



**Association of Australian Ports and  
Marine Authorities  
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***Competition at Australia's ports***

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## **Introduction**

Australians are benefiting like never before from some of the most buoyant economic conditions seen in recent times in this country, and international demand for our resources is unquestionably fuelling much of the prosperity we are currently enjoying.

That demand, and the desire by Australian businesses to improve their efficiency on the world stage, thereby making them more competitive, puts additional strain on our logistics sector that services those imports and exports.

The sector is responding to the challenge by growing, seeking efficiencies and improving coordination of land, sea and air transport. Mergers, consolidation and the creation of large, integrated logistics chains have been strong features of recent times and operators at our largest ports are also pursuing the benefits of greater integration, but consolidation brings with it unique challenges.

Allowing businesses to merge can create more competitive and efficient operations that contribute to the economy's success, and there is a strong argument for taking as much of a hands-off approach as possible. But allowing mergers to go ahead unchecked has the potential to harm, rather than serve the economy as a whole, by creating monopolies that shut down competition, drive up prices and ultimately eat into the competitive gains we have thus far achieved.

Our ports are the international gateway for our trade activity, and ensuring they are functioning efficiently in a way that ensures reasonable and fair access for all players is crucial to our future prosperity. But there are challenges ahead that you, as the leaders of this industry, will need to tackle if that momentum towards greater efficiency and international competitiveness is to continue.

I'd like to take the opportunity today to look at some of the recent developments affecting the sector and the ACCC's role in assessing proposals for mergers and acquisitions and in authorising anti-competitive conduct.

I'd also like to touch on how we are addressing the growing demand at the nation's ports – both in the resources sector and in the containers area, and why competition will remain central to the advancement of our port-related industries in the face of these pressures.

### **Emergence of integrated logistics chains**

One way of becoming more competitive is to grow. Linking up the separate components of a complicated business like a container transport or freight operation not only allows greater control of each link in the chain, it can allow for greater efficiency and lower transaction costs relative to less integrated rivals.

It's been a popular strategy with larger Australian operators, and it has seen those businesses gain a greater presence on the world stage against other multinational competitors.

But a report released in Geneva last month by the World Economic Forum ranked Australia's economy 19<sup>th</sup> in the world for global competitiveness. The report notes continuing issues with levels of business sophistication as well as labour market concerns. Clearly we still have some way to go.

For a good example of the type of coordination and growth I am talking about, we can look at Queensland Rail. The company has made no secret of its

intentions to become a major new force in national rail freight. Queensland Rail CEO Bob Scheuber said recently that the company's purchase of the above rail operations of ARG was part of its strategy to position itself for a renaissance of rail freight in Australia.

Toll's growth into a more integrated, international operation is another case in point. Just last week the company predicted its recently acquired Asian operations would double their revenue by 2010 as a direct result of efficiencies achieved through streamlining and linking its logistics operations.

But the tendency towards larger, vertically integrated businesses does present some issues in the logistics sector, as the ACCC noted in its 2004 submission to the Productivity Commission's inquiry into National Competition Policy.

While smaller, less efficient players are being pushed out of the market, businesses that own what regulators like to call "bottleneck infrastructure" such as rail terminals or stevedoring facilities, can find themselves with the ability to squeeze competitors. Through their increased control they are able to restrict access to facilities or increase prices, so as to favour their own operations.

### **State of Australian stevedoring**

Central to a discussion on improving efficiency at our ports is a look at the state of our container stevedoring industry. We are currently finalising our eighth annual report which we will publish next month. Over the eight years of the ACCC's monitoring program, some patterns are emerging.

Our monitoring programs have shown us that the industry has begun to invest in new container terminal infrastructure. However, we have also seen a recent trend towards rising costs, revenue growth and profits remaining strong.

Industry is responding to increased demand by looking to increase capacity at Australia's ports, but that response appears to be coming not a moment too soon.

A recent study by the Bureau of Transport and Regional Economics estimated that total container trade is expected to increase by 5.4 per cent a year in the next 20 years. At the major ports, it is expected to increase 7.4 per cent at Brisbane, 5 per cent in Sydney, 4.9 per cent in Melbourne, 5.3 per cent in Adelaide and 5.4 per cent in Fremantle.

That report found that current capacity of Australia's largest ports at Sydney, Melbourne and Brisbane could be put under strain in the coming years, with Port Botany in particular expected to reach full capacity by 2010.

There are nevertheless, signs that in the past users have benefited from reforms.

### **The impact of reforms**

There are indications that users of stevedoring services have benefited from reforms at our ports. Our monitoring shows us that real unit revenues (a proxy for prices) fell by 2.26 per cent in 2004-05 and by 20 per cent since 1998-99.

Shipping lines have also benefited from enhanced productivity and quality of service. However, in 2004-05 the data indicated that productivity gains are levelling off.

### **The role of competition**

And so the monitoring work raises questions about approaches to competition at Australian container ports.

Before discussing competition at our ports, it is useful to insert into the discussion a statement of the ACCC's underlying philosophy about the role competition plays.

Through competition, firms and institutions become more efficient, innovative and flexible. Consumers have greater choice and possibly lower prices. Competition is also a means of enhancing community welfare by promoting a more efficient use of resources, thus providing greater returns to producers and higher real wages.

Markets that work in this way are the aim. But certain areas within the transport sector such as ports and rail have high barriers to entry, entrenched players and national monopoly infrastructure. If left to its own devices, the industry would not be fair and competitive without regulation setting some of the rules.

Which brings me to our ports and how they are responding to increased competition.

### **Increasing competition at our ports**

The pressure being placed on Australia's ports as highlighted by the BTRE report again raises the question of whether a third stevedoring operator would be required in Australia.

The ACCC would be broadly supportive of an increase in competition in any sector, as long as it resulted in benefits for those that rely on the services provided, i.e. the customers. What we generally expect to see as the number of competitors in an industry increases, is that it may become more difficult for one firm to predict how its competitors might respond to its own actions. As a result, competitors are more likely to offer the firms they deal with (such as port managers and shipping lines) their 'most competitive' terms and conditions. This in turn can increase the efficiency of stevedoring services provided at a port.

That said, economies of scale also need to be taken into account where they relate to container terminal operations. Increases in the scale of operations may lead to substantial increases in throughput capacity and subsequent reductions in average costs. There may also be efficiencies available to a large operator, in terms of management and coordination of workforce and equipment, which may not be available to stevedores operating on a small scale. However, it is difficult to quantify the minimum efficient scale of operation a new entrant would need to become established.

The ACCC remains aware of the possibility that such barriers to entry may make it difficult for new entrants who bring with them increased competition.

I note that the incumbent players have already commented that the industry may not yet be capable of sustaining a third major force in stevedoring.

### **Significant mergers**

On the mergers front, we have seen some significant activity since the start of 2005. Among the more notable mergers that impact on the transport and logistics sector are:

- Dubai Ports' acquisition of P&O Ports
- Patrick's acquisition of a majority shareholding in Virgin Blue
- A.P. Moller-Maersk's acquisition of Royal P&O Nedlloyd
- Queensland Rail's and Babcock & Brown's acquisitions of ARG assets
- Patrick's proposed acquisition of FCL
- And of course, Toll's acquisition of Patrick.

### **The Toll/Patrick merger**

Toll's acquisition of Patrick has represented the greatest shift to the industry of all the recent merger activity, and in the area of ports, our competition assessment of the proposed merger raised a number of issues.

Market inquiries told us Toll and Patrick were the only two companies with a current real chance of acquiring the range of facilities and businesses required to supply integrated logistics services.

In essence, without some form of undertaking to divest assets, a merged Toll/Patrick would have been in a position to potentially discriminate in favour of its own operations in the use of Pacific National's rail line-haul service, Patrick's container terminals (including wharf cartage/stevedoring) and Bass Strait shipping services.

Clearly, this would not have been in the interests of competition.

However, the ACCC noted that alternative container terminal facilities were available from P&O, which, when provided in combination with other freight forwarders' services, could potentially compete against both Toll and Patrick. Also, market inquiries with customers indicated that while some customers preferred to deal with one operator for all their logistics needs, others would use a range of operators to maintain competitive tension or capitalize on the particular expertise of operators in particular areas.

What the market told us was that Toll's commitment to divest 50% of Pacific National, along with a number of other structural and behavioural undertakings, would reduce its ability to have any additional influence over the activities of Pacific National. The undertakings also paved the way for a new entry into non-bulk east-west rail line-haul services and provide some additional safeguards including non-discrimination clauses to prevent Pacific National discriminating in favour of Toll.

In relation to container port terminals, Toll also undertook not discriminate in favour of Toll or Patrick's freight forwarding or logistics operations in terms of price or service quality.

The intent of the undertakings is to ensure that effective and vigorous competition remain a feature of this important part of the national transport chain.

However divestiture of Toll's assets that represent competition concerns is not the end of the matter for the ACCC. Remember, our goal is to enhance competition and as such the commission will carefully consider all prospective investors looking to take up these assets, but will not approve an acquisition that leads to a substantial lessening of competition through benign neglect or the buy-in of a passive investor.

For example, it will not be good enough for an investor to acquire a half interest in Pacific National if it intends to abdicate management responsibility to Toll.

Toll has also given behavioural undertakings that require Pacific National not to discriminate in favour of Toll and require Toll to maintain an arms-length approach to Pacific National's management. It is to have no access to customer information.

### **Logistics chains - potential trade practices issues**

There are of course ways of generating some of the benefits of greater coordination and integration that do not involve mergers or acquisitions. In such cases efficiencies in logistics chains may be achieved through some degree of coordination or cooperation between potential competitors.

Of course, the formation of logistic chains or industry based solutions to bottlenecks can raise very serious trade practices concerns.

Even short term solutions, such as the queue management schemes currently operating at the coal loading terminals at the Port of Newcastle and Dalrymple Bay, can involve agreements between industry participants, including coal producers and port facility owners. Agreements, particularly between competitors, that allocate or coordinate capacity can raise concerns.

Generally speaking, the competition provisions of the Trade Practices Act prohibit arrangements that have the purpose or effect of substantially lessening competition in a market. More specific provisions also expressly prohibit agreements between competitors as to prices at which they might buy



or sell or which have an anti-competitive purpose of limiting their dealings with others.

### **A range of regulatory tools**

While minimalist regulation remains the ideal, the individual and sometimes unique characteristics of different markets require a range of approaches to achieve the best outcomes for industry and consumers.

The tools available to the ACCC are a mix of so-called 'light-handed' and more 'heavy handed' forms of regulation. This is particularly relevant to our ports, that are viewed as key infrastructure and as such are subject to regulation to enhance competition.

Our regulatory tools range from price monitoring, designed to provide hands-off information on how markets are performing, through to regulating access on important forms of infrastructure where smaller players risk being shut out from participating in a market because of the restrictions on access to essential bottleneck infrastructure. Each form plays an important role in the goal of establishing efficient, competitive and fair industries.

### **Regulating access**

In certain circumstances – most notably markets that have natural monopoly characteristics – competition cannot be relied upon to ensure efficient outcomes. This is recognised through the Trade Practices Act also providing the ACCC with a variety of roles to regulate industries where competition is less than adequate. To create competition, access provisions are therefore required and this has meant a regulatory framework that oversees access conditions including negotiations to determine access prices. Undoubtedly this can be the high end of regulatory intervention.

However, it is worth noting that access regulation only takes effect when buyers of such services are unable to reach commercial agreements with the providers of those services.

Part IIIA of the Trade Practices Act provides safeguards for those seeking access when the incentives may not be in place for a commercial agreement to be struck.

Under Part IIIA, the ACCC may have a role in determining terms and conditions of such services. In broad terms, the ACCC has a role either through arbitrating disputes about access in those cases where services have been “declared” or through assessing access undertakings that are submitted to it by infrastructure owners.

### **The ACCC’s role as an industry regulator**

It is worth noting however that the ACCC has no role in administering regulatory access regimes at any Australian port. In fact, only ongoing regulatory role that the ACCC has in the ports sector is the monitoring of the costs, prices and profits of stevedoring services.

### **Amendments to Part IIIA**

Changes to the National Access Regime (Part IIIA) passed the Senate on 10 August 2006. A number of amendments have been made to the legislation. The changes are of a diverse nature but critically for the ACCC the amendments give specific direction to the Commission about the principles that should be taken into account when making regulatory decisions.

The ACCC will be required to have regard to a newly inserted objects clause. The objects of the new legislation are to:

- (a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
- (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

In addition, pricing principles have now been inserted. The ACCC is required to have regard to these pricing principles when making arbitrations, undertaking and access code decisions.

A range of timelines have now been inserted and the ACCC will be required to include in its annual reports the time taken to make arbitrations, access code and competitive tendering decisions.

These changes clearly show priorities regarding the future of regulation - achieving timely decisions, improving consistency and by providing pricing principles the aim is to provide greater certainty.

### **COAG Reforms (February 2006)**

On the government side, there have also been some significant developments. At its February meeting, COAG signed a "Competition and Infrastructure Reform Agreement" to provide a simpler and more consistent national system for the economic regulation for nationally-significant infrastructure, including ports, railways and other export related infrastructure.

Again the changes proposed are diverse and potentially wide ranging in their impact. They include:

- amendments to the Competition Principles Agreement to introduce an objects clause and pricing principles similar to those proposed (and now introduced) into Part IIIA
- binding timelines requiring regulators to make regulatory decisions within six months, subject to 'stop the clock provisions'.

- a requirement for state access arrangements to be submitted for certification under Part IIIA as soon as practical and no later than 2010
- the introduction of a streamlined process for certification

These reforms are to achieve the primacy of Part IIIA as the national access regime. They are to set right what has been one of the major flaws of the competition reform process - the lack of consistency across infrastructure industries and therefore the uncertainty that is created when infrastructure providers have to deal with different regimes and regulators operating between the different states.

I quote these figures frequently but with over 20 state-based regimes in operation covering rail, ports, gas and electricity and 11 federal, state and territory economic regulators how can we stay ahead of advances in international competitiveness?

Of particular interest to this audience, COAG agreed to a number of principles and measures.

Most significantly, it agreed that ports should be subject to economic regulation only where necessary to promote competition in upstream and downstream markets.

To overcome the current discrepancies that exist around the country, a consistent, national approach should also be applied to the economic regulation of significant ports where warranted.

That regulation should be based on commercial outcomes through competitive market frameworks in preference to economic regulation. Third-party access to port facilities should be provided in a competitively neutral environment and regulatory prices oversight should be undertaken where warranted by an independent body.

Of course, competition, being the driver of efficiencies and lower prices, should be pursued in relation to the provision of port and related infrastructure

facility services, except where the benefits of restricting competition outweigh the costs.

The application of these regulatory principles spelt out at the COAG meeting had competition at their core as it relates to the provision of port services and efficient investment in and use of key port infrastructure.

The goals set out by COAG are clearly designed to foster competition between suppliers of port services, port planning and administration, which should in turn allow new entrants into the sector. The benefits that would ideally flow would include high productivity of port operations and lower costs to the users of port services.

Moreover, COAG hopes that streamlined regulation will promote efficient investment in port infrastructure, in particular, timely adjustment to increases in demand for port services. Lower port handling and shipping costs would therefore contribute significantly towards the competitiveness of Australian exports.

### **The monitoring role and light handed regulation**

Unfortunately, all forms of regulation do represent a certain degree of interference in the natural functions of the market, and as such remain controversial. A number of reports and reviews, including last year's Prime Minister's Export Infrastructure Taskforce review, have emphasised the role of 'light handed' regulation and within this context the role of price monitoring.

Monitoring can be important in providing the community with certain types of price and other financial information. It can also provide information to government about, for example, structural changes in particular sectors of the economy. Monitoring of quality of service can also provide a gauge of the performance of firms with market power. This information may help government determine the nature of future oversight arrangements.

Monitoring on its own, however, will not fix issues within a market. For it to be effective, monitoring needs to be linked to a series of thresholds that trigger other action. In the case of our monitoring work in container stevedoring, the role can be thought of as like manning an observer post watching a bushfire. We can look at the smoke and alert others that there may be a fire – but unless they are ready to respond by finding the source of the fire and doing something about it, simply watching the fire spread won't stop houses from burning down.

### **Part X of the Act**

An ACCC speech on ports and related industries would not be complete without a mention of Part X of the Trade Practices Act.

Part X provides a scheme of exemptions for conference agreements between liner shipping companies from several of the competition provisions of the Act. This means that liner shipping companies, provided they register with the Department of Transport and Regional Services, can undertake activities that would otherwise be prohibited as anti-competitive conduct. In certain circumstances, the ACCC can hold an investigation to determine whether an exemption ought to be lifted.

Earlier this year the ACCC released a report following an investigation into an alleged breach of Part X by the members of the Australia to Europe Liner Association. The ACCC report urged both shipping lines and shipper bodies to develop arrangements to manage confidential information that is necessary to Part X negotiations. I understand that the liner group and the exporters association have taken steps to develop such arrangements.

Of course, the other significant development this year has been the Australian Government's response to the Productivity Commission's inquiry into Part X. While the Government did not accept the PC's recommendation, it did accept several pro-competitive reforms – including the recommendation that broad-

based discussion agreements no longer be given the blanket protection of Part X.

I also note that our trading partners are not standing still in reforming the special exemptions granted to liner shipping groups. The announcement by the European Commission last month that – from October 2008 – lines will lose their blanket immunity to engage in price fixing and capacity regulation – is another example of our trading partners implementing pro-competitive reforms.

## **Conclusion**

Before I leave you today, I'd like to throw out a couple of challenges to the audience to consider the role you as industry leaders can play in ensuring the continued improvement of our ports and associated industries.

### Liner shipping

For those involved in liner shipping companies your challenge will be to adapt to the regulatory reforms that appear to be gaining momentum. The government – in its response to the Productivity Commission's most recent inquiry into Part X of the TPA – expressed a definitive view about "discussion agreements". In fact, the Government's response stated that:

"The Government considers discussion agreements, which Australian shippers strongly oppose, do little to provide scheduled liner cargo shipping services to and from Australia. Discussion agreements pose significant anti-competitive risks as they facilitate collusion among carriers and their ability to influence freight rates acts to the detriment of Australian shippers"

## Port managers

Port managers will need to find a means to drive greater efficiency through their ports. In some cases this may involve more coordination, in other cases it will involve increased competition. A starting point might be the schemes developed for the Hunter Valley and Dalrymple Bay coal systems. While I understand that a relatively small number of users may have simplified the coordination task in those cases, what can be learnt so that a similar model could be applied to the nation's container ports?

The challenge is therefore to increase the efficiency with which transport and infrastructure services are delivered while avoiding agreements that are anti-competitive. Our experience shows us that this is possible. However, good advice is necessary and an early approach to the ACCC can assist to navigate the trade practices issues.

This challenge appears to be especially relevant to landside connection to stevedoring terminals.

It is incumbent on all those here today to rise to meet the challenges our newfound prosperity has presented us with. Our ports and related services will need to expand to meet growing demand, and new ways will have to be found to introduce more competition if we are to be competitive on a global scale.

Announcements such as the establishment of new container terminal facilities by Sydney Ports Corporation and the Port of Brisbane Corporation are positive signs that industry is stepping up to meet these challenges.

I am confident that industry, government and regulators will find ways to overcome obstacles as they arise. Because the continued future prosperity of our economy dictates that we must.

Thank you.



