-discussing provisions would generally not be authorised under Part VII (particularly where they covered a dominant share of the trade on a route), unless it could be demonstrated that such provisions were needed for the agreement to result in a net benefit to Australia.

Australian shippers and carriers raised concerns that relying on Part VII would result in Australia's regulation being inconsistent with the regulation of liner cargo shipping in other jurisdictions (notably the EU and the United States). There is a fear that repealing Part X would represent a 'leap in the dark' — relying on Part VII authorisation would be a significant departure from the regulation of liner cargo shipping in the major jurisdictions. The interaction of the Part VII process with the regulation of the liner cargo shipping industry in the United States and EU is outlined below.

United States

The United States allows agreements to receive exemption from its competition laws so long as they contain certain provisions, including those allowing confidential individual contracting (resulting in individual pricing). The United States also allows carrier agreements to issue non-binding guidance on the provisions which individual contracts should contain. In practice, these regulations have resulted in conference agreements either being terminated or replaced by discussion agreements on the majority of US routes (Gardner et al. 2002, p. 339).

Indeed, no new conference agreements have been registered since 2000 (FMC 2003). Consortia are now the most common form of agreement on US routes, representing around 73 per cent of all registered agreements in 2003 (FMC 2003).

Under Part VII, the Commission anticipates that many discussion agreements would not be granted authorisation. United States regulation allows discussion agreements but such agreements only represent around 14 per cent of registered agreements (FMC 2003). While the Commission notes that there could be an inconsistency, between the two countries, such an inconsistency has been occurring for several years on the trans-Atlantic route without any noticeable detrimental effect. It is not expected, therefore, to result in damage on Australian–US routes. Should it be demonstrated that it has, or will likely lead to, detrimental effects, this would be an argument in support of authorising discussion agreements under Part VII provided it can be shown that such agreements would lead to a net public benefit to Australia.

Upon repeal of Part X, common pricing provisions would not be authorised in most agreements. This would bring the current Australian regulations into line with the majority of registered agreements in the United States. Conferences would either be replaced with consortia (as has been the experience in both the United States and EU — see Pons 2002), or would operate in the same manner as consortia — that is, supply-side coordination without common pricing. Since the majority of US agreements are supply-side agreements there should not be any significant detrimental effect should Part X be repealed.

European Union

The EU provides either individual or block exemptions from its competition laws through an authorisation process similar to Part VII in the TPA. The EU currently has block exemptions for consortia (which started in 1995 and was re-authorised in 2000 — Regulation 823/2000) and conferences. The regulation of post-OSRA conferences is shown through the TACA decision. Conferences are granted authorisation provided that, among other things, they provide for confidential individual contracting, do not engage in supply management, and do not allow non-binding guidance on the terms of individual contracts. The EU does not provide any exemption for discussion agreements. Consequently, such agreements are not present on the Australia–EU route.

Relying on the Part VII authorisation process would result in Australia's regulation of liner shipping becoming more consistent with the *current* EU regulation than it is currently under Part X. It is anticipated that consortia would be authorised under Part VII — this is the same as the EU. Discussion agreements, *prima facie*, would generally not be authorised under Part VII — this is the same as the EU.

Conferences, as currently authorised under EU law in line with the TACA decision (no joint price fixing, nor joint discussions), may receive authorisation under Part VII due to the removal of anticompetitive price fixing or discussing provisions. Traditional conferences (all goods carried under a common price) are allowed under the EU block exemption — although such agreements are rare in the post-OSRA setting. Such conferences would most likely not be authorised under Part VII. However, since these agreements are not common (over 80 per cent of trade on the Australia—EU route is carried under individual pricing) it seems unlikely that this would result in significant difficulties.

The EC is currently reviewing the block exemption granted to conferences (Regulation 4056/86). In its White Paper (ECDG 2004c), the EC noted that the requirements under the Treaty of Rome for a block exemption are no longer met. The EC has proposed to repeal the block exemption and is currently seeking comments on the need for any replacement legislation. If the block exemption is repealed, conferences would not be granted immunity from EU competition laws. It would therefore be likely that conferences would no longer operate on any EU route (similar to discussion agreements). If this occurs, and Part X is repealed in Australia, both the EU and Australian regulation of the liner shipping industry would, in effect, be the same.

FINDING 8.4

The anticipated effect of repealing Part X and relying on individual authorisation under Part VII of the TPA is unlikely to result in any practical inconsistencies with the regulations as currently applied in both the United States and the EU. Further, should the EU remove its block exemption for conferences, the Australian regulation of liner shipping under Part VII would, in practice, mirror the regulation in the EU.

9 Options for modifying Part X

If Part X is retained, a more selective process should be introduced for registering agreements, together with measures aimed at promoting competition in the supply of shipping services.

The registration process should differentiate between agreements on the basis of the extent of anticompetitive risk that different types of agreements pose. Rapid and low-cost registration under Part X would continue to be provided for agreements that provide potential benefits with the least anticompetitive risk. Those that pose a higher anticompetitive risk would be required to be assessed individually for authorisation under Part VII of the TPA. The Commission considers that Part X could be modified to improve outcomes in one of three ways:

One: agreements that include price fixing provisions or set maximum service levels (typically conferences and discussion agreements) could be excluded from eligibility for Part X registration.

Two: discussion agreements could be excluded from eligibility for Part X registration, in conjunction with the introduction of protection of confidential individual service contracts.

Three: protection could be introduced for confidential individual service contracts by disallowing clauses in registered agreements that limit the use of such contracts while providing enforceable penalties if confidentiality is breached.

9.1 Differentiating between agreements

As discussed in chapter 7, agreements registered under Part X have varying potential to provide a net public benefit for Australia. The balance between public benefit and anticompetitive detriment depends on the type of agreement and on the characteristics of the markets in which the agreements operate. In general, agreements that contain provisions limiting competition among members on freight rates and agreements with a high market share on a particular route, present a

greater level of anticompetitive risk than other agreements aimed at achieving operational efficiencies.

Choosing between agreements is essential if Australia is to maximise the expected benefits from allowing anticompetitive behaviour to occur. The Commission's preferred option, outlined in chapter 8, involves choosing between agreements by using the existing authorisation process available under Part VII of the TPA. That chapter concluded that the Part VII evaluation process is adequate and appropriate for liner shipping, and that, with a suitable transition mechanism in place, Part X of the Act should be repealed.

However, if Part X is retained, a more selective registration process should be introduced, recognising that different agreements have different balances of likely benefits and costs for Australia. Essentially, this involves continuing the simpler, faster and lower-cost registration process available under Part X for those agreements that provide the greatest potential public benefit with the lowest anticompetitive risk. Those agreements which present a greater anticompetitive risk would be required to seek authorisation under Part VII and be subject to individual evaluation. Two approaches are presented below either of which would, together with other recommendations contained in this chapter, improve the balance of benefits and cost for Australia from allowing carrier agreements exemptions from the laws governing anticompetitive behaviour.

Differentiating between agreements on the basis of key characteristics

Chapter 7 looked at the broad types of agreements between carriers to provide scheduled liner cargo shipping services. It concluded that the essential gain from such agreements derives from the supply-side coordination of shipping assets. This covers such things as slot chartering (the sale or cross-chartering of space or slots on vessels), vessel sharing (pooling), the coordination of sailing timetables and agreement on ports of call. Such arrangements are typically included in consortia. Such agreements deliver most of the benefits sought through cooperative shipping arrangements, including cost savings, service rationalisation and reduced uncertainty, thereby enabling a more reliable scheduled service to be provided. They do not seek to manage freight rates or limit maximum capacity. However, where the agreement parties have a very strong presence in a particular market, there is the potential for agreements to be used to manipulate available capacity to influence freight rates.

This emphasis on the management of shipping assets has been reflected in a number of the submissions to this inquiry. Those Australian users of shipping services who supported retention of Part X typically stressed the need to coordinate services to

Australia which is, by international standards, a small and regional source and destination for trade (Flinders Port South Australia, sub. 2; Port of Brisbane Corporation, sub. 10, p. 3; Tasmanian Freight Logistics Council, sub. 12, p. 1). For example, the Department of Transport and Regional Services (DTRS) commented:

> Australian shippers in all States and Territories require liner shipping services of adequate capacity, frequency and reliability to provide them with stable access to world markets. The level of freight rates may not be the prime consideration in many cases, although unforseen or rapid increases in rates are often a problem for shippers. [and that],
>
> Australia's geographical situation and the relatively small size of its liner trades means that its liner services are long, thin north-south trades, and that a liner regime allowing collaboration between shipping lines may be more important to Australia than to other, larger economies that are serviced by the mainline east-west trades. (sub. 9, p. 4)

More specifically, the Australian Peak Shippers Association (APSA) commented that:

> APSA has no problem with cost savings and efficiency enhancing agreements such as vessel sharing agreements or space chartering agreement all of which operate in Australia's trades. (sub. 5, p. 18)

The Importers Association of Australia considered that, if Part X were to be retained, the exemption should not be extended to pricing discussions and agreements, but confined to allowing shipping conferences to discuss other areas of mutual benefit such as capacity sharing and expected future demand for services (sub. 19, p. 2).

The Australian Chamber of Commerce and Industry (sub. 15, pp. 10, 15) questioned the need to allow price fixing and rate discussions, pointing to the OECD review's conclusion that there is no convincing evidence that they offer more benefits than costs. This OECD review of competition policy in liner shipping, presented in 2002, recommended that limited antitrust exemptions not be allowed to cover price fixing and rate discussions. It also considered that capacity agreements should be carefully scrutinised to ensure that they do not distort the markets in which they are present.

Similarly, the European Commission, in its 2004 review of liner shipping regulation, concluded that:

> It would appear that the restrictions of competition (price fixing and supply regulation) by conferences are not indispensable, since there are less restrictive alternatives available (notably services by independent operators, operational co-operation through consortia and alliances and long term contracting) which are able to assure equivalent reliable liner shipping services to the benefit of consumers. (ECDG 2004a, p. 22) [emphasis in original]

This concern about the price fixing elements of shipping agreements has been reflected in changes in both the United States and the European Union, where both jurisdictions have significantly strengthened the protection of confidential individual service contracts between shippers and carriers to facilitate competition and break down the ability of conferences to coordinate and manage freight rates. In addition, the European Union has different arrangements for granting exemptions to consortia (which do not include price-fixing arrangements) than to conferences (chapter 6).

Modifying Part X to differentiate between agreements

From the discussion in chapter 7 and extensive literature on the shipping industry, it is clear that the expected benefits flow from the supply-side coordination and management of shipping assets and the scheduling of services, while the greatest anticompetitive risks are posed by the inclusion of provisions to set or discuss freight rates, or manage capacity to indirectly influence rates. It is also clear that agreements do not need to contain both elements to be successful in providing scheduled liner shipping services as the existence, throughout the shipping world, of consortia and various vessel sharing arrangements (which do not contain freight rate setting provisions) attest.

Thus, Part X could be modified to select on the basis of key features of agreements. The current 'automatic' registration process would continue for agreements with low-risk features, while requiring agreements with higher-risk features to be subject to more stringent evaluation. Agreements with low-risk features would be ones that do not contain provisions:

- for the fixing or other regulation of freight rates;
- for the setting of non-binding guidance on freight rates;
- for freight rates to be discussed between members; or
- that seek to limit the maximum level of capacity on offer.

In this context, freight rates need to be defined quite broadly. Part X provides a quite broad area of exemption for carriers, essentially relating to the full range of terminal-to-terminal services and the pricing of those services. More specifically, the Act refers to freight rates as being base freight rates, surcharges, rebates and allowances. If provisions in agreements relating to the fixing or regulation of freight rates were to be excluded from eligibility for Part X exemptions, then this should relate to all prices charged in relation to a terminal-to-terminal service.

This would enable key types of existing agreements to continue to be registered under Part X, notably slot chartering arrangements and consortia without price

setting provisions. Other types of agreements, such as conferences, discussion agreements, and those consortia which include price provisions, would only be eligible for speedier registration under Part X if clauses covering these matters were removed.

Parties to agreements that sought to continue to contain provisions managing freight rates or maximum capacity would be required to demonstrate that there was a net public benefit from the inclusion of these additional features in the proposed agreement. Benefits flowing from the asset management provisions of such agreements would not be considered unless it could be demonstrated that they could not be achieved in the absence of price fixing or maximum capacity management. Rather than introduce a new, or duplicative, review process under Part X for such agreements, they would be required to seek authorisation under Part VII of the TPA.

The Department of Transport and Regional Services expressed some reservations about Australia unilaterally removing price setting from Part X exemptions saying:

> … Australia should not be in advance of its major trading partners in removing conference exemptions for price fixing, as there would be a danger that Australian shippers, particularly exporters, would lose the countervailing power they exercise under Part X, if outwards conferences now managed in Australia were to be run entirely from overseas.
>
> However, if Australia's trading partners removed pricing exemptions, then it may well be in Australia's interests to follow suit, by amending Part X to reduce the range of matters with which conference agreements may deal. This option, which would retain the basic structure of Part X including provisions giving countervailing power to shippers, should be seriously considered at the next review of Part X. The next review of Part X should be in three to five years' time, depending on whether and how quickly our trading partners move to adopt this approach. (sub. 9, p. 35)

This view was reiterated in its subsequent submission (sub. DR18, p. 7). The Department considered that excluding pricing and capacity limitation clauses from exemption under Part X would probably be too big a change at this stage, given that our major trading partners still permit them. Only the European Union has shown signs of moving against such provisions. The Department concluded that:

> Unless such a change has strong shipper support (and it was not evident in most shipper initial submissions), the Department considers that Australia should not proceed with such a change unless it is also adopted by its major trading partners. (sub. DR18, p. 7)

Conversely, the ACCC considered that the option of excluding price fixing and quantity control clauses from agreements eligible for approval under Part X was the preferred option among those being considered for change to Part X. The ACCC said:

> The ACCC views this method of discrimination as useful as it recognises that situations that allow competitors to reach arrangements or understandings to "supply less and/or charge more" risk distorting market signals and causing harm to customers. Consistent with this, arrangements between competitors on price are deemed by s.45A of the TPA to substantially lessen competition. (sub. DR30, p. 7)

Introducing different treatment of agreements on the basis of their inclusion of price fixing provisions would certainly not be unique to Australia. As outlined in chapter 6, the European Union has provisions for the differential treatment of agreements, with different rules for consortia and conferences, and no provision for discussion agreements to receive block exemptions. Similarly, the United States effectively precludes formal price fixing provisions, though it does allow the discussion and development of non-binding guidance on rates for members.

With appropriate transitional arrangements, the impact on the provision of shipping services will be minimal. As table 2.8 (chapter 2) indicates, there are only two routes (those to and from central and south America) on which discussion agreements operate without member consortia, and on those routes the discussion agreements cover less than 40 per cent of the shipping capacity provided. On other routes, the member consortia supply and manage the shipping services and such services should be largely unaffected if the 'umbrella' discussion agreement ceased to operate. Even on routes where the more traditional price-fixing conferences are significant, independents, consortia and various vessel sharing agreements (many operating as sub groups within a conference agreement, notably on routes to and from Europe) dominate the supply of shipping services.

Transitional arrangements are, nonetheless, a necessary part of any significant change to registration criteria under Part X. Most of the operational agreements (such as consortia) would be unaffected by measures to prohibit price-setting provisions. Others agreements, if given time for review and restructuring, could remove such provisions thereby ensuring that the carriers could continue to provide the service by way of a registrable agreement. A set of transitional arrangements similar to those outlined in chapter 8, where the recommendation to repeal Part X is discussed, could be considered if Part X were modified to move a significant number of agreements from Part X to the authorisation system under Part VII.

The Department of Transport and Regional Services (sub. DR18, p. 7) noted that the removal of exemptions for collective price setting by members of conference agreements would mean that conferences could not discuss or negotiate freight rates or surcharges collectively with shippers. They would be able to do so only on an individual basis.

This seems to be a reasonable interpretation of the consequences of excluding collective price setting from Part X agreements. It means that, were this option to be introduced, shippers would still be able to negotiate collectively over price, but only with individual carriers, not with the conference members as a group. The carriers would not be able to negotiate collectively with shippers and shipper organisations over price matters but would be able to do so over other aspects of the relationship. In practice, this may not represent a major change from the point of view of shippers. Many shipper organisations focus primarily on non-price aspects of the service in their consultations with carriers, leaving price matters to negotiation between the individual shipper and an individual carrier (Australian Meat Industry Council, sub. DR24, p. 1; Tasmanian Freight Logistics Council, trans., p. 51). In addition, individual service contracts are an increasing feature of relationships between shippers and carriers, particularly with the growth of discussion agreements and the decline of fixed ‘conference’ rates.

The simpler Part X registration process for key types of agreements should reduce administrative and compliance costs, provide greater certainty than would be available if all agreements needed case-by-case evaluation, and should enable the organisation of scheduled liner cargo shipping services to continue to be provided with minimal disruption. It would, however, involve a greater risk of approving agreements with anticompetitive effect than if all agreements were assessed individually.

The Commission considers that this is a viable option for modifying Part X which would deliver a workable mix of certainty, minimal administration and compliance costs, while introducing an essential review process for agreements where the net public benefit is much less apparent.

Excluding discussion agreements

An alternative for a more selective registration process under Part X is explicitly to exclude discussion agreements from eligibility for registration. While this is likely to be a less extensive change than that outlined above, a number of participants, particularly those representing shipper interests strongly supported this approach. The Department of Transport and Regional Services highlighted the calls from shipper groups saying:

> Discussion agreements are based on reaching a non-binding consensus between carriers. Nevertheless, their typical breadth of membership means that they appear to be able to exercise significant market power, at least when the members agree on the need to abide by agreed rates. It appears that this may be the case at present, when there is the prospect of rate restoration as market conditions have improved (for the carriers)

after a period of low or falling rates. Discussion agreements may be less effective at other stages of the freight rate cycle. (sub. 9, p. 5)

APSA commented that:

It is the strong view of shippers generally that discussion agreements are formed to limit or even eliminate competition on price and capacity by combining Conference members and independent carriers in any particular trade where they can discuss issues such as the level of freight rates that each is charging. … APSA believes that discussion agreements were deliberately designed by them to allow the maximum protection under Part X but with the minimum or no obligations on behalf of the carriers to abide by any agreement. (sub. 5, p. 18)

APSA also noted complaints from shippers that arrangements they thought confidential, were discussed between agreement members, and that such information sharing can be used to limit competition.

Currently Discussion Agreements meet with shippers before Conferences. The rates negotiated with the Discussion Agreements are non-binding and voluntary but the result of those negotiations filter down to the Conferences and Consortia with whom shippers must have genuine binding negotiations for firm and workable arrangements. (sub. 5, p. 9)

Information from APSA and individual shippers, suggest that members of a discussion agreement present a united front on freight rates (including surcharges), at least to smaller shippers.

Essentially, the problem presented by discussion agreements for Australian shippers is that they are predominantly demand-side agreements and do little or nothing in the area of providing scheduled liner cargo shipping services (chapter 4). This service provision is predominantly undertaken by the operational agreements or conferences that are parties to the discussion agreements. At the same time, by bringing together, in a discussion group, previously competing liner service groups and independent carriers, competition can be reduced to the detriment of Australian shippers. Also, it is by no means clear that the existence of discussion agreements is necessary for the provision of competitive and reliable scheduled services. For example, there is no evidence to indicate that the level of service is inferior, or the level of freight rates higher on routes to and from the European Union where discussion agreements do not receive exemptions from their antitrust law.

Carriers argued that discussion agreements should not be treated differently from other forms of agreement exempt under Part X. Shipping Australia Limited said that discussion agreements did not inhibit competition and that the ACCC in its recent investigation could not establish that there was a net public detriment:

> Discussion Agreements do not result in a substantial lessening of competition on any Australian trade route. However, if the exemption was no longer extended to Discussion Agreements, then minimum service levels negotiated with shipper groups would obviously be considerably lower in any particular trade lane and the opportunity to exchange information between shippers and carriers on future likely demand and supply factors would be seriously undermined. (sub. 16, p. 41)

The Department of Transport and Regional Services expressed some reservations about the practicalities of excluding discussion agreements, saying:

> Although many shipper groups may well favour the sweeping approach of excluding discussion agreements from registration under Part X, a major problem with that approach is that discussion agreements exist in many overseas liner trades, and indeed have reportedly supplanted traditional conferences in some major trades. To exclude discussion agreements from registration could create major problems of compatibility with the liner cargo shipping regimes of most of our major trading partners. A further issue for consideration is whether excluding discussion agreements from registration under Part X would have the effect of inducing shipping lines that have collaborated in non-binding discussion agreements to instead join some form of binding conference. (sub. 9, p. 38)

Excluding discussion agreements is unlikely to present a compatibility problem with our major trading partners. Incompatibility arises if one set of legislation requires (rather than allows) behaviour that is prohibited in another (chapter 8). This is not the case here as regulation in other countries, such as the United States, does not mandate that discussion agreements exist, only allows them. In addition, the experience of trade between the United States (which allows discussion agreements) and the European Union (which does not allow them) indicates that this difference does not disrupt the provision of liner shipping services between them. It is also worth noting that on Australian routes, discussion agreements operate on routes where they are allowed in the other jurisdiction and do not operate on the European – Australia routes, apparently without any detriment in the quality of service offered.

The Commission considers that discussion agreement members are unlikely to transform themselves into price-fixing conferences in any significant way for a number of reasons. First, most Australian discussion agreements already encompass consortia and similar types of operational agreements among their members, implying that those who are willing to enter into a more binding agreement have already done so. Second, it is because discussion agreements allow collective action on a non-binding basis, that they can include participants with diverse interests, ranging from those in tight conference agreements to independent operators.

For independent carriers, the non-binding nature of discussion agreements is likely to be more appealing than a price-fixing conference because there is little, or no

cost, in terms of limiting their commercial freedom of action, to joining a discussion agreement, but there are the potential benefits from collective action (essentially, it is a 'one-way bet').

The option of excluding discussion agreements from eligibility for registration under Part X received considerable support from shippers and shipper bodies. APSA commented that:

> APSA has further considered the future of Discussion Agreements but confirms its earlier comments that Discussion Agreements should not be registered and that current Agreements should be deregistered. The Agreements have no value to exporters who believe their motive is to destroy competition. (DR 14, p. 2)

The Department of Transport and Regional Services commented that:

> [It] … notes that most shippers favour the second option to exclude discussion agreements (the primary cause of the call by shippers for the review to be brought forward) from Part X exemptions. The Department considers that lines would be able to operate satisfactorily under more traditional forms of conference agreement. However, the Department is concerned that there is some risk that discussion agreements might operate from overseas jurisdictions, with Australian shippers not having the right to call the parties to the negotiating table as at present under Part X. Nevertheless, the views of Australian shippers should be paramount on this issue.
>
> Overall, the Department considers this option [excluding discussion agreements] preferable, at this stage, to the option of excluding all price and route capacity provisions from exemption. (sub. DR18, p. 8)

Shipping Australia Limited, representing carriers, was opposed to excluding discussion agreements, saying that:

> The speed of vessels, frequently, reliability, scope of service such as additional port calls, have all been enhanced within the discussion agreement environment. The ability to discuss demand and service requirements, fix maximum rates when necessary and surcharge levels in addition, have provided the necessary confidence to undertake these additional investments and provide a degree of stability which has encouraged the necessary investments, as I said, by the shipping lines, parties to those agreements. (trans., p. 17)

Defining discussion agreements

The 1999 Productivity Commission review argued that there could be difficulty in defining discussion agreements in order to remove their exemption.

> A problem created if discussion agreements were to be regulated differently is the need to define them. At the margin, differentiating discussion agreements from the somewhat more restrictive and comprehensive conference structure and the somewhat looser consortium agreements covering slot swapping may prove to be difficult. Definitional issues eventually may involve complex legal argument, the absence of

which appears to have been a notable advantage of the operation of Part X. (PC 1999, p. 157)

Box 9.1 **Department of Transport and Regional Services' suggestions for definitions to exclude discussion agreements from Part X**

The following definitions of "conference", "discussion agreement" and "registrable conference agreement" are offered for consideration. They attempt to restrict registration under Part X to those kinds of agreements that involve all the parties actually engaging together in the provision of liner shipping services. The definitions attempt to exclude registration of agreements in which all the parties are not involved in producing the same set of joint liner services, but merely operate in the same trades.

Conference means an unincorporated association of 2 or more ocean carriers, all the members of which are engaged together, or propose to engage together, in jointly providing outwards or inwards liner cargo shipping services, whether as vessel operators or space charterers.

Conference agreement means:

- an agreement between members of a conference, and may be either;
- an outwards conference agreement; or
- an inwards conference agreement; but
- not a discussion agreement.

Discussion agreement means an agreement between ocean carriers, where all members of the agreement are not jointly engaged in the provision of outwards or inwards liner cargo shipping services, and where the principal purpose is to allow those ocean carriers to discuss the terms and conditions of ocean carriage, including freight rate charges, on a non-binding basis.

Registrable conference agreement means an agreement between members of a conference which relates to joint outwards or inwards liner cargo shipping services provided by the members of that agreement, where the joint service may be:

- provided by the members of the agreement as an association only; or
- [to allow for registration of consortia or space sharing agreements within a conference] in conjunction with other ocean carriers, provided that the members of the conference and those other ocean carriers are all members of another registerable conference agreement [ie the overall conference agreement];
- to remove doubt, non-binding agreements, commonly referred to as discussion agreements, are not registerable conference agreements unless they relate to liner cargo shipping services provided jointly by each and every member of the agreement, whether as vessel operators or space charterers.

Source: DTRS (sub. 9, p. 39).

While expressing the reservations outlined above, the Department of Transport and Regional Services did address the issue of defining discussion agreements, if it were considered appropriate to exclude them from Part X (box 9.1).

The European Union has taken a different approach. Rather than defining discussion agreements for exclusion from their antitrust exemptions for shipping, they have defined the range of agreements, or characteristics of agreements, that are eligible. That is, they have defined consortia and conferences eligible for block exemptions (box 9.2), with discussion agreements being excluded by default.

Box 9.2 **EU definitions of consortia and conferences eligible for block exemptions**

Consortia (regulation 823/2000)

A 'consortium' means an agreement between two or more vessel-operating carriers which provide international liner shipping services exclusively for the carriage of cargo, chiefly by container, relating to one or more trades and the object of which is to bring about cooperation in the joint operation of a maritime transport service, and which improves the service that would be offered individually by each of its member in the absence of the consortium, in order to rationalise their operations by means of technical, operational and/or commercial arrangements, with the exception of price fixing.

Conferences (regulation 4056/86)

Regulation 4056/86 provides a block exemption for agreements (conferences) that contain price fixing and supply regulation provisions.

Source: Chapter 6.

Were discussion agreements to be excluded from registration under Part X, defining such agreements for this purpose would be an important task and critical to the practical implementation of such a change. Inevitability, there will be some degree of 'trial and error' and 'loopholes' may appear as participants become familiar with the new regulations and how they operate. However, shippers have an interest in ensuring that any prohibition on discussion agreements works well, and can be expected to monitor progress and provide feedback to the Department. Together with a willingness to be responsive and make modifications as necessary, the task of successfully developing workable definitions should not be insurmountable. This would equally be the case whether discussion agreements were directly defined for exclusion, or 'registrable conference agreements' defined for inclusion, under Part X.

Conclusion

The Commission considers that discussion agreements add little to the provision of scheduled liner cargo shipping services on Australian trade routes but, by bringing together competing parties to discuss market conditions, services and freight rates, they enhance the ability of carriers to act in an anticompetitive manner, thereby limiting competition to the detriment of Australian shippers. Consequently, discussion agreements should be excluded from registration under Part X.

This would not mean that discussion agreements are prohibited on Australian trade routes. Members of a potential discussion agreement would still be able to seek authorisation under Part VII, but would need to establish that the agreement provides a net public benefit.

The Commission does not consider that specifically excluding discussion agreements from eligibility for registration under Part X would have any significant impact on the management of supply of shipping services, as in the vast majority of cases this function is undertaken by other agreements operating independently under the non-binding arrangements covered by the discussion agreement.

The effectiveness of this option would be greatly enhanced if it was adopted in conjunction with the promotion and protection of confidential individual service contracts between carriers and shippers. If the option of excluding discussion agreements were to be adopted, measures to protect confidential individual service contracts outlined in the following section and in recommendation 9.2 should also be introduced.

The Commission recommends that:

RECOMMENDATION 9.1

If Part X is retained, either:

agreements that contain the following provisions should be excluded (with appropriate transitional arrangements) from eligibility for registration under Part X:

- ***for the fixing or other regulation of freight rates;***
- ***for the setting of non-binding guidance on freight rates;***
- ***for freight rates to be discussed between members; or***
- ***that seek to limit the maximum level of capacity on offer.***

or

discussion agreements should be excluded from eligibility for registration under Part X, together with measures to protect confidential individual service contracts outlined in recommendation 9.2.

Differentiating between agreements on the basis of market share

Whether potentially anticompetitive arrangements can, in practice, significantly lessen competition in a particular market depends crucially on the collective market power of the parties. A number of factors will influence this, but an important benchmark is market share. Other things being equal, the higher the market share of the parties to an agreement, the greater is the likelihood that they will have effective market power, and thus be able to act in an anticompetitive fashion.

An option for modifying Part X to be more selective in the approval of shipping agreements would be to provide registration under current Part X arrangements of agreements with a low share of the market (and thus with limited ability to reduce competition) on a particular route. Agreements with a higher market share would require case-by-case evaluation using the authorisation process under Part VII of the TPA.

This option is presented in more detail in appendix F. However, the Commission has concluded that, on balance, introducing a market share criteria would provide few benefits over the two approaches discussed above, but would involve a greater change to current arrangements. It would impose greater transition costs than the earlier option of differentiating between agreements on the basis of their key characteristics and, for those agreements registered under Part X, it would involve a greater level of ongoing administration and compliance costs.

FINDING 9.1

Introducing a market share threshold would involve a major change to the current arrangements, present significant transitional costs, and involve a much higher level of ongoing administrative and compliance costs.

9.2 Promoting competition

One of the most influential changes introduced in the United States as part if its 1998 reforms were provisions allowing and specifically protecting individual service contracts (ISCs) between carriers and shippers. Specifically, carrier agreements cannot:

- prohibit members from engaging in negotiations for service contracts with one or more shippers;
- require members to disclose negotiations or make public the terms and conditions of such agreements (excluding those publicly listed with the United States Federal Maritime Commission, but including the freight-rate and service commitments); or
- adopt mandatory rules or requirements affecting the right of members to enter into service contracts.

Carrier agreements are permitted to adopt non-binding voluntary guidelines that relate to the terms and procedures of a member's service contract, providing that such guidance specifically states that members have the right not to follow such guidance.

The Federal Maritime Commissions, in evaluating the reforms noted that:

> … carriers generally report that 80 per cent or more of their liner cargo currently moves under service contracts … Most shippers presently are negotiating one-on-one with individual carriers, instead of negotiating with rate-setting conferences or groups of carriers.
>
> The emergence of global markets, the improved service of non-conference carriers, and the deregulatory nature of OSRA [Ocean Shipping Reform Act of 1998] are catalysts that have contributed to the restructuring of the liner shipping industry. This has led to a de-emphasis of traditional conferences and a dramatic increase in efficiency-enhancing operational types of agreements, such as vessel-sharing and space charters. (2001, p. 2)

Similarly, the European Union, following its revised TACA [Trans-Atlantic Conference Agreement] decision (chapter 6), requires that conferences which use ISCs do not include:

- a prohibition on individual service contracts;
- restrictions, either binding or non-binding, on the contents of such contracts; and
- a prohibition of independent action on joint service contracts.

In addition, the terms of the contract are to remain confidential, except where the shipper consents to such disclosure.

The European Commission, in its recent review of its shipping regulation noted:

> The growing importance of individual service contracts (representing about 90% of cargo on the transatlantic trade) would seem to show that conference price fixing is not needed to ensure reliable shipping services. (ECDG 2004a, p. 17)

The OECD (2002) in its final report on competition policy in liner shipping, recommended that the following principles in relation to contracting be applied to guide further reassessments for the validity of antitrust exemptions for the liner shipping sector. These principles are:

- *freedom to negotiate* — shippers and ocean carriers should always have the option of freely negotiating rates, surcharges and other terms of carriage on an individual and confidential basis;
- *freedom to protect contracts* — shippers and ocean carriers should always be able to protect contractually key terms of negotiated service contracts, including information regarding rates, and this confidentiality should be given maximum protection; and
- *freedom to coordinate operations* — ocean carriers should be able to pursue operational and/or capacity agreements with other carriers as long as those do not confer undue market power to the parties involved (OECD 2002, pp. 77–80).

Shipping Australia Limited argued that the development of ISC's and discussion agreements were linked, saying:

> The development into discussion agreements from that system [fixed conferences] in my view allowed the lines to negotiate individual contracts with individual customers. It did give the free market back to the customer. The discussion agreement allowed the lines to talk about capacity demand. … lines have been able, through this discussion process, to be able to measure the capacity to the demand and then the discussion agreements gave the trade, the individuals, the ability to negotiate what they saw as fair deals, and they weren't bound by one price for all. I honestly believe that was why the development took place, because it did give the carriers some measure of ability to talk about capacity and demand but still allowed the free market to dictate the price. (trans., p. 27)

Shipping Australia Limited agreed with the proposed amendments to Part X providing for the confidentiality of individual service contracts. (sub. DR4, p. 28)

APSA argued that similar protection for confidential individual service contracts should be included in Part X. It proposed that Part X be modified to include a provision for:

> Exporters to be able to negotiate confidential agreements directly with individual members of a conference or consortia – similar to arrangements contained in the US Ocean Shipping Reform Act 1998 which came into force on 1 May 1999. (sub. 5, p. 6)

It subsequently restated this position (sub. DR 14, p. 1).

APSA's view was supported by Blue Scope Steel (sub. 18, p, 5) which argued that shippers must be allowed the option to negotiate their freight business with either an

individual line or a conference, with assurance of confidentiality of such freight agreements.

Under Part X, there is no provision which precludes conference agreements from limiting the ability of members to enter into individual contracts. Indeed, some agreements registered in Australia do include provisions specifically limiting the ability of members to offer different freight rates or services to individual shippers.

Other agreements, particularly discussion agreements which are inherently non-binding on members, do allow individual contracts with conditions varying from the 'consensus' rates, and such agreements may include confidentiality clauses. However, the Commission was informed of a number of complaints from shippers that information about their individual contracts were passed on to other members of the discussion agreement when they had expected that this information to be confidential.

Modifying Part X to preclude the registration of agreements that contain provisions limiting confidential ISCs or the matters that can be included in such contracts, would have two key effects.

First, clauses in the 'traditional conference' which seek to enforce standard or common freight rates to be offered by parties to the conference would effectively become unenforceable. Such agreements would need to be restructured to remove any clause that limits the ability of individual carriers to enter into individual service contracts or which limits the range of matters that could be included in such contracts.

Second, action against carriers for breaching the confidentiality of a contract would be undertaken by the regulator at Government expense, rather than the current situation where action under contract law for any breach by a carrier of a confidentiality clause would need to be undertaken by the individual shipper.

In the United States, action against carriers is undertaken by the Federal Maritime Commission and includes penalties ranging from fines for procedural breaches to court injunctions against the agreement, effectively withdrawing protection from antitrust legislation.

Were Part X to be modified to introduce clear protections for confidential ISCs, modifications to the range of penalties available under Part X would be warranted. The current situation where deregistration of the agreement is the only penalty is too inflexible, particularly if the breach is by only one member of a registered agreement. A range of penalties, including fines should be considered, and be applied on a non-discretionary basis following investigation by the ACCC.

The Department of Transport and Regional Services expressed some reservations about mandating the right of individual conference members to enter into service contracts with shippers saying:

> … mandating in Part X the right of individual conference members to enter into service contracts with shippers (a feature of the 1998 US amendments) is seemingly an attractive option to be considered for Part X. This was one of the changes to the US liner regime that were aimed "at promoting a more market-driven, efficient liner shipping industry", and the US Federal Maritime Commission in 2001 reported "… the apparent widespread general satisfaction with the current US regulatory framework for ocean shipping …".
>
> However, Australian shippers are differently situated compared to US shippers, who are served primarily by the mainline east-west trades and are thus much more assured of adequate liner services no matter what the form of liner regulation is adopted. Also, this amendment to the US liner regime appears to have contributed to the reported replacement of conference agreements in various US trades by discussion agreements. Discussion agreements are strongly opposed by Australian shippers. Therefore this option would need careful consideration. (sub. 9, p. 35) [emphasis in original]

Subsequently, the Department considered that the introduction of protection for confidential individual service contracts would be a feature that could usefully be added to Part X (sub. DR18, p. 5), but that:

> The Commission's view that Part X should preclude disclosure to other carriers of the provisions of individual service contracts goes further than the US regime. The US regime does not mandate confidentiality, which is up to the contracting parties. It merely removes the previous requirement that the terms and conditions of such contracts had to be made public. So carriers in liner agreements are free under the US regime to agree to make known to each other the terms and conditions of individual service contracts, unless of course this is contrary to what is specified in the agreement with the shipper. In 2001, the Federal Maritime Commission found that only 35% of service contracts had confidentiality clauses, some of which allowed the carrier to disclose terms to other carriers in the agreement. No doubt this percentage has since increased. (sub. DR18, p. 20)

There appears to be some confusion as to the manner in which ISCs would operate. Their use would not be mandated. The Commission considers that they should operate in a manner similar to that in the United States. That is, requiring that conference agreements do not contain any clauses that limit the ability of members to enter into confidential individual service contracts, or which limit the range of matters that can be covered by such contracts, while introducing clear protections for the confidentiality of such contracts if the shippers wish for such confidentiality. The key difference between the situation in the United States and that being proposed by the Commission for Australia, is that the Commission considers that carriers should not be allowed (as they are in the United States) to adopt non-binding voluntary guidelines that relate to the terms and procedures of a member's

service contract. This is to avoid the situation, as occurred in the United States, where the US conferences evolved into discussion agreements.

The Commission’s view is that consideration should be given to the option of modifying Part X to specifically preclude clauses in registered agreements that limit the ability of carriers from entering into confidential individual service contracts; which limit the range of matters to be included in such contracts; or from requiring that the terms and conditions of such contracts be disclosed to other agreement parties or otherwise made public. Whether such contracts are entered into would remain a matter for negotiation between the individual parties involved. They would not be mandatory but, if entered into, confidentiality provisions would need to be respected. This means that, in addition to excluding certain types of clauses from registered agreements, Part X should clearly state that carriers shall not discuss or otherwise disclose, directly or indirectly, the provisions of individual service contracts to other carriers, whether they are members of the registered agreement or not, and enforceable penalties, including fines, should be introduced to deal with any breach.

The range of matters eligible for inclusion within individual service contracts, and thus subject to the protection of confidentiality, should be broad, covering all aspects of the terminal-to-terminal service for which carriers receive exemptions under Part X.

In the Commission’s view, even if there were to be no selectivity introduced into the registration process under Part X, it would still be worthwhile modifying Part X to provide for the protection of confidential individual service contracts.. Were selectivity in agreement registration to be introduced, such protections for ISCs are less important if agreements containing price control provisions are excluded (the first part of recommendation 9.1). However, if only discussion agreements are excluded from registration(the second part of recommendation 9.1) then protection for confidential individual service contracts should be introduced concurrently to form a package of related reforms.

The Commission recommends that:

RECOMMENDATION 9.2

If Part X is retained, and neither (or only the second) of the options in recommendation 9.1 are adopted, Part X should be modified so that agreements should not be eligible for registration if they contain provisions that:

- ***prohibit members from engaging in negotiations for individual service contracts; or***

- ***require members to disclose negotiations or make public the terms and conditions of such agreements; or***
- ***adopt rules or requirements affecting the right of members to enter into individual service contracts; or***
- ***allow the discussion or development of non-binding guidelines that relate to the terms and procedures of a member's individual service contract.***

Part X should be amended to prohibit carriers from discussing or disclosing, directly or indirectly, the provisions of individual service contracts to other carriers.

9.3 Other modifications to Part X

Other options proposed by some participants in this inquiry include a range of measures that aim to increase the countervailing power that Part X seeks to provide for Australian shippers, or at regulating aspects of the outcome of negotiations between carriers and shippers, essentially in response to their experiences in the current tight shipping market. These options include:

- requiring 'all-in' freight rates to be offered to shippers;
- requiring freight rates to be offered in Australian dollars;
- requiring the provisions of agreements between parties to a registered conference agreement and a designated shipper body to be binding;
- requiring carriers to provide information justifying price increases;
- involving shipper bodies in the negotiation of contracts between carriers and stevedoring companies;
- providing for government funding of shipper bodies; and
- developing a code of practice to cover negotiations between parties to conference agreements and designated shipper bodies.

Some of the modifications to Part X raised by participants seek to enhance the countervailing power that Part X provides to Australian shippers, while others seek government intervention in the outcomes of negotiations between carriers and shipper bodies. These are discussed in more detail individually in Appendix G.

However, as found in chapter 7, the nature of the markets within which Australian exporters and importers operate means that countervailing power is not effective. The modifications proposed by participants do not change this situation in any fundamental way. In addition, the exercise of countervailing power relies on

collective negotiation and commonly agreed, often binding, outcomes. It is antithical to the promotion of individual contracts and to the development of a competitive market.

Those modifications seeking to increase government intervention in the outcome of market negotiation are partly a response to the current tight shipping market. Adding extra regulation is unlikely to address issues which are better left to commercial negotiation. Additional requirements would also involve carriers in added cost, or increased risk, and such costs will inevitably be reflected in freight rates and quality of service.

Nevertheless, some action can be undertaken by shipper groups to improve the relationship between themselves and carriers. The development of an agreed code of practice covering good-faith negotiations is something that can be developed by the industry without the need for legislation or government involvement.

FINDING 9.2

Encouraging greater competition in liner shipping markets would be more effective in helping shippers than further government intervention aimed at prescribing or influencing the outcome of commercial negotiation between carriers and shippers.

9.4 Australia's WTO and Free Trade Agreement obligations

Australia has entered into a number of international agreements, some of which include reference to competition policy. The Department of Foreign Affairs and Trade (DFAT) (sub. 4, p. 8) noted that competition policy has been dropped from the Doha Round of World Trade Organisation trade negotiations and that no negotiations [in relation to competition policy] will take place during this current round.

Competition policy is covered in Australia's free trade agreements with the United States (AUSFTA), Singapore (SAFTA) and Thailand. DFAT informed the Commission that:

> … the competition chapters of these agreements would allow either continuation or removal of the exemptions from competition policy created by Part X of the TPA. (sub. 4, p. 8)

DFAT also noted that under the AUSFTA and SAFTA the reservations regarding TPA provision for shipping services cannot be made more restrictive under the terms of the respective FTAs, and that under the AUSFTA, parties are subject to a

ratchet mechanism. This means that if Australia liberalises a measure described in a reservation, it is bound by the change and cannot subsequently make the measure more restrictive.

However, the areas where Australia has reservations (to which the above ratchet mechanism would apply) are very limited. DFAT said that Australia has reservations covering the elements of Part X that provide:

- for international liner operators to be represented by a person who is a resident in Australia, and who will act as a agent for the purposes of the TPA;
- that only Australian flag operators can apply to the ACCC to examine whether conference members, and non-conference operators with substantial market power are hindering other shipping operators from engaging efficiently in the provision of outward liner cargo services to an extent that is reasonable. (sub. 4, p. 8)

As part of the options for change discussed in this chapter, neither of the two matters mentioned above have been the subject of suggested change. DFAT commented that, were these provisions to be removed (say as part of the repeal of Part X), this would be regarded as a liberalising step, '… although probably of quite modest value from a negotiating perspective' (sub. 4, p. 8). Consequently, it does not appear that Australia's international obligation place anything other then minor restrictions on its ability to repeal or modify Part X of the TPA.

10 Review and enforcement under Part X

This chapter considers the Part X review and enforcement processes. It finds that they have a number of features which differ from the normal procedures under the TPA. When behaviour under a registered agreement warrants review, the Australian Competition and Consumer Commission (ACCC) has to prove that, not only are there exceptional circumstances warranting the review, but also that the behaviour being reviewed results in public detriment — something that has proven to impose a particularly high burden of proof.

The range of penalties available is very limited and, for some offences, relatively severe. In effect, deregistration of an agreement in full or in part is the only penalty available, irrespective of the seriousness of the breach of the provisions of the Act.

The Commission recommends that, if Part X is retained, when a review is being conducted into the net benefit of the behaviour of parties to an agreement, those parties, and not the ACCC, should be required to demonstrate that the conduct has resulted, or is likely to result, in a net public benefit.

It also recommends that: there no longer be Ministerial discretion in the imposition of penalties under Part X; the introduction of a range of appropriate penalties, including fines, for breaches of the procedural provisions of the Act; and that the use of undertakings be limited to situations where deregistration of an agreement is threatened.

The Part X review and enforcement processes have a number of features which differ from the normal procedures under the TPA. These contribute to the situation where the imposition of effective penalties for breaches of provisions of this part of the Act are problematic.

The next section outlines a range of comments received about the existing review and enforcement process. This is followed by sections which look at particular

aspects of the process, and includes recommendations aimed at improving its effectiveness.

10.1 Participants comments

No agreement has been deregistered, either in part or in full, since Part X has been in operation. The Department of Transport and Regional Services indicated that, since 1989, in two of the five cases of Trade Practices/Australian Competition and Consumer Commission investigations, the Minister had accepted undertakings (sub. DR18, p. 20). The Australian Peak Shippers Association reported that 'Only once, in 1993, was it necessary for the Minister to threaten a Conference with de-registration.' (sub. DR11, p. 8) In part, the problematic nature of review and enforcement results from the nature of the legislation itself. As Professor Fels (the then Chairman of the ACCC) commented:

> … this is a reflection of the permissive nature of the Part X regime and the minimalist nature of obligations it imposes on lines. (Fels 2001, p. 8)

However, it also reflects the practical difficulties of concluding an investigation, and the subsequent procedures in place under Part X, before deregistration can occur. The Department of Transport and Regional Services referred to the ACCC's view on the difficulty of successfully conducting a review:

> The ACCC said in its media statement on the report on its investigation into the Asia-Australia Discussion Agreement, that demonstrating a public detriment constituted a "remarkably high threshold". (sub. 9, p. 34)

In its submission to this inquiry, the ACCC has been critical of the difficulty of successfully concluding reviews into complaints of behaviour by carriers under Part X:

> The ACCC has conducted five Part X investigations over the last 15 years. This experience has suggested there are several constraints on the effectiveness of this investigation function including:

- movements in actual market freight rates are not easily observable;
- the existence of contracts between lines and shippers and their effect on average prices cannot be observed;
- there is little incentive for shipping lines to provide information, especially as it pertains to potential public benefits of particular liner agreements;
- establishing proof of the anti-competitive detriment resulting, or likely to result from the conduct of parties to registered agreements is problematic—in particular, distinguishing anti-competitive detriment from the effects of other forces in the market raises evidentiary problems; and

- similarly, measuring public benefits that are integral to particular liner agreements is problematic. (sub. 21, pp. 2–3)

This view has been reinforced by the experience of the most recent review into the Asia–Australian Discussion Agreement. In its final report, the ACCC said that there were not sufficient grounds to recommend the revocation of the agreement, despite finding anticompetitive behaviour and being unconvinced that the public benefit outweighs the anticompetitive detriment. The ACCC commented:

> A *prima facie* assessment of the ACCC's investigation history indicates that it is difficult to recommend deregistering a liner agreement. For example, the ACCC was unable to recommend deregistration of the AADA [Asia–Australian Discussion Agreement] despite concluding that the public benefits claimed by the AADA had not been substantiated. Therefore, the ACCC believes there is little incentive for shipping lines to provide evidence of public benefits under the current Part X arrangements, either prior to registration or during investigations. (sub. 21, p. 6)

Even were an adverse finding to be made by the ACCC, there is no certainty that any penalty would have resulted. Part X requires that the Minister shall not give a direction to cancel the registration of a registered conference agreement unless the Minister has consulted with the parties to the agreement with the objective of '… obtaining an undertaking or action by the parties …' that would make deregistration unnecessary (s. 10.45(1)(b)). Essentially, this means that parties to a registered agreement can avoid any penalty for past behaviour by giving an undertaking not to engage in that behaviour in the future.

Even then, deregistration is at the discretion of the Minister. As stated in the Act (s. 10.44(1)), the Minister *may* direct the Registrar to cancel the registration of an agreement.

Shipping Australia Limited rejected the view that the review and enforcement processes under Part X were not very effective (sub. DR4, p. 18). Rather it viewed the 'light-handed system of regulation' provided by Part X encouraged commercial resolution of the disputes that inevitably arise.

The range of available penalties under Part X is limited, being:

- deregistration of the agreement;
- deregistration of a particular provision of the agreement;
- deregistration of a particular party to the agreement; or
- deregistration of particular conduct.

But the range of circumstances under which the Minister may exercise the power to deregister an agreement are quite broad (s. 10.45). They range from technical

compliance with provisions of Part X, such as the requirement to notify the Registrar of events that affect the agreement, to more fundamental changes or behaviour that places the essential benefits and costs of the agreement under question. This makes the enforcement of some of the more minor 'technical' aspects of the requirements placed on carriers under Part X difficult. It is unlikely that an ACCC investigation would be initiated over such minor matters and it is unlikely that the Minister would be prepared to impose the potential disruption to services that deregistration could bring in response to minor breaches of Part X provisions.

FINDING 10.1

The review and enforcement processes under Part X are not very effective. As well, the range of penalties available under Part X is limited and relatively severe, despite a wide range of potential breaches, both minor and major.

The enforcement process needs to be strengthened so that effective penalties are in place with a realistic expectation that enforcement will occur. The following section looks at a range of options to modify the enforcement process with this objective in mind.

10.2 Initiating a review and the role of 'exceptional circumstances'

Currently, a review by the ACCC can be undertaken:

- after a referral by the Minister following a shipper complaint;
- as the result of a shipper complaining directly to the ACCC; or
- may be initiated by the ACCC itself.

The matters that can be the subject of a review are quite broad (s. 10.45), ranging from a variety of procedural breaches to more substantial issues relating to whether the agreement (or part of the agreement) substantially lessens competition and does not provide a net benefit to the public. A referral by the Minister or a review following a shipper complaint can cover any of the matters listed in the Act for review, including situations where behaviour is believed to have resulted in a substantial lessening of competition. However, in this situation, 'exceptional circumstances' must be demonstrated before deregistration can be proposed.

Reviews initiated by the ACCC are limited to situations where a substantial lessening of competition is suspected (s. 10.45(3)) and, as with other such reviews, a direction to deregister an agreement can only be made if it can be demonstrated that 'exceptional circumstances' exist. The ACCC may also initiate a review where

it is suspected that the parties to an agreement are unreasonably preventing the entry of a party to that agreement (s. 10.45(4)).

This ‘exceptional circumstances’ provision can be seen as acting in a similar way to the ‘material change in circumstances’ provision in Part VII of the Act. There the material change in circumstances test serves to limit reviews of authorised agreements to situations where there has been a change which calls into question the grounds on which the original authorisation was granted.

Clearly, a threshold provision is desirable before the substance of a registered agreement (as opposed to procedural breaches) can be reviewed. Once approval for an agreement has been provided, it is reasonable for the parties to the agreement to have a degree of certainty that, so long as the conditions under which the approval was given have not changed, and that they do not breach the requirements of the Act, that they can continue to operate as approved.

Earlier, the Commission questioned why there was a difference in the wording used in the threshold provision introduced in 2000 to that already in operation under Part VII. However, the practicality of replacing the Part X wording with that from Part VII was questioned. The ACCC said:

> The ACCC’s view is that administration of a “material change in circumstances” test may be impractical. While the test works consistently with Part VII, where the ACCC carries out the initial assessment of market circumstances, it would be difficult to administer where another agency carries out the initial registration under Part X. Further, as no competition analysis or assessment of circumstances takes place at the time an agreement is registered under Part X, it would be difficult for the ACCC to subsequently establish whether a change had occurred in the circumstances. (sub. DR30, p. 8)

The Department of Transport and Regional Services also considered that the current ‘exceptional circumstances’ test is preferable to the proposed ‘material change in circumstances’ test, saying:

> The material change in circumstances test could introduce a high level of uncertainty into the operation of registered agreements, as liner shipping is a dynamic industry where circumstances can change quickly as changes in national and world economic conditions, changes in currency relativities etc. affect trade flows. (sub. DR18, p. 5)

It considered that the material change in circumstances test:

> … is potentially much broader in application than the exceptional circumstances test. The latter contains in the test an unreasonableness element regarding the outcome of conduct under the agreement which it would appear the former does not. (sub. DR18, p. 26)

Because of these comments, particularly in relation to the workability of the initially proposed change, the Commission considers that the 'exceptional circumstance' provision should not be altered.

10.3 Reversing the onus of proof

Where a review into the substance of an agreement (as opposed to procedural breaches) is being conducted, a key criterion (box 10.1) in assessing behaviour is establishing:

> that conduct or proposed conduct has not resulted in, or is unlikely to result in a benefit to the public that outweighs the detriment to the public constituted by any lessening of competition. (s. 10.45(3)(c))

Box 10.1 **Criteria used by the ACCC in its most recent review under Part X**

The most recent review under Part X by the ACCC was conduced in terms of the criteria referred to in section 10.45(1)(a)(viii) of the TPA 1974. Those criteria are:

- the agreement includes a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition (within the meaning of section 45); and
- the parties to the agreement have engaged in conduct, or propose to engage in conduct, to give effect to or apply the provision; and
- that conduct or proposed conduct has not resulted in, or is unlikely to result in a benefit to the public that outweighs the detriment to the public constituted by any lessening of competition; that
– has resulted, or is likely to result, from the conduct; or
– would result, or is likely to result, if the proposed conduct were engaged in; and
- there are exceptional circumstances that warrant the giving of a direction under subsection 10.44(1) [for the cancellation of an agreement, in part or in full, or of a party to an agreement].

Exceptional circumstances would likely exist if:

- an agreement has the effect of giving its parties a substantial degree of market power;
- the conduct of the parties to the agreement has led to or is likely to lead to an unreasonable increase in freight rates or an unreasonable reduction in services; and
- the anti-competitive detriment of the agreement outweighs the benefit to shippers flowing from the agreement.

Source: ACCC (2004a, pp. xiv–xv).

This has proved very difficult to establish. The ACCC commented that:

> … due to the current structure of Part X, there is little incentive for the lines to provide evidence to the ACCC during investigations to demonstrate that liner agreement provide public benefits to Australia. (sub. 21, p. 12)

It is the nature of the liner shipping industry that the necessary information on costs and prices, and of the nature and effects of the arrangements between parties to shipping agreements rests with the carriers. In a number of its investigations, the ACCC has commented on the difficulty of obtaining the necessary information needed for an informed decision on the effects of the behaviour under review.

In this situation, it is reasonable to consider changing the onus of proof in relation to public benefit and detriment from the ACCC to the parties to the registered agreement. They are the ones best placed to provide the information necessary for such an assessment (chapter 8).

Reversing the onus of proof is not without precedent in Australian law. For example, in the occupational health and safety area, firms are required to demonstrate that they have taken all reasonable and practical steps to manage the risks involved rather than a requirement on the part of the regulator to demonstrate that the firm did not take such steps. This reversal of the standard onus of proof is on the basis that the firm involved is the party with the information necessary to undertake such proof.

The ACCC addressed the matter of placing the onus of proof on the parties to the agreement, saying:

> … the criteria pursuant to the Part X investigation provisions (section 10.45) prescribe an usually high level of evidential proof before a confident and unambiguous recommendation can be delivered on the conduct of lines subject to a Part X investigation. In its consideration of regulatory options for the future, the PC should consider a regime under which, as a minimum, the most potentially detrimental agreements place the onus of establishing an overwhelming public benefit on those lines entering into that agreement. (sub. 21, p. 12)

One option is to have a conditional or sequential system whereby the ACCC is required to find positively on key 'first step' criteria such as the existence of anticompetitive clauses and anticompetitive behaviour (the first two dot points in the list of criteria in box 10.1). Only if the ACCC makes a positive finding on this would the parties to the agreement be required to demonstrate that the public benefit exceeds the anticompetitive detriment (the third dot point in the criteria listed in box 9.1).

In considering the reversal of the onus of proof, the Department of Transport and Regional Services commented that any such reversal of the burden of proof should

be restricted to 'exceptional circumstances' cases referred by the Minister (sub. DR15, p. 5).

With particular relevance to discussion agreements, it considered that:

> Rather than an outright ban on discussion agreements, which could cause jurisdictional problems, the Department suggested consideration of a reversal of proof regarding the public benefit test in exceptional circumstances cases (most discussion agreements would meet the required criteria). The burden of proof of public benefit in any ACCC investigation of shipper complaints would likely make the parties to discussion agreements much more considerate in their dealings with shippers. (sub. DR15, p. 31)

The ACCC supported the proposed change to the onus of proof saying:

> In effect, this amendment would become a retrospective net benefit test, albeit without the benefits of transparency and consultation that authorisation provides. As such it is still less satisfactory than requiring the parties to the agreement to establish likely net public benefit prior to engaging in the conduct. Nevertheless, it would assist to lower what is currently an unusually high and convoluted burden of proof that the ACCC faces in Part X investigations and would help to ensure that members to an agreement have an incentive to provide information to the ACCC. (sub. DR30, p. 7)

As mentioned earlier, the range of matters that can be the subject of an ACCC review is quite broad — ranging from a very narrow review of failure to meet a procedural matter (for example, ss. 10.45(1)(a)(i) to (vii)) to more broad reviews, such as when an agreement substantially lessens competition without benefit to the public (s. 10. 45(1)(a)(viii)). While the option of an alternative range of penalties for breaches of procedural matters is reviewed later in this chapter, the focus of the option for reversing the onus of proof is on areas where the public benefit of the behaviour is under review, rather than when procedural matters are being looked at.

It is important, however, that the review process under Part X not become a de facto 'authorisation' process requiring parties to a registered agreement to prove net public benefit after the agreement is in operation. In these circumstances, the Department's suggestion that the reversal of onus of proof be limited to 'exceptional circumstances' cases referred to the ACCC by the Minister has merit. The requirement that exceptional circumstances must be demonstrated in such situations serves as an essential limit on the extent of such reviews.

Thus, the Commission considers that reviews based on a reversed onus of proof should be limited to situations where the review is into whether an agreement, or a provision of an agreement, substantially lessens competition without benefit to the public, and where exceptional circumstances can be demonstrated. The parties to a registered agreement being reviewed by the ACCC in relation to section 10.45(1)(a)(viii) should be required to demonstrate that the conduct or proposed

conduct has resulted in, or is likely to result in a benefit to the public that outweighs any anticompetitive detriment resulting from any lessening of competition.

The Commission considers that the ability of the ACCC to initiate reviews should be retained, as the discipline of ‘exceptional circumstances’ would apply whether the review was as the result of a referral by the Minister, or conducted by the ACCC on its own initiative under section 10.48(2).

10.4 Ministerial discretion

Another feature of Part X is the situation where the imposition of penalties (deregistration or partial deregistration) is at the discretion of the Minister — something that does not appear in relation to other breaches of the TPA.

Some reservation was expressed by the Centre for Customs and Excise Studies about the suitability of providing such discretionary powers to a Minister (sub. 20, pp. 31–2). It suggested that the Ministerial role should be removed and replaced by a system based on ACCC inquiry, mediation, arbitration and ultimately court proceedings.

In general, it is undesirable that the imposition of penalties for breaches of the law be discretionary. Ministerial discretion has the potential to make enforcement uncertain, as well as creating a potential conflict of interest between the Department as the agency developing policy and as the advisor to the Minister on matters of deregistration. This potential conflict would be more acute if proposals to establish greater departmental involvement in negotiations between carriers and shippers were to be adopted.

The Department of Transport and Regional Services commented that a strategic modification to the Part X regime that might be considered would be to transfer to the ACCC the powers of the Minister responsible for shipping to revoke exemptions under Part X, where this is justified on public interest grounds. The Department said that this:

> … would bring shipping conference conduct further within the ambit of the competition policy regulator and keep the Minister at arm’s length from the enforcement of Part X conditions and sanctions. It would have similar effects to the notification option, but without the need to expand the mainstream notification procedures especially for the liner cargo shipping sector. Under this option the ACCC would have the power to enforce remedial action, subject to appeal to the Competition Tribunal.

> Under the approach, the ACCC also could be given the role of first seeking undertakings that would make deregistration unnecessary, that now sits with the Department, before an agreement is deregistered. (sub. 9, p. 36)

Further, the Department considered that it:

> … sees no problems in the Minister's powers to revoke Part X exemptions (ie. de-register agreements in whole or in part) being transferred to the ACCC. The Department considers this a reasonable proposition provided the current process of first seeking undertakings is maintained, together with rights of appeal to the Australian Competition Tribunal against de-registration. (sub. DR18, p. 11)

The Department also suggested that the ACCC be able to seek undertakings from carriers, saying:

> Another possibility for short-circuiting the process of dealing with shipper complaints would be for the ACCC to be able to seek undertakings from the conferences at an early stage (at present this step is undertaken by the Department under s10.45(1)(b) after an ACCC investigation and report to the Minister that recommends deregistration). (sub. 18, p. 45)

Alternatively, the Department suggested directly changing the current provisions for discretionary deregistration to one where this would 'automatically' occur following a breach of undertakings. The Department said it:

> … would support the removal of Ministerial discretion by Part X being amended to provide that the Minister shall (rather than may) direct the registrar to deregister an agreement (wholly or in part) in cases where satisfactory undertakings have not been given. (sub. DR18, p. 16) [emphasis in original]

The Commission considers that discretion in the application of penalties under Part X should be removed, whether in relation to deregistration, or in relation to the application of financial penalties, the introduction of which is discussed in the following section. In the interests of simplicity, and retaining the administration of Part X as much as practical within a single agency, the Commission considers that modifications to the Act to remove discretion in the application of penalties would be more practical than transferring the application of penalties from the Minister to the ACCC. The Commission considers that the term 'may' should be changed to 'must' in section 10.44(1) of Part X, and that a similar wording should be used if any alternative range of penalties were to be introduced.

Amending penalties

The penalties for breaches of Part X of the Act are the deregistration or partial deregistration of a conference agreement, or the deregistration of a particular party to the agreement. The 2000 amendments introduced a more scaled set of penalties,

but these are limited to situations where carriers breach undertakings given to the Minister to avoid action to deregister an agreement. The ultimate penalty for breaching an undertaking is also the deregistration, or partial deregistration of an agreement. The lack of scaled penalties means that, if the only available sanctions under Part X are so 'extreme' that they are unlikely ever to be used in practice, then a system is operating where a considerable level of unacceptable practices can continue unchecked.

Both the Australian Peak Shippers Association and Shipping Australia Limited addressed the issue of some form of penalties other than deregistration. The Association commented that:

> … penalties should be considered on shipowners commensurate with the commercial benefits they derive from the exemptions from Part IV as simply cancelling an agreement may not be a sufficient deterrent. (sub. 5, p. 15)

Shipping Australia Limited suggested that:

> …. a system of money penalties [could be] introduced for breaches of Part X that really do not warrant withdrawal of the exemption. (sub. 16, p. 12)

Greater administrative and enforcement costs will be involved in introducing a greater range of penalties, but it is clear that the current system without the flexibility of scaled penalties is resulting in the lack of enforcement of the procedural requirements of Part X.

In these circumstances, the Commission can see some merit in proposals to consider sanctions other than deregistration, particularly in relation to procedural breaches of the Act. Examples include, not offering to negotiate with shippers or failure to notify the register of events that affect the agreement or of variations to the agreement. Such behaviour does not change the fundamental nature of the agreement itself and thus does not call into question the expected benefits from allowing that agreement to operate. Deregistration is, in such circumstances, an inappropriate and even excessive response.

In addition, if provisions relating to confidential individual service contracts, or some of the other measures proposed by participants in this inquiry were to be adopted, the usefulness of sanctions other than deregistration would be enhanced.

The Department of Transport and Regional Services considered that a range of penalties could usefully be added to Part X for breaches of procedural provisions, especially those relating to carriers' obligations towards shippers (sub. DR18, p. 11). Shipping Australia Limited (DR 4, p 8) also saw a useful role for financial penalties, saying at the hearings that:

> Of course you have under Part X also another series of reasons why the Minister could withdraw the exemption. We feel some of those are probably better met by a financial penalty. Failure to give adequate notice may be bad, but to actually have your whole exemption withdrawn is a bit difficult. (trans., p. 23)

Having an administrative body imposing monetary penalties would only seem practical where clear 'per se' breaches are likely to have occurred. This would include such things as a failure to attend negotiations, or a failure to provide documents. Considerations in establishing monetary penalties include:

- setting out a pyramid of enforcement, which would outline the offences in decreasing levels of seriousness, and set out what are appropriate types and amounts of penalties at each level;
- whether an administrative penalty scheme or a court imposed penalty scheme is more appropriate, or whether (like a traffic infringement notice) a regulator can impose an 'on-the-spot' penalty with the penalised party having time in which to indicate whether they want the matter dealt with by the court (on the understanding that the court can impose a far higher penalty);
- if an administrative penalty scheme is introduced, consideration would need to be given as to the appropriate bodies for investigation and/or enforcement of applicable penalties;
- what is the appropriate avenue to appeal a decision to impose a penalty; and
- whether other non-monetary penalties could be introduced, such as (for example) temporary suspension of an agreement's exemption.

As mentioned earlier, in the interests of administrative simplicity, responsibility for the application of any additional range of penalties would be better retained within the agency responsible for administering Part X of the TPA, that is, with the Department of Transport and Regional Services. It also should make provision for appropriate avenues for appeal.

Monetary penalties should not, however, be used for fundamentally anticompetitive behaviour which threatens the balance between anticompetitive detriment and public benefit. Here, deregistration is appropriate, opening the parties to the agreement to the full provisions of the Trade Practices Act which has a well established range of procedures and penalties if anticompetitive behaviour continues.

10.5 The role of undertakings

If a greater range of penalties were to be introduced, and if they were to apply on a non-discretionary basis following an ACCC review, then the role of undertakings would need to be modified. As currently structured, undertakings can be used by parties to a registered agreement to avoid penalty by offering to undertake to modify future behaviour. Such undertakings do have a role in situations where, for example, there has been a change in circumstances such that the net benefits of the existing agreement are questioned but where modifying that agreement, by way of undertakings, will allow the agreement to continue and to provide benefits in the future.

However, undertakings should not be used to avoid other penalties introduced to handle breaches of the provisions of Part X which do not place in question the fundamental nature of the agreement. Such things would be, for example, failure to notify the registrar of required matters, failure to offer negotiations with shippers, or, if introduced, breaching the protections provided for confidential individual service contracts. Undertakings, essentially designed for an agreement to continue to operate in changed circumstances, should not be used to avoid penalties that would, in a scaled penalty environment, not call for the deregistration of the agreement.

The Department (sub. DR18, p. 28) also suggested that, in the event that the power to deregister agreements remains with the Minister, the ACCC could be given the power to recommend to the Minister, in any report following an ACCC investigation, that particular undertakings be sought from the parties to a registered conference agreement. The Department said:

> … this would introduce greater flexibility into the sanctions regime of Part X, and emphasise the role of undertakings rather than deregistration. It would enable the ACCC to give the Minister guidance as to the form in which undertaking might usefully be sought. (sub. DR18, p. 28)

The introduction of a range of penalties, including fines, does provide the flexibility to penalise past behaviour in a scaled and measured way as a necessary deterrent to unacceptable behaviour in the future, without necessarily taking the final step of deregistering an agreement. Undertakings can remain as a tool in the enforcement regime, providing parties to an agreement the option of avoiding the final penalty of deregistration through modifying future behaviour, but not as a means of avoiding penalties (such as fines) for past behaviour.

10.6 Alternative review process suggested by Shipping Australia Limited

As an alternative to the existing review process, Shipping Australia Limited suggested that a panel be established to assess complaints (sub. DR4). The proposed panel would be chaired by the Department of Transport and Regional Services, with representatives from the ACCC and the Department of Foreign Affairs and Trade. Emphasis would be on conciliation, with penalty imposition remaining at the discretion of the Minister. The proposed Panel would have no power to direct any action, other than, *in extremis*, to refer matters to the Minister.

The Department did not favour this proposal, saying that it:

> … cuts across the schema on which Part X is premised. Section 10.01(2)(b) states that it "is the intention of the Parliament that the principle objects of Part X should be achieved: (b) through increased reliance on private commercial and legal processes and a reduced level of government regulation of routine commercial matters."
>
> However, the most important reason for not adopting such a proposal is that it weakens the only sanction open to shippers who are left with a grievance after negotiations with the parties to a conference agreement – a complaint to the ACCC (which may choose to investigate and report to the Minister) or to the Minister (for possible referral to the ACCC for investigation and report).
>
> This sanction is intended to give the conferences a strong incentive to be reasonable in their dealings with shipper bodies and shippers generally. To weaken this incentive by interposing a potentially very time-consuming bureaucratic process would be to undermine the whole approach underpinning Part X. (sub. DR18, p. 34)

The Commission concurs with the Department's views on this matter. It is difficult to see how the proposed alternative would result in a more effective review and enforcement system. As the Department noted, it would weaken the incentive for carriers to deal reasonably with shippers and add a very time consuming and bureaucratic process into the Part X procedures.

10.7 Recommendations to improve the review and enforcement process

In relation to the enforcement provisions of Part X and the reviews conducted under those provisions, the Commission recommends that:

RECOMMENDATION 10.1

If Part X is retained, the following changes should be made to the review and enforcement process:

- ***the parties to a registered agreement being reviewed in relation to section 10.45(1)(a)(viii) of the TPA be required to demonstrate that the conduct under review has resulted, or is likely to result, in a net public benefit;***
- ***Section 10.44(1) be amended such that the Minister 'must' rather than 'may' direct the Registrar to cancel the registration of an agreement whether in part or in full;***
- ***a range of penalties, including fines, be introduced for breaches of the procedural provisions of Part X; and***
- ***the use of undertakings be limited to situations where deregistration is threatened, and not be available as a means of avoiding fines resulting from procedural breaches of Part X.***

APPENDIXES

A Conduct of the inquiry

A.1 Introduction

The Commission received a total of 61 submissions during the inquiry — 24 were received prior to the release of the draft report in October 2004 and a further 37 following its release. All submissions are listed in section A.2. In addition, those who provided comment on the draft report at public hearings are shown in section A.4.

Following receipt of the terms of reference, the Commission placed advertisements in national and metropolitan newspapers and appropriate publications inviting public participation in the review. Information about the inquiry was circulated to people and organisations likely to have an interest in it. The Commission also released an issues paper to assist parties in preparing their submissions. Subsequent information about the progress of the inquiry has been sent to those who have expressed an interest. All of this information has been made available on the Commission's website (http://www.pc.gov.au).

A.2 List of submissions

The following table lists submissions received. Submission marked with DR were received after the release of the draft report.

Table A.1 **Submissions received**

Participant	*Submission no.*
ACIL Tasman Pty Ltd and Thompson Clarke Shipping Pty Ltd	17, DR 9
Australian Chamber of Commerce and Industry	15
Australian Competition and Consumer Commission	21, DR 30
Australian Cotton Shippers Association	DR 3
Australian Federation of International Forwarders Ltd	8, DR 22

continued next page

Table A.1 **continued**

Participant	*Submission no.*
Australian Horticultural Exporters Association	13, DR 8
Australian International Movers Association	14, DR 21
Australian Meat Industry Council, The	22, DR 24
Australian Peak Shippers Association Incorporated	5, DR 11, DR 14
Australian Shipowners Association	3
BlueScope Steel Ltd	18, DR 27, DR 36
Bunbury Port Authority	1, DR 1
Centre for Customs & Excise Studies – University of Canberra	20
Department of Foreign Affairs and Trade	4
Department of Transport and Regional Services	9, DR 18
Federation of ASEAN Shipowners' Association	DR 26
Fletcher, Dr Tony	23, DR 2, DR 28, DR 32, DR 35, DR 37
Flinders Ports South Australia	2
Gift and Homewares Australia	DR 15
Importers Association of Australia	19
International Chamber of Shipping (ICS)	7
Japanese Shipowners' Association, The	11, DR 23
Maritime Law and International Trade Group — University of Newcastle	24
Ministry of Land, Infrastructure and Transport — Japan	DR 25
National Farmers' Federation	DR 29
NSW Road Transport Association Inc	DR 7, DR 33, DR 34
P&O Ports Limited	DR 31
Patrick Ports Group	DR 17
Port of Brisbane Corporation	10
Shipping Australia Limited	16, DR 4, DR 20
Singapore Shipping Association	DR 16
South Australian Shippers' Users' Group	DR 12
SPC Ardmona Operations Limited	DR 6
Tasmanian Freight Logistics Council Ltd	12
Trade Practices Committee of the Law Council of Australia	DR 13
Western Australian Shippers Council and the Chamber of Commerce & Industry of Western Australia	6, DR 10
Wool Commodity Group (Aust)	DR 5
Zerby, Mr John	DR 19

A.3 Visits

Leading up to the Draft Report, the following people and organisations were visited by the Commission.

Australian Capital Territory

Australian Chamber of Commerce and Industry

Bureau of Transport and Regional Economics

Department of Foreign Affairs and Trade

Department of the Prime Minister and Cabinet

Department of the Treasury

Department of Transport and Regional Services

Federal Chamber of Automotive Industries

National Farmers Federation

New South Wales

Australian Meat Industry Council

Canadian Pacific Ships

Hetherington Kingsbury Pty Ltd

P&O Nedlloyd

Shipping Australia Limited

Victoria

Australian Consumer and Competition Commission

Australia Federation of International Forwarders

Australian Horticultural Exporters Association

Australian Peak Shippers Association

General Motors Holden

Importers Association of Australia

Keith Trace and Associates Pty Ltd

Murray Goulburn Co-op

Patrick Stevedores

A.4 Public hearings

Table A.2 **Public hearings**

Date	*Participant*	*Transcript page no.*
Sydney		
1 December 2004	NSW Road Transport Association Inc; and	
	Johnstons Transport Industries	3 – 17
	Shipping Australia Limited; P&O Nedlloyd and	
	Maersk Australia	15 – 43
Melbourne		
6 December 2004	Tasmanian Freight Logistics Council	45 – 54
	Australian Peak Shippers Association	55 – 70
	Australian Federation of International Forwarders	71 – 80
	ACIL Tasman; and	
	Thompson Clarke Shipping	81 – 102
	Australian Horticultural Exporters Association; and	
	John Holman and Company	103 – 116
	Australian Chamber of Commerce and Industry	117 – 124

B Participants' views

Table B.1 **Participants' views**

Submission	*Sub. no.*	*Participant's views*
ACIL Tasman Pty Ltd and Thompson Clarke Shipping Pty Ltd	17 & DR9	The structure of the liner cargo shipping industry has remained largely unchanged since the 1999 PC review, however, trade and trade imbalances have increased on some routes. The observed Australian shipping services are consistent with economic theories that predict the need for collusive arrangements to promote stable shipping services. ACIL and TCS supported the conclusion of the 1999 PC review that Part X is the most effective form of regulation to achieve the objective of a competitive liner shipping service of quality sought by shippers. Policy should be made in the public interest, best represented in this context by shippers. Most shippers have supported the current arrangements or variations of them.
Australian Chamber of Commerce and Industry (ACCI)	15	ACCI argued that Part X should be repealed. Liner cargo is an integral part of Australia's international trade relationship and the competitiveness, efficiency and regulatory interventions have implications for the users of the service. The blanket exemptions allowed under Part X allow carriers to form cartels and engage in anticompetitive behaviour. There is uncertainty as to the public benefit of the arrangements given the lack of available information including freight rates and capacity. ACCI supports the view of the OECD that most anticompetitive conduct is a net loss and that the onus of proof should be on the proponents of the conduct to establish a net public benefit. Such an authorisation process under Part VII for other similar industries has allowed similar anticompetitive behaviour.
Australian Competition & Consumer Commission (ACCC)	21 & DR30	The ACCC is of the belief that Australia would be better served by abolishing Part X and allowing the provisions of the TPA to be applied to liner shipping. The authorisation process under Part VII gives the ACCC the power to authorise individual shipping conference agreements if it can be shown that the public benefit is likely to outweigh any public detriment from any lessening of competition. If Part X were repealed, transitional arrangements would be appropriate.
Australian Cotton Shippers Association	DR3	Supported the submission of the Australian Peak Shippers' Association. There should be a distinction between importers and exporters in assessing net public benefit. Discussion agreements are contrary to the spirit of Part X. Unlike conferences, discussion agreements limit competition by limiting or regulating capacity and price.

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Table B.1 continued

Submission	Sub. no.	Participant's views
Australian Federation of International Forwarders Ltd (AFIF)	8 & DR22	Shipping is an important input into the Australian economy and there is no compelling evidence that the shipping lines have failed in their contribution to the Australian economy under Part X. There is an imbalance between import and export trade, not only in terms of total container numbers, but also in types of containers and the ports that exports and imports use. It would be damaging to Australian shipping if Part X provisions were different to our major trading partners, and Australia should not lead the world in introducing dramatic change. If Part X was removed, discussions with carriers would move overseas. Part X could be modified to limit associations to 1/3 of any market.
Australian Horticultural Exporters Association (AHEA)	13 & DR8	AHEA presented a similar view to that of APSA — supporting the retention of Part X particularly the power of shippers to negotiate collectively. AHEA argued for the exclusion of Discussion Agreements from registration and the other proposals put forward by APSA aimed at strengthening the negotiating power of shipper organisations. Australian horticultural exporters, who are diverse and unique competitors against each other in the global market, have weak market power relative to the well resourced and informed carriers. AHEA is of the belief that if Part X was repealed, market forces would mean that carriers would concentrate on lucrative trades and horticultural exporters shipping service would diminish.
Australian International Movers Association (AIMA)	14 & DR21	Part X has limited price increases and stabilised shipping costs. The substantial increases that have occurred are outside AIMA's control. Repealing Part X could increase freight rates and deteriorate shipping services. In the long run, the import/export imbalance could lead to a less predictable tonnage and would be detrimental to all parties. Part X should be retained.
Australian Meat Industry Council, The (AMIC)	22 & DR24	On balance, given the special requirements of the meat export sector and its dependence on a reliable international sea freight option, AMIC supported the continuation of the ability to meet with the lines as an industry and to discuss those issues of importance to members that can deliver a more dependable level of service. If Part X is the only means of maintaining current provisions (for collective negotiation with carriers) then it should be retained.
Australian Peak Shippers Association Incorporated (APSA)	5, DR11 & DR14	APSA supported the retention of Part X, but with major amendments. APSA is of the belief that liner shipping is a unique industry and its operational characteristics which include the inability to store output, variations in demand and the long life of vessels justify special treatment under the TPA. Moreover, it is the belief of APSA that Part X has been instrumental in providing Australian shippers with high quality and competitive shipping services. Without Part X Australia could not sustain a comprehensive service at competitive freight rates as carriers would service their own interests. However, in the light of developments since 1999, APSA proposed several amendments to give greater safeguards to exporters, including:

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Table B.1 continued

Submission	Sub. no.	Participant's view
APSA continued		• excluding discussion agreements from registration under Part X; • requiring that contracts be offered on an all-in basis and in Australian dollars; • protection for confidential agreements negotiated by exporters; • the development of a code of negotiating practice; and • greater requirements for the provision of information to shipper bodies, including contracts with stevedoring companies.
Australian Shipowners Association (ASA)	3	ASA supports the retention of Part X because its objectives protect Australian flag shipping, promote stability and is a regulatory regime with minimal administrative costs.
BlueScope Steel Ltd	18 DR27 & DR 36	On the whole, under Part X, Australian exporters have been well served by competitive and efficient liner shipping services. Under any amendment of the Part X regime which preserves the entitlement of shipping lines to engage in cartel activity (particularly in relation to pricing), whether by means of authorisation or otherwise, it would be important to explicitly maintain the elements of Part X which enable collective action by shippers. Shippers must be allowed the option to negotiate their freight business with either an individual line or a conference with assurances of confidentiality.
Bunbury Port Authority	1 & DR1	Liner services to regional ports was a key issue for the Bunbury Port Authority. It was the Port's belief that Part X did not encourage liner ships to stop at regional ports because of a lack of competition between carriers. Accordingly, they argued that Part X should be repealed. However, if Part X was to be retained it should be modified to encourage liner ships to stop at regional ports.
Centre for Customs & Excise Studies – Uni. of Canberra	20	Part X provides an interesting model for the conduct of shipper and carrier negotiations as it contains unique provisions which recognise and redress the material inequality of shippers in their negotiations with carriers.
Dept of Foreign Affairs and Trade (DFAT)	4	Efficient and reliable liner services are important for Australia's international competitiveness, trade performance and national economic welfare. Given that freight rates for exporters appear competitive and that countervailing power appears to be working for exporters, so that liner services are of adequate frequency and coverage, DFAT supported retaining Part X. However, DFAT noted that importers do not appear to be benefiting. DFAT suggested that confidential contract clauses which formed part of the changes in US regulation could be considered. Proposed changes to Part X could be accommodated within existing international agreements.

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Table B.1 continued

Submission	Sub. no.	Participants' views
Department of Transport and Regional Services (DTRS)	9 & DR18	The Department's considers that the views of Australian shippers are of particular importance as their interests broadly reflect the national interest. The Department supported the retention of Part X, but with modifications aimed primarily at strengthening the negotiating power of shipper organisations, including: • introducing provisions for agreements between shipper bodies and conference agreement members to be binding; • requiring carriers to offer the option of all inclusive freight rates and rates in Australian dollars; • requiring carriers to provide adequate justification to shippers for rate increases; and • providing peak shipper bodies with a 'veto' over the registration of conference agreement (as an alternative to excluding discussion agreements from registration). The Department noted the past and possible future international regulatory changes and argues that it would be risky for Australia to change Part X in advance of its major trading partners. If our major trading partners remove exemptions for price fixing and price discussions, then Australia should remove the exemptions as well.
Federation of ASEAN Shipowners' Association	DR26	Supports retention of Part X. A repeal of Part X would lead to destructive competition among carriers and may also result in an oligopoly in liner shipping. Abolition of Part X would be inconsistent with the regulatory regimes of Australia's major trading partners.
Dr Tony Fletcher	23, DR2, DR28, DR32, DR35, & DR37	Part X should be repealed. Australia does not have the maritime industry strength or ability to put pressure on overseas shipping lines because it does not have a merchant marine of any international or coastal consequence. A merchant marine fleet should be developed. Discussed the estimation of the value of liner services to Australia.
Flinders Ports South Australia	2	Part X serves the community interest through benefits provided to industry in terms of frequency of services and port calls; access to markets; and availability of space and equipment. It was the Port's belief that these factors may be adversely affected by removing Part X, which could result in increased cost and a reduction in the quality of service for shippers.
Gift and Homewares Australia	DR15	Supported retention of Part X with amendments designed to improve the negotiating position of shippers, including greater notice of rate increases and provision of justification for those increases. The participant was concerned about the lack of price competition, and the inability of importers to be able to access sufficient and timely sea freight and container services. Argued that the agreements registered under Part X should be made more readily available to shippers.

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Table B.1 continued

Submission	Sub. no.	Participant's views
Importers Association of Australia (IAA)	19	The Association struggled to see how Part X currently delivers benefits for importers. If Part X is retained, the IAA believes that there should be three changes: the exemption should not be extended to pricing discussions; member lines should be required to give earlier notice of increases in freight rates; and service standards should be included in Part X negotiations.
International Chamber of Shipping (ICS)	7	Maritime competition laws are broadly in alignment in the major trading areas. This current system of liner conferences serves shippers by allowing shipping services to cope better with severe and sudden imbalances in trade flows. The provision of a reliable regular service requires a large capital investment. Available capacity needs to exceed shipped volumes to allow for seasonal peaks, imbalances in inbound and outbound trade and other market changes. The discussions on capacity management allow ship operators to limit extreme rate fluctuations and commit to long term investments required for ships, containers and logistics infrastructure. In addition, the liner sector is open and very competitive and, if Part X was abolished, it is likely to lead to a concentration of carriers and a reduction in competition.
Japanese Shipowners' Association, The (JSA)	11 & DR23	JSA supported the retention of Part X and supported the submission presented by Shipping Australia Limited. Associations allowed under Part X allow carriers to save significant costs and improve service quality and efficiency. Shippers benefit from robust service options and reasonable rates. Attention was drawn to the Japanese self-regulatory approach.
Japanese Ministry of Land, Infrastructure and Transport	DR25	Argued that conferences and other agreements between carriers promoted stability of freight rates and service levels. These agreements do not always increase the profits of carriers.
Maritime Law and International Trade Group — University of Newcastle	24	The benefits of Part X of the TPA significantly outweigh the disadvantages and thus Part X should be retained in its present form. The current regime seeks to and achieves a balance of carrier interests, with the interests of shippers and consumers.
National Farmers' Federation (NFF)	DR29	Supported the repeal of Part X and considered that the liner shipping industry should be subject to the general provisions of the TPA. Transitional arrangements should be put in place with agreements registered under Part X authorised under Part VII for 3 to 5 years (such authorisation subject to revocation if abuse of market power is established).
NSW Road Transport Association Inc	DR7, DR33 & DR34	Supported the repeal of Part X. Noted the similarities between the road freight industry (where no provision similar to Part X exists) and liner shipping. Commented on the operation of stevedoring facilities at Port Botany, in particular, that stevedores were more sensitive to the needs of the carriers than those of the trucking industry.

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Table B.1 continued

Submission	Sub. no.	Participant's views
P&O Ports Limited	DR31	Responded to comments made in the public hearings by the NSW Road Transport Association. Discussed the vehicle bookings system at Australian ports.
Patrick Ports Group	DR17	Responded to points made by the NSW Road Transport Association about stevedoring operations at Australian ports.
Port of Brisbane Corporation	10	Part X and conferences provide a net benefit through coordination of services and promoting stability. Over recent years there has been a high level of service at relatively low freight rates and access to export markets is being achieved.
Shipping Australia Limited (SAL)	16, DR4 & DR20	The shipping industry has a combination of characteristics that make it unique, some of which mean that competition between carriers would lead to unstable price and service provisions. Without exemptions from competition laws to form cooperative arrangements there would not be provision of a comprehensive reliable scheduled service on the 'long and thin' Australian routes. Part X should be retained, but could be improved by making discussion agreement conditions binding and having government officials provide a conciliatory and facilitative role in the case of disagreement. The role of the ACCC should be removed or only used as a last resort.
Singapore Shipping Association	DR16	Supported retention of Part X. Repeal of Part X may promote 'destructive competition' among ocean carriers and would be inconsistent with the regulatory regime of Australia's major trading partners.
South Australian Shippers' Users' Group	DR12	Supported retention of Part X as a means of protecting services to ports in South Australia and Tasmania. The recent withdrawal of a service to South Australia was a result of discussion agreements undermining the negotiating position of shippers. It is vital that shipper groups retain the ability to negotiate tariff rates with carriers.
SPC Ardmona Operations Limited	DR6	Supported the retention of Part X as it provides certainty for exporters, but discussion agreements do not promote healthy competition.
Tasmanian Freight Logistics Council	12	Only one regular service to Tasmania is made by a carrier operating under Part X arrangements. It is doubtful whether this regular service would continue without Part X due to the low container volumes and this could effect exporters. The other services transhipped through Melbourne are slower.
Trade Practices Committee of the Law Council of Australia	DR13	Supported the repeal of Part X and considered that the liner shipping industry should be subject to the general provisions of the TPA. Considered that the cost of authorisation was relatively low. Transitional arrangements should be put in place and agreements reviewed by the ACCC in accordance with the risk of anticompetitive detriment.

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Table B.1 continued

Submission	Sub. no.	Participant’s views
Western Australian Shippers Council Incorporated (WASA) and the Chamber of Commerce and Industry of Western Australia (CCIWA)	6 & DR10	CCIWA and WASC supported abolishing Part X and applying Part VII. Major changes to the international shipping industry since 1993 have resulted in a reduction in the necessity and the effectiveness of shipping conferences. However, the effect of removing Part X on service levels and shipping rates needs to be considered. It is the belief of WASA and CCIWA that market forces already determine the level of shipping services and freight rates for Australia and not the provisions under Part X. However, consideration should be given to initial interim authorisation with a faster review process, discussion agreements should not be authorised and price fixing should only be authorised with offsetting public benefit. APSA should be retained and publicly funded and shipping lines shoud have an Australian office.
Wool Commodity Group (Australia)	DR5	Supported the submission of the Australian Peak Shippers’ Association.
John Zerby	DR19	Discussed changes to the regulation of liner shipping in the United States.

C Shipping data

This appendix presents data on Australian liner trade routes. Table C.1 reports the volume of cargo shipped on Australian trade routes; while figure C.1 provides information on the value of liner trade routes. Tables C.2 and C.3 report liner exports and imports by commodity classification.

This appendix also provides information on the relative importance of Part X agreements. These estimates are provided in tables C.4 to C.21.

The Commission has also considered how trade on smaller trade routes — where few Part X agreements are registered — may be influenced by agreements on larger routes. This information is presented in tables C.23 to C.32.

C.1 Australia's liner cargo trade

Table C.1 **Cargo volumes on major Australian liner trade routes, 2003**

Trade route	*Exports*	*Imports*	*Ratio of exports to imports*	*Ratio of exports to imports 1997*
	Tonnes	Tonnes		
Japan & North Asia	3 626 708	2 094 055	1.7	3.5
South East Asia	4 398 970	3 133 557	1.4	2.0
East Asia	3 455 355	3 520 697	1.0	2.2
Europe	1 836 726	3 516 693	0.5	0.6
North America	1 558 058	1 731 434	0.9	0.6
New Zealand	1 743 133	1 537 274	1.1	1.0
Total			**1.1**	**1.5**

Source: PC (1999, p. 20); BTRE (2004).

Table C.2 **Liner export commodity groups by weight and value, 2003**

Exports	*Weight*	*Value*
	Tonnes	$ '000
Meat and meat preparations	1 264 492	4 752 223
Iron and steel	438 656	330 364
Vegetables and fruit	885 959	933 157
Dairy products and birds eggs	836 946	2 002 184
Feeding stuff for animals	1 211 494	716 810
Chemicals	534 485	954 572
Aluminium and aluminium Alloys	968 188	2 277 327
Cereals and cereal preparations	1 214 082	591 899
Wool, sheep and lambs	331 956	2 312 675
Machinery	275 289	3 060 618
Road vehicles and transport equipment	300 699	3 498 634
Cotton	464 021	913 005

Source: BTRE (2004).

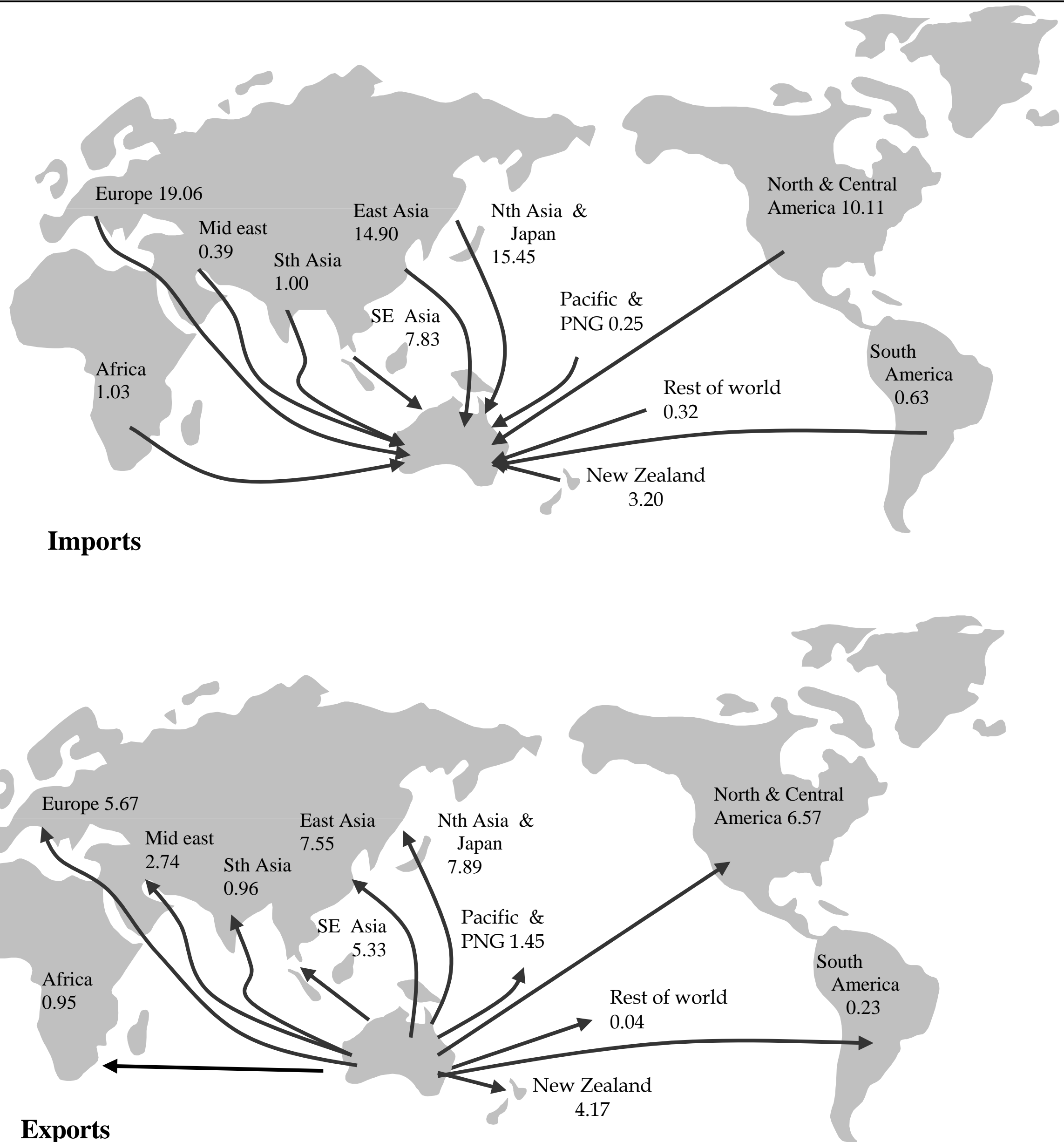
Table C.3 **Liner import commodity groups by weight and value, 2003**

Imports	*Weight*	*Value*
	Tonnes	$ '000
Paper, paperboard and articles of paper	1 428 693	2 098 637
Chemicals	1 225 163	2 328 766
Machinery	1 520 348	19 399 184
Non-metallic mineral manufactures, nes[a]	1 421 850	1 460 584
Miscellaneous manufactured articles nes	784 318	4 107 562
Iron and steel	1 006 899	1 245 945
Cork and wood	267 355	573 369
Vegetables and fruit	600 192	884 980
Textile yarn, fabrics and made-up articles	70 496	165 238
Road vehicles and transport equipment	1 042 124	14 644 505
Manufactures of metals, nes[a]	633 894	2 540 305
Articles of apparel and clothing accessories	309 586	3 704 954

[a] Not elsewhere specified.

Source: BTRE (2004).

Figure C.1 **Liner trade by value, $billion**



Source: Department of Transport and Regional Services (sub. 9, p. 7).

C.2 Capacity data for members of Part X agreements and independents

The following tables present available capacity on Australia's trade routes for the 2003-04 financial year (tables C4 to C21). For each trade route, the share of available capacity is reported for registered Part X agreements and independent

carriers. The following section outlines how the data was constructed. Important caveats regarding the interpretation of the data are reported in footnotes.

How the data was constructed

The capacity on a trade route is derived from information on sailings from Lloyds List and vessel capacity information. The Lloyds List sailing information contains the vessel name, operator and ports at which the vessel stops. The Commission determined the capacity of the vessels, primarily from information given in Containerisation International (2003 and 2004), but, in some cases, from carriers. In calculating shipping capacity, the Commission has assumed that export containers weigh 18 tonnes and that import containers weigh 14 tonnes[1]. This information on sailings and vessel capacity, when combined, provides an estimate of the available capacity of each sailing on a trade route over the year. The capacity of each trade route is estimated by aggregating the capacity of the individual sailings over the year on the relevant trade route[2].

The capacity share of the registered Part X agreements on each trade route was estimated using the capacity on the trade route over the year and information from the Registrar of Liner Shipping and Shipping Australia on the members and ports covered by Part X agreements on each trade route. The assumptions on which agreements are operational on each trade route, their members and ports covered are outlined in the following tables.

For estimating the capacity share of each Part X agreement, the capacity on a trade route was assumed to be carried by an agreement if: (i) the operator was a member of an agreement; and, (ii) the individual sailing serviced at least one overseas port covered by the agreement. For example, on the Australia to North Asia trade route, if a sailing from Evergreen was to service one of Shanghai, Hong Kong or Busan ports, then the full capacity of this sailing would be allocated to the NCA Vessel

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[1] This assumption, made on the basis of information provided by ACIL Tasman and Thompson Clarke, only affects the total capacity estimates and should not affect the capacity share estimates. It would require the capacity utilisation of vessels to systematically differ between agreements and/or between agreements and independents for the accuracy of capacity share estimates to be affected. The Commission does not have evidence that capacity utilisation differs between agreements. However, even if it did, sensitivity testing on the capacity share estimates reveals that it would require large differences in capacity utilisation, which are unlikely, for the capacity shares to be affected by a significant amount.

[2] The available capacity estimates for some trade routes will be greater than containers actually carried because of transhipment. If a vessel sails on multiple trade routes during the one sailing, then the full capacity of the vessel is allocated as potentially available capacity to each of the trade routes.

Sharing Agreement. This approach was applied to all agreements on each trade route, with the aggregated capacity of each agreement being divided by the total capacity on the route to derive capacity shares reported in the following tables[3].

Table C.4 **Australia to Africa and Indian Ocean Islands, 2003-04**

Available capacity of 296 495 TEUs (7 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Independents		Maersk MSC PONL[a]	100	All

[a] Only one sailing for the year.

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.5 **Africa and Indian Ocean Islands to Australia, 2003-04**

Available capacity of 300 572 TEUs (6 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Independents		Maersk MSC	100	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

[3] On some trade routes, the capacity share of agreements add to more than 100 per cent. This is because there is an overlap between members of agreements and/or the ports covered. For example, on the Australia to Europe route, PONL is a member of the Contship/PONL vessel sharing agreement and a member of the Contship/PONL/HSDG vessel sharing agreement, this means that, in the absence of information to assign PONL’s capacity between the two, PONL’s entire capacity on the route is used when calculating the share of both agreements. However, PONL’s entire capacity is counted only once when aggregating total capacity for the route. In a number of cases, all the members of an operational agreement are members of a wider agreement, particularly discussion agreements.

Table C.6 **Australia to Central and South America, 2003-04**
Available capacity of 356 901 TEUs (9 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia-Caribbean Discussion Agreement	Discussion Agreement	Hamburg Sud PONL	29	All
Australia-Mexico Discussion Agreement	Discussion Agreement	ANZL Hamburg Sud PONL	37	All
Independents		Contship Maersk MOL MSC	63	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.7 **Central and South America to Australia, 2003-04**
Available capacity of 298 657 TEUs (6 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia-Caribbean Discussion Agreement	Discussion Agreement	Hamburg Sud PONL	3	All
Australia-Mexico Discussion Agreement	Discussion Agreement	ANZL Hamburg Sud PONL	20	All
Independents		Contship Maersk MOL	80	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.8 **Australia to Europe, 2003-04**

Available capacity of 456 879 TEUs (11 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia New Zealand to Europe Liner Association	Conference	ACTA CMA-CGM SA Marfret Consortium Hispania Lines Contship Hamburg Sud Hapag Lloyd PONL SCNZ	47	Jedda Damietta Malta La Spezia Dunkirk Le Havre Zeebrugge Hamburg Rotterdam Tilbury
Northbound Trade Participation Agreement	Consortia	Marfret Consortium Hispania Contship Hapag Lloyd ACTA PONL SCNZ	41	All
Contship/PONL Vessel Sharing Agreement	Consortia	Contship PONL	39	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
Contship/PONL-Hapag-Lloyd Vessel Sharing Agreement	Consortia	Contship Hapag Lloyd PONL	39	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
CS/PONL - HSDG Vessel Sharing Agreement	Consortia	Contship PONL Hamburg Sud (Columbus)	41	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
Contship/PONL-CMA CGM/Marfret Vessel Sharing Agreement	Consortia	Contship PONL Marfret CMA CGM	46	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
Independents		Maersk MSC	53	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.9 **Europe to Australia, 2003-04**

Available capacity of 586 910 TEUs (13 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Europe to Australia and NZ Conference Members' Agreement	Conference	ACTA CMA CGM CHL Contship Hapag Lloyd Marfret PONL SCNZ	52	La Spezia Damietta Hamburg Dunkirk Le Havre Rotterdam London (Tilbury)
Southbound Trade Participation Agreement	Consortia	ACTA CMA CGM CHL Contship Hapag Lloyd Marfret PONL SCNZ	52	All
Contship/PONL Vessel Sharing Agreement	Consortia	Contship PONL	45	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
Contship/PONL-Hapag-Lloyd Vessel Sharing Agreement	Consortia	Contship Hapag Lloyd PONL	45	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
CS/PONL - HSDG Vessel Sharing Agreement	Consortia	Contship PONL Hamburg Sud (Columbus)	46	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
Contship/PONL-CMA CGM/Marfret Vessel Sharing Agreement	Consortia	Contship PONL Marfret CMA CGM	52	Tilbury Hamburg Rotterdam La Spezia Damietta Suez
Independents		Maersk MSC Spliethoff	46	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.10 **Australia to New Zealand and South Pacific Islands, 2003-04**

Available capacity of 822 372 TEUs (20 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia/Fiji Discussion Agreement	Discussion Agreement	PONL Pacific Forum Line ANZDL Neptune Shipping Hamburg Sud	6	Suva
Australia/New Zealand Discussion Agreement	Discussion Agreement	ANZDL Contship Hamburg Sud FESCO PIL PONL MSC MISC	54	Auckland Wellington Lyttleton Tauranga Napier Nelson Bluff New Plymouth
Australia/New Zealand Vessel Operators' Discussion Agreement	Discussion Agreement	Contship ANZDL PONL MSC ANL Container Line Pty Limited	56	Auckland Wellington Lyttleton Tauranga Napier Nelson Bluff New Plymouth Port Chambers
Australia US Containerlines Association	Conference	PONL Columbus Line ANZDL Lykes Line	6	Suva Papeete
Butterfly service	Consortia	PONL MSC ANZDL and Contship slot charter	32	Napier Lyttleton Wellington Nelson Bluff
US Pacific Coast Oceania Agreement	Consortia	PONL Hamburg Sud ANZDL Lykes Lines FESCO Mearsk–Sealand	51	All
Independents		CCS LHISS MOL MSC NYK PES Sofrana	22	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.11 **New Zealand and South Pacific Islands to Australia, 2003-04**

Available capacity of 902 332 TEUs (19 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia/Fiji Discussion Agreement	Discussion Agreement	PONL Pacific Forum Line ANZDL Neptune Shipping Hamburg Sud	2	Suva
New Zealand/ Australia Discussion Agreement	Discussion Agreement	Contship ANZDL PONL Hamburg Sud FESCO MISC PIL MSC NGAL AWPL PNG SC	59	All
Australia/New Zealand Vessel Operators' Discussion Agreement	Discussion Agreement	Contship ANZDL PONL MSC ANL Container Line Pty Limited	41	Auckland Wellington Lyttleton Tauranga Napier Nelson Bluff New Plymouth Port Chambers
Butterfly service	Consortia	PONL Mediterranean Shipping Company (MSC) ANZDL and Contship slot charter	13	Napier Lyttleton Wellington Nelson Bluff
US Pacific Coast Oceania Agreement	Consortia	PONL Hamburg Sud ANZDL Lykes Lines FESCO Maersk – Sealand	47	All

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Table 11 **continued**

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Independents		ANL CCS CGM CMA LHISS Marfret MOL NGPL NYK PES PIL Sofrana Spliethoff	22	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.12 **Australia to North America East Coast, 2003-04**

Available capacity of 251 914 TEUs (6 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia/United States Discussion Agreement	Discussion Agreement	ANZDL Hamburg Sud FESCO Lauritzen Cool PONL Seatrade Group Lykes Line Maersk Sealand	47	All
Australia US Containerlines Association	Conference	PONL Columbus Line Australia New Zealand Direct Line (ANZDL) Lykes Line	11	Los Angeles/Long Beach Philadelphia San Francisco/Oakland Savannah Seattle/Tacoma Oakland
Columbus/PONL Space Charter Agreement	Consortia	Columbus PONL	13	Houston Norfolk Philadelphia Savannah
Contship/PONL vessel sharing agreement	Consortia	Contship PONL	17	Manzanillo Savannah Philadelphia New York Zeebrugge
Contship/PONL/Hapag-Lloyd vessel sharing agreement	Consortia	Contship PONL Hapag-Lloyd	17	Manzanillo Savannah Philadelphia New York Zeebrugge
Contship/PONL-CMA CGM/Marfet Vessel sharing agreement	Consortia	Contship PONL CMA CGM Marfret	23	Manzanillo Savannah Philadelphia New York Zeebrugge
CS/PONL HSDG Vessel Sharing Agreement	Consortia	CS PONL HSDG	17	Manzanillo Savannah Philadelphia New York Zeebrugge
Independents		MSC	40	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.13 **North America East Coast to Australia, 2003-04**

Available capacity of 272 668 TEUs (6 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
United States/Australasia Discussion Agreement	Discussion Agreement	ANZDL CMA CGM Contship Fesco Hamburg Sud Lykes Lines Maersk Marfret PONL	40	Los Angeles Oakland Seattle Philadelphia New York Savannah
Australia US Containerlines Association	Conference	PONL Columbus Line Australia New Zealand Direct Line (ANZDL) Lykes Line	35	Los Angeles/Long Beach Philadelphia San Francisco/ Oakland Savannah Seattle/Tacoma Oakland
Columbus/PONL Space Charter Agreement	Consortia	Columbus PONL	13	Houston Norfolk Philadelphia Savannah
Contship/PONL vessel sharing agreement	Consortia	Contship PONL	8	Manzanillo Savannah Philadelphia New York Zeebrugge
Contship/PONL/Hapag-Lloyd vessel sharing agreement	Consortia	Contship PONL Hapag-Lloyd	8	Manzanillo Savannah Philadelphia New York Zeebrugge
Contship/PONL-CMA CGM/Marfet Vessel sharing agreement	Consortia	Contship PONL CMA CGM Marfret	9	Manzanillo Savannah Philadelphia New York Zeebrugge
CS/PONL HSDG Vessel Sharing Agreement	Consortia	CS PONL HSDG	8	Manzanillo Savannah Philadelphia New York Zeebrugge
Independents		MSC Spliethoff	48	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.14 **Australia to North America West Coast, 2003-04**

Available capacity of 115 470 TEUs (3 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia/Canada Discussion Agreement	Discussion Agreement	ANZDL Columbus PONL Lykes Line Hamburg Sud FESCO	94	All
Australia/United States Discussion Agreement	Discussion Agreement	ANZDL Hamburg Sud FESCO Lauritzen Cool PONL Seatrade Group Lykes Line Maersk Sealand	100	All
Australia Canada Containerlines Association	Conference	PONL Columbus Line ANZDL Lykes Line	21	Vancouver
Australia US Containerlines Association	Conference	PONL Columbus Line Australia New Zealand Direct Line (ANZDL) Lykes Line	74	Los Angeles/Long Beach Philadelphia San Francisco/Oakland Savannah Seattle/Tacoma
US Pacific Coast Oceania Agreement	Consortia	PONL Hamburg Sud ANZDL Lykes Lines FESCO	94	Los Angeles/Long Beach San Francisco/Oakland Seattle/Tacoma Oakland

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.15 North America West Coast to Australia, 2003-04

Available capacity of 179 206 TEUs (4 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
United States/Australasia Discussion Agreement	Discussion agreement	ANZDL CMA CGM Contship Hamburg Sud FESCO Marfret PONL Lykes Line Maersk Sealand	100	All
Canada/Australia New Zealand Discussion Agreement (southbound)	Discussion Agreement	ANZDL Fesco Columbus Contship PONL	94	All
Australia US Containerlines Association (AUSCLA)	Conference	PONL Columbus Line Australia New Zealand Direct Line (ANZDL) Lykes Line	74	Los Angeles/Long Beach Philadelphia San Francisco/Oakland Savannah Seattle/Tacoma
Australia Canada Containerlines Association (ACCLA)	Conference	PONL Columbus Line ANZDL Lykes Line	21	Vancouver
US Pacific Coast Oceania Agreement	Consortia	PONL Hamburg Sud ANZDL Lykes Lines FESCO	94	Los Angeles/Long Beach San Francisco/Oakland Seattle/Tacoma Oakland

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.16 **Australia to North Asia, 2003-04**

Available capacity of 659 050 TEUs (16 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia/North and East Asia Trade Facilitation Agreement	Discussion Agreement	ANL COSCO FESCO Hyundai Kawasaki Kisen Kaisha K-Line Maersk Mediterranean Shipping Company (MSC) Mitsui O.S.K. Nippon Yusen Kabushiki Kaisha OOCL PONL Yang Ming Marine Transport ZIM	72	All
Australia Northbound Shipping Conference (ANSCON) *[Note, There is no activity under this Agreement at the moment but it is still current]*	Conference	ANL Container Line Pty Ltd Kawasaki Kisen Kaisha (K-Line) Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha Orient Overseas Container Line Ltd P&O Swire Containers Ltd (providing shipping services on behalf of: The Eastern & Australian Steamship Co. Ltd and China Navigation Company Ltd) ZIM Israel Navigation Company Ltd	33	Kaohsiung Hong Kong Chiwan Shanghai Manilla (transhipment) Yokkaichi Nagoya Yokohama Hakata Osaka Busan

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Table C.16 **continued**

Agreement	Agreement type	Members	Capacity share	Ports
Asia/Australia Services Slot Exchange Agreement	Consortia	COSCO Container Lines Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	23	Hong Kong Nagoya Yokohama Osaka
North East Asia Express (NEAX) Agreement	Consortia	Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	16	Nagoya Yokohama Osaka Busan Keelung Kaohshiung
NEAX and COSCON Joint Services Agreement	Consortia	COSCO Container Lines Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	25	Dalian Qingdao Shanghai Ningdo Xingang
COSCON/NEAX Asia/Australia Services Slot Exchange Agreement	Consortia	COSCO Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	23	Nagoya Yokohama Osaka Busan Hong Kong
Slot Exchange Agreement between ANL and ACE	Consortia	ANL Container Line Ltd China Shipping Container Lines Co Ltd OOCL	29	Nagoya Yokohama Osaka Busan Keelung Kaohshiung

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Table C.16 **continued**

Agreement	Agreement type	Members	Capacity share	Ports
NCA Vessel Sharing Agreement	Consortia	Hapag-Lloyd Evergreen Hanjin	5	Shanghai Hong Kong Busan Kaohshiung
Master Slot Charter Agreement between CSCL and OOCL	Consortia	China Shipping Container Line Orient Overseas Container Line Ltd	23	Kaohsiung Hong Kong Shanghai Chiwan
East Australia/Asia Agreement	Consortia	Maersk Sealand Mediterranean Shipping Company (MSC)	23	East Australia to Yokohama Osaka Nagoya Busan Kobe Keelung Yokkaich Hong Kong Kaoshiung
West Australia/Asia Agreement	Consortia	K Line Maersk	0	Fremantle to Yokohama Osaka Nagoya Busan Kobe Keelung Yokkaichi Hong Kong Kaoshiung
Independents		APL Hamburg Sud Lloyds Trist Lykes Lines MISC PAS PIL RCL Spliethoff	8	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.17 North Asia to Australia, 2003-04

Available capacity of 945 139 TEUs (20 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Asia - Australia Discussion Agreement	Discussion Agreement	ANL Container Line Pty Ltd China Shipping Container Line COSCO Evergreen FESCO Hanjin Hyundai Merchant Marine Kawasaki Kisen Kaisha K-Line Maersk Sealand Mediterranean Shipping Co (MSC) Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha OOCL PONL Hamburg Sud ZIM	90	All
Australia and New Zealand/Eastern Shipping Conference	Conference	ANL Container Line Pty Ltd Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha Orient Overseas Container Line Ltd P&O Swire Containers Ltd Yang Ming Marine Transport Corporation ZIM	31	Kaohsiung Hong Kong Chiwan Shanghai Manilla (transhipment) Nagoya Yokohama Osaka Busan

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Table C.17 **continued**

Agreement	Agreement type	Members	Capacity share	Ports
Asia/Australia Services Slot Exchange Agreement	Consortia	COSCO Container Lines Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	25	Hong Kong Nagoya Yokohama Osaka
North East Asia Express (NEAX) Agreement	Consortia	Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	15	Nagoya Yokohama Osaka Busan Keelung Kaohshiung
NEAX and COSCON Joint Services Agreement	Consortia	COSCO Container Lines Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	16	Dalian Qingdao Shanghai Ningdo Xingang
COSCON/NEAX Asia/Australia Services Slot Exchange Agreement	Consortia	COSCO Kawasaki Kisen Kaisha K-Line Mitsui O.S.K. Lines Ltd Nippon Yusen Kabushiki Kaisha P&O Swire Containers Ltd	25	Nagoya Yokohama Osaka Busan Hong Kong
Slot Exchange Agreement between ANL and ACE	Consortia	ANL Container Line Ltd China Shipping Container Lines Co Ltd OOCL	27	Nagoya Yokohama Osaka Busan Keelung Kaohshiung

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Table C.17 **continued**

Agreement	Agreement type	Members	Capacity share	Ports
NCA Vessel Sharing Agreement	Consortia	Hapag-Lloyd Evergreen Hanjin	4	Shanghai Hong Kong Busan Kaohshiung
Master Slot Charter Agreement between CSCL and OOCL	Consortia	China Shipping Container Line Orient Overseas Container Line Ltd	21	Kaohsiung Hong Kong Shanghai Chiwan
East Australia/Asia Agreement	Consortia	Maersk Sealand Mediterranean Shipping Company (MSC)	20	East Australia to Yokohama Osaka Nagoya Busan Kobe Keelung Yokkaich Hong Kong Kaoshiung
West Australia/Asia Agreement	Consortia	K Line Maersk	0	Fremantle to Yokohama Osaka Nagoya Busan Kobe Keelung Yokkaichi Hong Kong Kaoshiung
Independents		APL Lloyd Trist Lykes Lines PAS PIL RCL Spliethoff Unicom Westlink	10	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.18 **Australia to South East Asia, 2003-04**

Available capacity of 987 952 TEUs (25 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia/South East Asia Trade Facilitation Agreement	Discussion Agreement	ANL Container Line Pty Ltd APL PT Djakarta Lloyd Hyundai Merchant Marine K Line Maersk Sealand Malaysian International Shipping Corp (MISC) Mitsui O.S.K. Lines Ltd (MOL) NYK Orient Overseas Container Line Ltd (OOCL) PONL Pacific International Lines (PIL) RCL Feeder (Pte) Ltd ZIM	75	All
Australia Asia Express Service Agreement	Consortia	ANL Container Line Pty Ltd APL PT Djakarta Lloyd NYK PONL	17	Singapore Pt Kelang Jakarta (t/s) Bangkok (t/s) Penang (t/s)
AAX Operational Agreement	Consortia	ANL Container Line Pty Ltd APL PT Djakarta Lloyd NYK PONL	17	All
Australia Asia Alliance (AAA)	Consortia	Orient Overseas Container Line Ltd (OOCL)	19	Pt Kelang Singapore Penang

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Table C.18 continued

Agreement	Agreement type	Members	Capacity share	Ports
		Pacific International Lines Mitsui O.S.K. Lines Ltd (MOL)		Bangkok Jakarta
ASA Consortium Slot Exchange Agreement	Consortia	Lloyd Triestino Di Navigazione Spa Hanjin RCL Feeder (Pte) Evergreen, Zim slot charter	7	Singapore
NZAX Consortium Operating Agreement	Consortia	PONL NYK	11	Port Klang Singapore
East Australia/Asia Agreement	Consortia	Maersk Sealand Mediterranean Shipping Company (MSC)	16	Port Kelang (t/s) Belawan Dili (t/s) Semasang (t/s) Surabaya (t/s)
West Australia/Asia Agreement	Consortia	K Line Maersk-Sealand	9	Fremantle to Singapore Jakarta Surabaya Semasang Port Kelang
APL & Maersk-Sealand Slot Charter Agreement	Consortia	Maersk-Sealand APL	7	Singapore Fremantle
Independents		AAL CGM CMA Columbus Contship Crocodile Fesco Hapag Lloyd Marfret NGPL PAS Perkins	14	All

[a] The Australia to Middle East Gulf and West India/Pakistan/Sri Lanka conference is not reported as it represents less than 1 per cent of the combined South East Asian and Middle East route. However, it the conferences represents 9 per cent of the capacity to the Middle East.

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.19 **South East Asia to Australia, 2003-04**

Available capacity of 1 081 362 TEUs (23 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Australia Asia Express Service Agreement	Consortia	ANL Container Line Pty Ltd APL PT Djakarta Lloyd NYK PONL	22	Singapore Pt Kelang Jakarta (t/s) Bangkok (t/s) Penang (t/s)
AAX Operational Agreement	Consortia	ANL Container Line Pty Ltd APL PT Djakarta Lloyd NYK PONL	22	All
Australia Asia Alliance (AAA)	Consortia	Orient Overseas Container Line Ltd (OOCL) Pacific International Lines (PIL) Mitsui O.S.K. Lines Ltd (MOL) Malaysian International Shipping Corp (MISC) Hyundai Merchant Marine, ZIM slot charter	25	Pt Kelang Singapore Penang Bangkok Jakarta
ASA Consortium Slot Exchange Agreement	Consortia	Lloyd Triestino Di Navigazione Spa Hanjin RCL Feeder (Pte) Ltd Evergreen, Zim slot charter	10	Singapore
NZAX Consortium Operating Agreement	Consortia	PONL NYK	15	Port Klang Singapore
East Australia/Asia Agreement	Consortia	Maersk SeaLand Mediterranean Shipping Company (MSC)	11	Port Kelang (t/s) Belawan Dili (t/s) Semasang (t/s) Surabaya (t/s)

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Table C.19 **continued**

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
West Australia/Asia Agreement	Consortia	K Line Maersk-Sealand	11	Fremantle and Singapore Jakarta Surabaya Semasang Port Kelang
APL & Maersk-Sealand Slot Charter Agreement	Consortia	Maersk-Sealand APL	8	Singapore Fremantle
SE Asia/Darwin Direct Trade Facilitation Agreement	Consortia	Perkins Shipping Group New Guinea Pacific Line (China Navigation Co Ltd as manager)	0	Singapore and Darwin
South East Asia and South Asia Australia/Trade Facilitation Agreement	Discussion Agreement	ANL Container Line Pty Ltd APL Hanjin PT Djakarta Lloyd Hyundai Merchant Marine K Line Maersk SeaLand Malaysian International Shipping Corp (MISC) Mitsui O.S.K. Lines Ltd (MOL) NYK Orient Overseas Container Line Ltd (OOCL) PONL Pacific International Lines RCL Feeder (Pte) Ltd ZIM	78	All
Independents		AAL Columbus (Hamburg Sud) Crocodile Fesco Hapag Lloyd MSC/SAF NP PAS Westlink	11	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.20 **Australia to Papua New Guinea, 2003-04**
Available capacity of 70 464 TEUs (2 per cent of total outward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Independents		ANL CCS CEL Crocodile NGPL Sofrana	100	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Table C.21 **Papua New Guinea to Australia, 2003-04**
Available capacity of 90 823 TEUs (2 per cent of total inward capacity)

Agreement	*Agreement type*	*Members*	*Capacity share*	*Ports*
Independents		ANL CCS CEL Crocodile NGPL Sofrana	100	All

Source: PC estimates based on Lloyds List (various issues); Containerisation International (2003 and 2004).

Interpreting the share of independents

The share of independents tends to be higher on Australia's smaller trade routes (such as Africa, Central and South America and PNG). However, it is important to note that some carriers service smaller trade routes, while participating in agreements on other (larger) trade routes. For example, Maersk–Sealand services African ports (for which it is classified as independent) while on travelling to North American ports under the Australia USA discussion agreement. The agreements on these larger trade routes may affect the provision of service on the smaller trade routes by influencing a company's overall vessel deployment and pricing strategy.

The extent to which an agreement on a larger route influences a subsidiary smaller route will depend on the number of members in the agreement on the larger route who also service the smaller route. Consequently, for the capacity share estimates reported above, the Commission has assumed that agreements (on larger routes) operate on the smaller trade routes when all the members of the agreement also operate on that smaller route.

However, the Commission acknowledges that where less than all members operate on a smaller route they may nonetheless be influenced by agreements on larger routes. Thus, the estimated capacity for each carrier is reported for the smaller routes only. Also listed for each carrier is the other routes on which they provide a service and the agreements to which they belong while providing a service to the small route (tables 25 to 31). The results suggest that for some of Australia's smaller trade routes, the Commission's estimate of independents needs to be interpreted cautiously to avoid overstating the independence of these carriers.

Capacity shares

Alternative estimates of independent capacity were provided by ACIL Tasman and Thompson Clarke (sub. DR9, p. c1). On some trade routes their estimate for independent capacity share was higher than the Commission's and on some it was lower (table 22). Overall, the share of independents was 4 per cent higher than the Commission's estimate.

Table C.22 **Independent share of trade route**

Imports			*Exports*		
Route	*PC*	*TCS*	*Route*	*PC*	*TCS*
	%	%		%	%
Europe	53	80	Europe	46	66
S & W Asia	91	67	S & W Asia	100	67
SE Asia	14	40	SE Asia	11	33
North Asia	8	18	North Asia	10	17
N America	29	10	N America	34	10
NZ	22	31	NZ	22	35
Total	31	35	Total	27	31

Source: (sub. DR9, p. c1).

The differences in the capacity share estimates are largely definitional. ACIL Tasman and Thompson Clarke:

- defined consortia members as independent if they were not part of a conference or discussion agreement[4]; and

[4] The Commission does not believe that defining a carrier who is a member of a consortia as independent is appropriate when evaluating the competition on trade routes. The ACCC did not define members of consortia as independent carriers in its recent AADA investigation, saying: "For any given service the vessels may be provided by one shipping firm (an "independent") or by several acting together (a "consortia")" (ACCC 2004, p. 24).

- assumed that all transhipment was carried by independents[5].

Capacity levels on trade routes

ACIL Tasman and Thompson Clarke also argued that the Commission's capacity share estimates, reported in the draft report, were erroneous because the estimate of available capacity for each route was significantly higher than the number of containers actually lifted. The difference between the Commission's estimates and those of ACIL Tasman and Thompson Clarke[6] can be largely explained by the different treatment of weight restrictions imposed on vessels and the allocation of capacity for sailings which cover multiple routes. When similar weight restrictions are imposed and the problem of vessels sailing on multiple trade routes is eliminated, the Commission's total export and import capacity on Australian routes is 2.48 and 3.2 million TEUs. Although this is still above the ACIL Tasman and Thompson Clarke estimate of 1.94 and 2.28 million TEUs, it includes capacity to Africa, Central and South America and Pacific Islands which were not included in their estimates. When this is taken into account, the Commission's total capacity estimates are similar to those of ACIL Tasman and Thompson Clarke.

For the final report, the Commission has imposed weight restrictions, however, its available capacity estimates are higher than what was carried because the Commission has used a broader definition of trade routes and has not made assumptions about the allocation of capacity between routes.

For a number of sailings, vessels sail on multiple trade routes and to calculate market share would require knowledge of how the capacity is allocated between the different routes. This information is not known, even by Shipping Australia Limited. Given this lack of information, the Commission has allocated the full capacity of the vessel to each route on which it sails. For example, if a vessel sails from Australia to Singapore and then on to Europe, its full capacity will be allocated to both the South East Asian and European routes. Because of this, the capacity estimates reported should be interpreted as representing available capacity on each route.

The Commission's reporting of available capacity is the same as Shipping Australia Limited presented in its submission. For example, they reported the European

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[5] The Commission does not regard the assumption that all transhipment is carried by independent carriers as reasonable. In assessing the agreements on routes which are affected by transhipment, for example Europe, the agreements clearly state that the agreements cover transhipment. Shippers also confirmed assuming that all transhipment was carried by independents was inaccurate and gave the example of European cargo being transhipped through Singapore as largely being carried under the European Conference (APSA, pers. comm., 10 February 2005).

[6] Which are also higher than the number of containers lifted.

capacity including the South East Asian capacity because it can be transhipped to Europe, which means that the European capacity reported was 490 000 TEUs annually. In contrast, ACIL Tasman and Thompson Clarke made assumptions regarding the distribution of cargo between routes. For example, they assumed that 33 per cent of the cargo on the South East Asian route is transhipped to Europe. However, ACIL Tasman and Thompson Clarke also acknowledged that it will vary over time depending on market conditions and that an audit of the trade, at any particular time, would in all likelihood reveal a different distribution (Thompson Clarke Shipping, pers. comm., 11 February 2005).

Given the lack of publicly available information on the allocation of cargo across routes, the Commission is of the view that it is more appropriate to use available vessel capacity, rather than introducing an additional area of uncertainty by using assumptions that are difficult to substantiate.

The Commission also considers that a broader definition of routes is required to align with the definition of markets for competition policy purposes. The ACCC has outlined that:

> The critical issues in product market definition in liner shipping are:
>
> - the availability of competing services that are perceived by shippers as being substitutable;
> - switching costs for shippers; and
> - the probability of switching in response to a freight rate increase. (ACCC 2004, p. 35)

It is for these reasons that the Commission has defined nine trade routes to align with market definitions. For example, the Commission has amalgamated previously separate Europe and the Mediterranean, but does not believe that it is appropriate to amalgamate the North American East Coast and North American West Coast (as ACIL Tasman and Thompson Clarke have) because the two routes are not close enough substitutes to constitute the same market.

How agreements on larger routes influence trade on smaller routes

Tables C.25 to C.32 provide the capacity shares for carriers on Australia’s smaller trade routes and the ways in which these carriers deploy capacity across routes. The tables report the other trade routes serviced by the carriers while servicing the relevant route (column 2) and the agreements the carriers are members of on these routes (column 3).

For example, as table C.25 indicates, there are 3 carriers (Maersk, MSC and PONL) which service the African and Indian Ocean Islands (route 1):

- Maersk and MSC jointly operate a service from Australia to Africa and the Indian Ocean Islands which also services ports on the Central and South American route (route 3). When they also sail on route 3, Maersk and MSC share of capacity on route 1 is 6.6 per cent.
- Maersk and MSC operate a service to Africa and the Indian Ocean Islands which also services ports on the Central and South American route (route 3) and the North American East Coast (route 9). Maersk is a member of the Australia/United States Discussion Agreement (AUSDA) that operates on the North American East Coast route (route 9). When they also sail on routes 3 and 9, Maersk and MSC share of capacity on route 1 is 13.1 per cent.
- Maersk and MSC operate a service to Africa and the Indian Ocean Islands which also services ports on the Central and South American route (route 3), the European route (route 5), the North American East Coast (route 9) and the South East Asian route (route 17). Maersk is a member of the Australia/United States Discussion Agreement (AUSDA) that operates on the North American East Coast route. When they also sail on routes 3, 5, 9 and 17, Maersk and MSC share of capacity on route 1 is 31.4 per cent.
- Maersk and MSC also operate a service to Africa and the Indian Ocean Islands which also services ports on the European route (route 5), the North Asia (route 13) and the South East Asian route (route 17). Maersk and MSC are members of the Australia North and East Asia Trade Facilitation Agreement (ANEATFA) and Maersk is a member of the Australia South East Asia Trade Facilitation Agreement. When they also sail on routes 5, 13 and 17, Maersk and MSC share of capacity on route 1 is 26.9 per cent.

Table C.23 **Route abbreviations**

Route No.	*Route Name*
1	Australia to Africa and Indian Ocean Islands
2	Africa and Indian Ocean Islands to Australia
3	Australia to Central and South America
4	Central and South America to Australia
5	Australia to Europe and Mediterranean
6	Europe and Mediterranean to Australia
7	Australia to New Zealand and South Pacific Islands
8	New Zealand and South Pacific Islands to Australia
9	Australia to North America East Coast
10	North America East Coast to Australia
11	Australia to North America West Coast
12	North America West Coast to Australia
13	Australia to North Asia
14	North Asia to Australia
15	Australia to Papua New Guinea
16	Papua New Guinea to Australia
17	Australia to South East and Southern Asia and the Middle East
18	South East and Southern Asia and the Middle East to Australia

Table C.24 **Abbreviations used for agreements**

Abbreviation	*Agreement Name*
AUSDA	Australia/United States Discussion Agreement
ASEATFA	Australia South East Asia Trade Facilitation Agreement
SEADA	South East Asia Australia Discussion Agreement
ANEATFA	Australia/North and East Asia Trade Facilitation Agreement
ANDA	Australia New Zealand Discussion Agreement
ANVODA	Australia New Zealand Vessel Operators Discussion Agreement
USPSCOA	US Pacific Coast Oceania Agreement
BFYS	Butterfly Service
AUC	Australia US Containerlines Association
ANEC	Australia and New Zealand to Europe Liner Association
NTPA	Northbound Trade Participation Agreement
CPVA	Contship PONL Vessel Sharing Agreement
SEATFA	South East Asian Trade Facilitation Agreement
ACCA	Australia Canada Containerlines Association
ANZLA	Australia New Zealand to Europe Liner Association
NZAX	NZAX Consortium Operating Agreement
AAESA	Australia Asia Express Service Agreement
CPUSA	Contship PONL Vessel Sharing Agreement
CANZDA	Canada Australia New Zealand Discussion Agreement
USADA	US Australia Discussion Agreement
EANZC	Europe to Australia New Zealand Liner Association
EAA	East Australia/ Asia Agreement

Table C.25 **Australia to Africa and Indian Ocean Islands, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
Maersk/MSC	3	-	6.6
	3,9	AUSDA	13.1
	3,5,9,17	AUSDA	31.4
	5,13,17	ASEATFA, ANEATFA	26.9
Maersk	5,17	ASEATFA	21.5
PONL	17	ASEATFA	0.4

Source: PC estimates.

Table C.26 **Africa and Indian Ocean Islands to Australia, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
MSC/Saf	6,10	AUSDA	3.1
	10,18	AUSDA,SEADA	6.1
	4,6,10	AUSDA	37.3
	4,10,18	AUSDA,SEADA	11.2
	4,6,10,18	AUSDA,SEADA	8.1
Maersk/MSC	6,14,18	AUSDA,SEADA	34.2

Source: PC estimates.

Table C.27 **Australia to Central and South America, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
ANZDL	7,9,11	ANDA, ANVODA, USPSCOA, BFYS, AUC, AUSDA	8
Contship	7	ANDA, ANVODA, BFYS	1
	5,7	ANDA, ANVODA, BFYS, ANEC, NTPA	8
	5,7,9	ANDA, ANVODA, BFYS, ANEC,NTPA, CPVA	2
Maersk	7, 9	USPSCOA, AUSDA	13
MOL	7	-	1
PONL	5,7	ANDA, ANVODA, BFYS, USPSCOA, ANEC, NTPA, CPVA	29
MSC/Saf	1	-	5
	1,9	-	9
	1,5,9,17	-	24

Source: PC estimates.

Table C.28 **Central and South America to Australia, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
ANZDL	8,12	ANDA, ANVODA, USPSCOA, BFYS, AUC, AUSDA	14.9
	12	USPSCOA, AUC, AUSDA	1.3
Columbus	8,12	ANDA, AUC, AUSDA	2.4
Contship	-	-	1
Maersk	8,10	USPSCOA, AUSDA	20.2
MOL	8	-	1.6
PONL	8,12	ANDA, ANVODA, BFYS, USPSCOA, ANEC, NTPA, CPVA	0.9
MSC/Saf	2,6	-	1.6
	2,6,10	AUSDA	36.8
	2,10,18	AUSDA, SEATFA	11.3
	2,6,10,18	AUSDA, SEATFA	8.1

Source: PC estimates.

Table C.29 **Australia to New Zealand and South Pacific Islands, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
ANL	-	-	3.4
ANZDL	3,11	AUSDA, ACCA, USPCOA	4.6
	11	AUSDA, ACCA, USPCOA	2.5
CCS	15	-	2.2
Columbus	11	AUSDA, ACCA, USPCOA	3.7
Contship	-	-	1.1
	3	-	0.7
	3,5	ANZLA, CPVSA, NTPA	4.3
	3,5,9	ANZLA, CPVSA, NTPA	1.1
Fesco	11	AUSDA, ACCA, USPCOA	3.3
LHISS	-	-	0.2
Maersk	-		0.2
	3,9	AUSDA	6.7
	11	AUSDA	1
MISC	17	-	1
MSC	-	-	2.1

continued next page

Table C.29 **continued**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
MSC/Saf	-	-	11.1
MOL	17	ASEATFA	0.1
	(3)		(0.5)
Neptune	-	-	0.8
NYK	-	-	0.6
	17	ASEATFA	0.4
PES	-	-	0.1
PFL	-	-	0.7
PIL	-	-	2
	17	ASEATFA	4.6
PONL	-	-	10.8
	17	ASEATFA, NZAX, AAESA	1.2
	3,5,9	ANZELA, NTPA, CPUSA, AUSDA, AUSCA, CPSCA	3.1
	11	AUSDA, AUSCA, CPSCA	2.8
	3,5	ANZELA, NTPA, CPUSA	10.8
	3	-	0.7
Sofrana	-	-	1.2
	15	-	1.6

Source: PC estimates.

Table C.30 **New Zealand and South Pacific Islands to Australia, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
ANL	-	-	3.4
ANZDL	4,12	USADA, AUCA, CANZDA, USPCDA	0.5
	4,12	USADA, AUCA	4.6
	12	USADA, AUCA	0.5
CCS	16		3.2
	-		3
Columbus	4,12	USADA, CANZDA, AUCA	1
	12	USADA, CANZDA, AUCA	2.7
	6	CPVSA	0.8
	-		0.1
Contship	4,12	USADA, CANZDA	0.3
	6,10	USADA, CPVSA, EANZC, STPA	0.4
	6	EANZC, CPVSA	3
Fesco	12	USADA, CANZDA	3.1
Maersk	4,12	USADA	0.6
	4,10,14	USADA,AADA,EAA	6.3
	12	USADA	0.4

continued next page

Table C.30 **continued**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
	-	-	9.6
MISC	-		1.9
MSC	-		1.9
MSC/Saf	-		11.1
MOL	4	-	0.6
Neptune	-		0.8
NYK	18	SEATFA, AAESA, NZAX	0.4
	-	-	0.8
PES	-		0.1
PFL	-		0.7
PIL	18	SEATFA	0.5
	-		6.4
PONL	18	SEATFA, AAESA, NZAX	2.1
	4,12	USADA, CANZDA, AUCA, USPCOA	0.3
	6,10	EANZCA, STPA, CPUSA, USADA, AUCA	0.4
	12	USADA, CANZDA, AUCA, USPCOA	2.3
	6	EANZCA, STPA, CPUSA	3.8
	-	-	6.2
Sofrana	16		1.5
	8		1.1

Source: PC estimates.

Table C.31 **Australia to Papua New Guinea, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
ANL	-		6.5
CCS	-		10
	7	-	20
CEL	-		10.9
Crocodile	17	-	2.5
NGPL	17	-	35.1
Sofrana	7	-	15

Source: PC estimates.

Table C.32 **Papua New Guinea to Australia, 2003-04**

Carrier	*Routes also serviced*	*Agreements*	*Capacity share*
ANL	-		6.1
CCS	8		30.6
CEL	-		11.2
Crocodile	-		5
NGPL	-	-	5.6
	8,18	-	26.6
Sofrana	-		0.5
	8	-	14.5

Source: PC estimates.

D Economic issues

D.1 Costs in liner shipping

Fixed costs are high, marginal costs are low

For a container vessel providing a scheduled service on a particular route, approximately 80 per cent of costs are independent of load (Franck and Bunel 1991; Stopford 2003, p. 83; Brooks 2000b). As a result, a fully loaded ship costs little more to operate than an empty one (Butz 1993).

The main fixed costs are capital, crew, fuel and port costs. These are incurred irrespective of whether the ship sails fully, or partially, laden. Marginal costs include costs associated with loading and unloading cargo, plus the opportunity cost of the extra time spent in port that could otherwise be spent in transit. However, this opportunity cost, which could arise from waiting for cargo to arrive at the dock, is not significant for liner services, as vessels depart on the scheduled date regardless of whether they are carrying a full cargo.

While fixed costs have always been significant for international shipping services, the advent of containerisation reduced marginal costs further by lowering cargo handling requirements (Butz 1993). The trend towards larger containerships has also raised the ratio of fixed to variable costs (ECLAC 1998).

Fixed costs in liner shipping arise from unavoidable costs incurred as a result of the decision to run a scheduled service, as well as capital vessel costs. The capital costs of using a container vessel consist of the opportunity cost of the capital invested plus allowance for economic depreciation[1]. Vessel operating costs include crew costs and costs related to repair and maintenance, insurance and stores. Fuel costs, port dues and agency fees will be incurred when a voyage is undertaken. Costs are also involved in the loading, unloading and storage of cargo. Generally speaking, vessel operating costs, voyage costs and cargo handling costs are relatively constant per TEU shipped — although some cargoes have special handling requirements

[1] The decline in the resale value of the vessel over its useful life.

which incur a cost. In the short run, operating costs may be avoided if the vessel is laid up (United Nations 2001, p. 126; Stopford 2003, p. 83).

The extent of fixed costs in liner shipping also differs from those involved in charter or tramp shipping. When a ship is chartered for a single voyage, the voyage costs, cargo handling costs and a proportion of the operating costs will be variable and can normally be attributed to a user. However, when a vessel operates as part of a liner service, according to a fixed timetable and with scheduled port calls, voyage costs and operating costs are largely fixed whenever spare capacity exists on the vessel and cannot be attributed to an individual user (United Nations 2001, p. 126).

Non-separability of costs

Non-separable costs are an important feature of many forms of transportation, particularly those offering a scheduled service as part of a network. Once a commitment is made to offer transportation services at a particular time, and on a particular route, attributing the 'overhead' costs of that service to any specific user must, by necessity, be arbitrary. The costs incurred as a result of that commitment must be met, whether or not the vessel operates at full capacity.

While there are some costs which are attributable to a particular cargo, these will only be a small proportion of the total. For example, some cargoes may require refrigeration or other special handling requirements which will involve a higher cost. Others may be heavy and occupy a relatively large amount of stowage.

In most industries, fixed costs are typically non-separable. However, in the case of liner shipping, some operating costs may also be non-separable (jointly incurred fuel costs are an example).

Joint costs

Joint costs arise when the provision of a service also entails the provision of another service, in essence as a by-product. For example, the decision by a shipping company to provide carriage on one leg of a trade route implies that the return leg will also be serviced. The fuel costs incurred on the return leg are a joint cost of the decision to service the route.

Joint costs cannot be attributed to a specific voyage, let alone to a particular cargo, and can only be escaped jointly when the service is withdrawn. The existence of joint costs has implications for pricing strategies (section D.2). Since the transit costs of a fully laden vessel are similar to those of an empty vessel, freight rates will be determined by demand on each leg of the route. The extent to which joint costs

are ultimately covered may also depend on the degree of competition on the route. If freight rates exceed those necessary to cover costs, other carriers may enter and compete rates down; while rates which are insufficient to meet avoidable costs may prompt exit (United Nations 2001, p. 49).

Common costs

Common costs are similar to joint costs in that they are necessary to provide a service; although, their existence does not necessarily imply a service will be provided. Examples include company overheads which cannot usually be allocated to a specific ship, although agency fees and warehouse charges may be directly attributed to specific liner services (United Nations 2001, p. 125). Non-avoidable vessel capital costs which would occur even in lay-up are an example of common costs.

Route specific costs may be avoidable

While there are large fixed costs associated with operating a containership, carriers can avoid making losses on a particular route by repositioning a vessel to an alternative route at relatively low cost. Thus, the fixed costs of committing to a route, while substantial, may also be avoidable.

It has been argued that, if losses on a route can be avoided at relatively low cost, market instability may result as vessels enter and exit a route with little encumbrance (Pirrong 1992; Sjostrom 2003). This freedom of entry and exit is contrasted with other industries which experience economies of scale as a result of fixed costs which are sunk[2]. In these industries, the presence of substantial sunk costs may act as a deterrent to entry. Investment in a telecommunications network or a gas pipeline are examples of investments which generate sunk costs. The link between avoidable fixed costs and competition is discussed in section D.3.

Economies of vessel size

A number of empirical studies have investigated the relationship between costs and vessel size. Haralambides et. al. (2002) estimated that an increase in liner size from 4000 TEU to 6000 TEU reduced average crew costs by 30 per cent; average fuel costs by 20 per cent; average port and canal charges by 15 per cent; and average insurance costs by 10 per cent. Similarly, Cullinane and Khanna (1999) identified

[2] Sunk costs are those that cannot be recovered, for example through the sale of an asset. In this sense, commitment to an asset whose cost is sunk is largely an irreversible investment decision.

significant economies of vessel size up to 8500 TEU. However, they also noted that rising port charges as vessel size increases ultimately place a limit on unit cost reductions. Notteboom (2004, p. 88) reports that a 12 000 TEU containership, deployed on the Europe to Asia route would generate cost savings per container slot of 11 per cent compared to a 8000 TEU vessel and 23 per cent compared to a 4000 TEU vessel. Similarly, a 10 000 TEU vessel deployed on the trans-Pacific route would produce cost savings of 50 per cent per container slot compared to a 4000 TEU vessel.

According to Stopford (2002, p. 9), the largest economies are achieved at lower levels of capacity. As container ships increase in size up to 2000 TEU, average total cost falls by 20 per cent. From 2000 to 4000 TEU average costs fall by 7 per cent. Increases in ship size from 4000 to 6000 TEU lead to a decline in average costs of 4 per cent; as do increases from 6000 to 18 000 TEU.

The importance of fixed capital costs in generating economies of scale is shown in the table D.1. Average capital costs decline by 45 per cent as the vessel size increases from 725 TEU to 4600 TEU.

Table D.1 **Average vessel capital costs**

Ship size	*Average capital costs*
TEU	$US million per 1000 TEU
725	18
1000	16
1700	12
2000	14
2750	12
4600	10
6200	11
18000	10

Source: Stopford (2002, p. 10).

Capital commitments are higher in liner shipping than in bulk shipping where the average vessel price is less around half that of a container ship with similar capacity (UNCTAD 2003, p. 44).

In addition to the presence of high fixed costs, there are several technological reasons why increasing the size of a containership reduces unit costs:

- The physical nature of capacity on a vessel. Carrying capacity, which depends on the volume of a ship, increases more than proportionately than the surface area of the hull.
- Crew size changes little with the size of a container ship.
- There are economies of engine size, crew accommodation and navigational equipment (Stopford 2003, p. 9).

Maintenance and insurance costs do not appear to lead to diseconomies of vessel size. Rather, these expenses tend to increase in proportion to the value of the ship (Stopford 2003, p. 9).

Efficient capacity management

The ability of carriers to exploit vessel-size economies depends on market conditions and the ability to effectively manage capacity. Imbalances between cargo shipped on each leg of a route are a standard feature of liner shipping (chapter 2) and may complicate attempts by carriers to achieve operational efficiencies. Variability in demand may also be managed by operating vessels with spare capacity (ACIL Tasman and Thompson Clarke Shipping sub. 17, p. 33).

Trade-offs exist between vessel size and service frequency and these trade-offs become more important as the route length increases. Larger vessels can carry more cargo on a particular route with less frequent sailings. The growth of hub-and-spoke networks has enabled carriers to realise cost savings by servicing hubs with the largest vessels. Cargo is then transhipped from these ports on smaller vessels. However, the ability to realise cost reductions through network efficiencies is necessarily conditional on market demand. According to Notteboom:

> Liner service network design tends to move from a pure cost-driven exercise to a more customer-oriented differentiation exercise, as the optimal network design is not only a function of carrier-specific operational factors, but more and more of shippers' needs (for transit time and other service elements) and of shippers' willingness to pay for a better service. A pattern with the biggest ships possible on high-speed operations between a reduced number of hubs could be interesting from a pure liner network cost perspective, the less convenient that network could be for the shippers' needs in terms of frequency and flexibility … As liner service network design has become a more customer-oriented differentiation exercise, this could very well introduce a tendency towards less transhipment and more direct ports of call (even for the bigger vessels). (2004, p. 95)

It has been argued that intense service competition may prevent the full exploitation of economies of vessel size. As discussed below, carriers may enter into technical arrangements — known as consortia — to better manage capacity deployed on a

route. Such agreements limit the extent to which 'excessive' capacity deployment may prevent the realisation of operational efficiencies. For example, carriers may contract to charter space (known as slots) on vessels currently deployed rather than deploying new capacity. The ability to exploit these economies may also depend on avoiding coincident scheduling (known as 'bunching') with competitors.

Economies of fleet size

While there is strong agreement in the literature that economies of vessel size exist, there is less consensus on the existence of economies of fleet size. Cassidy (1981), Zerby and Conlon (1982), and Sayers (1986) all argued against the presence of fleet economies. According to Sayers:

> … there is no significant organisational economies in liner shipping. This is because the only cost items which changes with the number of ships are administration, land and agency costs, and these items only comprise a small proportion of total costs. (quoted in Meyrick and Associates 1999, p. 9)

However, Meyrick and Associates (1999) and Deakin and Seward (1973) argued that fleet economies may exist, pointing to dynamic efficiency improvements in combining organisations and a reduction in transaction costs. Market trends appear to support this view as ship ownership has been increasingly concentrated among a smaller number of firms (chapter 2). Meyrick and Associates (1999, p. 9) identified three reasons for the existence of economies of fleet size:

> Firstly, there is a dawning awareness in the industrial organisation literature that economists are inherently prone to underestimate the importance of transactions costs in determining the optimum firm size and scope of operation. Secondly, large firms or consortia controlling many vessels have greater flexibility in redeploying vessels between trades in response to fluctuations in capacity. Thirdly, large firms have greater access to network economies, arising from the simultaneous operation of a number of interlocking routes. (1999, p. 9)

However, there may be limits to individual firms realising fleet economies. Industry concentration is not high in liner shipping compared to other industries (Brooks 2001, p. 21) and attempts in the past to monopolise individual trade routes by carriers have proved unsuccessful (Sjostrom 1989). This may reflect the fact that the capital requirements to generate fleet economies may expose an individual company to risk that could be spread by cooperative vessel sharing agreements with other lines.

Economies of scope

Economies of scope arise when it is cheaper for a firm to jointly produce two or more products than it is to produce those products separately. In liner shipping, economies of scope arise from cost savings which arise from servicing several clearly distinguishable submarkets (Meyrick and Associates 1999, p. 12). For example, when a ship with reefer capacity is deployed on a route enabling refrigerated cargo to be shipped along with general cargo.

Realisation of economies of scope often occurs alongside economies of scale. For example, adding more ports of call to a voyage enables greater exploitation of vessel capacity but also enables the cost of traversing the intercontinental legs of the voyage to be spread over a greater number of shippers (Meyrick and Associates 1999, p. 13).

Network externalities

Carriers and shippers can benefit from cost savings generated by network externalities. A network externality arises when an increase in customer base lowers costs — or confers additional benefits — to other consumers[3]. Having access to a network, rather than single separate routes, increases the volume and variety of services that an operator can offer. The operator can reduce average costs by spreading them across a higher volume of cargo (exploiting economies of scale) or a wider range of services (exploiting economies of scope). For example, it may use a vessel deployed on the direct route between ports A and B to carry cargo which is destined for port B as well as for other ports on adjacent routes. Furthermore, by adding additional ports to the network the operator significantly increases the range of services it can offer.

As with other forms of transportation, the unit costs of operating a network in liner shipping falls as the amount of traffic on a route rises or the network grows (Butz 1993). For example, an increase in demand on one leg of a route will enable costs to be reduced on the return leg. Similarly, adding an additional port to a network may enable costs to be reduced elsewhere. The benefit thus conferred may be passed on to shippers through lower freight rates. According to the United Nations (1998,

[3] Network externalities are often said to arise in telecommunications where a consumer derives benefits from being able to contact others who are part of the same telecommunications network. Costs advantages can also be obtained if common network costs are shared between a larger number of subscribers. At some point, a network externality can become negative if congestion occurs. Another example of a network externality is where an increase in consumers' ownership of DVD players encouraged video rental outlets to stock DVD movie rentals.

p. 33), the cost savings generated by increased frequency of sailings for a growing number of shippers are more important than the economies generated by vessel size.

The ability of carriers to realise network externalities have been enhanced by technological advances in the industry. The costs of transhipping cargo through hubs has been reduced by improved methods of scheduling container movements (such as computerised booking); greater investment in container moving equipment; and other improvements in labour productivity which have reduced cargo handling costs and times (Butz 1993).

D.2 Demand and pricing strategies

As noted above, the high fixed costs associate with operating a container vessel impart significant economies of vessel size and imply that the cost of running a fully-laden vessel is not significantly greater than running a vessel at low capacity. In turn, this suggests that carriers may face particular issues in relation to capacity management and pricing.

Price discrimination

High value products moving in a shipping container attract a higher rate than low value products moving in a shipping container even though the incremental cost of shipping both are the same (Zerby and Conlon 1982; Reitzes, 1993; Stopford 2003, p. 359; Brooks 2000, p. 209).

This form of price discrimination is a variant of Ramsey-Boiteux pricing. Ramsey-Boiteux pricing involves charging a mark-up over marginal cost which is inversely related to the own-price elasticity of demand for the product[4]. The demand for high-valued cargo may be less responsive to changes in freight rates because transportation costs represent a lower proportion of the commodities final selling price when domestic transportation costs and wholesale and retail margins are included (Reitzes 1993).

Economists normally view a mark-up of price over marginal cost as indicative of allocative inefficiency and the exploitation of market power. However, pricing above marginal cost can be also efficient under certain circumstances. In particular,

[4] Where a common price is unable to cover a fixed cost, a pricing strategy which imposes a larger proportionate mark-up on customers with a more inelastic demand may be welfare improving. Optimal Ramsey-Boiteux pricing is achieved when there is an equal proportionate reduction in demand by all customers as a result of the pricing strategy or when the marginal efficiency loss of pricing above marginal cost is equal across all customers.

in an industry such as liner shipping which is characterised by high, non-separable fixed costs[5] (Sjostrom 2002, p. 17; Levine 2002). If carriers charge a common mark-up for each unit of cargo carried, they may exclude cargo which can pay its marginal cost but is unable to meet its assigned share of fixed costs. Carriers may also utilise quantity discounts for larger shippers[6]. Such an approach can be efficient because: it recognises that the marginal value of shipping services are lower for larger shippers; the cost of negotiating discounts with large shippers are lower than the cost of negotiation of smaller shippers (who typically have disparate requirements); and commitment of cargo from a larger shipper can reduce the uncertainty associated with revenue streams from the voyage[7].

Table D.2 **Representative ocean freight rate levels**

Good	*Shelf price per unit*	*Freight per unit*	*Freight as a share of value*
	$US	$US	%
Motor cycle	6 000	85.00	1.4
Television	500	10.00	2.0
Cassette recorder	160	1.50	0.9
Vacuum cleaner	75	1.00	1.3
Bottle of whiskey	35	0.16	0.5
Coffee (kilogram)	12	0.14	1.2
Cheese (200 grams)	2	0.03	1.5
Beer (can)	1	0.01	1.0

Source: Shipping Australia Ltd (sub. 16, p. 35).

The practice of expressing the rate as a proportion of the value of the cargo also reduces the likelihood that, by charging a flat fee per container, lower value cargoes (for which a flat fee would represent a higher proportionate value) are excluded from the market.

[5] The problem is similar to that faced by public utilities. One solution is to impose marginal cost pricing and use a subsidy (funded by taxpayers) to cover fixed costs. Ignoring the efficiency costs associated with raising the cost of the subsidy, such an approach will promote allocative efficiency in the utility market. However, with private provision, fixed costs must be paid for by users in some way and price discrimination or multi-part pricing will be required.

[6] This is known as second-degree price discrimination.

[7] In this sense, the large shipper is analogous to a large retailer who acts an ‘anchor’ tenant in a shopping centre. The presence of the large retailer encourages custom which benefits all retailers in the shopping centre. The owner of the shopping centre can internalise this positive externality by charging a higher rent to smaller retailers.

However, there are some limitations which may prevent carriers from implementing efficient price discrimination strategies. The carriage of cargo in standardised modular containers, and the diverse nature of the goods shipped, may prevent carriers from finely differentiating between cargoes. The extent of the mark-up over marginal cost, and in particular, whether it is larger than necessary to ensure that the carrier avoids making losses will also be determined by market conditions.

Some economists have questioned whether carriers practise price discrimination (Sjostrom 1992; Butz 1993; Clyde and Reitzes 1995). They point to evidence that higher value cargo may be more expensive to transport because of refrigeration and handling requirements or higher implied damage liability. Cargoes also have different packing densities and as a consequence utilise different amounts of container space, implying different handling costs.

The argument that carriers do not practise price discrimination is sometimes linked to the conclusion that conferences do not exercise market power. In competitive markets, it is argued, attempts at price discrimination would be unwound as customers arbitrage between firms and price is competed down to marginal cost. However, while firms with market power use price discrimination, the existence of discriminatory pricing is also consistent with competition in the industry.

Levine (2002) identified a wide range of competitive industries, including airlines, restaurants, hotels and agricultural producers, who practise price discrimination. Levine concluded that the use of price discrimination as a means of recovering fixed costs is the norm rather than the exception. Similarly, Dana (1998) found evidence of price discrimination in the airline industry following increased competition in the industry. According to Dana, price discrimination in a competitive industry may be more likely when the product is not storable since fixed costs must be recovered from current, not future, consumers.

Price discrimination may also be a means of reducing market uncertainty. Dana (1998) examined the role of advance-purchase discounts in competitive markets. These discounts are aimed at lower valuation customers with more certain demand and can be a means by which these customers avoid future price fluctuations.

The presence of high joint or common costs makes a policy of charging a single price incompatible with the existence of a competitive industry. Marginal cost pricing, under these circumstances, would drive firms out of business. The relevant test for whether market power is being abused is not the use of price discrimination but whether industry supply is kept artificially low. In practice, the pricing of slots is likely to be driven by opportunity cost — in other words, at the margin, price will be determined by whether one shipper’s demand for slots is competing with, or complementary to, other shippers’ demands. Thus, in the long-run, if average

revenue is just sufficient to cover average costs, it would be difficult to sustain the proposition that such differential pricing is inefficient or uncompetitive, even though the resulting allocation of the fixed cost across shippers may appear somewhat arbitrary. On the other hand, discriminatory pricing may also enable excess profits to be earned. This would be indicative of an exploitation of market power. In practice, however, distinguishing between the two is not a trivial exercise.

Peak-load pricing

In addition to practising price discrimination to cover fixed costs, carrier pricing strategies may reflect capacity utilisation.

Peak-load pricing provides a means of managing demand when vessels are at, or near, capacity. Once vessel capacity has been reached, the value of slots on the vessel increases. Until capacity is reached, loading an additional unit of cargo imposes no cost on other users (aside from the cargo handling cost which can be attributed to the cargo). However, once capacity is reached, additional units cannot be loaded, imposing a cost on other users. This increase in cost cannot normally be attributed to any one cargo and must therefore be shared between all users. Hence, it is only when capacity is reached that price plays a useful role in rationing demand. Peak-load pricing can be efficient and acts as an important signal for the commitment of additional capacity to a route.

Peak-load pricing can take the form of a ‘peak season’ surcharge; although Davies (1986) argued that carriers may also implicitly practice peak-load pricing by choosing to carry relatively more high value (and high paying) cargoes at times of peak demand. A US Federal Maritime Commission investigation found evidence of carriers on Transpacific routes replacing low value with high value cargoes at times of tight capacity:

> The most common and widespread method used by carriers to increase revenues during peak season was to reduce or eliminate the carriage of less profitable cargo and to replace it with cargo which produced a better financial return. The report contains samples of documents which evidence carriers’ efforts to reduce or eliminate carriage of cargo based upon low contribution levels, or, conversely to solicit cargo which produced greater profit, knowing that other cargo would have to be rejected. (Won 1999, p. 1)

D.3 Core theory and the market

The core is the set of transactions which buyers and sellers, acting alone or in groups, have no incentive to change. It is the feature of a market which gives it

stability. A market with an empty core may exhibit chaotic behaviour as agreements are continually renegotiated, leading to instability in prices and quantity. There are a number of conditions which have the potential to produce an empty core, many of which may be present in the market for liner shipping (Sjostrom 1989; McWilliams 1990; ACCC, sub. 18, p. 20). In theory, an empty core is more likely to occur when:

- fixed costs are large relative to operating costs;
- the capacity of each firm is large relative to market demand;
- firms offer similar products;
- market demand is relatively inelastic; and
- market demand and/or costs vary over time.

Figure D.1 illustrates how an empty core could arise in a market where capacity is added in large, discrete increments; fixed costs are avoidable (that is, there are no sunk costs); firms have different costs and, operating costs are zero. The vertical segments indicate the price range which ensures a firm will not make a loss on avoidable fixed costs. A firm will add capacity whenever price is sufficient to ensure that losses are avoided. Prices below P_0 are insufficient to generate profits for the second firm. When the price rises above P_0 it is a signal to entry by the second (higher cost) firm. The potential for instability may arise when demand is not large enough to generate a normal rate of return for the capacity supplied by both firms, as shown in figure D.1.

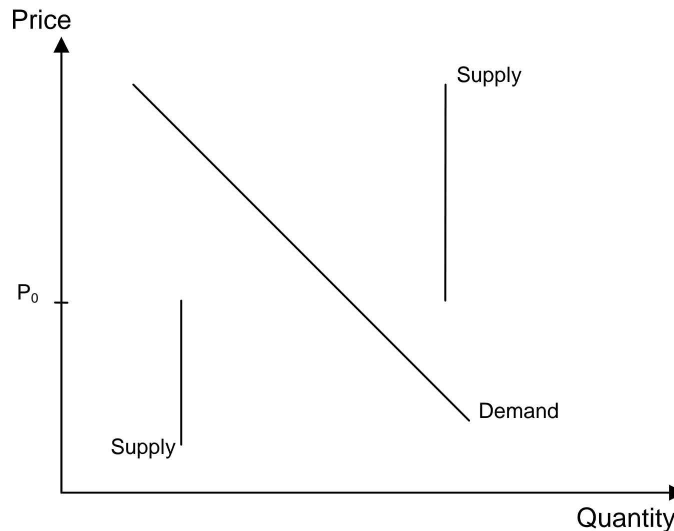
In order for this market to have a core, the demand curve must intersect the supply curve on one of its vertical segments (each representing the commitment of additional capital). Because, as shown in the diagram, demand is inadequate to justify the presence of the second firm, prices may fall resulting in losses for both firms. If these losses can be avoided by exit, the higher cost firm may leave the industry giving rise to the possibility of monopoly profits and a signal to entry by another supplier.

In an industry where capacity increments are small, the gaps between the vertical segments of the industry supply curve shown in figure D.1 will be smaller, reducing the likelihood of an empty core. Similarly, other things equal, the steeper (or more inelastic) is the market demand curve, the more likely it will not intersect the supply curve on one of its vertical segments.

The presence of high operating costs will also reduce the chances of an empty core emerging. As variable costs become more important relative to fixed costs, operational factors become more significant in firm supply decisions (in figure D.1, as operating costs increase relative to fixed costs, the segments of the supply

function become flatter). The decision becomes not simply whether to offer a service or not, but at what level of capacity the service should be offered.

Figure D.1 **Industry supply[a] and demand in a market with an empty core**



a Firms assumed to have different costs.

Source: McWilliams and Keith (1994).

To see how this analysis might apply to liner shipping, consider the following example. If demand on a particular trade route is such that the two firms servicing the route are able to make above normal rates of return, this may act as an incentive to entry by a third carrier. However, with three firms servicing the route, capacity exceeds demand. Carriers therefore have an incentive to negotiate with shippers to ensure that the capacity they have committed is utilised and they avoid making a loss. Through this negotiation process, prices may be driven down to unsustainably low levels resulting in losses for all three shipping lines.

If all firms offer a similar product, the ability to compete on the basis of service is diminished, and destructive price competition may emerge. However, even when the basic service provided is similar to that offered by other firms, there are means by which a firm can differentiate itself and make demand for its product more price inelastic. Customer loyalty programs are an example: ‘In passenger aviation … one can explain frequent flyer programs in terms of retaining customer loyalty while keeping fares above short run marginal costs in a volatile market’ (Button and Nijkamp 1998, p. 19). When firms have the same cost structures, the market may be unstable if price is not equal to the minimum average cost of the representative supplier. If price is higher than this, the resulting profits will be a signal to enter the industry, while a lower price may prompt all firms to exit. This case is unlikely to

apply to liner shipping because, as noted by the OECD (2002, p. 47), costs differ markedly between carriers.

Market instability may also be related to whether or not it is possible for firms to hold inventories. In many industries, firms can avoid losses by storing unsold output until demand increases. However, unsold output cannot be stored in the liner shipping market. Once a vessel sails with unsold capacity, the opportunity to fill those slots with paying capacity has been lost.

D.4 The economics of cartel behaviour

Price leadership

It has been suggested that conferences may act as price leaders. That is, the market power possessed by shipping conferences enables them to set prices without reference to those charged by non-conference lines. Once the conference has determined the new level of freight rates, so the argument goes, non-conference lines tend to raise their rates so as to restore the 'normal' relationship between their own and the conference's rates.

> Ever since the formation of the first liner shipping conference, the existence of shipping conferences has served to limit capacity and raise the barriers to entry. Typically, carriers enter the market using chartered tonnage and then, once established, are co-opted into the conference to stabilize rates, leaving the market susceptible to a new low-priced entrant. In many jurisdictions, rebates and loyalty contracts are deemed anti-competitive and carriers, cautious about jeopardizing their anti-trust exemptions, are more likely to seek alternative ways of raising barriers to entry. For example, a line may increase capacity on a particular route to act as a barrier to entry (or as a pre-emptive grasp for market share) or may invest in terminals, inland facilities or agency networks to achieve a similar outcome. (Brooks 2000a, p. 58)

Price leadership is a pricing strategy in an oligopolistic industry in which one firm sets the price and, either implicitly or explicitly, other firms follow its example. The fewer the number of firms in an industry (that is, the greater the number of interdependencies of output decisions among individual firms), the more effective price leadership is likely to be. Effective price leadership exists when price movements initiated by the leader have a high probability of sticking and there are no maverick or non-conforming firms.

However, route contestability and the increased preference for carriers to associate through non-binding discussion agreements (which discuss capacity levels and do not set a common tariff schedule), may have reduced the ability of conferences to act as price leaders. Price setting in liner shipping may now reflect the complex

interaction of competitive strategies adopted by lines within an agreement, firms in competing agreements and independents.

Entry deterrence

The ability of cartels to earn above-normal rates depends on their ability to prevent entry to the market by potential competitors. The original model which examined the behaviour of capacity commitment in deterring entry was developed by Stackelberg in the 1930s (Vives 1999, p. 199). This model examined a two-firm industry, in which there are entry costs, across two time periods. In the first period, the incumbent chooses a level of capacity, which is then fixed. A potential entrant, observes this commitment before deciding on whether to enter the industry and, if so, with what level of capacity. If the incumbent firm cannot deter entry, it may be able to attain higher profits by limiting the scale of entry of the potential competitor. The model where a single firm faces competition for a potential entrant has been extended to one in which the incumbent is an oligopoly containing several members (Vives 1999, pp. 209–11). This model may have relevance in analysing the market for liner shipping (Fusillo 2003).

Once entry occurs, rivalry in the second period may take the form of either price or capacity competition. Assuming price competition prevails, the adoption of a lower price by the incumbent forces a matching price cut by the new entrant. This lowers the profitability of both firms. The incumbent's pricing and investment strategy will depend on whether it wants to deter or accommodate its rival. An aggressive pricing and investment strategy by the incumbent may hurt its rival immediately, but also lead the new entrant to adopt a tougher stance in succeeding rounds (Vives 1999, p. 215). A less aggressive pricing and investment stance may enable the incumbent to hold but not increase its market share.

If competition takes a non-price form, the decision by the incumbent to expand output implies a lower equilibrium output for the new firm. In this situation, the incumbent may invest aggressively — making a tough commitment hurts the new entrant and may influence it to commit less capacity in the future. However, Benoit and Krishna (1991) developed a model in which an aggressive increase in capacity by the incumbent may actually encourage entry by establishing conditions under which the two firms may collude in the future to reduce industry output. This is more likely to be the case if there is a history of collusion in the industry.

If industry entry costs are avoidable, there are a number of possible outcomes. The entrant may choose not to enter, in response to an aggressive increase in capacity by the incumbent. It may enter with a modest commitment of capital. Or, it may choose to enter with a substantial level of its own capacity. This, in turn, may lead to the

incumbent to exit the industry in the belief that the new competitor will continue to commit a large amount of capacity to the market (Vives 1999, p. 218). Much depends on the signals sent and the credibility of each firm.

Cartel behaviour and demand conditions

There is evidence that when demand — and capacity utilisation — is low, it may be more difficult for cartels to maintain discipline among member firms (Vives 1999, p. 318). However, Eswaran (1997) develops a model in which the presence of a low-cost firm enforces discipline across the business cycle. The low-cost firm acts as a 'swing' producer, reducing output at times of low market demand and protecting the relatively more inefficient members of the cartel from bankruptcy. It is this protection which ensures that the high cost firms maintain the cartel agreement during times of high demand. While the members benefit from higher prices throughout the market cycle, important competitive pressures on inefficient firms to lower costs are muted.

D.5 Conferences and operational efficiency

Under open conferences, any excess profits may be competed away by competition among current or new members (PC 1999, p. B7). However, open conferences may also give rise to excess capacity and higher costs. Devanney, Livanos and Stewart (Devanney et al. 1975) were the first to develop a formal open cartel model applying to liner shipping. The conference initially acts as a collusive oligopoly, restricting capacity and setting freight rates above average cost. With prices fixed, lines compete on a service rather than a price basis. Competition between lines for market share leads to increased service frequency, giving rise to over-tonnaging, increased costs and higher freight rates. The process continues with higher rates encouraging further over capacity and yet higher rates in the future. However, this process is inherently unstable. If it were to continue, an independent operator with lower costs could enter the market and capture market share. The potential for open conferences to encourage technical inefficiency was also examined by Jansson and Shneerson (1978).

E Registration checklist under Part X

Date application received		........../........./.........
1.	Both application and agreement stamped by Registrar	YES / NO
2.	Is this an (*agreement/variation) and has a new file been made up *delete one	YES / NO
3.	Application fee included ....s10.26-1(c)	YES / NO
4.	Is there a complete copy of both the application and agreement ....s10.27(l)	YES / NO
5.	Name of applicants ....Reg 38 1 (a) & 3(c)	YES / NO
6.	Address of applicants ....Reg 38 1 (a) & 3(b)	YES / NO
7.	Signature of applicants ....Reg 38 1(a)	YES / NO
8.	Summary of agreement (100 words) ....Reg 38 3(b)	YES / NO
9.	Is agreement dated ....Reg 38(c)	YES / NO
10.	Was application for varying conference agreement made within 30 days of above date ....s10.42(3)	YES/NO/NA
11.	Period of the agreement ....Reg 38 3(d)	YES / NO
12.	Trade area covered by the agreement ....Reg 38 3(e)	YES / NO
13.	Not applicable (re Australian Law) ....s10.06(1)	
14.	Does the agreement contain provisions that exclude or purport to substantially lessen competition s10.08 1(a)(b)	YES / NO
15.	Does the agreement contain only restrictive provisions which fall under Section 10.08 1(c)	YES / NO
16.	Does application contain any request for confidentiality ....s10.34(1)	YES / NO

17. Does the application include a satisfactory statement supporting confidentiality ....s10.34(2) YES/NO/NA

18. Has an abstract been made of any confidentiality request? ....s10.35 YES/NO/NA

19. Is application acceptable and complete YES / NO

20. Not applicable (re withdrawal of parties) .... s10.06(2)

Does agreement contain restrictive provisions applying to:

21. Fixing/Regulating of freight rates ....s10.08 c(i) YES / NO

22. Pooling or apportionment of earnings/losses and traffic ....s0.08 c(ii) YES / NO

23. Restrictions or other regulations of the quantity or kind of cargo to be carried by parties to the agreement .s0.08 c(iii) YES / NO

24. Restrictions or other regulations of the entry of new parties to the agreement ....s10.08 c(iv) YES / NO

25. If answer to Q. 15 is [NO] does this fall within s10.08(1) (d) YES/NO/NA

26. Is justification provided ....Reg 38(3) (f) YES/NO/NA

27. If answer to Q. 15 is [NO] is there an exemption order in place for this agreement, or has one been applied for .... (s10.72A) YES/NO/NA

28. Re Q. 26, if the answer to Q. 27 is [NO], has this justification been provided to the TPC for overall benefits test YES/NO/NA

29. Has the application and agreement been checked for any contradictory or ‘open ended’ clauses YES / NO

30. If [YES] does application appear to satisfy requirements for provisional registration (also check Q. 19) ....s10.28 YES / NO

If YES

Deadline for decision (...../...../.....) – is this within 14 days from the date of receipt and has the agreement been entered in the register. YES / NO

Have applicants been notified of provisions registration YES / NO

If NO

Applicant is to be advised of rights of appeal. Has this been done? ....s10.85 YES/NO/NA

Has a copy of the registered agreement been provided to the Australian Competition & Consumer Commission YES/NO/NA

Comments:

....
....
....
....
....

F Modifying Part X: identifying agreements by market share

Whether potentially anticompetitive arrangements can, in practice, significantly lessen competition in a particular market depends crucially on the collective market power of the parties. A number of factors will influence this, but an important benchmark is market share. Other things being equal, the higher the market share of the parties to an agreement, the greater is the likelihood that they will have effective market power, and thus be able to act anticompetitively. Other factors that influence this situation are whether the market is contestable (that is, whether potential competitors can easily enter the market if prices are above competitive levels) and the degree to which the agreement limits internal competition, that is, the scope for members to 'cheat' for individual gain.

While these qualifications can be important, market share is often a good 'threshold' indicator of potential market power. It is typically one that can be readily observed and measured. Thus, it has been used as a benchmark indicator for allowing certain potentially anticompetitive arrangements, notably in the European Union for consortia agreements (chapter 6).

An option for modifying Part X to be more discriminating in the approval of shipping agreements would be to provide 'automatic' registration under current Part X arrangements of agreements with a low share of the market (and thus with limited ability to reduce competition) on a particular route. Agreements with a higher market share would require case-by-case evaluation (with the onus of proof placed on the parties to the proposed agreement demonstrating a net public benefit from the agreement).

APSA suggested that a market share criteria could be considered for Australia, saying that:

> The market share of carrier agreements should be limited to less than fifty percent. Additionally in trades where there are few carriers ie. Europe and USA no individual carriers should command more than thirty percent of the trade. (sub. 5, p. 17)

Similarly, the Australian Federation of International Freight Forwarders, (sub. 8, p. 6) while arguing for the continuation of Part X exemptions, proposed, among

other things, that any one shipping line should be limited to no more than one-third of any market.

However, The Department of Transport and Regional Services expressed reservation about introducing a market share criteria:

> The Department would not favour such an approach, as trade (or even capacity) shares would be difficult to monitor given the dynamic nature of the industry and the variability of cargo flows. It would prefer to retain the current general approach underlying Part X, that agreements should be registered and receive the exemptions until such time as an agreement can be demonstrated by the ACCC to have given the Minister grounds for its deregistration, and thereupon being deregistered unless the parties to the agreement give satisfactory undertakings regard future conduct. (sub. 9, p. 36)

Modifying Part X

The option of providing automatic registration for 'low' market share agreements aims to achieve the essential benefits of shipping coordination while minimising the anticompetitive risks involved. Automatic registration for agreements under a specified market-share threshold, would provide a degree of certainty for carriers when establishing such shipping arrangements, and would minimise the compliance and administrative costs associated with registering low-risk agreements.

However, it would also risk approving some agreements that would not provide a net public benefit. That is, it would allow a wider range of types of agreements to be registered, including those which manage or negotiate freight rates and set capacity limits. At low market share levels, however, it is less likely that agreements containing such rate fixing or capacity management would have the effect of substantially lessening competition in the market.

As there would be little to be gained by introducing a separate case-by-case evaluation process under Part X for agreements with a market share higher than any threshold, such agreements would be required to seek authorisation under Part VII.

Measuring market share

Two issues are important when it comes to measuring market share. These are: estimating likely market share at the time that registration is being sought; and monitoring market share over time.

In the European Union, market share is measured with reference to the volume of goods carried (freight tonnes or 20-foot equivalent units), and includes provisions for temporary changes in the market share as market conditions change (box F.1).

Box F.1 EU measurement of market share and allowances for market changes over time

European Commission regulations state the following in relation the market share:

1. In order to qualify for the exemption provided for in Article 3, a consortium must possess in each market upon which it operates a market share of under 30% calculated by reference to the volume of goods carried (freight tonnes or 20-foot equivalent units) when it operates within a conference, and under 35% when it operates outside a conference.

2. The exemption provided for in Article 3 shall continue to apply if the market share referred to in paragraph 1 of this article is exceeded during any period of two consecutive calendar years by not more than one tenth.

3. Where one of the limits specified in paragraphs 1 and 2 is exceeded, the exemption provided for in Article 3 shall continue to apply for a period of six months following the end of the calendar year during which it was exceeded. This period shall be extended to 12 months if the excess is due to the withdrawal from the market of a carrier which is not a member of the consortium.

Source: European Community Regulation 823/2000, p. 8.

A potential problem could arise where the likely market share of a new agreement is unknown. However, in practice, agreements rarely represent significant 'greenfield' entrants to a trade route. In practically all cases, they represent the grouping and regrouping of existing service providers where the level of service, capacity and cargo carried are readily identifiable and measurable. Even where significant new entrants are involved, because a scheduled service has to be offered before the agreement can be registered, the capacity on offer by the new service should be known.

Management of a market share threshold system over time will require the continual monitoring of the volumes of trade of agreement parties and other service providers on each trade route. This should not be an onerous task. There are few routes to and from Australia, and there are only a limited number of carriers and vessels on these routes. Such information is readily available. Indeed, it is reasonable to expect that the department monitoring Part X of the TPA to collect such data as an input into informed policy decisions of government.

Because of inevitable changes in markets over time, provisions to accommodate 'temporary' breaches of the market share threshold, similar to those in the EU (box F.1), would need to be introduced in Australia. While the specification of the extent of allowable variation in market share and the time scales involved may seem elaborate, they do provide a degree of certainty and predictability for the parties involved.

Market shares of current agreements and the likely impact of introducing a market share threshold

An important feature of any option to introduce a market share threshold is the level of that threshold. The EU includes a two-step process 30/35 per cent and 50 per cent, and some participants have suggested similar levels for Australia. There is no clear way of determining the 'ideal' threshold level. Any level would be, to some extent, arbitrary and would depend on an assessment of the level of risk involved. There is the risk of registering agreements that are not in the public interest if the threshold is too high. If the threshold level is set too low, there is the risk of imposing excessive costs on the assessment process. At the same time, the pre-existing situation should be considered. Currently, all agreements are registered, and the introduction of a threshold, even a relatively high one, would represent a significant departure from the current arrangements.

The market shares of existing agreements provides an indication of the likely transitional costs associated with a move to a market share threshold, and this could be considered when setting the threshold level. Using the European Union market share thresholds of 35 per cent and 50 per cent as a guide, table 2.8 (chapter 2) indicates, that of the 20 discussion agreement identified by the Commission as being operational, 11 have a market share in excess of 50 per cent while 15 have a market shares in excess of 35 per cent. Data on the market shares of conferences and consortia is more difficult to interpret because of the overlap in membership between different agreements — a common feature on Australian trade routes. Nevertheless, the Commission's preliminary data, based on information from the Registrar of Liner Shipping and Shipping Australia, indicates that many agreements have high market shares, particularly if a 35 per cent threshold were to be used. This is particularly notable in relation to conferences on the routes to and from Europe, and the dominant consortium on the route to and from the North American west coast. However, on routes to and from Asia, all existing consortia and conferences have estimated market shares of less than 35 per cent.

The option of introducing a market share threshold is likely to have a greater impact on existing agreements than the options outlined in chapter 9, depending on the level of the market share threshold used. Certainly, if the European Union thresholds of 30, 35 and 50 per cent were used, many existing agreements would not be eligible for 'automatic' registration, and the modification of other existing agreements to make them eligible may be more difficult as it would involve changes to the scheduled service itself (removing carriers or vessels so as to be able to operate under the threshold) rather than simply removing provisions from agreements. Were such an option to be introduced, transitional arrangements allowing carriers time to review and adjust their agreements would be necessary to minimise any disruption.

At the same time, this option is likely to involve a greater level of continuing administration costs involved with monitoring market share levels and reassessing agreements that move above the threshold. But, to the extent that anticompetitive detriment rests essentially on market power, this option addresses this matter more directly. The essential question is whether this outcome is worth the additional administrative and compliance costs involved.

On balance, the Commission considers that introducing a market share criteria would involve a greater level of ongoing administration and compliance costs, as well as greater transitional costs, than the option of discriminating between agreements on the basis of their key characteristics (chapter 9).

G Other modifications to Part X

Other options proposed by some participants in this inquiry include a range of measures that aim to increase the countervailing power that Part X seeks to provide for Australian shippers, or at regulating aspects of the outcome of negotiations between carriers and shippers, essentially in response to their experiences in the current tight shipping market. These options include:

- requiring all-in freight rates to be offered to shippers;
- requiring freight rates to be offered in Australian dollars;
- requiring the provisions of agreements between parties to a registered conference agreement and a designated shipper body to be binding (while not restricting the ability to enter into confidential individual service contracts, and consistent with the regulation of Australian's trading partners);
- requiring carriers to provide information justifying price increases;
- involving shipper bodies in the negotiation of contracts between carriers and stevedoring companies;
- providing for government funding of shipper bodies
- providing peak shipper bodies with a 'veto' over the registration of agreements; and
- developing a code of practice to cover negotiations between parties to conference agreements and designated shipper bodies to maximise the opportunities for negotiations to be conduced in good faith.

G.1 All-in freight rates and the treatment of surcharges

The Department of Transport and Regional Services (sub. 9, p. 43) said that shippers would prefer an all-in freight rate negotiated with the carriers for an agreed period, or as contract rates for the various liner cargo commodities. The Australian Peak Shippers Association (APSA) also indicated support for all-in freight rates saying that 'Anti-trust immunities should extend only to the setting of all inclusive freight charges' (sub. 5, p. 14).

APSA was particularly concerned about the increasing use of surcharges as a component of the freight costs for shippers and that surcharges increased the uncertainty and risk faced by shippers. APSA said that 'The problem, or burden, for exporters is that overseas buyers will not accept prices for our products qualified by various surcharges' (sub. 5, p. 20).

The Department of Transport and Regional Services (sub. 9, p. 42) commented that carriers have argued that the use of surcharges makes for greater transparency. Shippers, however, believe surcharges render only the ocean freight component readily negotiable, leaving a significant proportion of freight costs non-negotiable as they are set by formulae agreed by the carriers. In relation to transparency, APSA commented that:

> … the lines have been told repeatedly exporters have no interest in transparency because there is no way to ensure that the surcharges are truly transparent anyway. Shippers require all-inclusive rates. (sub. 5, p. 20)

As a means of ensuring that all-in freight rates were offered to shippers, the Department suggested that:

> Part X should be amended to require the parties to a registered conference agreement to offer "all-in" freight rates (i.e. terminal-to-terminal without any surcharges) as an option for shippers to take up if they wish. (sub. 9, p. 5)

The Department also said that it would not appear that prescribing such an option in Part X would raise any significant compatibility problems with overseas regimes if it were to be restricted to shipping arrangements that were contracted in Australia (that is, for most exports and some imports) (sub 9, p. 45).

Subsequently, the Department of Transport and Regional Services said that its proposal did not involve a requirement that carriers offer an all-in-freight rate, only that carriers:

> … be prepared to negotiate in good faith with shippers on an all-in freight rate basis and on an Australian dollar freight rate basis if that is what the shipper wanted. (sub. DR18, p. 21)

APSA went further than simply proposing that all-in freight rates be offered as an alternative to the current pricing structure. APSA said that the fixing of surcharges be excluded from Part X of the TPA and proposed that 'Price fixing of freight surcharges by shipping conferences and consortia no longer be exempt from the full force of Part IV of the TPA' (sub. 5, p. 6).

Rather than attempting to define surcharges for the purposes of excluding them from Part X, something that may prove difficult, APSA proposed that the

exemption available under Part X be available only in relation to the setting of all-in freight rates.

Requirements to offer all-in rates (rolling in surcharges) or to offer rates specified in Australian dollars (see the following section) are attempts to shift elements of risk from the shipper to the carrier. The Department of Transport and Regional Services noted that 'Shippers have said that the widespread use of surcharges in liner shipping effectively transfers financial risk from the liner operator to the shipper' (sub. 9, p. 42). Similarly, APSA commented that it:

> … has repeatedly rejected surcharges suggesting that shipping lines have at their disposal various hedging options, for example, to cover movements in currencies and fuel process. However, the standard response from lines is that it is too difficult and at the end of the day the shipper carries the risk. (sub. 5, p. 20)

It is optimistic to believe that shifting risk to carriers can be done at no cost. Surcharge systems exist as a means of handling certain types of risk. Similarly, foreign trade involves exchange risk. These risks represent real costs that are ultimately reflected in costs to shippers. The question is essentially one of who undertakes the process of managing that risk — the carrier who then passes on the cost of risk management to the shipper, or the shippers themselves through use of the variety of modern financial techniques available for risk management.

In addition, it may be simple enough to require carriers to offer an all-in freight rate in addition to the current range of pricing structures on offer. However, if they are reluctant to do so (and this may be for sound business reasons), they can simply offer the all in-rate at a 'risk' premium which makes its acceptance effectively unviable, or attractive only to very few shippers. Once such behaviour occurs there will inevitably be pressure for more regulation, say to specify that the all-in rate cannot exceed the total of the component rates by more than a certain amount. Even if such specification could be set 'correctly', it is likely to be inflexible, and so the burden and complexity of regulation grows.

Nevertheless, it is reasonable to expect that carriers are better placed to manage these risks (either themselves or through market-based risk-management systems) because it is the business they engage in on a regular basis. Smaller individual shippers, who may export or import infrequently, would be less well placed to engage in appropriate risk management in an unfamiliar area. In such a situation, and in a competitive market, you would expect to see such a service being offered by carriers (or even by specialist intermediaries such as freight forwarders) as an option to shippers who would prefer to pay a higher fixed price where risk is reduced rather than a lower price with a higher risk of variation. That this does not appear to occur may well be the result of the Part X exemptions that allow collective action between carriers, reducing competitive pressures, and making it

easier to shift risk management onto shippers. There is less incentive for carriers to adapt and promote modern risk management strategies as part of their marketing strategy. Even if this were the case, the level of all-in rates in a more competitive market may be quite low. The United Stated Federal Maritime Commission noted that, following the introduction of protection for confidential individual service contracts (ISCs) in United States agreements, roughly 10 per cent of the contract rates were all-inclusive (FMC 2001, p. 20).

As specified in recommendation 9.1, the Commission considers that freight rate setting, whether on an all-in basis or as separate components, should be excluded from the trade practices exemptions offered under Part X. In addition, there are no grounds for government to intervene in the market to specify the nature of the freight rate contracts between shippers and carriers by specifying that carriers must offer all-in freight rates.

G.2 Australian dollar freight rates

The Department of Transport and Regional Services suggested that the Commission should examine the question of whether Australian shippers should be able, at their option, to obtain freight costs fixed in Australian dollars at the time of booking cargo. The Department noted that freight rates denominated in US dollars were introduced relatively recently by ocean carriers in the Australian liner trades, with the agreement of most, but not all, Australian exporters (sub. 9, p. 45). The Department's preferred approach was to:

> Amend section 10.41 to include an obligation for parties to registered conference agreements to offer to fix freight rate charges in Australian dollars [as an option for shippers to take up if they wish] at the time of making the contract for carrying the cargo or at the time of booking the cargo. (sub. 9, p. 46)

However, as noted earlier, the Department explained that its intention was only for carriers to be required to negotiate, in good faith, about Australian dollar freight rates, if the shippers wanted this (sub. DR18, p. 21).

Whether freight rates are offered in Australian dollars, or other currencies, should be a matter of commercial negotiation between carriers and shippers. Both have access to hedging arrangements designed to manage exchange risk, and the general expectation is that the market will place that risk with the party best able to manage that risk, and thus able to do so a lowest cost.

More generally, there are a number of risks inherent in attempting to introduce detailed regulation of the outcome of the negotiations between carriers and shippers. First, the regulator must correctly assess what would have occurred in a well

operating market, one free from significant market failure. Second, the regulation must be specified in a way that is implementable in a cost-effective way that limits avoidance and thus minimises the pressure for an escalation of regulation. Third, there is the risk that such regulation will lock in place outcomes that may become obsolete in the face of changing market circumstances. Fourth, of particular relevance to Part X, it undermines one of the stated desirable features of the regulation, that of 'light handed' regulation leaving the relationship between carriers and shippers to commercial negotiation.

The Commission considers that there are insufficient grounds for government to intervene in the market to specify that carriers must offer freight rates in Australian dollars.

G.3 Making agreements between conferences and shipper bodies binding

The option of making agreements between shipper bodies and the parties to registered conference agreements binding was suggested by a number of participants as a way of overcoming the uncertainties faced by shippers as a result of the growth of non-binding conference agreements (principally discussion agreements) on Australian trade routes.

There is no provision for agreements between designated shipper bodies and Part X conferences to be binding, unless the parties to the conference agreement are prepared to enter into such an arrangement. In addition, the legislation is drafted in such a way that parties to a conference agreement can readily change the provisions of an agreement, subject only to the requirement that they notify designated shipper bodies and offer to negotiate on those matters. There is no requirement to come to any agreement in relation to those changes.

The Department of Transport and Regional Services proposed that:

> Part X should be amended to explicitly make offers made to shippers by the parties to a conference agreement, including a discussion agreement, in the course of negotiations conducted pursuant to s10.41 [which relates to negotiation concerning changes to conference agreements], binding on those conference parties if accepted by the shippers, so long as the lines involved remain parties to the agreement. (sub. 9, p. 5)

Specifically in relation to discussion agreements, the Department suggested that:

> An amendment is desirable to clearly distinguish between any non-binding consensus reached between the parties to a discussion agreement, and any outcomes of negotiations with shippers, which should be binding obligations on the parties to a

> discussion agreement to the extent that those parties have reached an agreement with shippers.
>
> Such an amendment would need to prevent the binding nature of obligations to shippers from any crossing over to agreements purely between the parties to the agreement, which need to remain clearly non-binding in agreements with such typically wide membership. (sub. 9, p. 41)

Along similar lines, Shipping Australia Limited suggested that the operation of Part X, in relation to discussion agreements, could be improved by:

> The Minister of Transport and Regional Services seeking undertaking from parties to Discussion Agreements that the Agreement be amended so if agreement is reached with a designated shipper body on specific issues, being maximum rates or increases for particular commodities, formulae for surcharges and other terms and conditions of service then the parties will collectively adhere to that agreement for whatever period it covers and not deviate from it. (sub. 16, p. 11)

and:

> This binding provision would only apply to Discussion Agreements which, in that part of the Agreement, would effectively turn it into a Conference Agreement and it would not inhibit in anyway market rates being negotiated between individual shippers and individual carriers. (sub. DR 4, p. 28)

It considered that this would overcome the problem identified by some shipper groups that negotiating with discussion agreement members was not fruitful because they could only reach agreement collectively on a non-binding consensus basis which may not last for very long (sub. 16, p. 11).

The Commission cannot see such a system as having, in practice, much by way of a positive impact. First, certain aspects appear difficult to implement in practice. For example, the Department's intention that the conditions be binding between the members of the Discussion Agreement and the shippers but not among the agreement members themselves would be difficult to achieve. As identified above, Shipping Australia Limited perhaps more realistically, identified that this would, in effect, turn the discussion agreement into a conference in relation to the negotiated binding matters — that is, binding among the agreement members. Similarly, it is difficult to see effective or relevant binding conditions being negotiated when, as Shipping Australia Limited has suggested, that it would not inhibit in any way market rates being negotiated between individual shippers and individual carriers.

Second, and perhaps more importantly, the 'unintended consequences' may well be highly anticompetitive. As there is no requirement between the shippers and carriers to come to any agreement on any particular matter covered by a registered agreement, it is difficult to see any provision being agreed by carriers, and thus

becoming binding, that they were not already willing to comply with. There is no incentive, or requirement, for carriers to agree on anything that they do not want to make binding. Indeed, it may provide added incentive for carriers to enter into discussion agreements where provisions are not binding on members, rather than the more traditional conference arrangements.

Of greater risk, however, is that the introduction of binding provisions could be used to introduce, legitimise and protect anticompetitive practices — using the binding provisions to limit competition between parties to the agreement, thereby strengthening the cohesiveness of the shipping cartel. Thus, there is a real danger that Australia will be setting up a means of enforcing collusive arrangements (something that can be difficult for a voluntary cartel), through enforcement of the binding conditions negotiated by the shipper bodies. The Commission cannot see how a 'spillover' of the binding conditions between the shipper body and the conference into the arrangement between carriers can be avoided.

The introduction of binding conditions also raises the potential for a conflict with laws in other jurisdictions. In general, such conflicts do not arise because typically these regulations allow, rather than require, certain behaviour. A conflict arises when one jurisdiction requires something that another jurisdiction prohibits. While Australia could introduce a provision allowing the negotiation of binding conditions, this would not be able to be done where a trading partner prohibits a certain type of behaviour such as collectively enforcing a single price. Where such prohibitions existed in other jurisdictions, this could limit the range of matters on which the Australian parties could reach binding agreements collectively.

An additional problem presented by the introduction of binding provisions in agreements is the potential it creates for conflict with the ability of individual shippers to negotiate directly with individual carriers. Currently, individual contracts are not restricted by matters agreed between designated shipper bodies and Part X conferences, unless the members of the conference agreement collectively 'hold the line' on the service or price offered. As outlined in chapter 9, APSA has proposed, and the Commission recommends, that the power of individual shippers to enter into individual contracts be explicitly recognised and protected within Part X. This would seem to be fundamentally incompatible with amendments to require binding provisions in negotiations between representative shipper bodies and Part X conferences. If, as some have suggested, the ability to negotiate individually be maintained, then the collective negotiation of binding conditions becomes of little relevance.

The Commission considers that it is undesirable to introduce provisions to make binding the results of negotiations between carriers and designated shipper bodies. To do so runs the risk of strengthening the anticompetitive features of carrier

agreements and is counter to the objective of encouraging greater competition through the promotion of confidential individual service contracts as proposed in recommendation 9.2 (chapter 9).

G.4 A code of practice for negotiations

In its submission, the Department of Transport and Regional Services posed the question of whether an industry code of conduct covering shipper/conference negotiations could be considered, and provided an example of voluntary guidelines as appendix 4 to their submission. It is reproduced in box E1 below.

A mutually agreed set of procedural guidelines could serve to minimise unnecessary friction over procedures and, by clarifying the relationships and obligations of the parties, could improve the opportunity for meaningful negotiations to occur.

However, in large part, views on whether negotiations are meaningful rest on the impressions the parties have about the outcomes, and whether those outcomes are to their satisfaction in a commercial sense. This largely depends on the market and power relationships that exist between the parties, something that is not fundamentally changed by regulating the procedures by which they negotiate, or even by a requirement to negotiate. In that sense, too much should not be expected from any code of practice developed to cover negotiations between carriers and shipper organisations.

In relation to the particular example provided by the Department of Transport and Regional Services, there are a number of features that warrant comment. The first is the matter of providing information or directing complaints to the ACCC or the Minister in the event that the parties to the negotiation fail to reach agreement. As currently written, the failure to reach an agreement between shippers and carriers is not a matter on which the ACCC nor the Minister can act. The Act only requires that negotiations be offered, and if accepted, be undertaken, not that an agreement be reached. It is thus not clear on what grounds a complaint could legitimately be made to the ACCC or the Minister, nor under what ground either the ACCC or the Minister could take action to arbitrate the dispute.

It would be preferable to have a clear process for handling failure to reach an agreement. Typically that would involve an independent dispute resolution process involving arbitration and provisions to ensure that the parties to the negotiation are bound by the results. It would also involve appropriate and measured penalties for refusal to comply with the arbitration decision, together with appropriate appeal mechanisms.

Box G.1 **Negotiations under Part X: an example of voluntary guidelines presented by the Department of Transport and Regional Services**

1. Genuine negotiations in good faith will be held under the existing provisions of Part X, with the attendance of an Authorised Officer if requested by either side, until either an acceptable compromise or a deadlock has been reached.

- negotiations often may concern changes in shipping arrangements that already have been implemented following expiry of the notice period under s.10.41 (2) of 30 days (or lesser period if agreed by both sides); but
- genuine negotiations requires that both sides are prepared to move, if necessary, from their initial positions in order to move towards a compromise;
- genuine negotiations requires that the representatives of both sides have the authority to commit their principals to a negotiated outcome; and
- good faith implies each side has a genuine wish to achieve a negotiated settlement of the outstanding issues;
- each side will use its best endeavours to provide, in a timely fashion, the information requested by the other side that is reasonably necessary for the negotiations;
- negotiations may be face-to-face, telephone or video conference, or fax;
- the Authorised Officer may suggest that the parties hold further negotiations;
- in general terms, each side will use its best endeavours to reach a commercial resolution.

2. If complete deadlock is reached in negotiations between shippers and the parties to a conference agreement, before a complaint is made to the Minister or directly to the ACCC:

(a) Either side (or both) may request the Authorised Officer, having considered the issues, to develop a strategy for further progressing matters. This may involve the Authorised Officer requesting further information from either side or from both sides.

(b) The Authorised Officer, having received any information requested of either side, will consider the issues in the context of the objects of Part X, and use his or her best endeavours to a develop a strategy for further progressing matters for both sides to consider.

(c) Both sides will consider the Authorised Officer's suggested approach, and should conduct at least one further round of genuine negotiations in good faith.

(d) If deadlock is again reached, each side should provide the Authorised Officer with a Statement of Reasons outlining why it is not prepared to move further towards a compromise position. The Statement of Reasons may later be given to the ACCC.

(e) The Authorised Officer and the opposing parties will consider the Statement of Reasons, and consider whether there is the possibility of further movement.

(f) If there is no such possibility, then both sides and the Authorised Officer will formally consider the question of whether all avenues for a compromise settlement have been exhausted, covering issues of amounts, timing, scope of application, offsets etc.

(g) If all avenues have been exhausted, the Authorised Officer will formally advise both sides of the options (including a complaint to the Minister or directly to the ACCC), and may also give an assessment of the likely response of the Minister or the ACCC;

(h) There will then be a "cooling off" period of 14 days before such a complaint is made.

Source: DTRS (sub. 9, p. 62).

The second feature of the Department's example is the involvement of an Authorised Officer (someone from the Department of Transport and Regional Services representing the Minister) in the negotiation process.

APSA supported the development of a code of practice for negotiations, but this would involve quite extensive involvement of the Authorised Officer, particularly in developing a strategy for further progressing matters in the event of a deadlock (sub. DR11, pp. 7–8). This involvement of government officials in commercial negotiations has some risks. There is the danger that any agreement reached will be seen as having the de facto 'approval' of the government. This may present a potential conflict of interest between the government as a party involved in negotiations and as the body whose role it is to regulate and enforce the provisions of Part X, particularly where, as is currently the case, both functions would rest within the same government agency.

The Department also considered that government should not be involved in the negotiation process saying:

> The Department agrees with the Commission's view that the Department should not be involved in the negotiation process. The Department notes the limited role of authorised officers in attending Part X negotiations. That role is mainly to give advice as to the requirements of the legislation, but also to observe the progress of the negotiations in the event of a complaint being made to the Minister, and to make suggestions designed to help keep matters from reaching a deadlock that might result in such a complaint or a complaint to the ACCC. The Department also agrees with the Commission's view (p188) that a voluntary code should be developed by shippers and carriers. (sub. DR18, p. 24)

Nevertheless, a code of practice to cover the procedures for negotiation between carriers and designated shipper bodies could serve a useful role in minimising unnecessary friction over procedures and, by clarifying the relationships and obligations of the parties, could improve the opportunity for meaningful negotiations to occur. However, any such code developed by the parties should not be enshrined in legislation and should not involve government in the negotiation process.

G.5 Requiring carriers to provide greater justification of price increases

The Department of Transport and Regional Services commented that one area of 'apparent ongoing irritation' for shippers has been obtaining information from carriers that supports or justifies an increase in freight rate charges or other negotiable shipping arrangements. The Department proposed that:

> Part X should be amended to require the parties to registered conference agreements to provide designated shipper bodies with adequate justification, including relevant quantitative data, for proposed increases in freight rate charges, as a separate obligation to the mutual obligation to exchange information under s. 10.41(1)(b). Such an obligation should be subject to a test of reasonableness. (sub. 9, pp. 41–2)

While such a requirement seems reasonable where pricing is cost-plus, it nevertheless presents some risks as it detracts from the process of prices being determined by supply and demand conditions. Implicit in such a proposal is the view that freight rate increases not based on cost increases are in some way not 'justifiable'. While it would be reasonable over the longer-term to expect prices to reflect costs (and in a competitive environment this could be expected to be the case as firms compete away any excess profits), in the short-term, this is not the case and often for good reason. For example, in periods of shortages, it is desirable for price increases to exceed cost increases both as a market-based means of 'rationing' the goods or service that are in temporary short supply, and as a signal to suppliers that there is unmet demand, thus providing an incentive to invest in increasing the supply of that product or service. Moreover, many liner shipping costs are joint or common and cannot be accurately attributed to individual shippers (appendix D). If regulatory mechanisms are put in place to attempt to link price increases only to provable cost increases, then there is the risk that the market will not react well to imbalances in demand and supply. Indeed, were such a system to be used to suppress price rises in times of shortage, it may well lead to capacity being withdrawn from Australian trade routes in search of greater returns elsewhere. This is unlikely to be in the long-term interests of Australian shippers.

It would be important, therefore, that 'adequate justification' of price increases should extend beyond simply increases in costs, and enable the inclusion of other relevant market conditions, including such things as market shortages and alternative opportunities in other markets.

In a subsequent submission the Department of Transport and Regional Services restated its view that it is necessary to strengthen existing carrier obligations in relation to the provision of information justifying proposed freight rates. It said:

> Obtaining such information appears to be a continuing problem for shippers. The Department in its proposal referred to "adequate justification, including relevant quantitative data", and the inference that this meant only costs is an unwarranted one that the Commission has drawn, and on which it appears to have based its arguments. There could be many factors, including a variety of non-cost ones, which could be part of such a justification. (sub. DR18, p. 24)
>
> The Department considers that it would smooth the path of shipper/carrier negotiations if the information provisions were to be amended so that there was a clear requirement,

subject to a test of reasonableness, for information to be provided to justify increases sought under the agreement. (sub. DR18, p. 25)

Despite the intention to allow 'non-cost' factors to be considered, it is inevitable that clearly measurable costs, rather than market conditions, will dominate shipper thinking, particularly when faced with freight rate rises. Rather than improving relations between carriers and shippers, this is likely to add another area of disputation, which is only likely to lead to increased shipper frustration given the limited practical influence that they would have on the outcome — something that shippers already complain about. For example, APSA commented:

> The surcharges have increased over the years too. I mean, once upon a time there were no surcharges. Lines seem to believe that they can just impose a surcharge. The outwards terminal handling charge is a good exercise, which came in in June 2000. We had 10 of our members sit down with them; they kept stating our opposition to them. The minister's representative was there and, no matter what we said, they were imposed a couple of months later. (trans., p. 65)

It is hard to see how more information, or more mandatory negotiation will change this. The Commission considers that such intervention is unnecessary and that there should be no specific requirement for carriers to justify price increases in their discussions with designated shipper bodies.

G.6 Shipper organisation involvement in the negotiation of stevedoring contracts

Stevedoring contracts are currently negotiated between the carriers and the stevedoring companies as an input cost into the shipping service. The overall shipping service is provided by carriers and charged to shippers using that service, with the stevedoring component usually identified by way of a surcharge. APSA asked that shippers be authorised to be involved in the negotiations between stevedores and shipping lines:

> … just to see what goes on. The stevedores have totally rejected our approaches in the past, because they say, "You're not the client, the shipping line is the client. What they do with you is something between you and the shipping line." (trans., p. 59)

APSA requested that:

> … provision be made under Section 10.24a for APSA to sight contracts between Stevedores and Shipping Conferences. The reason for this request is that exporters at the end of the day pay the cost of stevedoring but have no input to negotiations. (sub. DR14, p. 1)

The Department of Transport and Regional Services commented that:

> The Department doubts that stevedores and other entities that may have a contractual relationship with the parties to a conference agreement could realistically be brought directly under sections 10.41 and 10.52 of Part X where they have no direct contractual relationship with shippers.
>
> However, it may be possible to amend s. 10.24A to require that stevedoring contracts made by parties to registered conference agreements must not be entered into on a basis that prevents Australian shippers sighting those contracts for the purposes of negotiations under Part X. (sub. DR18, p. 31)

In providing a service to shippers, carriers have many costs that are inputs to that service. This involves things such as the cost of purchasing or leasing vessels, hiring crews, paying for fuel, and purchasing stevedoring services, among others. It is difficult to see why one particular element of the costs faced by carriers should be subject to scrutiny by shipper organisations. Contracts between suppliers and a company are an important feature of their competitive position in business, such information generally to be protected, if not from their customers, at least from their competitors so as to maintain any competitive edge that good negotiation could generate. Requiring carriers to provide shippers with details of their contracts with stevedores would seem to be an unwarranted intrusion into the business operations of carriers and stevedores. Even were such information to be provided, it is hard to see what influence shippers could have over either the content or outcome of these contracts.

The Commission does not consider it appropriate that the shipper bodies should have access to contracts between carriers and those supplying inputs to the carriers' business, whether they be for stevedoring services, ship crew costs, the leasing costs of vessels, or any other element of carriers' costs.

G.7 Shipper 'veto' over the registration of agreements

In a subsequent submission, the Department floated an alternative approach to dealing with participant's concerns over discussion agreements. This involves three key elements:

- giving shipper bodies the right to sit in on the discussions being conducted between members of the discussion agreement (sub. DR18, p. 29);
- giving relevant shipper bodies a 'veto' over the registration of conference agreements (sub. DR18, p. 4); and
- making conditions negotiated by discussion agreements with shipper bodies binding on the parties (sub. DR18, p. 29).

The Department commented that:

> This proposal [that shipper bodies attend meetings of members of Discussion Agreements] may have the potential to promote a positive working relationship between Australian shippers and carriers in a trade, in place of the current, apparently dysfunctional, relationships involving shippers and discussion agreements. It could provide the basis for shippers and carriers in a trade to exchange information about market conditions for cargo commodities, freight markets, and other matters of mutual interest concerning liner cargo shipping services. (sub. DR18, p. 29)

The 'veto' would be wider than just applying to discussion agreements, with the Department commented that the veto could serve to address the Commission's concern that there should be an up-front assessment of public benefit of liner agreements (sub. DR18, p. 4).

However, the proposed 'veto' would, in practice, be limited. The Department said:

> In this model, the exercise of a shipper veto would require a statement of reasons to be given to the Minister by the peak shipper body, and the Minister would have the power to overturn such a veto after appropriate consultations, perhaps involving undertakings. (sub. DR18, p. 27)

and:

> To ensure stability of services, there would probably need to be a requirement on shippers to negotiate within a reasonable time, and to provide a statement of reasons to the Registrar of Liner Shipping as to why agreement could not be reached with the parties to the agreement, in order that shippers could not effectively exercise a veto by refusing to negotiate or unreasonably withholding agreement. The views of shippers would be instructive as to this proposal. (sub. DR18, p. 28)

When preparing and presenting an agreement for registration under Part X, or for that matter in relation to any form of regulation, it is preferable that the rules, criteria, or the conditions that must be met, are clearly articulated and consistently applied. The 'veto' arrangement is uncertain and potentially arbitrary. There is no guidance on the criteria to be used when assessing the validity of the veto, or in establishing appropriate undertakings that may result. It is undesirable to subject business to such uncertain application of regulation, or subject them to regulation that is determined by another industry with potentially rival interests, rather than by government.

The Commission can see little merit in the proposal to allow shipper bodies to sit in on the meetings of members of discussion agreements. Part X is already characterised by procedures requiring consultations with shipper bodies with no limitation on the subsequent ability of carriers to act as they see fit, something that shippers already complain about. The proposed involvement of shipper bodies is essentially of the same nature.

In relation to making conditions negotiated between shipper bodies and discussion agreements binding, (a proposal also supported by Shipping Australia Limited (sub. DR4, p. 28)), the Commission has considerable reservations about both the effectiveness and consequences of such an approach. These are outlined in more detail elsewhere in this appendix where the issue of binding agreements is discussed more generally.

G.8 Funding shipper bodies

The question of the funding of designated shipper bodies, particularly the peak shipper bodies has been raised in this and earlier inquiries into Part X. The APSA noted that an earlier group, the Australian Exporters Association ceased operations due to insufficient funds from members and this was replaced by the Australian Shippers Council which was, until 1989, partly funded by the Australian Government on the basis of $2 for every $1 contributed by the membership (sub. 5, p. 4). Since 1989, the peak shippers body, and other designated shipper bodies have been funded by their membership, although some funding is still provided to APSA by government. The Department stated that it:

> … supports APSA through an annual contract for APSA to provide assistance to small shippers [$20 000 per year], and is also a member of APSA. APSA operates on a very small budget so this support is significant. (sub. DR18, p. 39)

In its 1999 report, the Commission said that the direct beneficiaries of APSA's efforts are shippers, particularly exporters, and that additional funding, if required, should come from shippers. However, the Commission commented that if the Government decides that additional finding for APSA is warranted, any government support would best come from general revenue. Given the relatively small sums likely to be required, the administrative and compliance costs of collecting a levy [from shippers] would far outweigh any revenue raised (PC 1999, p. 171).

In this inquiry APSA (sub. 5. p. 6) called for a broader source of funding for the Association and that this is required to meet the costs of:

- protecting the interests of all Australian exporters;
- research of shipper issues;
- conduct of negotiations; and
- education of shippers.

APSA commented that exporters receive the benefit of its work without being obliged to take up membership, and suggested funding along the lines of statutory marketing authorities (sub. 5, p. 7).

The Department of Transport and Regional Services stressed the importance of shipper representation to the effective operation of Part X, noting that shippers benefit from the work of both the exporters and importers peak body whether or not they take out membership and contribute to funding. The Department commented:

> Not unnaturally, this has given rise to a "free rider" problem that constrains the resources available to the shipper bodies, particularly the peak bodies.
>
> … we would ask that the Productivity Commission address the question of a mechanism for ensuring that adequate resources are available to ensure the ongoing viability and effectiveness of the peak shippers bodies. (sub. 8, p. 46)

Shipping Australia Limited also expressed support for strong and well resourced shipper bodies and said that it '… would not object to any recommended measures to enhance that role from the point of view of Government financial support' (sub. 16, p. 45).

The potential problem of people 'free riding' on the benefits generated by collective action is common to many industries and industry organisations. The problem in trying to address such situations is that it involves a number of important judgments — that the collective action provides significant benefits, that the benefits cannot be limited to those who contribute to collective action, and that the benefits warrant the administrative costs of introducing industry levies. The problem is compounded in a situation where there is a very large and diverse membership, where it would be difficult for members to ensure (in a situation of mandatory fees) that the organisation was responsive to their needs, and in a situation where some may benefit and some may not.

However, there is no necessary requirement that the benefits of negotiations by designated shipper bodes be made available to non-members. One option would be to allow a designated shipper body to negotiate conditions that would be available only to their members. In this way, the organisation has the incentive to pursue significant benefits and benefits that match the expectations of members. If such benefits were obtained by negotiation with carriers, the organisation would be able to attract a wider membership without the need for mandatory funding measures.

While the Commission is unclear about the real benefit that the peak shipper bodies deliver to exporters and importers, to the extent that benefits are generated and cannot be limited to members, it is shippers who are the beneficiaries. In this situation, funding should be sourced from Australian shippers rather then the community generally through any government contribution. In such a situation, those benefiting would clearly see the cost and thus have an incentive to monitor the trade off between the costs and benefits involved — an incentive that is considerably attenuated if funding was by taxpayers. However, as noted by the

Commission in its 1999 report, the administrative and compliance costs of collecting a levy from a large number of shippers, many of which are only intermittently involved in trade, would far outweigh any revenue raised. The Department expressed a similar view saying:

> The Department has not favoured a levy arrangement to fund shipper bodies due to the high proportion that collection and administration costs would form of the total amount collected, given the small amounts involved in running APSA. The Department notes that there are a large number of levies operating in the maritime sector already. (sub. DR18, p. 39)

An alternative would be to collect the funding levy through the parties to registered agreements (ocean carriers). While the levy would in the first instance be paid by the carriers, it would appropriately be passed on in costs to shippers. The considerably smaller number of parties to registered agreements makes the administration of such a levy much more feasible. In this way, the cost would be ultimately borne by shippers, and while one step removed, carriers would have an incentive to continually monitor the cost of the levy, and would have a continuing incentive to bring it to the attention of the industry and regulators. Such levies are not unknown. The airline industry, for example, has been subject to a number of levies designed to fund specific objectives. Such levies would, however, require legislation and involve ongoing administrative costs. In addition, it would place Australia in a unique position in levying the industry to fund collective shipper bodies.

On balance, the Commission considers that there is no case for government involvement in the funding of designated shipper bodies.

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