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AUSTRALIAN COMPETITION & CONSUMER COMMISSION

POSITION PAPER ON PART X INVESTIGATION INTO THE ASIA – AUSTRALIA DISCUSSION AGREEMENT (AADA)

**RESPONSE SUBMITTED BY SHIPPING AUSTRALIA LIMITED ON BEHALF
OF, AND AUTHORISED BY, THE MEMBER LINES OF THE AADA**

APRIL 2004

The following serves as a response by the member lines of the AADA to the preliminary findings in the ACCC's Position Paper. The order of issues and numbering (shown in brackets) follows that used in the ACCC's Position Paper.

Commission initiated Part X investigation (1.2)

The circumstances that originally gave rise to the Commission initiating its investigation appear tenuous. To justify its decision on the strength of having received a limited number of complaints and without providing any explanation as to the measures it had advanced to avoid an investigation, such as ensuring all avenues available under Part X had firstly been exhausted, including the convening of formal negotiations between the IAA and AADA, is a particular area of concern. The absence of such background invites questions as to whether the ACCC came to instigate its investigation with an open mind or simply used any complaints as a ready excuse to pursue its well publicised quest of reigning in all perceived forms of cartel behaviour and ultimately, in the context of liner shipping, the repeal of Part X of the TPA.

The AADA would be interested to learn how the Commission reconciled itself with the fact that a around 80% of freight on imports from North & East Asia involve contracts entered into at place of origin and that there were NO formal complaints received from any shipper or shipper organisation in China, Hong Kong, Taiwan, Japan or Korea of unreasonable behaviour by the AADA members during nor since the reference period. Furthermore, it is considered significant only one of the four designated secondary bodies for the inward trades that are registered in Australia under the provisions of Part X saw a need to respond to the ACCC's issues paper. To seemingly dismiss such circumstances and form a preliminary view that there are grounds to disallow the AADA powers to collectively discuss freight rates and surcharges on the strength of complaints from an insignificant sample of the market appears extreme.

It is interesting to note how selective the Commission has been in using information it has been presented with by the AADA and of the use of quotations from various reference publications and reports. The use of opinions taken from the *Haralambides et al 2003, Final Report for the European Commission*, November 2003 is a good example. It would be easy to be mistaken in believing that Haralambides et al, who were commissioned by the European Commission itself to provide a paper on the Review of Council Regulation (EEC) 4056/86 of 22nd December 1986, advocate the abolition of the anti-trust regulations under which Liner Shipping Conferences operate in the EU. In fact, the European Commissions Consultant concluded:

- “The responses reflect a fairly even split between advocates of maintaining Regulation 4056 as it is, and advocates of changing or abolishing it”.
- “Apart from the ELAA (European Liner Affairs Association), very little market information was provided in response to the Consultation Paper”

In the absence of conclusive evidence, the European Commission has rightly elected to maintain an open verdict and will continue with its review until such time as it is completely satisfied with all of the facts of the matter. This contrasts alarmingly with the approach adopted by the ACCC, who in the absence of evidence, has chosen to apply the make believe world of the “counterfactual” scenario to invent reasons justifying the partial deregistration of the AADA.

Objectives of Part X (2.3)

Contrary to the Commission's opinion, the four objects prescribed in s.10.01(1) go further than purely stable rates and services. The four objects in their entirety are of equal importance and therefore the Commission should not consider the requirement for “liner cargo shipping services of adequate frequency and reliability at freight rates that are *internationally competitive*” a less significant criterion. Unfortunately, it is noted elsewhere in the Commission's position paper (4.5) that scant regard has been made of the relevance of directly comparing the level of AADA freight rates with those applied on other International trade lanes.

Furthermore, throughout the Commission's position paper there is inadequate recognition given to the requirement that, as part of the public benefit tests associated to Part X, services should be *economic and efficient*. In this connection, the Commission gives the impression that the AADA exists to provide a social service and that any economic benefit its member lines might be able to derive from membership of such an Agreement is deemed contrary to the public interest.

Views of Interested Parties (3)

Importers Association of Australia (IAA) (3.1)

The IAA's claim that “importers are finding it extremely difficult to negotiate with the AADA” is difficult to accept given that not once has the IAA nor individual importers sought formal negotiations with the AADA in relation to freight rate increases that applied during the reference period.

The Commission further suggests, “the IAA appear unable to negotiate the duration or the magnitude of the peak season surcharge (PSS) with the AADA”. The evidence upon which the Commission bases such a view is hard to comprehend and could only be considered credible if the AADA had refused to formally negotiate such arrangements in relation to eligible Australian contracts with the IAA, which it did not.

The Commission ventures to suggest that “probably of greater significance, however, is the lack of negotiation regarding the minimum service levels achieved by the IAA and AADA”. The AADA takes exception to the inference that it has been negligent or obstructive in relation to its responsibilities under Part X and challenges the Commission

and the IAA to provide details of any situation where the AADA has denied the IAA the ability to negotiate minimum service levels. It is worth noting that not once has the IAA approached the AADA in respect of the likely cargo demands of its members.

Regrettably, it appears the Commission approached its investigation in a manner that consistently accepted as fact the IAA's assertions and in so doing publicly besmirched the conduct of the AADA without due cause.

It is the view of the AADA that the complaints raised by the IAA merely represent a symptom of the frustration it experiences by the ineffectiveness of the limited scope of its operation under Part X. Indeed, there is good reason to suggest that the IAA has effectively become dysfunctional which is an outcome forecast by member lines when Part X was last amended to, inter alia, create the IAA's present role.

The AADA's submission to the Commission's Issues paper (pages 17-22) sets out the relevant laws of the other Countries involved in the trade lane in response to the request of the ACCC to try and understand the serious jurisdictional issues raised. The clear conclusion; in accordance with the advice of Professor James Crawford was that "ultimately the local regulation affecting outward liner shipping should be taken as paramount so as to avoid conflicts arising from overlapping jurisdictions". It is incredible that the Commission has omitted any reference to these problems in its preliminary report and they must be addressed in the final report!

Australian Peak Shippers Association (APSA) (3.2)

Since the ACCC's investigation concerns the behaviour of the AADA with whom APSA has no first hand experience, it is hoped the philosophical views APSA expressed in relation to Part X and discussion agreements in general, were ultimately treated without due relevance in the process of the Commission's deliberations of the conduct of the AADA.

Shippers (3.3)

AADA members take very seriously all of the concerns expressed by customers but believe such issues require to be put into perspective. During the reference period members were unquestionably faced with an unprecedented level of demand, which caused a number of pressure points across their services. Co-inciding as it did with the effects of the global phenomena of strengthening cargo demand, a dearth of suitable tonnage had developed causing charter rates to hit record highs, which in turn meant members experienced a situation where they simply did not have the ability to acquire or afford to acquire long term tonnage solutions that would have relieved demand pressures at that time. However, contrary to the Commission's view that AADA members conspired to not position additional or larger vessels, the facts of the matter are that

whenever the opportunity has arisen members have and still do, unilaterally, deploy vessels of larger capacity to help ease the extra-ordinary level of cargo demand.

Provision of specialised services (reefers) (4.1.6)

There is a flaw throughout the Commission's Position Paper concerning the scale of competition to the AADA. The Commission states that the AADA has 100% of the reefer market, this is not so. What the Commission fails to recognise is that apart from the existence of vessel operators on the North East Asia trades there also exists a variety of slot charter arrangements involving non-AADA lines who have access to reefer plugs and thus pose a competitive threat to the AADA in terms of pricing for both reefer and dry cargoes.

Whilst the Commission is not incorrect in stating that under the current excess demand scenario carriers are filling reefers with dry cargo, such a practice needs to be put into context. In reality, perhaps only one in ten reefers would be filled with dry cargo, which is partially attributable to the fact that dry cargo exporters do not wish their cargo loaded in such a container owing to the higher risk of damage and downtime associated with such equipment.

Description of Transshipment Liner services between North East Asia and Australia (4.1.7)

The caveats which the Commission listed against its estimates of the market structure of the capacities of liner trades into Fremantle seem to render such an estimate lacking in factual substance. Nevertheless, the Commission has still opted to establish a set of opinions, which the AADA finds wrong, in particular:

- Because the Commission did not receive details from the AADA concerning transshipment services via Singapore to Fremantle of P&O Nedlloyd, APL, ANL, OOCL, MISC, Zim, APL and RCL, it has simply concluded that such lines do not offer such services. However, such lines do in fact operate transshipment services but outside of the AADA. Therefore, since the AADA is not accountable for those services it does not consider it to be its responsibility to attempt to define the characteristics of same. Consequently, by removing this significant collection of operators from its assessment of competition, the AADA considers the opinions formulated by the Commission to be inherently flawed.
- To suggest transshipment services are unlikely to lift a significant amount of cargo that originates from North East Asia owing to the prohibitively long transit times is viewed as an over generalisation and completely overlooks the point that many imports are not time critical and therefore a reasonable number of shippers tend to

focus on the freight rate competitiveness of such alternative services rather than transit times.

Asia – Australia Discussion Agreement & Australia New Zealand Eastern Shipping Conference (4.1.8)

As mentioned under items 4.1.6. and 4.2 above, the Commission's assessment of the extent of competition to the AADA is considered flawed and may explain a number of ambiguous observations and conclusions reached by the Commission during the course of its investigation.

Freight Rates (4.5)

Despite the Commission's statement (page 19) that in its analysis of competition and the impact of the AADA, it had compared freight movements for imports from North East Asian ports with recent movements in international freight rates, little evidence can be found of this. As alluded to earlier, the AADA finds the Commission's lack of proper regard for the international competitiveness of its freight rates most disturbing. In its response to the Commission's Issues Paper the AADA provided a comparison of its rates with those applied in the Asia to USA and Asia to Europe trades in October 2000 and October 2003. Such data clearly demonstrated that the competitiveness of the freight rates Australian importers have been paying on goods from North East Asia has remained remarkably consistent, if not slightly improved, compared with freight rates paid by their American and European counterparts.

In addition to which and notwithstanding the Commission being dismissive of the significant benefit importers in Australia have gained from the appreciation of the Australian dollar during and after the reference period, there can surely be no doubting the fact that in real terms the affordability of freight rates changed by AADA members has placed Australian importers in a very favourable position in the context of international competitiveness.

The AADA wishes to re-iterate that by international standards the freight rates charged by its members are a fair price for services rendered and are affordable by importers in Australia.

Findings on Characteristics on the North East Asian Trade (5)

As mentioned previously, the Commission's assessment of competition to the AADA is considered inherently flawed and therefore requires to be treated with caution.

With regard to the observations listed by the Commission relating to competition on the trade, the AADA would comment that to suggest its members did not compete vigorously in respect of capacity, crucially ignores the inhibiting factors relative to the record price and availability of additional tonnage at the time. Perhaps the Commission might care to expand upon its findings in particular whether it holds the view that despite the unprofitability of existing services, AADA members should have committed to a programme of major capital investment without due regard for certain key economic requirements such as an expectation of a reasonable return on such investment, which the market dynamics at that time could not support not least because of the prevailing level of round voyage freight rates.

Does the AADA Agreement Include a Provision that has the purpose of Effect of substantially lessening Competition? (6.3)

The Commission neglects to adequately highlight that the scope of the IAA's influence under Part X is restricted to matters effecting eligible Australia contracts. Because of this, many of the IAA's complaints have not been properly put into context.

Did the Parties to the AADA engage in conduct that gave effect to the anti-competitive provisions of the Agreement – Observations from the trade (6.4.1)

Although the AADA has emphasised the point that *consortia and/or individual lines independently determine their own capacities and schedules* and thus effectively compete using both service and price differentials, the Commission has chosen to down play such a statement and instead elected to conclude, based on *prima facie* evidence, that the AADA has had the effect of reducing competition from six competitors to one all powerful organisation controlling 93% of the trade. The Commission not only over states the AADA's trade share but implies that the AADA members have conspired to restrict capacity and apparently agreed not to deviate from the application of the full amount of increases announced. Both assertions are utterly false and once more the Commission fails to afford adequate weight to the reality surrounding the unavailability of additional (affordable) tonnage and that no barriers existed preventing other carriers from entering the trade during the reference period. As such the AADA disputes the Commission's claim that it had been successful in deliberately lessening competition.

Capacity differential (6.4.2)

The Commission suggests that it is "likely" some of the six separate consortia/carriers would have responded to increased cargo demand by increasing capacity more quickly without the presence of the AADA. The Commission believes the AADA "may" have distorted its member's incentives to invest in additional capacity and furthermore

contends that under the AADA, each consortia/carrier “chose not to invest in significant additional capacity”.

The AADA notes each of these allegations are based on supposition and that the Commission has opted to dismiss the reality that the various consortia/carriers separately, *not collectively*, considered matters pertaining to the provision of additional capacity. The AADA is adamant that had the means been available the consortia/carriers would have independently acted to capture the first mover advantage. Indeed, there exists evidence of this. For example, during the period November '03 to January '04, an opportunity arose whereby an AADA member found the means to deploy two larger capacity vessels (4000teu vessels instead of its usual 2500teu size) for five round voyages. Since then more than one member has positioned extra sailings to augment their standard services. Such actions were undertaken in an entirely unilateral manner.

It is interesting to observe that the Commission almost begrudgingly notes, “even in the absence of the AADA there is *some* chance that the six consortia/carriers may have opted not to increase supply to meet surging demand”.

Despite the admission that its findings are not conclusive, the Commission has nevertheless elected to judge the AADA guilty of constraining capacity. In such circumstances, it might have been reasonable to expect an open verdict would have been found, unless a bias existed in the conduct of the Commission’s deliberations.

Differences in the levels of freight rates (6.4.3)

As discussed above, it is considered unjust that in the absence of sufficient facts the Commission has adopted various definitive opinions based purely upon conjecture.

Differences in the speed of freight rate increase (6.4.4)

There exists a fundamental flaw in the Commission’s assessment of what the counterfactual scenario would have represented. What the Commission has importantly failed to appreciate is that a world without the AADA would not have simply comprised six consortia, which significantly have no ability to discuss pricing, but also would have included the existence of the Australia New Zealand Eastern Shipping Conference (ANZESC). The presence of ANZESC whose member number nearly half of that of the AADA, and who are able under its agreement to agree on pricing, would have commanded a significant influence in the market place. Furthermore, since the majority of consortia comprise ANZESC and non-ANZESC members, it is not unreasonable to suggest that under the counterfactual the extent and speed to which supply and demand factors would have become commonly known would not have been too dis-similar to that of the factual.

The Commission's failure to give due regard to the existence of ANZESC in the counterfactual renders its findings inherently flawed.

The Commission suggests that the existence of the AADA may have contributed to the successful implementation of the US\$200 PSS. What the Commission fails to give credence to is the fact that the PSS was originally introduced not as a result of a decision taken by the AADA but rather as an independent action by one carrier which other carriers subsequently elected to follow. Thus it can be argued that such a charge would have been successfully introduced regardless of the existence of the AADA.

The comment by the Commission that "based on information supplied by shipping lines indicate that profits on the trade are verging on unusually high levels" provides a false impression. The AADA provided the Commission an extensive set of cost and revenue information, which essentially showed that over for the past 5 years members would have achieved a negative rate of return on sales. Whilst the extent of lines losses might have improved over that reference period, the Commission's remark that lines are on the verge of making *unusually high* profits is misleading and should have more appropriately read *that for the first time in 5 years lines are possibly on the verge a making a marginal profit*.

Such circumstances further show that the AADA has not created an anti-competitive environment where excessive profits are being achieved. Indeed, the reality is that during and prior to the reference period, lines failed to even derive a return on their investments, which is a situation notably absent from the Commission's preliminary position paper.

Service standards (6.4.5)

Since the Commission's finding that shippers suffered some anti-competitive detriment in relation to service standards as a result of the AADA was directly determined from its flawed counterfactual, the AADA suggests such finding should be ignored in the interest of preserving some objectivity in the Commission's position paper.

Findings on the anti-competitive detriment (6.5)

Did the conduct of the parties to the AADA result in a public benefit that outweighs the detriment resulting from a substantial lessening of competition (6.6)

In addition to the comments expressed in its earlier submissions, the AADA would observe that the Commission has under estimated the public benefit that would have flowed from its conduct during the reference period. In particular, the Commission appears to have omitted the significance of the AADA's attempt to restore freight rates to viable levels in the context of contributing towards an improvement in the viability of members existing services which in turn enhances their ability to contemplate the considerable investments necessary to expand current services to meet the *continuing*

growth in the requirements of importers. Should AADA members not have adopted such conduct there is strong evidence to suggest the continuation, let alone the expansion, of existing services would have been brought into question, much to the detriment of the public benefit.

Conclusions on Public Benefits and Anti-competitive Detriment (6.7)

For reasons mentioned above, the AADA believes the Commission has not properly taken into account all issues associated with the public benefit test and urges the Commission to adopt a broader view before readily finding against the AADA.

Exceptional Circumstances (7)

Did the AADA provide its members a substantial degree of market power? (7.1) and Did the AADA facilitate a situation of tight supply(7.1.1)

In arriving at the conclusion that the AADA provided its members with a substantial degree of market power over the reference period, the Commissions erroneously claims that in 2002-03:

- The AADA capacity share was 94% - *This fails to recognise the capacity that members chartered to non-AADA members.*
- The AADA comprised 16 of the 17 shipping lines operating in the trade – *This overlooks the shipping lines that slot charter space from AADA members.*
- Slow responsiveness of capacity supply was the fault of the AADA who acted to delay its members investing in additional capacity. *This suggests a form of premeditated action by the AADA whereas all matters relating to capacity provision are strictly the preserve of individual consortia/carriers, the effect of which would have been little different under the counterfactual allowing for the existence of ANZESC.*
- The AADA blunted competition that would have otherwise occurred between parties to the AADA, causing rate increases to be faster and rate levels to be higher. *This is based on a counterfactual absent of the significant influence that would have been associated with the operation of ANZESC.*

Reasonableness of increases in freight Rates (7.2)

The Commission has approached this issue solely from an importers point of view. It would not seem unreasonable to have expected some consideration to have been given to the shipping lines perspective. In light of this, the AADA would comment that although the Commission acknowledges that the availability of suitable additional or replacement tonnage to cater for the booming trade from East Asia became very scarce during the reference period, which caused charter rates to reach record high's, it appears the Commission deems lines efforts to place themselves in a position where they could actually afford to undertake such major investments was unreasonable. This is particularly relevant given the financial data provided to the Commission which demonstrated that AADA members were still incurring loses on round voyages completed during the October '02/September '03 period.

Whilst the Commission has elected to treat as irrelevant the advantageous effect the appreciation of the Australian dollar has had on the cost of imports, the AADA maintains that shipper's ability to afford to help place member lines in a position to invest in additional tonnage has undeniably improved during the reference period. The AADA assumes the Commission does not hold with the view that the member lines should be responsible for subsidising imports from North and East Asia.

Movements in average freight rates for other Australian liner trades (7.2.1)

The AADA questions the relevance of such a comparison given that the dynamics of the different Australian liner trades are quite distinct. The AADA considers a more meaningful comparison would have been of rates on other trade routes out of Asia to determine whether the AADA's rates remained internationally competitive. The AADA's submission to the ACCC's Issues Paper confirms this to be the case.

Potential public benefits of discussion agreements and other types of registered agreements (7.3.1)

The Commission regards as negligible any public benefit that may have arisen through the AADA's role in resolving any problems inherent in providing liner shipping capacity. Disturbingly, such conclusion is formed simply on the strength of the Commission not having been presented with arguments based on economic theory linking the existence of the AADA to resolution of such problems. For the Commission to summarily reach such a conclusion without having actually asked to be provided with an economic theory is considered totally unreasonable.

In view of this, the AADA will be conveying to the Commission a copy of the analysis of "Economics of Liner Shipping Conferences" prepared by Meyrick & Associates Pty Ltd, which was submitted to the Productivity Commission Inquiry into International Liner Cargo Shipping (A review of Part X of the Trade Practices Act).

The Commission's Assessment (8.2)

As mentioned earlier, the Commission's hypothetical counterfactual scenario is significantly unrealistic since no adequate allowance has been attributed to the certain existence of ANZESC whose members notably accounted for 42% of the container throughput from North East Asia to East Coast Australia during the period October '02 to September '03. Whilst ANZESC's current operation focuses upon the Japan and Korea trades, there is every reason to assume that in the absence of the AADA its members would have maintained their previous practise of jointly discussing pricing as well as supply and demand factors for the East Asia markets.

In light of this omission, the AADA considers all findings reached by the Commission that involve the use of the counterfactual scenario should be treated as invalid.

Exceptional Circumstances (8.3)

Assessment of the longer terms net public benefit of the AADA (8.3.4)

As discussed above (7.3.1), for the Commission to conclude the AADA should be regarded as having little public benefit in the context of resolving problems inherent in the provision of capacity supply, because it had not received any economic theory linking the AADA with the resolution of such problems, is considered grossly unreasonable.

The Commission's Position (9)

For the various reasons outlined above, the AADA believes the Commission's determination of its conduct to be factually deficient and theoretically unsound especially in the context of the counterfactual scenario. As such the AADA would urge the Commission to review its conclusions in a manner that embraces the boarder environment where the VAST MAJORITY of freight payers in the trade from North East Asia have not found any reason to formally complain about its conduct, either during or since the reference period, and also to give due recognition to the fact that for AADA member lines to gear up for the rapid growth in importers demands for goods from East Asia there must exist an expectation of a reasonable return on such investment.