Australian
Competition &
Consumer
Commission

Part X Investigation

Asia-Australia Discussion Agreement
for
Australian Southbound Liner Trades from North East Asia

Position Paper

April 2004

Key Messages

- The Australian Competition and Consumer Commission (the 'Commission') may advise the Federal Government to revoke the protection which exempts a group of cargo shipping lines from the price fixing provisions of the *Trade Practices Act* 1974 ("the TPA").
- The Commission's preliminary view is that there are grounds for such a course of action in relation to the members of the Asia-Australia Discussion Agreement (AADA).
- The Commission has arrived at this view following an investigation into the conduct of members of the AADA, a registered agreement under Part X of the TPA. The investigation was prompted by allegations from Australian importers of *unreasonable* increases with respect to the speed and magnitude of freight rates for cargo being shipped from North East Asia to Australia.
- The rates implemented by the members of AADA in July, August and October 2003, increased the cost of shipping containers by approximately 100 per cent over market rates that existed in June. The price increases observed in 2003 appear to have resulted in sudden and significant cost increases for Australian businesses importing goods from China, Hong Kong and Taiwan.
- Part X of the TPA allows international shipping cargo operators a special exemption from several laws that prohibit anti-competitive conduct. In principle, the exemption allows the shipping lines to discuss freight rates, capacity levels and scheduling.
- The exemption is granted as the public benefits in terms of improved efficiency of shipping services, scheduling and certainty of services are generally considered to outweigh any anti-competitive detriment. However, the Commission has a responsibility to investigate situations where the exemption may have been used to unreasonably raise freight rates.
- The Commission's analysis indicates the AADA used its exemption to substantially lessen competition on the North East Asia to Australia trade. Despite burgeoning demand for exports from China and a global scarcity of cargo vessels, the Commission considers the shipping lines would have been more likely to have increased their vessel capacity in a more competitive market. Restricting capacity and agreeing to freight rates increases is likely to have increased rates faster than would otherwise have been the case, absent the AADA.
- The Commission's preliminary view is that the anti-competitive detriment associated with AADA's price increases outweighed any public benefit provided by the AADA's exemption from price fixing prohibitions during the period investigated. It therefore appears that grounds exist to revoke the AADA's exemption from the price fixing provisions of the TPA.
- Comments on the Commission's Position Paper are now invited.

Abbreviations

AAA	Australia – Asia Alliance Container Consortium
AADA	Asia – Australia Discussion Agreement
AAX	Australia Asia Express Container Consortium
ABS	Australia Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACE	Australia China Express Container Consortium
AFIF	Australia Federation of International Forwarders
ANLCL	Australia National Container Line
ANSCON	Australia Northbound Shipping Conference
ANZESC	Australia New Zealand Eastern Shipping Conference
APL	American Presidents Line
APSA	Australian Peak Shippers Association
ASA	Australia South Asia Container Consortium
BTRE	Bureau of Transport and Regional Economics
CCIWA	Chamber of Commerce and Industry of Western Australia
CI	Containerisation International
COSCO	China Overseas Shipping Company
CSCL	China Shipping Container Line
DOTARS	Department of Transport and Regional Services
DWT	Dead weight tonnage
EANZC	Europe Australia and New Zealand Conference
ESC	European Shippers Council
EU	European Union

FBIA	Food and Beverage Importers Association
FESCO	Far Eastern Shipping Company
FEU	Forty foot equivalent unit
FOB	Free on Board
GHA	Gifts and Homewares Australia
HMM	Hyundai Merchant Marine
IAA	Importers Association of Australia
K Line	Kawasaki Kisen Kaisha
LLDCN	Lloyd’s List Daily Commercial News
LT	Lloyd Triestino
MISC	Malaysia International Shipping Company
MLS	Minimum Levels of Service
MOL	Mitsui OSK Line
MSC	Mediterranean Shipping Company
MSL	Mearsk Sealand
NAX	North Asia Express Container Consortium
NEA	North East Asia
NEAX	North East Asia Express Container Consortium
NYK	Nippon Yusen Kaisha
OECD	Organisation for Economic Cooperation and Development
OOCL	Overseas Orient Container Line
OSRA	Overseas Shipping Reform Act (US)
PAS	Project Asia Service
PC	Productivity Commission
Pers. Comm.	Personal communication

PIL	Pacific International Line
PRC	Peoples Republic of China
PSS	Peak Season Surcharge
RCL	Regional Container Line
SAL	Shipping Australia Limited
SEATFA	South East Asia / South Asia – Australia Trade Facilitation Agreement
SLC	Substantial Lessening of Competition
TEU	Twenty foot equivalent unit
TFA	North East Asia Trade Facilitation Agreement
THC	Terminal Handling Charges
TPA	Trade Practices Act
TSA	Transpacific Stabilisation Agreement
VSA	Vessel Sharing Agreement
WTO	World Trade Organisation
WW	Wallenius Wilhelmsen

Glossary of Terms

Asia Australia Discussion Agreement (AADA) - a registered discussion agreement under Part X of the TPA 1974. Parties to this agreement limited exemptions to engage in conduct that would otherwise breach sections 45 and 47 of the TPA. It is a non-binding agreement in the sense that its parties are not bound by decisions made collectively.

Australian Federation of International Forwarders - a designated secondary body under Part X representing freight forwarders for both northbound and southbound liner trades. It can (but does not) negotiate collectively on behalf of freight forwarders freight rates with the shipping line parties to registered agreements.

Australian Peak Shippers Association (APSA) - designated peak shipper body for exporters registered under Part X of the TPA *1974*. Its role is to negotiate on behalf of exporters with the shipping line parties to agreements, the level of terminal handling charges, and general tariffs covering contracts negotiated in Australia and minimum service levels for northbound trades that the parties are obligated to provide.

Break-bulk - non containerised cargo, that is usually of peculiar mass or shape and difficult to pack in containers.

Cartel – An association of competitors that, by agreement, limits the degree of competition of competition that would otherwise prevail in the buying and selling of goods and services by members of the cartel.

Carrier – Shipping line.

Consortium - A joint venture by members of a registered conference agreement signifying a higher degree of cooperation in service agreements such as the sharing of vessels under a shipping pool.

Dead weight tonnage (DWT) – the container capacity of a vessel measured by tonnage when fully loaded.

Designated peak shipper body - An association designated by the Minister for Transport and Regional Services representing the interests of Australian shippers generally for the purposes of negotiations under Part X of the TPA 1974.

Designated secondary shipper body - An association, designated by the Minister for the purpose of negotiations under Part X representing the interests of all or any of the following:

Australian shippers in a particular trade;
Australian shippers of particular types of goods;
Shippers in a particular region in Australia;
Producers of goods of a kind exported, or proposed to be exported, from Australia.

Discussion Agreement - An agreement between conference and non-conference lines to reach a non binding consensus over, for example the charging of common freight rates and a variety of service arrangements.

Forty Foot Equivalent Unit (FEU) - the standard measurement of a 40 foot by 8 foot by 8 foot container.

Freight Rate – Defined for the purposes of this investigation as the 'base' blue water freight rate. The charge for shipping cargoes from one port to another. For the purposes of the Trade Practices Act it is defined as including base freight rates, all 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. There are two such peak shipper organisations: the Australian Peak Shippers Association representing exporters and the Importers Association of Australia representing importers. It is usually only small shippers that have no ability to negotiate freight rates with lines that pay the General Tariff rates.

Importers Association of Australia (IAA) - a designated peak shipper body for importers registered under Part X of the TPA. Its role is to negotiate on behalf of importers with the shipping line parties to agreements the level of terminal handling charges, general tariffs covering contracts negotiated in Australia and minimum service levels for southbound trades that the parties are obligated to provide.

Load Factor- A term for the capacity utilisation of a vessel measured in terms of full containers divided by number of slots.

Liner Service - A scheduled service on a particular trade route.

Loop - A service rotation by a liner 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. For import trades, it is subject to negotiation between the designated peak shipper body, the IAA and the AADA.

Northbound – liner services that carry Australian exports from Australian ports to those located overseas.

Part X- the part of the Trade Practices Act 1974 which grants liner shipping companies limited exemptions for potential breaches of sections 45 and 47 of the TPA.

Peak Season Surcharge (PSS) - a temporary surcharge imposed by lines in periods of seasonally high demand.

Rate Restoration Program - the process of raising average freight rates in the market back to the level of the General Tariff.

Relay – Transhipment Liner operator

Roll On Roll Off (Ro Ro) - liner service for vehicular trades.

Reefer- Refrigerated container

Shipping Australia Limited – secretariat representing the shipping line parties to various registered agreements on Australia's liner trades.

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.

Southbound – liner services originating in overseas ports that are destined for Australia and carry Australian imports.

Terminal Handling Charge (THC) - the recovery surcharge imposed by the lines for container stevedoring costs. In general it represents about 80 per cent of stevedoring charges.

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

EXECUTIVE SUMMARY

E1. Background and Introduction

The Commission commenced its Part X investigation into the market conduct of the parties to the Asia-Australia Discussion Agreement (AADA) in October 2003. The AADA is a registered agreement amongst 16 shipping lines[1] that participate in the North East Asia – Australia southbound (import) liner trades. Under Part X of the Trade Practices Act *1974* (TPA), the parties to the registered agreement have limited exemptions from sections 45 and 47[2] of the TPA *1974* and are legally allowed to discuss collective rate making.

The impetus for the Commission's investigation was a number of individual complaints from importers and freight forwarders, beginning in May 2003. These concerned a series of coordinated freight rate increases that were announced and subsequently implemented by the parties to the AADA. The Commission also received complaints from various industry bodies including the peak designated importer shipper body, the Importers Association of Australia (IAA).

The magnitude of the announced freight rate increases was significant and suddenly applied with little notice given to importers. In addition the carriers announced a Peak Season Surcharge for the high demand season from August 2003 to February 2004. Furthermore, the AADA has continued to announce further freight rate increases to be implemented later in 2004. Table E1.1 shows the timing and the scale of the announced freight rate increases.

Table E1.1: Announced freight rate increases and application of peak season surcharges by the AADA

1 July 2003	1 August 2003	1 October 2003	1 January 2004	1 April 2004	3rd Quarter 2004	4th Quarter 2004
$US500 per TEU[3]	$US200 per TEU	$US250 per TEU	$US300 per TEU (Korea only)	$US250 per TEU	**To be announced**	**To be announced**
$1000 per FEU	$US400 per FEU	$US500 per FEU	$US600 per FEU (Korea only)	$US500 per FEU		
Increase in base freight rates	Peak season surcharge till 1 February 2004	Increase in base freight rates	Increase in base freight rates	Increase in base freight rates		

Source: Lloyds List Daily Commercial News various issues

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[1] There are 16 parties to the AADA, however, two shipping lines, Evergreen Marine and Hanjin Line are non participant parties to the AADA.
[2] With the exceptions of 47 (6) and 47 (7) relating to third line forcing.
[3] TEU – Twenty foot equivalent unit, the standard size of a 20 foot by 8 foot by 8 foot container
FEU – Forty foot equivalent unit, the standard size of a 40 foot by 8 foot by 8 foot container.

The cumulative increases in announced freight rates over the period 1 July 2003 to 1 October 2003 total $US750 per TEU and $US1500 per FEU as well as the additional imposition of a $US200 per TEU ($US400 per FEU) Peak Season Surcharge. According to industry sources, the announced freight rate increases have succeeded in raising average freight rates paid by shippers in the trade. For example, in its submission, the IAA states that freight rates increased from between $US500 to $US700 per TEU to between $US1300 and $US1450 per TEU from September 2003 to December 2003. This is a rise of over 100 per cent in little over three months. Many other importers made similar claims, providing examples of increases in freight rates of over 100 per cent.

The steps taken by the Commission in this investigation to date include the release of an issues paper and a questionnaire addressed to the carrier members of the AADA and their one East Coast (of Australia) competitor Project Asia Service in November 2003. Most of the responses to the Issues paper were received by the Commission during December 2003, while that from the AADA was received on early January 2004. In total, the Commission received 13 submissions from interested parties.

This position paper represents the preliminary view of the Commission about the recent market conduct of the parties to the AADA, and its assessment of the anti-competitive detriment and public benefit attributed to the AADA.

E1.1 Criteria by which the AADA market conduct is assessed.

The Commission has conducted this investigation in terms of the criteria contained in section 10.45 (1) a) viii) of the TPA *1974.*

The criteria are as follows:

a. 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

b. the parties to the agreement have engaged in conduct, or propose to engage in conduct, to give effect to or apply the provision; and

c. 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:

   i) has resulted, or is likely to result, from the conduct; or
   ii) would result, or be likely to result, if the proposed conduct were engaged in; and

d. there are exceptional circumstances that warrant the giving of a direction under subsection 10.44 (1).

Guidance as to the meaning of "exceptional circumstances" is provided in the Minister's second reading speech upon the introduction of the Trade Practices Amendment (Liner Cargo Shipping Bill 2000) into Parliament. Relevantly, the Minister indicated that 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.

Subsection 10.44 (1) outlines the options for the Australian Government Minister for Transport to respond to a recommendation from the Commission.

This position paper makes the preliminary finding that all of the criteria are satisfied and would justify making a recommendation to the Minister. Such a recommendation would involve the registration of the collective price setting powers of the AADA under article 4 of the Asia – Australia Discussion Agreement being cancelled pursuant to subsection 10.44 (1) (b) of the TPA *1974*. The justification for this remedial approach is presented in section E4.

In its assessment of exceptional circumstances, the Commission has assessed the balance of anti-competitive detriment and the public benefit to shippers flowing from the agreement. In this investigation, the Commission has reached the preliminary conclusion that a causal connection between the role and actions of the AADA and alleged public benefits that flow from conference agreements has not been established. This issue is further discussed at E1.2.3 and E1.2.4.

E1.2 The Assessment of the Commission against the Criteria.

This section summarises the assessment of the Commission on the basis of the statutory criteria. In all cases it finds that the criteria are on balance satisfied.

a. **the agreement includes a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition (SLC) (within the meaning of section 45);**

The Commission has found that the AADA includes a provision which had the effect of allowing the parties to substantially lessen competition on the southbound North East Asia – Australia liner trade.

Article 4 of the AADA allows the parties to the Agreement to meet or otherwise discuss their rates, capacity, scheduling and rules in the trade and to reach, on a voluntary and non-binding basis, a consensus thereon. The authority of the parties includes, but is not limited to, consideration, discussion, exchange of information and consensus on all aspects of transportation and service in the trade.[4] The appropriate test of substantially lessening competition is that employed under section 45 of the TPA. Section 45 prohibits a corporation from:

> Making a contract or arrangement, or arriving at an understanding if a provision of that contract, arrangement or understanding that has the purpose, or would be likely to have the effect of substantially lessening competition.

To assess this, the position paper adopts the methodology of comparing a counterfactual scenario (a southbound liner trade with no AADA operating) with that of the factual scenario for a *reference period*. The *reference period* is defined as April 2003 to February 2004. This position paper assesses the likely differences in the conduct of market participants in the trade (North East Asia to the East Coast of Australia) in both scenarios. The market structure of the counterfactual consists of five consortia (NAX, ACE, NEAX, FESCO, MSC/MSL)[5] and one independent carrier COSCO. Four of the consortia and COSCO are of roughly equal capacity[6] size and share (each between 14 and 21 per cent), while FESCO's capacity share is smaller at 7 per cent. By contrast, PAS (the only line not party to the AADA), has a capacity share of less than 2 per cent.[7]

The market structure of the factual scenario consists of the same underlying market structure, albeit with the five consortia and one independent carrier, COSCO, having the ability to discuss rates under the aegis of the AADA. The only carrier offering competition to the member lines of the AADA in the direct liner trade southbound from North East Asia to the East Coast Australian ports is PAS.

As is the case with the factual scenario during the *reference period* it is assumed that there would have been no new entry by a carrier into the southbound liner trade under the counterfactual scenario.

The differences in terms of market conduct between the two scenarios stems from greater impetus for the carriers under the counterfactual scenario to compete during the *reference period*. This competition takes the form of both price competition and quantity competition, the latter being defined as the introduction of additional and / or larger vessels into the liner trade by the incumbent consortia. Given the significant increases in import demand that has been experienced in this southbound liner trade,[8]

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[4] Excerpt from Asia- Australia Discussion Agreement article 4 (Agreement Authority) December 2002 p 1.

[5] NAX consists of Evergreen Marine, Hanjin Line and ANLCL
NEAX consists of K Line, NYK, MOL, P&O Swires Containers
ACE consists of China Shipping Company and OOCL
MSC/MSL consists of MSC and Maersk Sealand
FESCO consists of FESCO, HMM and Columbus Line

[6] At between 90 to 100 per cent average vessel utilization at present, the capacity shares are roughly equivalent to market shares.

[7] Theoretical capacity shares of the direct southbound liner trades from North East Asia are PAS – 1.9 per cent, FESCO – 7.2 per cent, COSCO – 13.7 per cent, NAX – 17.5 per cent, NEAX – 19.1 per cent, ACE – 19.9 per cent and MSC/MSL – 20.8 per cent. This places the combined capacity share of the AADA at 98.1 per cent.

[8] In terms of number of containers (TEUS), the number of imported full containers from East Asia that entered Australia's three largest ports increased by 52 per cent in 2002/03.

the price competition that would arise in this counterfactual scenario between the five consortia and COSCO is as follows:

- there would have been greater competitive impetus due to the fact that there are six rivals in the market instead of six potential rivals discussing rate increases in common;

- there would be some short term uncertainty in terms of the carriers understanding about whether their vessel utilisation is improving due to a general demand boom or due to the level of its comparative freight rates against those of other carriers;

- this would be enhanced due to greater uncertainty about each others' price setting intentions and mutual knowledge of each others' load factors in the absence of the AADA setting focal-point price rises;

- however, once it became general knowledge amongst the participants in the trade that they are all facing a demand boom, then freight rates will tend to rise generally in any case. This is due to two factors. Firstly, shippers would search for relatively cheap deals, due to low customer switching costs and drive up relatively low freight rates. Secondly, once the carriers realise that each others' load factors are above 90 per cent, then there is no longer any fear of losing customers to each other.[9]

- consequently, in the absence of the AADA, freight rates could have risen to similar levels, albeit not as quickly due to greater initial uncertainty. (The Commission has, however, noted that, in the presence of strong demand and in the absence of the AADA, capacity supplied to the trade may have been higher which could have affected absolute freight rate levels.)

The Commission considers that in the absence of the AADA, the individual consortia would have been more likely to have invested in larger, if not additional, vessels to improve their market share in a southbound liner market characterised by excess demand. The reasons for this are outlined as follows:

- although the shipping lines can react reasonably quickly to each others decisions to bring in new vessels, there is a first mover advantage in terms of establishing a customer base among shippers who cannot obtain liner services and also the first mover may obtain lower charter costs than later movers. There may also be an advantage in being the first to procure, increasingly difficult to obtain charter vessels. Charter costs are increasing due to the 'boom' conditions on several trade lanes connecting China with the rest of the world;

- even though formal decision-making about new investment is in the hands of the individual consortia, the market information provided by the AADA as

[9] A carrier that cut its rates would lose revenue because it could not service the shippers it could attract in any case because its vessels are close to full.

well as its purported aim of collectively raising rates will temper inclinations by lines to break ranks on new investment, in the short term;

- despite falling freight rates on the northbound leg of the liner trade the Commission considers that the carriers are currently profitable in provision of their liner services, taking into account both directions; and

- anecdotal evidence points to new entrants, (Hapag Lloyd, APL and PIL) along with incumbents (Zim Line, Evergreen Marine and Hanjin Line) being the first to announce the introduction of a substantial amount of new capacity to the trade. While it is recognised that carriers have different priorities in adding vessels to liner trades in response to relative profit signals, there is a strong coincidence that none of the AADA lines introduced significant capacity[10] into the trade in response to excess demand in the *reference period*.

The greater proclivity of the consortia in the absence of the AADA to compete on freight rates until they realise that they are in a market where demand is booming would have tempered freight rate increases and led to greater price dispersion in the short run. The greater proclivity of the consortia, in the absence of the AADA, to obtain a first mover advantage over their rivals and improve market share in a period of excess demand and tight world supply of vessels would have tempered the longer term increases in freight rates. In addition, it would also address the issues of deteriorating service standards, which have led to delays, and cost impositions upon shippers.

b. the parties to the agreement have engaged in conduct, or propose to engage in conduct, to give effect to or apply the provision; and

The Commission has concluded that the parties to the AADA have engaged in conduct to give effect to the provision contained in Article 4 of the AADA agreement.

The parties to the AADA coordinated a collective increase in southbound base liner freight rates of $US500 per TEU ($US1,000 per FEU) on 1 July 2003 and a collective increase of $US250 per TEU ($US500 per FEU) on 1 October 2003. In addition they introduced a collective Peak Season Surcharge of $US200 per TEU ($US500 per FEU) over the period 1 August 2003 to 1 February 2004. As such, they have given effect to the provision contained in article 4 of the AADA agreement.

c. 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:

i) has resulted, or is likely to result, from the conduct; or
ii) would result, or be likely to result, if the proposed conduct were engaged in; and

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[10] China Shipping Company replaced two smaller vessels with two larger vessels in November 2003. LLDCN (2003), Time right for more tonnage say shippers, Thursday December 12 2003 p 12

The position paper concludes that there was no net public benefit accruing from the role or actions of the AADA over the *reference period*. In a period of excess demand there are no apparent "market failure" problems concerning supply capacity to the trade that an anti-competitive agreement could, in theory, be expected to address. In addition, freight rates would not be considered stable, as they were being driven higher by high demand. The AADA would have the likely effect of forcing those rates higher than would have been the case in the absence of the AADA. Finally, services are inadequate to the task as there is not enough supply response from the members of the AADA to this period of excess demand.

The implicit competitive detriment that flows from the conduct of the parties to the AADA is that which flowed from the provision (article 4) of the agreement which the carriers have acted upon. This position paper finds that in the counterfactual world there would have been greater proclivity by the individual consortia to compete on price and offer greater discounts in the short term. In the longer term, there would have been greater proclivity by some consortia to introduce additional or larger vessels or both to improve their share of the southbound trade from North East Asia. The market conduct of announcing collective freight rate increases has eliminated most price dispersion previously available in the market and appears to have eliminated any price competition in the short run. It has also signalled to the carrier members that, for the short term at least, it is more profitable not to break ranks and invest in additional shipping capacity for this liner trade. This has resulted in higher freight rates and greater shipper inconvenience in terms of delays and lack of service than would have been the case without the AADA.

However, the position paper acknowledges that the period of excess demand has certainly strengthened the AADA member lines inclination to adhere to AADA decisions. In a period of excess supply it is unlikely that the AADA would have achieved similar levels of rate increases.

Thus the Commission regards that the competitive detriment that flows from the market conduct of the AADA during the *reference period*, that is by collectively increasing freight rates by substantial amounts, outweighs the public benefits that flow from the same market conduct.

d. There are exceptional circumstances that warrant the giving of a direction under subsection 10.44 1)

This position paper finds that in times of excess demand, such as during the *reference period*, the AADA possesses substantial market power. This is demonstrated by its ability to sustain a significant freight rate increase in the trade. Also, the AADA comprises a significant proportion of both the shipping lines and the liner capacity supplied to the direct southbound liner trades from NEA.[11]

The only competition afforded the AADA on the direct trade to Australian East Coast ports is from the breakbulk operator PAS which is not dedicated to the container

[11] Between 94 (excluding Hanjin Line and Evergreen Marine) and 98 per cent (including Hanjin Line and Evergreen Marine). AADA represent 16 out of 17 shipping lines (including Evergreen Marine and Hanjin Line) or 14 out of 17 lines (excluding Evergreen Marine and Hanjin Line).

trade, has much slower transit times from some East Asian ports, and lower frequency than the AADA carriers.[12]

There are potentially four[13] carriers which can offer transhipment services via the Port of Singapore to the East Coast ports of Australia from NEA. The services that these offer are slower due to the longer distances via the Port of Singapore and the waiting time in Singapore. The estimated market share of the entire import trade from NEA of the transhipment operators is about 15 per cent, compared to that of the AADA at 84 per cent.[14]

There is more competition offered by non-AADA lines for import cargoes bound for Western Australia. For imports sourced from NEA to Fremantle, the market share of the AADA lines is estimated at 47 per cent, while that for the other non-AADA lines are estimated at 53 per cent.

Whilst the position paper finds that there are no regulatory barriers to entry and in the Commission's estimation the southbound liner trades from North East Asia appear to be contestable, the Commission notes that there has been no new entry into this liner trade by vessel providers[15] since 1999. On the other hand, since 1999 a significant number of slot sharers and by vessel providers have left the trade.[16]

In the period May 2003 to December 2003, there were no announcements of new entry into the southbound liner trades from North East Asia, and the AADA submitted that it regarded the prospect of new entry as unlikely. Thus it appears that neither prospective nor actual new entry constrained the AADA from raising rates in the latter half of 2003. On the other hand, it appears that the rate rises eventually provoked new entry, with very recent announcements of two new services from NEA collectively employing up to ten additional vessels.[17]

In summary, the AADA carriers possess market power in periods when there is excess demand. They have succeeded in raising market freight rates by over 100 per cent in a relatively short period during 2003, and these rates have not subsequently fallen. There is limited competition offered by a very small fringe competitor (PAS) in the direct liner trades and there is some competition offered by transhipment operators via the Port of Singapore. These services to the East Coast of Australia are slower because of the longer distances involved as well as the waiting time at the Port of

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[12] The AADA carriers have a fixed day weekly service, whereas PAS has a once a 17-18 day service (not fixed).

[13] There are only four potential transhipment operators to the East Coast of Australia these are MISC, PIL, RCL and APL. It is only known for sure that PIL and APL tranship via Singapore from North East Asia to Australia.

[14] The market share of the AADA excluding Hanjin / EM is 72 per cent and 84 per cent including Hanjin / EM (estimate), in terms of full containers lifted from North East Asia to East Coast ports from October 2002 to September 2003. The market share of PAS is 0.5 per cent.

[15] There has been entry by slot share partners Columbus line, APL, and HMM.

[16] Since 1999, slot sharers Cho Yang, Yang Ming, RCL, and Lloyd Triestino have left the trade as well as vessel providers Wallenius Wilhelmsen and Kyowa Opal.

[17] Two new consortia are reported to be entering the trade in May 2004. These are HEH, consisting of Hapag Lloyd along with Evergreen Marine and Hanjin Line and ZAP consisting of Zim Line, APL and PIL. They will both employ five vessels possibly increasing the number of vessels by up to 10 (a rise in vessel capacity of about 25 per cent).

Singapore. Finally, while the market is generally considered to be contestable, there was no actual entry during the latter half of 2003.

E1.2.1 Reasonableness of Freight Rate Increases

The AADA collectively announced[18] two significant increases in freight rates across the liner trade, totalling $US750 per TEU ($US1500 per FEU) in a four month period. In addition, a $US200 per TEU Peak Season surcharge for the period August 2003 to January 2004 (inclusive) was introduced.

Furthermore, the AADA announced a rise of $US300 per TEU ($US600 per FEU) for imports sourced from Korea on 1 January 2004 and there is a further planned increase of $US250 per TEU ($US500 per FEU) for imports sourced from PRC, Hong Kong and Taiwan on 1 April 2004.

The first set of rate increases succeeded in raising market freight rates by over 100 per cent little over three months**.** The rate increases that were initiated by the AADA carriers were higher than any other freight rate increases coordinated by other discussion agreements or conference agreements amongst lines on other Australian liner trades in the latter half of 2003. **This position paper finds these rate increases to be unreasonable in the context of the characteristics of the industry, and particularly due to the impact of the increases upon importers.** Firstly, importers may lack the flexibility to change supply sources away from East Asia in the short term. Secondly, importers may be forced to absorb the freight rate increases because they are locked into contracts with buyers in Australia and the latter often expect import price reductions due to the appreciation of the Australian dollar. Importers have complained that there was very little notice given of the freight rate increases and that it is now becoming difficult to procure shipping contracts of more than three months duration.

E1.2.2 Unreasonableness of withdrawal of capacity

Whilst the position paper does not consider supply reduction, because there has been no supply reduction by the parties to the AADA, it acknowledges that the importers are concerned that service standards have fallen due to the lack of supply response by the carriers to the situation of excess demand. There are several instances of delays and congestion that have been reported to the Commission. This has resulted in cost penalties for importers in the form of missed orders, increased wastage of products and a markdown of prices on imported goods.

E1.2.3 Assessment of net public benefit of the AADA

Finally the Commission compared the public benefits with the competitive detriment flowing from the operation of the AADA itself.

[18] For imports sourced from PRC, Taiwan and Hong Kong, Korea

This position paper finds that over the life of the AADA that the competitive detriment has outweighed the public benefit derived from the AADA. The position paper does, however, acknowledge the complexity and difficulty in determining public benefits in the liner shipping industry.

The claimed public benefit of discussion and conference agreements is the stability of services and stability of freight rates that it offers shippers over time. In this respect the Commission notes the objects of Part X include promoting "…conditions in the international liner cargo shipping industry that encourage stable access to export markets…" and "…as far as is practicable, to extend to Australian importers … the protection given by this Part to Australian exporters."[19]

It is possible, although not demonstrated in this case, that the AADA offered the benefits of stability to shippers over the period 1999 to May 2003. Following a period of capacity reduction between 1999 and 2001, the capacity offered by the AADA liner services have been reasonably stable. The number of vessels provided by the AADA at 30 vessels remains unchanged since 2001, although there have been marginal changes to vessel capacity due to replacement of smaller vessels with larger vessels.

The long term trend of freight rates for southbound liner cargoes has been reasonably stable over the period 1999 to 2003, with increases in 2000 followed by a slump in 2001. These are shown in Table E1.2.

Table E1.2: Index of indicative market freight rates for general cargos on Southbound liner services from Shanghai to Australia June 1999-December 2003 (lower and higher ends of a range, based on $US/TEU).

	Index (lower)	Index (higher)
June 1999	100	100
June 2000	108	107
June 2001	100	100
December 2001	88	87
March 2002	88	87
June 2002	77	80
September 2002	85	80
December 2002	115	120
March 2003	108	107
June 2003	100	100
September 2003	100	100
October 2003	108	107
December 2003 (prelim)	154	147
December 2003 (importers)	154	193

Source: Confidential market inquiries, submissions from importers.

[19] Section 10.01, Part X, Trade Practices Act *1974*.

The above table shows that **freight rates have been reasonably stable in a narrow band over the period 1999 to June 2003,** after which freight rates have increased substantially.

According to the AADA submission, attempts to collectively raise freight rates for cargoes from East Asia were made on eight occasions over the period January 2000 to July 2003. Only one proposed increase (in July 2000) was regarded by the AADA as successful in raising rates while another in October 2000 was regarded as partially successful.

Information presented to the Commission did not establish a causal nexus between the role and actions of the AADA and the perceived stability of services and freight rates over the period 1999 to July 2003. The Commission did not attempt to characterise a scenario with no AADA due to the inherent difficulty of modelling the actions of competitors in the trade over an extended period. That is, over a suitably long enough period it is difficult to characterise the varying levels of freight rates, supply structures and perhaps new entry prior to 2003 in the absence of the AADA. Additionally, the economic models and underlying theory would not unequivocally explain whether or not the AADA as a discussion agreement was effective in generating service and freight rate stability. The following points about the AADA and its role are noted:

- the AADA appears to have no punishment mechanisms to deter members that 'cheat' on other members by cutting prices or increasing capacity (especially during periods of excess supply);

- the AADA members submitted that the AADA encouraged the employment of fixed term contracts with shippers as part of its stabilisation of services and freight rates, and that it benchmarked contract freight rates. However, it is not proven if it is necessary to have a collective rate making agreement to achieve this;[20]

- the appearance of service stability provided by the AADA members would have been helped by the relative lack of entry and exit by vessel providers in the liner trade over the period May 1999 to December 2003. This may have been due to the deliberate strategic setting of excess capacity by the AADA member lines, although the position paper concludes that this is probably not the case; and

- while there were many changes in the names and memberships of the various consortia on the liner trade, the services offered to shippers remained remarkably stable. This may have been attributable to the influence of both the AADA and its northbound equivalent agreement, the Trade Facilitation Agreement (TFA).

[20] The use of fixed contracts can address potential empty core problems without recourse to a price fixing agreement.

E1.2.4 Economic Theory

A number of economic theories have been developed in an attempt to describe behaviour in the international liner shipping industry. The theories have sought to explain whether certain characteristics inherent in operating scheduled services in cargo shipping mean that services may not be supplied even though it would appear profitable to do so, or that would mean that services are withdrawn to such an extent that it is regarded as inadequate. The theories explore whether anti-competitive agreements are effective in over-coming these perceived market problems.

The underlying economic theory that supports the idea that anticompetitive agreements provide stability (and therefore a public benefit) is contentious, and is disputed by some maritime economists. Further, the econometric testing of this theory is not well developed.

This position paper makes brief reference to the theory of destructive competition and empty core theory. The Commission does not find the destructive competition model to be relevant to the North East Asia – Australia trade since the theory is not readily compatible with a reasonably contestable market.

Empty core theory is a concept that, in lay terms, implies that supply to an industry is in a state of continual disruption because at any particular time supply is not well-matched with demand. However, the data to determine whether there is an empty core problem on the North East Asia – Australia liner trade would not be readily available. Moreover, even if an empty core were to manifest in this trade, the theory indicates that it is best rectified by the application by fixing price and allocating capacity across the entire trade – a mechanism that the AADA does not appear to provide in times of excess supply.

In the course of its investigation the Commission has not been presented with any arguments based on economic theory that links the existence of the AADA to resolution of any problems that may be inherent in providing liner shipping capacity to this industry. Therefore, for the purposes of this investigation, the Commission has regarded as negligible any public benefit that may have arisen through the AADA's role in resolving such problems.

E2. Assessment of Anti-competitive Detriment

The competitive detriment that flows from the operation of the AADA over the period 1999 to April 2003 is also difficult to assess. Competitive detriment can be regarded as the lessening of price, quantity (capacity) and quality of service competition between the consortia groups because of the AADA. The Commission notes that there appeared to be some price competition amongst the members of the AADA over the period 1999 to April 2003. The fact that the AADA failed to collectively raise rates after October 2000 points to some level of price competition between member lines and little influence of the AADA over freight rates in a period of excess supply. It can only be surmised that freight rate competition would have been greater without the AADA. The little econometric evidence on the subject points to a (statistically) weak moderating influence by conference agreements on freight rate competition in periods of excess supply.[21]

The quantity (capacity) competition is defined as service competition in terms of numbers of vessels and services provided by each of the member consortia / carriers[22] party to the AADA. According to the AADA submission, decisions on investment in capacity are left to each individual consortium and not the AADA. However, it can be argued that the forum provided by the AADA provides the decision-makers in the consortia with greater certainty as to the intensions of other AADA members. This forum may also increase the carriers' sense of mutual interdependence and vulnerability to retaliation by other members to introducing new vessels.

In terms of capacity competition, the carrier members of the AADA did not expand supply levels appreciably after June 2001. It is difficult to categorically determine the influence of the AADA on the decisions of its members to not invest in additional shipping capacity after June 2001.

On one hand, despite a gradual improvement in load factors on the southbound liner trades from NEA to Australia, market freight rates for cargoes carried southbound continued to fall over the period from June 2001 to June 2002, and began to slowly recover shortly afterwards (Table E1.2). Also, load factors for the northbound liner trades from Australia to North East Asia began to fall from June 2001 onwards along with northbound freight rates. Using data supplied by the AADA, the profitability of services on this trade improved during 2002 due to improved demand on the southbound leg.

The incentive for a member carrier of the AADA to add capacity into the trade would be affected by its potential success in winning key customers, both importers and exporters, from other lines. If all lines are lowering their rates through price competition, then there may be either little incentive for customers to switch or there may be compensatory losses and gains of key customers between carriers. This may result in carriers not adding capacity regardless of the AADA over the period from June 2001 to April 2003. Finally, the lines that are party to the AADA previously experienced a period of intense competition on this trade based on providing capacity and may have thereafter been cautious about expanding vessel numbers and sizes to compete for market share.

On the other hand it could be argued that the AADA may have had a moderating influence on decisions by the consortia to not invest in additional capacity in order to improve chances of effecting future rate increases through the AADA. It is possible that the AADA had a role in facilitating the reduction in vessels employed on the trade which occurred from mid-1999 to mid-2001. This reduction would have assisted the success of the AADA's rate rise in July 2000 and partial success in raising rates in October 2000. Additionally, while there have been a number of changes in liner membership of the consortia agreements, at the same time there has been remarkable stability in the liner services provided by the consortia to shippers

[21] Haralambides H et al (2003) op cit p 102
[22] COSCO are not part of a consortium but are members of the AADA.

since mid 2001. This could be attributed to a 'moderating influence' of the AADA on quantity competition, by sharing details of vessel capacities and load factors.

Whilst the role of the AADA in affecting competition based on capacity decisions is difficult to determine, the Commission considers it possible that the AADA facilitated decisions by its members to not invest in additional capacity. **This leads the Commission to the preliminary conclusion that the competitive detriment of the AADA associated with a diminution of price and quantity competition outweighed the benefits of the AADA in its provision of service and freight rate stability.**

E3. The Commission's Preliminary Conclusions

This position paper presents the preliminary view of the Commission taking into account market information, economic theory and the information contained in the responses to the Commission's issues paper and questionnaires.

The position paper concludes that all criteria pursuant to section 10.45 (1) (a) (viii) are satisfied. Consequently the Commission's preliminary view is that the Australian Government Minister for Transport and Regional Services has grounds to deregister the AADA as it relates to conduct that has the effect of regulating freight rates.

The Commission's view is that a causal connection between the role and activities of the AADA and any public benefits that may have flowed from the AADA agreement since 1999 has not been established.

The Commission now invites submissions from any parties that wish to comment on the analysis and conclusions presented in this position paper.

E4. Commission Position

The Commission's preliminary view is that, pursuant to section 10.44 (1) (b) (iii) of the Trade Practices Act *1974*, the Australian Government Minister for Transport and Regional Services has grounds to direct the Registrar of Liner Shipping to cancel the registration of the Asia- Australia Discussion Agreement (AADA) as far as it relates to permitting the discussion, collective setting and agreement of freight rates (including base freight rates, surcharges, rebates and allowances) and giving effect to any such agreements.

Pursuant to section 10.44 (6), the exemptions provided by Subdivision A of Division 5 should cease to apply in relation to this conduct. The Commission notes that any exemptions provided to the AADA by sections 10.17A (2) and 10.17A (4) will no longer apply, and that the direction will limit the exemption provided to conference members under section 10.17(2). The former mentioned provisions relate to exemptions from section 45 for the making of, and putting into effect freight rate charges in a freight rate agreement among parties participating on an inbound liner trade.

The Commission has formed its view on this matter on the basis of consideration of submissions received by the Commission in the course of conducting this investigation. The Commission has found that detriment has flowed from those provisions of the AADA agreement that allow for a consensus regarding pricing. Detriment that may have flowed from the non-pricing aspects of the AADA has not been the focus of this investigation. The Commission has also noted the views of most importers in not calling for the deregistration of the AADA in its entirety. A direction by the Minister in the terms set out above would still allow the IAA and the AADA to discuss minimum levels of service for the southbound liner trades from North East Asia and will also allow discussion of service provision to take place between the AADA and any designated secondary importer bodies in the future.

The Commission has also formed the view that the collective setting and discussion by parties to the AADA of surcharges should also be repealed. Firstly, this is to inhibit a potential collective increase by the AADA in shipping 'prices' paid by shippers through the mechanism of surcharge setting. This could effectively circumvent the intention of the Commission in its recommendation that the collective freight rate setting power be disallowed. Secondly, the prohibition on the discussion and collective setting of surcharges will encourage competition between the various consortia and carriers in the setting of surcharges to the benefit of shippers. In turn this may allow competition between the consortia and carriers to drive down those elements of costs that some of the surcharges are designed to recover.

Table of Contents

1. Introduction

Following several complaints from shippers, the Australian Competition and Consumer Commission (the 'Commission') initiated an investigation into the conduct of parties to a discussion agreement registered under Part X of the Trade Practices Act 1974 (the 'TPA'). The Commission will report to the Australian Government Minister for Transport and Regional Services on whether grounds exist for deregistration of the discussion agreement.

This *Position Paper* comprises the Commission's preliminary conclusions that it has reached as a result of its investigation. The Commission invites submissions from interested parties in response to the findings of the Position Paper. The Commission will take into account any responses in coming to a final position. Based on this final position, the Commission will report to the Minister.

1.1 Background to the Asia – Australia Discussion Agreement matter

Members of the Asia – Australia Discussion Agreement (AADA), a registered discussion agreement under Part X of the *Trade Practices Act 1974* (TPA), announced increases in freight rates by approximately 100 per cent in a period of four months during 2003, including the introduction of peak season surcharges.

The AADA formed in 1999 and was initially registered in April 2000. It has since been varied three times. Currently, it comprises 16 shipping lines[23] that operate on the southbound NEA trade routes, specifically between ports located in the Peoples Republic of China, Taiwan, Hong Kong, Japan, Korea and the Philippines and Australian ports.

The purpose of the investigation is to report to the Australian Government Minister for Transport and Regional Services whether or not there are sufficient grounds in relation to matters referred to in section 10.45(a) (viii) to recommend deregistration of the AADA.

The nature of discussion agreements was the subject of comment by the Productivity Commission in its 1999 report on the shipping industry.[24] The Productivity Commission found that discussion agreements should be regulated no differently from other forms of agreements between shipping lines. In its response to the Productivity Commission's recommendations, the Australian Government announced several proposed legislative amendments to Part X, including the way discussion agreements operate. The Government was of the view that discussion agreements have the potential to cover a large proportion of carriers in a particular trade (as they do for the NEA trade lanes) and could consequently affect competition.

[23] There are 16 parties to the AADA however, two shipping lines do not participate in meetings with the other lines on AADA matters.

[24] Productivity Commission (1999), International Liner Shipping Cargo: A Review of Part X of the Trade Practices Act 1974, Final Report.

1.2 Commission initiated Part X investigation

In May 2003, the Commission began receiving complaints from importers concerning the announced freight rate increases by the AADA to be implemented on 1 July 2003. The Commission also approached the Importers Association of Australia (IAA), which voiced its concerns about the magnitude and speed of the announced price increases. There were further complaints by importers about the announcement of a peak season surcharge to be implemented in addition to the freight rate increases on 1 August 2003. The Commission received information from importers that the freight rate increases implemented on 1 July and 1 October 2003 succeeded in raising freight rates in the NEA – Australia southbound liner trades.

The aforementioned legislative amendments included the introduction of subsection 10.48 (2A), which provides for the Commission to launch an investigation on its own initiative. Pursuant to subsection 10.48 (2A), the Commission can initiate a Part X investigation into the market conduct of parties to a registered agreement into the question whether grounds exist for the Minister for Transport and Regional Services to be satisfied in relation to matters referred to in subsections 10.45 (1) (a) (viii). Subsequently, the Commission announced its intention to launch this investigation on 10 October 2003 under 10.48(2A) of the TPA.

1.3 Investigation Procedure

The Commission's approach to this investigation has involved a number of steps. Firstly, the Commission undertook preliminary discussions with some complainants with a view to ascertaining the nature of issues at the centre of the complaints. Following the distribution of the Issues Paper to interested parties, the Commission sought submissions and comments on the Issues Paper. A questionnaire to shipping lines was also circulated in order to obtain relevant cost and revenue data. Based on responses from interested parties, further market evidence and relevant economic theory, the Commission has prepared this Position Paper. The responses to this Position Paper will be taken into account by the Commission in reaching a final position. Based on this final position the Commission will make a report to the Minister.

1.4 Structure of this Report

A description of Part X, in particular its objectives, key provisions and recently introduced amendments are covered in the next chapter. Section 3 summarises the submissions made by interested parties to the Commission. Section 4 presents a description of the characteristics of the liner shipping services in the NEA trade, including supply/demand characteristics, barriers to entry and the behaviour of freight rates and capacity levels. The Commission's conclusions on the state of competition in the North East Asia – Australia liner trade are made in Section 5. The Commission's assessment against the Part X criteria is presented in Sections 6 and 7. The Commission's preliminary conclusions are presented in Sections 8 and 9.

1.5 Submissions to the Commission

The Commission invites written submissions on the matters identified in this position paper from all interested parties. Interested parties and members of the public are invited to submit written comments to the Commission (either in hard copy or electronic format) by the close of business, **Friday 30 April 2004 to:**

David Salisbury

Director, Rail and Waterfront,

Transport and Prices Oversight Branch

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2. Background to Part X

2.1 Anti-competitive conduct and Part X of the Trade Practices Act

This section provides an overview of Part X of the Trade Practices Act *1974* (TPA) as it relates to the matter currently under consideration. In addressing and reporting on issues raised during this investigation, it is important that interested parties understand the relevant legal framework.

Part IV of the TPA prohibits businesses from engaging in various forms of anti-competitive conduct including entering into agreements restricting dealings or affecting competition, dealing on a conditional or exclusive basis, and misuse of market power.

Specific provisions relating to the international liner shipping industry have been enacted in Part X of the TPA that allows limited and conditional exemptions from some of the prohibitions contained in Part IV. Put another way, under certain conditions, international shipping lines may legally enter into market sharing and price fixing agreements.

Specifically, Part X provides partial exemption from the application of s.45 (agreements restricting dealings or affecting competition) and s.47 (exclusive dealings). In order to satisfy such an exemption, potentially anti-competitive agreements must be registered with the Australian Government Department of Transport and Regional Services (DTRS). Part X does not provide exemption from the prohibitions against misuse of market power (s.46) or third-line forcing (ss.47(6) and (7)).

2.2 Role of ACCC under Part X

The administration of the provisions of Part X is primarily the responsibility of the DTRS. Under Part X the Commission has a role in investigating potential breaches of the conditions under which exemption has been granted, and reporting to the Minister for Transport on the results of its investigation.

At the request of the Minister for Transport (section 10.47(1)), or of an organisation affected by the operation of a registered conference agreement (section 10.48(2)) or (to a limited extent) on its own initiative (section 10.48(2A)), the Commission can investigate whether a registered conference agreement continues to satisfy requirements under Part X. Potential areas for investigation include the minium registration requirements for agreements contained in sections 10.06 to 10.08, allegations of failure to negotiate with designated shipper bodies, and the requirement to give due regard for the need for shipping services to be economic and efficient and of reasonable capacity and frequency to meet shippers needs. The Commission reports to the Minister, who then decides whether any action would be appropriate. This may include deregistration of the conference agreement.

2.3 Objectives of Part X

There are four objects prescribed in s.10.01 (1) of 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; and*
>
> *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*
>
> *to ensure that efficient Australian flagged shipping is not unreasonably hindered from normal commercial participation in any outwards liner cargo shipping trade; and*
>
> *as far as is practicable, to extend to Australian importers in each State and Territory the protection given by this part to Australian exporters.*

These objectives focus on Australia being provided continued access with international liner cargo shipping services of adequate frequency and reliability. The association of these objectives with provisions for exemptions from prohibitions for certain types of anti-competitive conduct implies a view that, if forced to compete, suppliers in this industry may not provide services at levels required by Australian shippers.

Constraints on the application of competition laws to liner cargo shipping markets currently also exist in a number of other countries.

2.4 How does Part X achieve its objectives?

Section 10.01 (2) states that the objects of Part X are to be achieved:

> *by permitting continued conference operations while enhancing the competitive environment for international liner shipping services through the provision of adequate and appropriate safeguards against the 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;*
>
> *through increased reliance on private commercial and legal processes and a reduced level of government regulation of routine commercial matters; and*

by the exercise of jurisdiction, consistent with international law:

over ocean carriers who have a substantial connection with Australia because they provide international liner cargo shipping services; and

to enable remedies for contravention of the provisions of this part to be enforced within Australia.

Essentially, Part X allows for providers of liner shipping services to behave in ways that would not otherwise be permissible under the TPA while imposing some constraints that limit the potential for abuse of market power. Part X does this by providing liner shipping companies with limited exemptions from trade practices laws to enter into co-operative arrangements in providing shipping services to Australian shippers. These arrangements include joint provision of services and agreements on capacity, service levels and prices charged. In return for these exemptions, Part X imposes certain obligations and requirements on parties to conference agreements, including an obligation to negotiate with shipper bodies and provide certain information. Part X also provides shippers with certain rights with the aim of enhancing countervailing power in their dealings with shipping lines.

2.5 Registration of agreements

The Part X exemptions only apply to parties to agreements that are registered under Part X.

There are various types of agreements between shipping lines on trades that can be registered with the Registrar of Liner Shipping (administered by DTRS) under Part X. Two relevant examples are:

Consortium - A joint venture by members of a registered conference agreement signifying a higher degree of cooperation in service agreements such as the sharing of vessels under a shipping pool.

Discussion Agreement - An agreement between lines (which could be between consortia and/or free agent lines) to reach a non-binding consensus over, for example, the charging of common freight rates and a variety of service arrangements.

For the purposes of this paper, when the term conference agreement is used it means any agreement that has been registered pursuant to the provisions of Part X (including provisionally registered agreements, unless the context suggests otherwise.). Part X does not contain definitions of the various types of agreements.

The types of agreements between the lines vary in terms of the implementation commitment and cost for the lines. Discussion agreements typically include both independently operating lines and lines operating in consortia agreements, and usually take the form of a non-binding consensus. The cost to a line of entering or leaving a discussion agreement is generally quite low. For example, members of discussion agreements can typically withdraw on very short notice of between 48 hours and 30 days notice.

The Registrar of Liner Shipping (the “Registrar”) accepts that a ‘discussion agreement’ satisfies the requisite definition of an “agreement” for the purposes of consideration under Part X. ‘Discussion agreements’ were first submitted for registration in 1989. To be accepted for registration 'discussion agreements' must however meet all of the relevant requirements set out under Part X of the Act. There are a number of discussion agreements that operate in several Australian trades which are currently registered under Part X.

All types of agreements must comply with certain conditions in order to be provisionally registered, and then satisfy additional requirements before being accepted for final registration..

Part X imposes a requirement on parties to provisionally registered conference agreements to negotiate minimum service levels with designated peak shipper bodies.[25] This is also a condition requisite for final registration, in that a conference agreement cannot be subject to final registration until this negotiation obligation has been satisfied. For import trades, the designated peak shipper body[26], which can act on behalf of all importers, is the Importers Association of Australia (IAA).

2.6 The Commission's Investigation

Part X provides that the Minister may, if satisfied of any of the matters set out in s.10.45(1), direct the Registrar in respect to complete or partial cancellation of (final) registered conference agreements.

Pursuant to subsection 10.48 (2A), the Commission may on its own initiative commence an investigation into whether there are grounds for the Minister to be satisfied in relation to the matters referred to in subsections 10.45 (1) (a) (viii) and (ix). In this respect the Commission has initiated an investigation into the AADA conference agreement and whether there are grounds for the Minister to be satisfied that the criteria under subsection 10.45 (1) (a) (viii) have been met. The Commission cannot make any directions to the Registrar. The Commission will report to the Minister on the outcome of its investigation, and it is up to the Minister to consider whether s/he is satisfied that subsection 45(1)(a)(viii) has been made out.

Relevantly, subsection 45(1)(a)(viii) specifies the following criteria:

> *that the agreement includes a provision that has the purpose of, or has or is likely to have the effect, of substantially lessening competition (within the meaning of section 45); and*
>
> *the parties to an 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*

---

[25] Other issues that may in practice be discussed between conferences and the designated shipper body include destination terminal handling charges, bunker surcharges, and currency adjustment factors.
[26] Part X provides for shippers' representative groups to register as designated shipper bodies and thus invoke the negotiation provisions in respect of parties to a registered agreement.

would result, or be likely to result, if the proposed conduct were engaged in; and

there are exceptional circumstances that warrant the giving of a direction under section 10.44 (1).

"Exceptional circumstances" is defined in the revised explanatory memorandum given by the Minister when introducing the International Liner Shipping Cargo Bill (TPA amendment 2000) into Parliament.[27] It was noted that these circumstances would cover situations where an agreement:

covers a substantial majority of shipping lines and capacity in a trade; and

where the conduct of those shipping lines has led to, or is likely to lead to, an unreasonable increase in freight rates: and / or

unreasonable reduction in services;

with the result that the public benefit from the operation of the agreement is outweighed by the an anti-competitive detriment.

As noted above, it is the Minister that decides whether any direction should be given to the Registrar in relation to total or partial deregistration of any conference agreement. A consequence of deregistration is that it removes the exemptions from application of Part IV of the TPA, and thereby renders future conduct by the parties to the full application of ss 45 and 47 of the TPA. In the event that the Minister was satisfied of a relevant matter and considered a direction was appropriate the Minister could direct the Registrar:

to cancel the registration of a registered conference agreement; or

to cancel the registration of a registered conference agreement so far as it relates to:

a particular provision of the agreement;

a particular party to the agreement; or

particular conduct (paragraph 10.44 (1)).

2.7 Other key aspects of Part X Relevant to the AADA Investigation

There are a number of aspects of Part X that are important in the context of the investigation into the conduct of the AADA members. These key provisions are particularly relevant as they provide the framework for assessing the criteria against which the conduct of the AADA's members is being assessed by the Commission.

[27] The Parliament of Australia (Senate), *Trade Practices Amendment (International Liner Cargo Shipping) Bill 2000* Revised Explanatory Memorandum p 6.

The key areas of Part X that are most pertinent to the complaints being investigated encompass the exemptions provided to both shipping lines and importers from application of certain provisions of the Trade Practices Act. Of particular significance are the provisions relating to:

- the obligation on parties to conference agreements to negotiate;
- negotiation requests; and
- obligations relating to an authorised Officer.

2.7.1 The Negotiation Process Provided for by Part X

Part X imposes obligations on shipping lines in respect of the negotiation process to balance potentially adverse effects the exemptions may have on outcomes for shippers.

Section 10.41 of the TPA sets out specific obligations on parties to registered conference agreements in relation to negotiations with shipping bodies. Section 10.41 gives the IAA (as the designated peak shipper body) or any designated secondary shipper body rights to:

- request parties to a registered conference agreement to take part in negotiations in relation to negotiable shipping arrangements;
- request parties to make available information that is reasonably necessary for the purposes of those negotiations; and
- at least 30 days notice of any changes in negotiable shipping arrangements.

The provisions require parties to a registered conference agreement to take part in negotiations with a relevant designated shipper body in relation to "negotiable shipping arrangements". In the context of the import trades, these "negotiable shipping arrangements" are restricted to "eligible Australian contracts" and those activities that take place on land in Australia. "Eligible Australian contracts" are defined as contracts either entered into in Australia, or contracts for which questions arising are determined in accordance with Australian law. Once established in a finally registered agreement, changes in negotiable shipping arrangements require at least 30 days notice to shippers (unless shippers agree to a lesser period of notice).

Section 10.41 envisages a quid pro quo exchange of information in the context of negotiations. That is, shipper bodies are required to make available information requested by the parties to an agreement in order to be able to obtain information from them.

The negotiation obligations/rights set out section 10.41 are limited to conference agreements that have been subject to final registration.

Part X provides for the (total or partial) cancellation of a finally registered conference agreement whereby the Minister may direct cancellation of registration if, inter alia, the Minister is satisfied that parties have contravened, or propose to contravene, the negotiation provisions of section 10.41 in relation to negotiable shipping arrangements. Even if the Minister is so satisfied, the Minister has discretion regarding whether to give such a direction.

2.7.2 *Negotiation requests*

Under paragraph 10.41(1)(a), parties to a (final) registered conference agreement must take part in negotiations in relation to negotiable shipping arrangements whenever reasonably requested by a relevant designated shipper body[28]. The Act does not specify what requests would be considered reasonable, or similarly, unreasonable. Parties to a conference agreement are obligated to consider the matters raised, and representations made, by the relevant designated shipper body. The value of negotiations is that shipping lines are required to give genuine consideration to the views of shipper bodies. However, parties to a registered agreement are not obligated to accept the views of a shipper body or any proposals put forward by a shipper body in negotiations and shipper bodies do not have the right to veto the final registration of agreements in respect of negotiable shipping arrangements.

Individual exporters cannot invoke the negotiation provisions of section 10.41.

2.7.3 *Obligations relating to an authorised officer*

Section 10.41 provides for the involvement of an authorised officer in negotiations between a shipper body and parties to an agreement. An authorised officer is an officer of the DTRS authorised by the Minister for Transport.

Parties are also required to give such information as the officer requires and consider suggestions made by an authorised officer. The type of information that an officer may require is not specified in Part X. It appears that parties are not bound by any suggestions of an authorised officer and, except for considering suggestions, are not otherwise limited with respect to any proposed change in negotiable shipping arrangements.

[28] Section 10.41 provides: ‘relevant designated shipper body’ means:
(a) a designated peak shipper body; or
(b) a designated secondary shipper body nominated by the Registrar (by written notice given to the parties to the agreement) for the purposes of the agreement for the purposes of this section.

3. Views of Interested Parties

A number of parties made submissions to the Commission's Issues Paper.

3.1 Importers Association of Australia (IAA)

The IAA maintains that there is no significant competition between AADA and non-AADA lines. Moreover, the IAA has observed no sign of price-related competition being exerted by non-AADA services on the NEA to Australia trade. Another potential source of competitive pressure, transhipment services through Singapore, was not considered to be a viable substitute for direct services from NEA. It also considers the AADA's service standards to have been inadequate in recent times, especially during the period of the PSS implementation.

A general contention of the IAA submission is that the AADA facilitated an substantive degree of market power in the market for AADA lines. As individual lines and as an aggregated discussion agreement, the IAA considers that Australian importers are finding it extremely difficult to negotiate with the AADA (collectively) and its members (individually). The IAA reports that smaller importers, usually represented by freight forwarders, have found negotiating freight rates most problematic. Small importers appear to have been affected most severely, as evidenced by their frequent claims of cargo delays attributed to AADA services.

The IAA also considers the AADA uses its market power to enter negotiations with little intent of granting concessions to Australian importers. For instance, the IAA appears unable to negotiate the duration or the magnitude of the PSS with the AADA. Probably of greater significance, however, is the lack of negotiation regarding the minimum service levels achieved by the IAA and AADA. The IAA commented during a meeting with Commission staff that it is invited to comment on proposals for agreement, but it is given very short timeframes to reply.

The IAA also claims that the AADA has implemented freight rate increases without taking due regard of their reasonableness or to Australian shippers' business interests. Moreover, the IAA alleges the AADA's overwhelming presence in the market allows the AADA members to implement a PSS without justification (the IAA contends there are no service benefits to shippers flowing from the PSS). The IAA also claims there are limited additional (repositioning) costs incurred by shipping lines during the peak cargo periods. The IAA considers that the freight rate increases would not have been as precipitous in the current market environment if the AADA did ***not*** exist.

However, the IAA did comment to the Commission that it was concerned that in the absence of the AADA some services from NEA to Australia may be withdrawn.

3.2 Australian Peak Shippers Association (APSA)

APSA considers that discussion agreements unambiguously limit competition by encompassing the vast majority of conference members and independent operators on a trade, to the extent that price and capacity related competition is virtually eliminated. APSA's contention was expressed as a general opinion, not as a direct assessment of what has evolved on the NEA to Australia trade.

APSA's submission, focussing substantively on the detriment discussion agreements cause shippers, emphasises the need for amendments to Part X of the TPA. The absorption of independent and conference carriers into discussion agreements is alleged by APSA to limit discretionary freight rate setting from numerous market participants to one all encompassing rate setting mechanism.

APSA believes that discussion agreements may not be as voluntary as the non-binding agreement pledge suggests, based on discussion agreements' ability to interfere with an individual carrier's behaviour. It has been APSA's long-standing desire to block discussion agreements' ability to operate with anti-trust (Part IV) exemptions from prohibitions on anti-competitive conduct.

APSA also contends that members that are party to discussion agreements are afforded excessive market power. Its submission indicates AADA shipping lines are seemingly incapable of using their substantial market power effectively or competently. APSA attests that instead of allowing rates to increase gradually over 2-3 years, lines party to discussion agreements let rates fall initially before imposing large increases on shippers over a short period of time, resulting in excessive volatility which shippers find difficult to accommodate.

3.3 Shippers

The ACCC received submissions from 13 shippers. Four asked that confidentiality be maintained.

Most of the importers' submissions do not explicitly address the issues of any long term benefits of the AADA in terms of its alleged provision of stable, adequate, reliable services and long term freight rate stability since 1999. Rather, they are focussed on the deterioration in service reliability and adequacy during 2003, as well as the recent significant increases in freight rates. An example of this is the submission by the Food and Beverage Importers Association (FBIA) which states that none of the public benefits of the AADA are being delivered at the moment.[29]

The Chamber of Commerce and Industry of Western Australia (CCIWA) submission stated that the presence of the AADA (and indeed all discussion agreements amongst lines on Australian trades) had not contributed to freight rate stability. The CCIWA points to the number of freight rate restoration programs but does not comment upon

[29] Food and Beverage Importers of Australia (2003) Submission to ACCC p 2

their effect in the market. Finally, the CCIWA does not consider that the AADA had a role to play in maintaining service stability. [30]

The IAA, the FBIA and GHA have all recommended that the collective rate-making powers of the AADA be deregistered in its entirety. Some benefits of the AADA according to the IAA are:

> Addressing service standards to ensure sufficient capacity and frequency to meet importers needs; and
> Consultation with bodies such as the IAA on service standards.[31]

However, according to the GHA, the Commission should seek undertakings from the AADA to realise some of these benefits in the current market climate. These issues including transparent pricing, advanced notice of intended rate increases, greater consultation with Importer Peak Bodies and adequate service standards.[32]

The CCIWA submission goes further and argues that discussion agreements are not in the national interest but stops short of making a recommendation about deregistration.

Several shippers' submissions passed comment on the availability of alternative cargo liner services from NEA for Australian importers to utilise. Babyco's response to the Commission's Issues Paper indicated there were *no* substitutable shipping services from NEA outside the AADA.

The CCIWA's submission indicated that substitution alternatives exist to AADA services for Western Australian shippers transporting goods to and from Fremantle. Conference and independents provide the alternative cargo shipment alternatives from Singapore to the AADA lines.

Approximately 12.5 per cent of GHA members used non-AADA aligned services at least once in conjunction with AADA lines to import goods from NEA.

Submissions from many importers indicated that they held similar views to the IAA. Many of the submissions expressed concerns that the AADA was operating as a cartel or monopolist. A majority of shippers felt that the AADA has been hindering price-related competition substantially. The CCIWA expressed the belief that competition between AADA members had failed to materialise on the Fremantle trade.

Moreover, virtually all submissions considered the AADA lines to be offering relatively poor and unreliable standards of service (especially during the peak season). By way of example, the results of the GHA's survey of its members showed that 50 per cent of its members were dissatisfied with the AADA's current service standards. Furthermore, 31 per cent of its members consider that AADA service standards have fallen since 2000. Several shippers also complained of unsatisfactory transit times, citing examples where containers had been delayed by three to four weeks.

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[30] Chamber of Commerce and Industry of WA (2003) Submission to ACCC p 5
[31] Importers Association of Australia (2003) Submission to ACCC p 8
[32] Gifts and Homewares Australia (2003) Submission to ACCC p 9

Several other issues of concern were expressed in the shippers' submissions. Some examples of these concerns are as follows:

- the vulnerability of small importers being at the mercy of the AADA lines' rate restoration programs;
- Redox Chemicals Pty. Ltd. put the view that the AADA has not contributed to more stable freight rates;
- the AADA's service standards have deteriorated, evidenced by shipment delays of containers, which shippers contend is caused by insufficient capacity in the market;
- the AADA has demonstrated little regard to the business interests of shippers;
- the ability of small and medium size shippers to negotiate with AADA lines regarding applicable freight rates has been limited;
- the negotiation process with designated inwards shipper bodies under the Part X legislation is neither clear nor transparent;
- the AADA has used the Part IV exemptions to introduce exorbitant freight rate increases to the market; and
- the use of the PSS has caused concern, as it has been applied by the lines without elevating service standards.

3.4 Asia – Australia Discussion Agreement (AADA)

In the absence of any common tariff agreed amongst AADA lines, the AADA submission considers that competition prevails amongst AADA members. The AADA identified examples between December 2000 and June 2003 when price-related competition between AADA lines eroded proposed rate increases by the AADA. For instance, from the December quarter 2001 to the June quarter 2003, the AADA announced a series of freight rates increases totalling $US400 ex China. However, the notified freight rate increases failed to fully 'stick' in the market and the cumulative increase at the end of the period was between $US75 and $US100. The AADA lines consider this is evidence of competition between AADA lines forcing freight rates lower.

The AADA submission states that competition prevails amongst all AADA and non-AADA members.

Having access to modern tonnage, which provides faster and more reliable schedules and meets international benchmarks, is a major benefit the AADA claims to offer Australian shippers. By virtue of collectively reviewing vessel capacities, utilisations and cargo demand, the AADA enhances the prospect of maintaining stable and adequate services by most accurately equating the capacity supplied by the lines with aggregate cargo demand from shippers. In so doing, the AADA reduces the likelihood that importers' requirements would be underestimated.

Despite having the ability to establish capacity levels and to discuss which members will provide an additional ship or retire a vessel from a trade, the AADA submission contends that AADA members restrict discussions to levels of capacity across the entire discussion agreement.

The AADA submits that the freight rates observed recently in the market have not been unreasonable but simply represent an effort to obtain a commercially fair price for services rendered. Prior to the recent rise in freight rates, the AADA considers that shippers enjoyed a prolonged period of low freight rates, which were proving unsustainable for the shipping lines. As evidence of this, some lines exited the trade.

The AADA submission claims that the AADA only announces indicative common freight rate increments and does not prescribe an absolute freight rate. Thus, most of the AADA member lines' actual freight rates in the market may be slightly different.

The AADA acts to moderate highly volatile freight rates that are associated with the industry. Meeting regularly to discuss market conditions and forecasts, the AADA is claimed to facilitate smoother freight rate movements by matching aggregate cargo demand with total vessel capacity more accurately than would otherwise be the case.

4. Market Characteristics of Liner Shipping Services in the North East Asia-Australia Trade

This section will provide some market background about the liner shipping services that operate on the trades between Australia and North East Asia. It will outline supply and demand characteristics of the liner trade as context for the Commission's analysis of competition and the impact of the AADA discussed later in this paper.

Section 4.1 reviews the supply characteristics of the North East Asia – Australia liner trade, in particular the southbound (import) liner trade from North East Asia that is the focus of this investigation. This will include a discussion on recent supply trends in the southbound North East Asia – Australia liner trades since 1999 (4.1.15). It will also include discussion on the state of price and non-price competition between incumbent shipping lines in the southbound liner trade (4.1.10) as well as discussion of the market definition in both functional and geographic terms (4.1.11 & 4.1.12).

The Commission's view of the state of competition amongst participant carriers operating on the southbound liner trades from North East Asia is presented in the next chapter and the discussion on competition serves as input to the Commission's substantial lessening of competition tests contained in Chapter 6.

Recent global trends in demand and supply for liner shipping will be described in section 4.2, while section 4.3 will examine the level of barriers to entry and to exit from this particular liner trade.

Section 4.4 outlines the demand characteristics of the trades, includes a presentation of recent import demand trends for goods from North East Asia and a discussion of the potential countervailing power of the importer community.

Section 4.5 presents recent freight rate movements for the carriage of imports from various North East Asian ports to Australian ports and compares them with recent movements in international freight rates.

Section 4.6 examines liner profitability and costs of service of the North East Asia – Australia liner trades.

4.1 Characteristics of Supply of Liner Shipping

The purpose of this section is to present background into the structure of liner services on the North East Asia – Australia liner trades with the aims of: defining the relevant market for the Commission's competition analysis; examining the market share of the parties to the AADA of the North East Asia – Australia liner trade and reporting trends in market freight rates. This provides a basis for the discussion of exceptional circumstances in chapter 7.

This section will set into context the significance of the North East Asia – Australia liner trades in relation to the other Australian liner trades, as well as examine the supply imbalances between the northbound and southbound legs of the liner trade. The major focus of the supply side will be on the market concentration of the North East Asia – Australia southbound liner trade, in particular the roles of the AADA and the various consortia amongst various shipping lines and on the degree of market contestability of the southbound liner trades.

4.1.1 Geographic Description of Liner Supply

The North East Asia – Australia direct liner trade is organized into two regions. The East Asia – Australia liner trade is fairly distinct from the North Asia – Australia liner trade. The former consists of liner trade between ports in Australia and those located in the Peoples Republic of China, Hong Kong, Taiwan and the Philippines. The latter consists of liner services between Australia and ports located in Japan and Korea.

There are a few carriers that provide direct liner services between Australia and both East and North Asia. Most lines provide direct services between one region and Australia and charter slots on carriers that provide direct services between Australia and the other region. There is however some overlap in the liner services between Australia and the two regions.

All of the carriers that serve the North East Asia – Australia liner trades do so in both directions and there are no lines that serve either the southbound[33] or the northbound trades only. Similarly, with the exception of two services, all direct liner services that operate between North East Asia and Australia do not call at ports in other countries outside the North East Asia region.[34] However, in addition to the direct liner trade, there are a number of carriers that offer transhipment services between the Port of Fremantle (in Western Australia) and North East Asia via the Port of Singapore. Though the full extent of any potential competition between transhipment services through the Port of Singapore and direct services to the east coast ports of Australia is not precisely known, it is considered to be minor. This is primarily due to the inferior transit times of transhipment operators.

All lines employ vessels that are dedicated to container services with the exception of Project Asia Service (PAS), which offers a combined break-bulk and container service. PAS offers slower transit times, less frequency and smaller range of Australia's principal ports (only Melbourne / Adelaide)[35] compared to the other lines.

The northbound and southbound liner trades are organised mostly on a consortia basis whereby a number of lines collectively supply liner services to the market. There are currently 18 shipping lines, which provide a total of seven liner services to the direct liner trade between North East Asia and the east coast of Australia. In addition all liner services between North East Asia and Fremantle are transhipment operations

[33] FESCO FNZL service calls at Brisbane southbound on its way to New Zealand.
[34] FESCO – FNZL sails northbound via New Zealand and PAS calls at Lae (PNG) on its way to Australia from Shanghai.
[35] The PAS service visits a number of smaller regional ports in its capacity as a break bulk service, these are Port Kembla, Newcastle, and Hobart.

through Singapore, as Fremantle is geographically close to Singapore. A total of six lines employing five separate services tranship imports to Fremantle from North East Asia. [36]

4.1.2 Consortia and Liner Services

A liner "service" comprises a scheduled sailing pattern for a given trade. The number of vessels required to provide a service varies from trade to trade. For any given service the vessels may be provided by one shipping firm (an "independent") or by several acting together (a "consortia").

The consortia that service the East Asia – Australia direct liner trade are:

> China Shipping/OOCL (collectively known as ACE);
> FESCO/Hyundai Merchant Marine (HMM)/ Columbus Line (2 loops – FAL, FNZL); and
> Maersk Sealand / MSC;

In addition there are independent liner services on the East Asia – Australia direct liner trade provided by:

> COSCO; and
> Project Asia Service (PAS).

In the East Asia – Australia liner trades, NEAX, Zim / Gold Star charter slot space on COSCO vessels while ANLCL charter slot space on ACE vessels. NEAX provide liner services between Australia and the East Asian ports of Keelung (Taiwan) and Hong Kong as part of their services to and from North Asia. The ANLCL/Evergreen/Hanjin (NAX) also have direct services between Australia and the East Asian ports of Keelung (Taiwan) and Kaohsiung (Taiwan) as part of their services between Australia and North Asia.

The consortia that serve the North Asia – Australia liner trades are:

> K Line, NYK, MOL, P&O Swires Containers (collectively known as NEAX);
> Maersk Sealand/MSC; and
> ANLCL/Hanjin/Evergreen Marine (collectively known as NAX);

In addition there is an independent liner service provided by PAS.

In the North Asia – Australia liner trades, COSCO charters slot space on NEAX Group vessels, while ACE and Gold Star/ HMM/ Zim charter slot space on NAX vessels.

[36] Chamber of Commerce and Industry of WA (2003) Submission op cit p 4

4.1.3 Description of Direct Liner services between Australia and North East Asia

In addition to competition on price, competitors in liner shipping trades typically use factors such as frequency of service, port coverage or range, order of port rotation within geographic areas, transit times and availability of specialised services such as provision of refrigerated containers (reefers).

For the direct liner trades between North East Asia and Australia, each of the six consortia/carrier groups has a fleet of five vessels, with the exception of PAS which has a fleet of four vessels. With the exception of the PAS vessels, each vessel has a scheduled port call frequency in Australia of once per five weeks, which implies that the scheduled port call frequency for each separate liner service in Australia is once per week. All of the services operate to fixed weekly schedules, which means that their vessels are expected to arrive and depart from Australian ports on the same day of a particular week. By contrast, PAS has a port call frequency in Australia of once every 17 days.

Table 4.1 presents a full description of the direct southbound liner trade between North East Asia and Australia in terms of capacities offered by the various carriers and consortia.

Table 4.1: Services in the Direct Liner Trades between Australia and North East Asia Oct 2002- September 2003[37]

Consortia / Company	No of vessels	Average TEU capacity	Average TEU reefer capacity	No of sailings per annum Oct 2002-Sep 2003	Theoretical Capacity Southbound TEUS	Theoretical Capacity Northbound TEUS
COSCO	5	1702	200	51	89,382	54,921
NEAX	5	2,400	300-720	52	124,800	94,783
ACE	5	2,500	200 – 400	52	130,000	78,700
Maersk Sealand/MSC	5	2,614	300	52	135,925	88,920
FESCO-FAL*	5	1050-1075	80-100	44	46,900	43,380
NAX	5	2200	300	52	114,000	74,285
AADA	**30**	**1050-2,500**	**80-720**	**303**	**641,007 (98.1)**	**434,989**
PAS	4	1800	-	20	12,000 (1.9)	12,000
Total Direct Trade	**34**	**1050-2,500**	**80-720**	**323**	**653,007**	**446,989**

Source: AADA and PAS (2003)
Does not include a five vessel service FESCO-FNZL that calls southbound to Brisbane, before sailing to New Zealand

[37] Does not include the Wallenius Wilhelmsen RO RO services, which withdrew from the container business in March 2003. This is a nine vessel service which has a call frequency in Australia of twice per month and it sails southbound from North East Asia to Australia via the US and New Zealand. Its transit time from North East Asia to Australia is estimated to be about 70 days.

According to Table 4.1, ACE, NAX, NEAX and Maersk/MSC employ similar sized vessels in the range of 2,400 to 2,600 TEU class, while COSCO has a fleet of smaller vessels with an average size of 1,700 TEU. FESCO-FAL employ a much smaller fleet with an average size of about 1,050 TEU. According to PAS, the capacity of its break bulk vessels is about 1,100 TEU. The number of recorded round trip sailings per annum for each service provided by AADA members varies from 44 to 52, while that for PAS is only 20.

4.1.4 Australian port coverage of consortia / carriers

The Australian port range of the direct liner services on the North East Asia – Australia liner trades is very similar. The Port of Melbourne is served by seven of the eight available liner services, with the exception of FESCO-FNZL, while Sydney Ports are served by six of the eight liner services, with the exception of FESCO-FNZL and PAS. Brisbane is served by all eight services on the southbound trade. The only scheduled direct liner services from North East Asia to both Adelaide and Hobart are with PAS.

The order of the Australian port rotation of the consortia / companies on the North East Asia – Australia liner trades varies. Four services (ACE, NEAX, COSCO and Maesrk / MSC) call at Sydney first, followed by Melbourne and Brisbane. Two services (NAX and FESCO-FAL) call at Melbourne first, followed by Sydney and Brisbane. One service (PAS) calls at Brisbane first, followed by Newcastle, Melbourne Adelaide, Hobart, Port Kembla and Newcastle.

4.1.5 North East Asia port coverage of consortia / carriers

The range of North Asian and East Asian ports serviced by the carriers on the direct trades is also similar. In the Peoples Republic of China, seven of the eight services call at Hong Kong and three of the eight services call at Shanghai (PAS, COSCO, ACE). Other Chinese ports are served by only one direct liner service on the East Asia – Australia liner trades. These are Chiwan (ACE), Yantian (FESCO –FAL), Xiamen, and Huangpu (COSCO). In particular, COSCO and ACE are China specialists. COSCO calls at four Chinese ports (Hong Kong twice), while ACE calls at three Chinese ports (Hong Kong twice). PAS and FESCO call at two Chinese ports and another three services call at only Hong Kong. For liner services that call at more than one Chinese port, all of them call at Hong Kong first.

In Taiwan, five of the eight services call at Kaohsiung, (ACE, NAX, Maersk/MSC, PAS, and FESCO –FAL) while two services call at Keelung (NEAX and NAX). For South Korea, four liner services call at Busan (Maersk/MSC, NEAX, NAX and PAS). Finally, for Japan, four liner services call at Yokohama (Maersk/MSC, NEAX, NAX and PAS), while three liner services call at Nagoya and Osaka (Maersk/MSC, NEAX, and NAX) and PAS calls at Kobe and Fukuyama.

The average transit times of the direct liner services over the year to September 2003 from North East Asia to the first Australian port of call are fairly similar.

The transit times of ACE and COSCO are 10 and 11 days respectively, while those for FESCO- FAL and PAS are 14 and 15 days respectively.

4.1.6 Provision of specialised services (reefers)

All of the consortia groups, as well as the individual carrier COSCO, provide slot space to carry refrigerated containers (reefers). The total refrigerated capacity offered by the consortia and COSCO as part of the AADA is 8,100 TEUS. PAS, the only non-AADA line, does not offer refrigerated capacity, which implies that both the market and capacity share of the AADA lines in this specialised market niche is 100 per cent. Owing to their specialised nature and higher operating costs, reefer services command higher freight rates in the market. However, the refrigerated capacity provided by the AADA lines is primarily used for northbound export liner trades to Japan and Korea, and not the southbound liner trades from PRC, Hong Kong or Taiwan. The lines may therefore incur a cost of bringing empty refrigerated containers back to Australia from North East Asia, although it is likely in the current period of excess demand for imports that carriers are filling reefers with dry goods.

4.1.7 Description of Transhipment Liner services between North East Asia and Australia

Apart from the direct liner trades there is the possibility for importers to use transhipment services to Australian ports via Singapore. Fremantle is serviced only by transhipment operators through Singapore.

All of the transhipment services to Fremantle operate on a fixed weekly basis. K Line / Maersk have fleet of two vessels while MSC has a fleet 8 vessels of 125 TEU. Neither of these latter services call at Australian ports other than Fremantle.

According to the Chamber of Commerce and Industry for WA, the number of liner services into Fremantle from North East Asia via transhipment through Singapore is six (provided by seven carriers).[38] Table 4.2 provides an estimate of the market structure of the capacities of the liner trades into Fremantle. There are however a number of caveats that must be made with respect to the data.

Firstly, the space allocation for transhipment cargoes from North East Asia on the various liner services from South East Asia relative to cargoes sourced from South East Asia is not known. Secondly, the allocations taken by PIL and MOL on the AAA vessels and the allocations taken by NYK on the AAX vessels is not known. Thirdly, the capacity of the Bight Loop of AAA is also not known and finally, it appears from both the AADA's response to the Commission's questionnaire and the CCIWA submission that several lines that could potentially offer transhipment options from North East Asia via Singapore to Fremantle currently do not do so. These are: P&O Nedlloyd, APL, and ANL (using the AAX service); and OOCL, MISC, and Zim Line (using the AAA service). Finally, APL and RCL operate

[38] ibid

dedicated shuttle services from Singapore[39] but may limit space available for cargo from North East Asia.

Table 4.2: Services in the Transhipment Liner Trades between Fremantle and North East Asia Oct 2002- September 2003

Consortia / Company	No of vessels	Average TEU capacity	Average TEU reefer capacity	No of sailings per annum Oct 2002- Sep 2003	Theoretical Capacity Southbound TEUS	Theoretical Capacity Northbound TEUS
K Line / Maersk	2	1,730	200-208	52	90,133	69,814
MSC	8	125	10	52	6,496	NA
AADA	**10**			**52**	**97,629**	**NA**
AAA (PIL & MOL) 2 loops	8	2,077 for Torres Loop only	NA	104	108,004 (Torres Loop only)	NA
AAX (NYK)	4	2,890	NA	52	150,280	NA
Total Capacity of Transhipment Trades to Fremantle	22	NA	NA	260	NA	NA

Sources: AADA (2003) and Sydney Ports Corporation Commerce and Logistics Review 2002-03

As for the other ports in Australia there are potentially four liner services[40] that can offer transhipment slots from Singapore / Port Kelang to Australian eastern seaboard ports for cargo that originates in North East Asia. It is however unlikely that these services would lift a significant amount of cargo that originates from North East Asia for the following reasons:

there are space constraints for transhipment cargoes bound for Australia via Singapore due to the significant increases in volumes that are lifted westbound from PRC to Europe; and

The transit times from North East Asia to Australia via Singapore are prohibitively long as compared to that of the direct services.

[39] All of these carriers ship cargoes from East Asia to Singapore via Intra-Asia or Far East to Europe services and also have services that connect Singapore with Fremantle.

[40] These are Australia Asia Express (AAX), Triple A Service (AAA) operating 2 loops, and Asia Australia Singapore Express Service (ASA).

Table 4.3 shows a comparison of scheduled transit times for a select number of potential transhipment services with those of direct services from Shanghai to Melbourne.

Table 4.3: Scheduled Transit Times and Frequency of selected Liner services from Shanghai to Melbourne

Name of Service	Direct	Transhipment	Transit time (days)	Frequency
Australia China Express (ACE) ANLCL /CSCL/ OOCL/ Zim	Yes		16	Fixed Weekly
COSCON –Loop COSCO / K Line/ MOL/ NYK/P&O Nedlloyd	Yes		18	Fixed Weekly
PAS	Yes		About 20	Every 3 weeks
APL China _Europe Express / AAX		Yes	25	Fixed Weekly
APL Mediterranean Express / AAX		Yes	23	Fixed Weekly
RCL Singapore – Shanghai Service / ASA		Yes	23	Fixed Weekly
RCL Shanghai Ningbo-Singapore Service /ASA		Yes	22	Fixed Weekly
MISC Asia – Europe loop B / AAA		Yes	20	Fixed Weekly
MISC Asia Europe loop D / AAA		Yes	21	Fixed Weekly
MISC China Straits Service / AAA		Yes	24	Fixed Weekly
PIL various / AAA		Yes	17 – 21 days	Weekly

Sources: Shipping Line websites

As can be seen from Table 4.3, the AADA services, ACE and COSCON Loop 2 offer faster transit times than their direct service competitor PAS and their potential transhipment competitors on the route from Shanghai to Melbourne. All of the lines with the exception of PAS offer fixed weekly service, while PIL potentially offers weekly services. The direct liner services have an advantage of between 25 per cent to 50 per cent faster transit time, compared to those of the transhipment services. The longer transit time of the transhipment services reflects the greater sailing distances from North East Asia via Singapore and the waiting time between connections at the Port of Singapore.

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

Finally, on the southbound North East Asia - Australia liner trades, all[41] of the members of the various consortia are also members of the AADA. In addition, a number of them are also members of the Australia New Zealand Eastern Shipping Conference (ANZESC). The AADA consists of the following 16 members, with the seven ANZESC members marked by an asterisk:

ANLCL; *
FESCO;
P&O Swires Containers; *
NYK; *
K Line; *
MOL; *
COSCO;
China Shipping;
Hyundai Merchant Marine (HMM);
Hamburg Sud (Columbus Line);
OOCL; *
Zim; *
Evergreen Marine Corporation;
Hanjin Shipping Company;
Maersk Sealand; and
MSC. [42]

The only carrier that does not belong to the AADA and participates on the North East Asia – Australia direct southbound liner trade is PAS. Consequently, the capacity share of the carriers that are parties to the AADA of the direct liner trade into the eastern states is indicated by Table 4.1 at about 98 per cent. The market share of the AADA lines in terms of volumes lifted into Fremantle is about 50 per cent. However, it appears that there is only one independent carrier, Pacific International Line (PIL), which offers an alternative transhipment service to those supplied by the AADA lines (MOL, NYK, MSC and K Line/Maersk).

Furthermore, according to the AADA submission, two AADA members (Evergreen Marine and Hanjin Line) do not in fact participate in meetings to discuss collective freight rate increases despite both being parties to the AADA.[43] Neither companies' name appears in the shipping press advertisements that announce forthcoming collective freight rate increases by parties to the AADA. Notwithstanding this, information provided to the Commission indicates that these two carriers adopt pricing practices that reflect those made by the "active" parties to the AADA. The role of the AADA on the southbound North East Asia – Australia liner trades will be further investigated in section 4.1.14.

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[41] Gold Star line is a fully owned subsidiary of Zim Line and therefore is also regarded as a member of the AADA.

[42] Asia Australia Discussion Agreement 24 December 2002, AADA (2003) Submission to ACCC p 4

[43] Asia Australia Discussion Agreement (2003), Submission op cit p 4

4.1.9 Market Definition

The purpose of this subsection is to define the market for the purposes of this investigation. This will allow the determination of the relevant market share of the parties to the AADA and provide some insight into the market power potentially available to AADA members.

Markets are defined by identifying substitutes in both consumption and production. If products are close substitutes then the price rise in one product will cause consumers to shift to the other (substitutes in consumption). On the other hand there may be producers that produce similar products and they could easily switch to the production (due to similar technology or low switching costs) to the product whose price has risen (substitutes in production).

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.

In terms of the North East Asia – Australia southbound liner trades, there are a number of parties that may potentially act as competitors. They may include the AADA-member lines to the extent that they actively compete with each other, lines that operate or may potentially operate on the trade who are not party to the AADA, or firms operating other modes of freight carriage such as Roll on Roll off (Ro Ro) operators ships, breakbulk vessels or airfreight.

4.1.10 Competition among shipping lines

From the point of view of shippers, the costs of switching between liner shipping services are generally considered to be low as there are no particular specialised equipment needs for the shippers to tie them to a particular shipping line.

The probability of switching between competitors by shippers in response to freight rate increases is dependent upon a variety of factors which in turn determine the level of perceived or real loyalty to a particular line by the shipper. This has several dimensions, which includes distance from the origin and destination ports and the value of the cargo.

In terms of port coverage all of the lines call at Hong Kong, while only one line calls at Xiamen (COSCO) and one consortia line calls at Chiwan (ACE). However, given that these ports are in very close proximity to Hong Kong, it could be expected that lines (comprising all seven services) that call at Hong Kong would place some constraint on freight rate increases by COSCO and ACE for calls in Xiamen and Chiwan respectively.

High volume shippers may have different needs to small shippers because they are seeking benefits such as guaranteed space availability or special equipment and as a group they may not be as ready to switch as small shippers. They may however possess greater countervailing power in negotiating suitable deals from their shipping line.

It is possible that some smaller shippers transporting low value goods may have less flexibility in choice of liner shipping companies because the liner companies regard their products as offering only a marginal contribution to revenue. In some cases, lines may offer low freight rates for a particular type of container cargo (such as wastepaper). When freight rates are rising, and demand for slot space becomes tight, the lines may displace low value cargoes in favour of higher valued cargo. If rates rise high enough, these lower valued good importers may be priced out of the market altogether. On the other hand, it has been claimed that lower valued cargo consignees are more loyal and will stay with liner companies in periods of freight rate decline in return for the liner company servicing their trade in previous times of buoyant rates, thus valuably contributing to their base loads when demand softens.[44] However, in general switching costs between shipping lines is considered low and there is very little evidence of capture of shippers by lines.

Very high value customers may have some customer loyalty to a shipping line that has a 'reputation' for quality service on the trade, rather than risk moving to another line whose quality of service is unknown. The extent of this type of loyalty is not known on this liner trade.

4.1.11 Breakbulk liner services and air freight operators

Breakbulk shipping and airline freight are possible substitute services are at opposite ends of the market spectrum. Importers of low valued goods may find the slower break bulk service offered by PAS as a suitable alternative to the liner services offered by the AADA lines. In responding to the Commission's enquiries, the importers, the AADA itself and PAS did not consider the PAS service as a serious competitive threat to the AADA lines. Although PAS does carry containers, it sets its own prices on the southbound liner trades using as a benchmark prices charged by the AADA-member lines. PAS also offers a lower quality of service in terms of transit time and frequency, the two major variables of non-price competition. Accordingly, PAS offers rates that are discounted below those of the AADA-member lines.

PAS has recently increased the number of vessels it has on the trade from three to four.[45] However, this expansion is largely due to improved prospects in breakbulk rather than in containers.

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[44] M Brooks (1997) Sea Change in Liner Shipping Regulation and Managerial Decision Making in a Global Industry p 203
[45] Containerisation International (2003), Tonnage Injection provides PAS booster, February 2003 p 39

As for air cargo services, these offer extremely fast transit times that are limited in capacity and relatively expensive. They are generally only suited to high valued, low weight cargoes. For the vast majority of cargo shipped by sea, the Commission does not consider air services to be economically viable substitutable services. As such, the Commission has not included them as part of the market being considered in this investigation.

4.1.12 The Geographic Market

Geographic boundaries of markets in liner shipping are usually defined in terms of trade lanes between regions (such as North Asia and Australia) rather than in terms of port pairs (such as Hong Kong and Melbourne). According to the extent that shippers move products to destinations inland, or source products from inland locations, they are offered a choice of port combinations in both countries.[46] In terms of the North East Asia to Australia southbound liner trades, this approach of trade lane rather than port pairs is largely adopted with one or two caveats. Firstly, in Australia, all of the shipping lines that participate in the North East Asia – Australia southbound liner trades offer direct liner services to all of the major ports on the eastern seaboard (Brisbane, Melbourne and Sydney). Several of these lines offer transhipment liner services via Singapore to Fremantle but there are no direct liner services between Fremantle and North East Asia. Also, using the direct services to the Australia east coast and then the rail link between Perth/Fremantle and the east coast would not be as competitive as the transhipment liner services through Singapore, due to the higher overall trip freight rates (the addition of the rail freight price onto a freight rate to Melbourne) and slower overall transit times.

Thus it could be recognised that, due to the different structure of services that call at Fremantle and the lack of possibilities to arbitrage rates by using rail services from the east coast, Fremantle and the east coast ports lie in distinctly different submarkets.

The Port of Adelaide on the other hand could be considered to be part of the east coast market even though only PAS offers liner services to Adelaide. This is because of the relatively more competitive land bridge services by road and rail over the shorter distance between Adelaide and Melbourne.

The final distinctions that can be made are between North Asia and East Asia. The former is defined as Japan and South Korea and the latter is defined as PRC, Hong Kong, Taiwan and the Philippines. The complaints concerning freight rate rises are those for carriage of goods from PRC, Hong Kong and Taiwan and to a lesser extent South Korea. This could reasonably lead the Commission to delineate East Asia as the relevant geographic market. However, it would appear to be relatively straightforward for a line to switch services between the North Asia and East Asia regions, for all it would require is a change in port rotation.[47] In addition, attempts to analyse liner shipping operations separately is complicated by the fact that several

[46] Pirrong (1992) An application of core theory to the analysis of ocean shipping markets, Journal of Law and Economics 35 pp 89 -131.
[47] The AADA-member lines are large global operators and already have a market presence in PRC due to their participation on other liner trades.

consortia (FESCO, MSC/MSL, NEAX, ACE) operate liner services from both regions, making an analysis of the operating costs and profitability associated with each region more difficult.

Thus, in assessing conduct associated with the AADA, the relevant geographic market is considered to be the North East Asia – Australia southbound liner market, rather than the East Asia – Australia southbound liner market. In Australia, for the purposes of this investigation, the Port of Fremantle in Australia is considered to be differentiated from the east coast ports and Adelaide.

4.1.13 Significance and Direction of the North East Asian Liner Trade

This section reviews the significance of the North East Asia – Australia liner trade and highlights the direction of that trade.

In terms of both volume and value the North East Asia – Australia liner trade carries about one third of liner exports from Australia and one third of liner imports to Australia.

Table 4.4 shows the significance of the North East Asia – Australia liner trades in term of value relative to other Australian trades.

Table 4.4: Value of containerised cargo on major Australian liner trade routes, 2002-03 ($A'000)

Trade Route	Exports	Imports	Ratio of Export to Import values
East Asia	7,549,108	14,896,857	0.51
North Asia	7,789,767	15,426,504	0.50
South East Asia	5,326,521	7,825,859	0.68
Europe	5,763,768	19,078,148	0.30
North America	6,440,070	10,023,227	0.64
New Zealand	4,167,015	3,198,113	1.31
Other	10,673,560	11,535,542	0.93
Total	**43,542,795**	**74,158,393**	**0.59**

Source: Bureau of Transport and Regional Economics, International Cargo Statistics Database (accessed January 2004).

Table 4.4 demonstrates that, in terms of value, liner imports from East Asia in 2002-03 were approximately $A14.9 billion, representing Australia's third largest source of imports after Europe and North Asia. The value of liner imports from North Asia was approximately $A15.4 billion in 2002-03. By contrast, the value of Australia's liner *export* trades with East Asia and North Asia was far lower at approximately $A7.6 billion and $7.8 billion respectively in 2002-03.

Data sourced from port authorities show that the trade imbalances in value are also replicated in terms container numbers. This means that ports such as Sydney and Melbourne accumulate significant numbers of empty containers from North East Asia.

4.1.14. The AADA and the North East Asia – Australia Southbound Liner Trades

In 1999, fifteen shipping lines operating on the North East Asia – Australia southbound liner trade formed the AADA, which was registered pursuant to Part X in April 2000. Since then it has been varied a further three times with China Shipping Co Ltd joining the agreement in August 2001, Yang Ming exiting the agreement in December 2002 and Columbus Line joining the agreement in January 2003. Currently there are 16 shipping lines that are members of AADA. There is only one shipping line that participates in the direct southbound liner trade from North East Asia and Australia that is not a party to the AADA. This is Project Asia Service (PAS). According to Table 4.1 the AADA's capacity share (including that of Evergreen Marine and Hanjin Line) of the direct southbound liner trade from North East Asia is 98 per cent. (Excluding the two "non-participating" carriers the AADA's capacity share of the direct liner trade is 91 per cent).

The AADA is a discussion agreement, which is a talking group between members of consortia and independent carriers (such as COSCO). Article 4 of the AADA registered agreement provides that member carriers can discuss freight rates, service items and trade rules.[48] The AADA also specifies that the agreement is non-binding in that member lines can choose not to abide by decisions made by AADA members collectively. In addition, member lines are free to quit the AADA on thirty days notice. According to the AADA submission, in practice the members of the AADA attempt to implement uniform collective increases in base market freight rates charged by the individual member carriers. However, the view of the AADA is that the degree of success in implementing AADA-agreed freight rate increases depends on the demand or supply surpluses in the market at the time.

According to the AADA's submission, the AADA is neither a forum for decision-making about joint scheduling and provision of service nor for joint investment decisions. Rather, investment decisions are made at the individual consortia forums such as ACE, NAX, and NEAX. What the AADA is argued to provide is a forum for collection of market intelligence about supply and demand factors in order to facilitate decision making about investment and scheduling of services.[49]

The Australia New Zealand Eastern Shipping Conference (ANZESC) is a registered conference agreement among seven liners companies (also members of the AADA) operating on the southbound liner trades from North East Asia. According to the AADA its main trade focus is North Asia (Japan and Korea) and so its role for the purposes of this position paper is probably not as relevant as those of the consortia.[50]

4.1.15 Recent Trends in Liner Supply from North East Asia to Australia

The purpose of this section is to describe the supply dynamics within the Australia – North East Asia northbound and southbound liner trades since 1999 (being the year the AADA was first formed). The trends in supply and demand balance of the

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[48] Ibid
[49] AADA (2003) Submission op cit p 13.
[50] AADA (2003) Questionnaire response to ACCC p 18

respective northbound and southbound liner trades between Australia and North East Asia and its implications for movements in freight rates will be outlined in section 4.3. The supply and demand trends will also set the context for the discussion of the impact that the AADA has had on competition in the recent past, which are developed in chapter 6.

In the period immediately prior to and including 1999, there was a significant expansion of liner capacity on the North East Asia – Australia northbound and southbound liner trades.[51] The capacity expansion was associated with entry by new carriers into the trade as well as some expansion in capacity by the then incumbents. In turn this led to a significant surplus of supply over demand, particularly northbound.

Over the period since 1999, there has been a significant reduction in the level of supply by the incumbent lines participating in the North East Asia – Australia northbound and southbound liner trades. This has coincided with a number of organisational changes in the liner membership of consortia and in service configurations to and from North East Asia. There has also been a few lines entering and exiting the trade.

In late 1999, commentators in the industry press reported that the North East Asian – Australia liner trades was 100 per cent over capacity.[52] This occurred due to market entry and increases in capacity by incumbent shipping lines. Over the period 1997 to 1999, MSC, Maersk, China Shipping Company and Evergreen Marine all introduced new liner services in this trade. The northbound conference ANSCON reacted by introducing an additional service to China and Western Japan in July 1999. As a result, freight rates fell dramatically in 1999 for both northbound and southbound trades. Northbound freight rates to Hong Kong fell to as low as $AUD450- 550 per TEU and southbound rates for cargoes from Hong Kong to Australia fell to between $US550 and $US600. [53]

In response to this oversupply, lines have substantially reduced their supply to this trade during 2000 and 2001. In late 2001 and 2002, there were numerous changes to membership of various carrier consortia agreements and some market entry and exit by shipping lines.[54] A modest increase in supply of capacity was reported in 2002.[55] Since September 2002, it appears that there have been only minor changes to capacity provided for both the northbound and the southbound liner trades, with some

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[51] In 1997, MSC entered the Australia North East Asia liner trades as an independent carrier, while the following year Maersk entered the Australia North East Asia liner trades by forming a consortium with Cho Yang and Blue Star Line. Later in 1998 Sea-Land entered in a slot sharing alliance with Maersk, before that company was acquired by Maersk in July 1999.

[52] LLDCN Asian carriers start the long march on rates Monday November 13 1999 p 1

[53] LLDCN Fundamentally the rates are shot but hopes grow that Asia has turned the corner Friday April 30 1999 pp 6-7.

[54] American Presidents Line and Columbus Line entered the trade in June and July 2002 while Yang Ming and Wallenius Wilhelmsen vacated the trade in April 2002, and March 2003.

[55] LLDCN, After the deluge, September 26 2002 p 11
During the changes it was also reported that the lines did not want to increase capacity significantly LLDCN, North East Asia trade: the same, done differently March 28 2002 p 3

consortia marginally increasing capacity while others reduced capacity.[56] The total number of vessels supplied by the AADA member lines to the southbound liner trade has remained unchanged at 30 since June 2001 (Table 4.6 p 45).

According to *Drewry, Container Quarterly*, the northbound capacity fell marginally from January 2003 to September 2003 while southbound capacity was marginally larger.[57]

This recent history suggests that the North East Asia – Australia liner trades are fairly contestable with a lot of entry and exit into the market over the period 1999 to 2002. However, this history also shows that many independent lines which entered the North East Asia – Australia liner trade have quickly formed partnerships with other lines already operating in the trade. This includes such traditionally independent lines as Maersk Sealand, MSC, COSCO and Evergreen Marine. On the southbound trade lane, all lines that have entered have subsequently joined the major discussion group, the AADA.

As of February 2003, the industry press reported that the lines that participate on these trades had no plans for additional or larger vessels and they doubted that there would be market entry in the then current environment.[58]

4.2 Global Trade Factors

Global trade factors have several implications for the current demand \ supply balance in the southbound liner trade from North East Asia to the major Australian east coast ports. The cyclical nature of international liner trades is borne out strongly in the past few years. Following a boom year in 2000, world merchandise trade slumped in 2001 and then growth picked up strongly again in 2002 and continued into 2003. According to the World Trade Organisation (WTO), world merchandise exports in volume terms grew by 11 per cent in 2000, fell by 0.5 per cent in 2001, and grew by 3 per cent in real terms in 2002. For 2003, the WTO forecast a real increase in world merchandise trade by 3 per cent.[59]

The major factors behind the recovery in trade in 2002 were strong import demand in the developing Asian economies including China, the transition economies and the US. In addition, China has recorded outstanding growth in exports and imports. According to the WTO, China's merchandise trade growth was three times faster than global trade in the 1990's. Further, between 2000 and 2002 China's exports and imports increased by 30 per cent against a background of slow growth in overall world trade.[60] These developments are reflected in demand trends for containerised trades in 2002.[61]

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[56] LLDCN, Lines' performance: how they fared, September 4 2003 pp 13-14
[57] LLDCN, op cit September 4 2003 p 11
[58] Containerisation International (2003), Healing Powers February 2003 p 37
[59] World Trade Organisation (2003), International Trade Statistics p 17 & p 19
[60] WTO (2003) op cit p 1
[61] This is partly driven by a pegged Yuan -$US dollar exchange rate and record foreign capital and relocation of industrial infrastructure to China. LLDCN (2003) Blockbuster Beijing turns world trade

4.2.1 *Global demand for liner cargo shipping services*

In 2002, volumes carried on several of the world's major east west liner trades began to recover from the low cargo growth of 2001. The strongest recovery in volumes was registered on the eastbound transpacific trades from Asia to the US, where volumes increased by 8.8 per cent from 2001 to 2002. For the corresponding period, westbound liner trade volume growth in 2002 was only 1.2 per cent, following no change in westbound volumes from the US to Asia in 2001.

Cargo volumes on the Asia – Europe eastbound liner trades increased by 4 per cent in 2002, and the westbound trades increased by 3.4 per cent. For the trans-Atlantic liner trades, volume growth was 4.7 per cent in 2002 on the westward leg from Europe to the US, but only 0.3 per cent in the opposite direction.

In 2003, cargo growth on the major east west liner trades has continued to expand. In the first ten months of 2003, the value of total exports from China increased by 32.8 per cent and the value of Chinese imports increased by 36.7 per cent compared to first ten months of 2002.[62] For the Far East – Europe westbound liner trades Drewry Shipping Consultants calculate that there was 18 per cent growth in cargo for the year 2003. It also predicts further increases in 13 per cent in 2004 and 10 per cent in 2005.[63] For the trans-Atlantic trades Mitsui forecasts a 3 per cent increase in the westbound trade to US from Europe and a 4 to 5 per cent growth in the trade in the opposite direction.[64]

4.2.2 *Global supply of liner shipping*

In the three years to 2002, world supply of liner shipping increased by 446,000 TEUS in 2000, 623,000 TEUS in 2001 and 640,000 TEUS in 2002.[65] This was prompted by low prices for new ship buildings. Both 2001 and 2002 represented historical peak years in annual (containership) vessel delivery in terms of tonnage. Despite the historically high delivery rate of new ship buildings into the trades, increases in demand easily absorbed the increase in supply and demand / supply balances on the major east – west trades remained tight in 2003.[66]

The continued surge in container demand has prompted the lines to issue new orders, some specifically designed for upgrading the east-west liner trades out of Asia. In 2002 orders for 87 vessels totalling 400,046 TEUS were placed with the shipyards and in 2003 a further 237 vessels at just over 1 million TEUS were ordered.[67] The

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on its head Thursday December 4 2003 p 13 and LLDCN (2003) Currency revaluation to release pressure valve, Thursday October 2 2003, pp 13-14

62 LLDCN (2003) China's trade just keeps growing November 17 2003 (electronic mail)

63 LLDCN (2003) Will 2005 be the year the box trades bubble bursts?, Thursday December 24 2003 p 4

64 Mitsui OSK Lines (2003), Container Trade Supply / Demand Forecast for Three Major East-West Trades November 28 2003 p 4

65 Mitsui OSK (2003) op cit p 1, Clarksons Research Studies (2002), Container Intelligence Quarterly 4th Quarter 2002 p 108

66 LLDCN (2003) Squeeze hits rates 1 May 2003 p 8

67 Mitsui OSK (2003) Containerships New orders as of 12 December 2003

current order book comprises 473 vessels of about 2.7 million TEUS or 36 per cent of the existing fleet.[68] In 2004, about 186 vessels of 670,000 TEUS are due to be delivered from the shipyards and a further 176 vessels of 721,000 TEUS are due to be delivered in 2005.[69]

According to a number of observers, the current lack of supply relative to demand is expected to continue, resulting in upward pressure on shipping charter rates and freight rates until 2005 or 2006.[70] For 2005, numerous analysts forecast that charter rates would start trending downwards due to a glut of vessels that will be cascaded out of the large east – west liner trades as these trades absorb the larger vessel new buildings.[71] However, they have also predicted that freight rates will continue to stay high due to continued high demand for products sourced from East Asia.

4.2.3 Recent Movements in Global Freight Rates

The lagging of supply of shipping capacity behind increase in global demand is likely to have contributed to some increase in global freight rates. In this respect the Commission notes that liner conferences have reportedly been successful in raising freight rates on Asia – Europe liner trades and trans-Pacific trades. However, there is elsewhere some evidence that announced increases are not being achieved.[72]

According to Drewry, average freight rates per TEU are forecast to increase by 7 per cent in 2003 to $US1224 per TEU for all liner trades. At the end of the second quarter 2003, average freight rates on the eastbound trans-Pacific liner trades to reached $US1,717, a twelve per cent increase when compared to the 2nd quarter in 2002. On the Asia –Europe trade routes, Containerisation International has reported that freight rates increased by 42 per cent for to reach $US1,570 in the second quarter 2003.

However, according to Drewry, the revenue per TEU (and profitability) of the carriers has not yet returned to the levels recorded for the boom year of 2000.

The potential implications of this buoyant worldwide liner market for the supply response of the carriers that participate on the North East Asia- Australia liner trades are as follows:

> vessel utilisation on many trades is likely to remain high and carriers will have a choice of a number of improving markets in terms of revenue and returns in which to place new vessels in competition with the North East Asia – Australia

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[68] LLDCN (2004) Box rates will boom but time bomb beyond 2006 warns broker (electronic mail) 21 January 2004 p 1
LLDCN (2003) Drewry paints upbeat picture of containership market 10 October 2003 (electronic) mail p 1
[69] LLDCN (2004) loc cit, BRS Alpha Liner (2003), Fleet Growth September 2003 p 8
[70] Mitsui OSK (2003) op cit p 1, LLDCN (2004) Will 2005 be the year the box trades bubble bursts? Thursday December 24 2003 p 4
[71] Ibid, LLDCN (2004) Broker's Boxship warning, Thursday January 22 2004 p 13
[72] LLDCN (2004) Shippers resist Asia rates, Thursday January 15 2004 p 9

liner trade. The opportunity cost of placing a vessel on the North East Asia – Australia liner trades has increased;

vessel charter rates have increased significantly in recent times due to the imbalance of demand for vessels over supply. For example, for a 2,750 TEU vessel suitable for employment on the North East Asia – Australia liner trades, charter rates have increased from about $US7,000 per day in January 2002 to about $US30,000 per day in December 2003.[73] This increases the actual and opportunity cost of introducing new vessels into the North East Asia – Australia liner trades for the carriers;

there is a dearth of suitably sized vessels for the North East Asia – Australia liner trades in the 2000-3000 TEU range;[74]

However, this may be addressed in future as larger (2000-3000 TEU) vessels are cascaded out of the east – west liner trades and replace the 1,700 TEU vessels.[75]

4.3 Barriers to Entry / Exit

4.3.1 Regulatory Barriers to Entry

The liner shipping industry is generally characterised having very low regulatory barriers to entry or expansion. As is the case with the North East Asia – Australia liner trades, there are few, if any, constraints imposed by Governments preventing or hindering entry into or expansion in markets. Governments in the North East Asia region have phased out cargo reservation policies that guaranteed market share for their own national carriers and made expansion by competitor lines more difficult. In fact, the market share of in China's international trade of its national line, COSCO, has fallen sharply since the 1980s because COSCO's capacity has not kept pace with the booming trade. [76]

The insignificance of regulatory barriers to entry or exit in the North East Asia – Australia liner trade is consistent with observations in the market over the period 1997-1999, where several lines entered almost at once.

4.3.2 Sunk costs and contestability of the North East Asia – Australia Liner trades

Even if barriers to entry associated with regulation are insignificant, in some markets the fundamental economics are such that they represent a barrier to new entrants.

At the time the Commission launched its investigation, new entry into the North East Asia – Australia liner trades did not appear likely. In response to questions

[73] AADA (2003) – Clarksons Research Studies, Submission op cit LLDCN (2004), Box routes face chop as charter rates go sky high Thursday February 19 2004 p 14
[74] AADA (2003) Submission op cit p 13
[75] LLDCN (2004) loc cit
[76] LLDCN (2003) Blockbuster Beijing turns world trade on its head 4 December 2003 p 13

concerning market entry the AADA submission stated that there was no expectation of new entry into this market.[77] Since that time this picture has changed with PIL, APL and Zim announcing that they will begin a new five vessel service between Australia and Hong Kong/ Taiwan in May 2003.[78] There is also speculation that Hapag Lloyd may enter the trade and commence a five vessel service with Hanjin Line and Evergreen Marine. This may lead to a further eight to ten vessels entering the liner trade during 2004. [79]

Entry into any particular Australian liner trade is not costless nor without risk, but the level of sunk costs may be quite low as vessels are not generally specialised for a trade and can be shifted from one trade to another.[80] However, a potential sunk cost arises if the new entrant must invest in terminal facilities. The Commission's observation is that in Australia, none of the carriers have direct interests in terminal facilities, with the exception of P&O Nedlloyd and P&O Ports. This suggests that ownership of terminal facilities in Australia is not a prerequisite to entry.

Several of the carriers currently operating on the North East Asia – Australia trade have interests in terminal infrastructure, and even dedicated terminal infrastructure, in North East Asian ports.[81] However, the Commission's view is that these ownership links are unlikely to represent a significant barrier to entry. This is simply due to the large size of (and the competition between) the container terminals in North East Asian ports.

Further, while conference lines previously employed loyalty programs and rebates to "capture" the business of shippers,[82] this practise has now declined. Notwithstanding this, incumbent lines could be expected to possess several advantages over an entrant such as experience in the trade, strong market branding, economies of scale or customer loyalty.

Finally, the Productivity Commission in its Part X Inquiry stated that while contestability in Australian liner trades is not perfect (which would require zero sunk costs and riskless entry and exit) potential competitors can constrain the pricing behaviour of incumbents.[83]

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[77] AADA (2003) Submission op cit p 17

[78] LLDCN (2004) Zim confirm east Asia talks Thursday January 15 2004 p 3

[79] New Zealand Shipping Gazette (2004), Take your partners for the next line dance, No 3/04, pp 20 & 22

[80] Trace K (1985) Contestable Markets Theory Applied to Australian Overseas Liner Shipping Arrangements, Maritime Studies, No 21 p 5

[81] Maersk Sealand has a dedicated terminal in Kaoshiung (Taiwan) and Yokohama (Japan). It also has terminal interests in Yantian, Qingdao and Dalian (PRC). Evergreen Marine has terminal interests and a dedicated terminal in Kaoshiung, while OOCL has a dedicated leased terminal facility also at Kaoshiung. COSCO have ownership stakes in terminals in Hong Kong, Shekou, Yantian, Shanghai, Zhangjigang and Qingdao (PRC). Hanjin Line has its own dedicated terminal facility in Busan, Korea. On the other hand potential new entrant, APL has dedicated terminals on long leases in Kobe and Yokohama, Japan and a terminal in Kaoshiung, Finally P&O Ports have terminal interests in Shekou (China) Source: Drewry (1998), World Container Terminals Global Growth and Private Profit, April 1998 pp 51-56 and p 42.

[82] Trace K (1985) op cit p 6

[83] Productivity Commission (1999), op cit B8-9.

4.4 Characteristics of Demand

This section will outline some of the demand characteristics of the North East Asia – Australia liner trades. Section 4.4.1 will examine recent demand trends for imports from and exports to this region in particular highlighting the dramatic increase in Australian imports from China and the Special Administrative Region, Hong Kong, in recent times. This demand surge is the market dynamic which is an important factor behind the significant increases in market freight rates for carriage of imports from China and Hong Kong as shown in section 4.5.

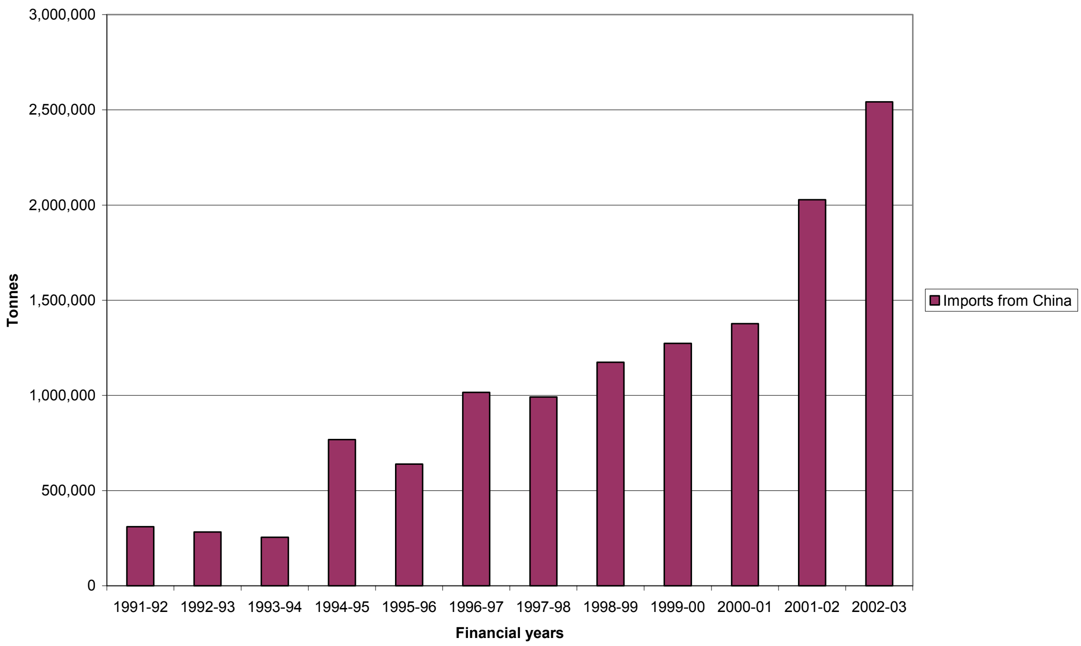
Section 4.4.3 will describe the other characteristics of this liner trade, namely a growing imbalance between northbound (export) and southbound (import) liner trades and its pronounced seasonality, when import demand spikes over the Australian spring and summer months. Furthermore, the divergent trends in capacity utilisation vessels operating on the respective northbound and southbound liner trades are shown in section 4.4.4.

Section 4.4.5 will examine the extent that Australian importers have countervailing power in its dealings with the shipping lines in the North East Asia – Australia liner trades.

4.4.1 Imports and Exports by Volumes and Value

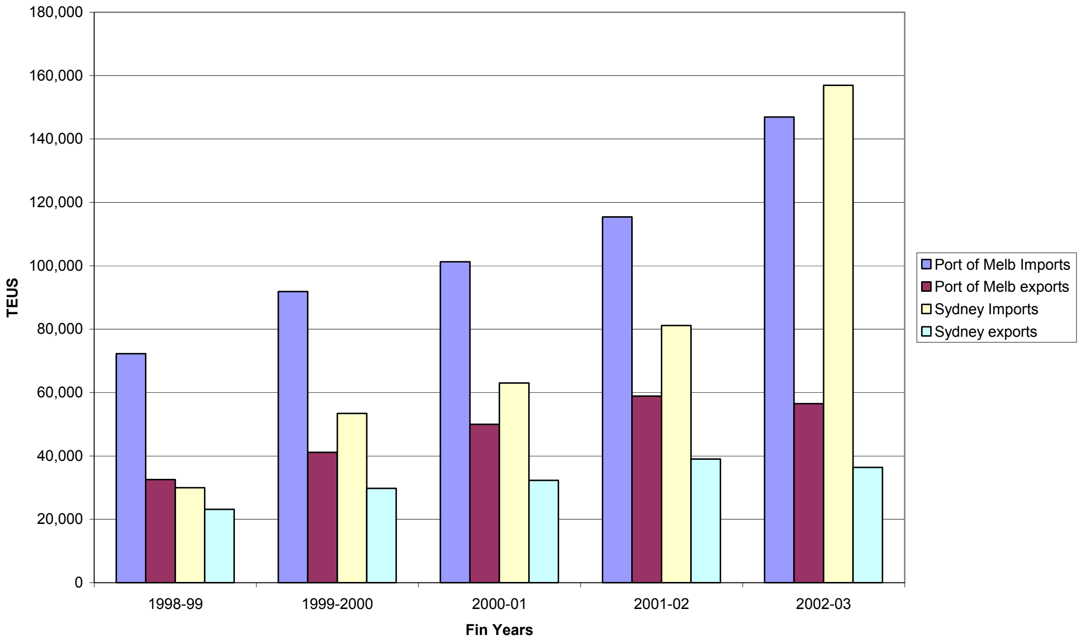
There has been a significant expansion in Australian demand for goods produced in the Peoples Republic of China (PRC) in recent years. In 2002-03, demand for liner imports sourced from the PRC in terms of weight increased by 25 per cent. This was the sixth consecutive annual increase since 1997-98. Since that time liner imports from PRC to Australia have increased on average by 17 per cent per annum. The largest single annual increase was in 2001-02, when liner imports from PRC increased by 47 per cent. These trends are shown in chart 4.1 below.

Chart 4.1: Trends in Liner imports to Australia from the Peoples Republic of China since 1991-92 by weight. (tonnes)



Source: BTRE International Liner Cargo Data Base accessed September 2003

Chart 4.2: Trends in containerised imports and exports between PRC, & Hong Kong through the Ports of Melbourne and Sydney 1998-1999 to 2002-03 (TEUS)



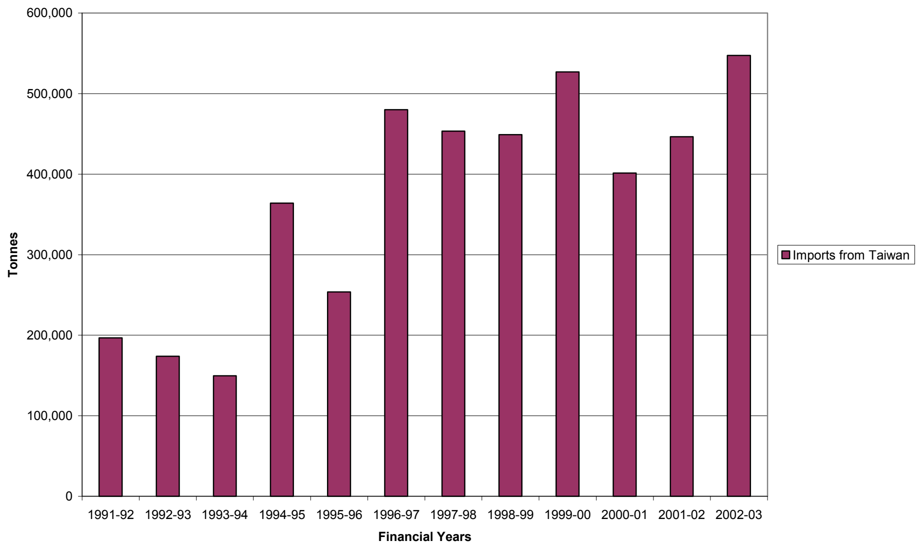
Source: Sydney Ports Corporation, Port of Melbourne Corporation (2003)

Chart 4.2 shows the scale of the recent import volume increases sourced from China and Hong Kong in terms of container numbers that flowed through Australia's two largest ports, Sydney and Melbourne over the period 1998-99 to 2002-03. Over that period, full container volumes sourced from China and Hong Kong that flowed through the Port of Sydney increased by 39 per cent per annum on average. In 2002-03, alone the annual increase was 93 per cent. Similarly for the Port of Melbourne, the average annual increase in full containers sourced from China and Hong Kong increased by 15 per cent per annum from 1998-99 to 2002-03. In 2002-03, the Port of Melbourne experienced a 27 per cent increase in the number of full containers sourced from China and Hong Kong.

While not represented in Chart 4.2, the Commission also notes that for the 2002-03 financial year the number containers sourced from PRC / HK and imported through the Port of Brisbane was 52.4 per cent higher than in the previous year.

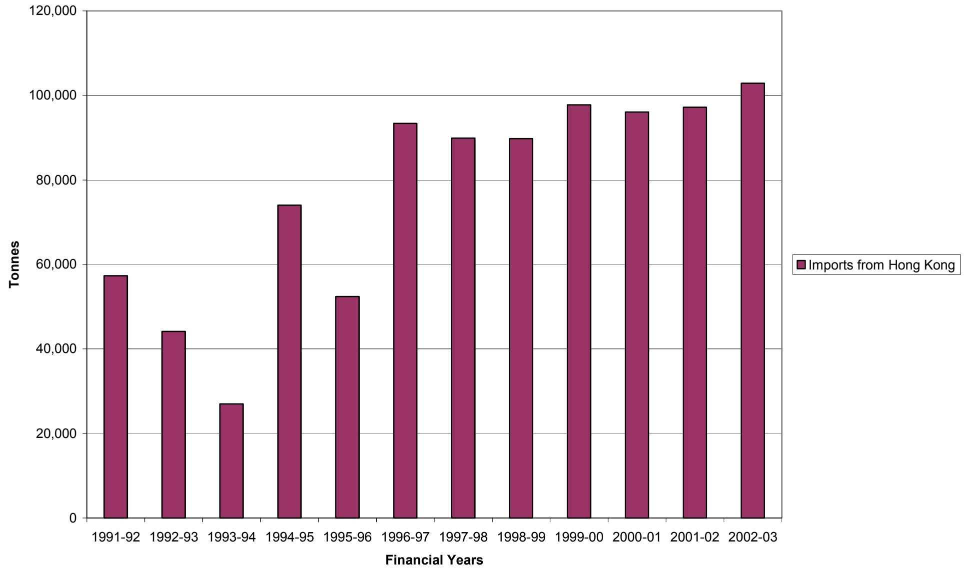
By contrast with import supply sourced from the PRC, trends in liner imports in terms of tonnage sourced from Taiwan and the Special Administrative Region, Hong Kong, have been more stable in recent years as shown in Charts 3.3 and 3.4. These charts demonstrate that although the Commission regards the market as comprising North and East Asia, the large increases in trade are primarily associated with the PRC.

Chart 4.3 Trends in Liner imports from Taiwan since 1991-92 by weight. (tonnes)



Source: BTRE International Liner Cargo Data Base accessed September 2003

Chart 4.4 Trends in Liner imports from Hong Kong since 1991-92 by weight. (tonnes)



Source: BTRE International Liner Cargo Data Base accessed September 2003

4.4.2 Export Volumes

As indicated by Chart 4.2, there is a large imbalance in the liner trade between East Asia and Australia, with volumes carried on the southbound (import) leg being far larger than those on the northbound (import) leg. By contrast, volumes on the North Asia – Australia liner trade is more evenly balanced than that of East Asia – Australia (although this is not reflected in value – refer Table 4.4, above).

Export tonnages to East Asia (PRC, Taiwan and Hong Kong) and to North Asia (Japan and Korea) have been flat due largely to the impact of the drought in Australia and to the strengthening of the Australian dollar against the US dollar. In terms of weight, liner exports to East Asia have increased on average by 2 per cent per annum between 1996-97 and 2002-03.

However, a general trend of increasing full container export volumes (as distinct from tonnages) through the Ports of Melbourne and Sydney to China and Hong Kong was dwarfed by the increases full container import volumes to these respective ports (particularly through Sydney).

Combining the export liner trades from the eastern seaboard ports to North and East Asia, it appears that in 2002-03, there was a fall of about 10 per cent in container numbers destined for North East Asia through the Port of Sydney. The container throughput through the Port of Melbourne destined for North East Asia was stable however, while that through the Port of Brisbane fell by about 2 per cent. This points to weakening load factors northbound for the lines engaged in these liner trades in 2002-03. This is further examined in the next section.

4.4.3 Trade Imbalances and Seasonality

Imbalances between the northbound and southbound North East Asia – Australia liner trades are marked and have increased significantly in 2002-03. The driver of the difference appears to be to the increased demand for import volumes, particularly from PRC and Hong Kong.

The Commission examined information available from various Australian port authorities for the 2002-03 year. This data showed the container imbalance between imports and exports in the North East Asia – Australia liner trades is particularly pronounced appreciably for the trades between PRC/Hong Kong and the ports of Melbourne and Sydney. In 2002-03, the Port of Sydney had a surplus of 120,000 import containers over exports, representing 75 per cent of all fully loaded imports. The Port of Melbourne had a surplus of 90,000 import boxes over exports (about 60 per cent of fully loaded imports) originating from PRC/ Hong Kong. Over the 2002-03 financial year, about 63,000 containers, representing about 40 per cent of fully loaded import containers were sent back empty to PRC/Hong Kong from the Port of Sydney. Similarly, about 46,000 containers (representing 30 per cent of fully loaded containers) originating from PRC/Hong Kong were returned empty from the Port of Melbourne in 2002-03.

Similarly, the Ports of Brisbane and Fremantle recorded a surplus of full import container volumes from PRC/ Hong Kong over full export container volumes in the order of 10,000 TEUS in 2002-03. The Port of Adelaide's surplus was 20,000 TEU's.

The data also indicates the extent to which the North East Asia – Australia liner trade is reliant upon the export trade to Japan to improve the overall balance of trade in the region. In each Australian port, with the exception of the Ports of Sydney and Adelaide, there is a significant surplus of full export containers over import containers in the Australian-Japanese liner trade. For the Ports of Brisbane and Fremantle this is sufficient to create a surplus of exports over imports for the trade with North East Asia.

After being relatively steady in recent years, the imbalances of imports over exports for the Australia -North East Asia liner trades through Australia's two largest ports has increased significantly in 2002-03 in line with the dramatic increase in import volumes from PRC and Hong Kong as shown in the following table 3.5. The imbalances of imports over exports in the Australia North East Asia liner trades increased by 150 per cent for the port of Sydney and by 134 per cent for the Port of Melbourne. Even the Port of Brisbane experienced a fall in its surplus of exports over imports on this trade by 70 per cent over 2002-03.

Table 4.5: Trends in supply imbalances for the Australia- North East Asia liner trades 1998-99 through the Ports of Sydney, Melbourne and Brisbane (TEUS)

	1998-99	1999-2000	2000-01	2001-02	2002-03
Sydney	-32,645	-46,281	-44,468	-54,914	-137,320
Melbourne	-33,304	-30,810	-29,769	-33,908	-75,012
Brisbane	NA	17,017	35,996	31,930	9,280

Sources: Port Authorities

The September and December quarters represent seasonal peaks in the import demand of all liner trades into Australia. This is due largely to Australian retail businesses ordering and restocking for Christmas. This pattern is replicated in the North East Asia – Australia liner trades where import volumes increase seasonally in the last two quarters of the year. The shipping lines, through the AADA, often time their rate increases to take effect in July and October to coincide with the peak season surge in demand. The rate increases announced by the AADA in 2003 appear to have succeeded in raising market freight rates. However, despite the seasonal peak, announced rate rises during peak demand months in previous years have not appreciably lifted market rates.[84] Also, in recent years the AADA members have introduced temporary (with a duration of approximately six months) peak season surcharges (PSS) to ration demand in the peak season. Peak Season Surcharges are also levied in order to cover the carrier's container repositioning costs. The AADA submission states that repositioning costs for the second half of 2003 are about $US311 per TEU which is less than the PSS of $US200.[85]

4.4.4 Capacity utilisation in southbound liner trades

While it is not possible to measure the extent of excess demand for import container slot space on carriers in the North East Asia – Australia southbound liner trades, it is possible to indirectly gauge the degree of recent tightening in the market. Anecdotal evidence from importers points to greater delays in getting boxes, more difficulties in booking space, and the non-availability of bookings 30 days ahead. All of these indicate a tightening of the demand/supply balance in the southbound liner trade.

In section 4.1.15 it was indicated that there have been modest capacity increases on the Australia – North East liner trades implemented by the lines since June 2001. Also since June 2001, as shown in the above sections, there have been significant increases in import volumes from PRC/ Hong Kong while import volumes from Japan and Korea have remained steady. Over the same period export volumes have been steady or have fallen. These factors combined point to significantly improved load factors for the lines on the southbound liner trade as well as deteriorating load factors on the northbound liner trades. These opposite trends are shown in the Table 4.6. According to this table, average monthly vessel utilisation (southbound) improved from 60 per cent in June 2001 to 90 per cent in June 2003. Over the same time period the average monthly vessel utilisation northbound fell from 88 per cent in June 2001 to 68 per cent in June 2003.

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[84] AADA (2003) Questionnaire Response p 10
[85] AADA (2003) Submission_ op cit p 9

The pronounced seasonality of the September peak in imports from North East Asia is also evident, where average monthly load factors reach the order of 98 per cent in each September quarter.

Table 4.6: Average monthly Load Factors for AADA lines June 2001 to September 2003 (full containers divided by total number of slots).

Year	Number of vessels southbound	Average monthly load factor of all vessels (southbound)	Number of vessels northbound	Average monthly load factor of all vessels (northbound)
June 2001	30	60%	30	88%
Sep 2001	30	98%	30	87%
Dec 2001	30	80%	30	80%
Mar 2002	30	72%	30	82%
June 2002	30	80%	30	78%
Sep 2002	30	99%	30	74%
Dec 2002	30	93%	30	68%
Mar 2003	30	85%	30	69%
June 2003	30	90%	30	68%
Sep 2003	30	100%	30	57%

Source: AADA Questionnaire

4.4.5 Countervailing Power of Importers

The purpose of this section is to examine the countervailing power of the importer community in Australia in its dealings with shipping lines in negotiating freight rates and service provision standards.

According to the ABS, in 2001-02, there were 54,385 businesses that imported goods into Australia of a value of greater than $A 10,000 on an annual basis. Collectively, they imported approximately $A 120 billion worth of goods. Of approximately 54,000 importers, 0.2 per cent (163) of importers imported 47 per cent ($A 56.3 billion) of imports by value into Australia. This group of large importers imported on average more than $A100 million worth of goods each. The next category of importer businesses, with individual imports ranging from $A 1 million to $A100 million, numbers 8,029 (or 14.7 per cent) and also brought $A 56.3 billion (47 per cent) of goods to Australia. By comparison, the great majority of importer businesses are relatively quite small. In 2001-02, over half of importer firms (29,329) individually had annual imports valued between $A10,000 and $A100,000, representing only $A 1 billion (or less than 1 per cent) of total goods imports.[86]

Consequently, on an individual basis, it could be expected that the importers in the first group, which import goods of a value of greater than 100 million dollars may possess some ability to negotiate favourable freight rates for themselves. Even in the

[86] Australian Bureau of Statistics (Dec 2002), International Merchandise Trade 5422.0 Feature Article Australia's Exporters and Importers 2001-02 p 18

current tight market for imports from North East Asia it is unlikely that it is becoming more difficult for this group of importers to negotiate freight rates with the lines. The AADA has advised the Commission that the practice of offering discounted rates had not appreciably changed in 2003.

According to the AADA, it is common for shippers to enter into contracts which offer negotiated discounts of between 10 and 25 per cent.[87] The IAA also stated that it believed that a handful of large firms could still negotiate discounts in the current market climate.[88] However, for the remaining groups of importers which represent the large majority, negotiating ability with the lines in the current market environment would vary individually. Obviously, the companies with import purchases in the range of close to $100 million would have more negotiating leverage than one that was closer to $1 million.

On a collective level, Part X of the TPA allows importers to negotiate in a collective manner with the conferences and discussion agreements that have been registered for the North East Asia – Australia liner south bound liner trades. Since April 2000, importers have been able to form designated secondary bodies and have them registered under Part X to negotiate collectively with the lines on freight rates for eligible Australian contracts. At present there are only four such bodies that have been registered under Part X. These are the South Australian Shipper Users Group, the West Australian Shipper Users Group, the Federated Chamber of Automotive Industries, and the Australian Federation of International Forwarders. The efficacy of these organisations as designated secondary bodies in representing the interests of importers in terms of their dealings with the shipping lines on the North East Asia-Australia southbound liner trades is unclear. Only one of these organisations responded to the ACCC's issues paper.

Additionally, the import trade's peak shipper body, the Importers Association of Australia (IAA) can negotiate (with the AADA) minimum service levels provided the lines to the trades. The IAA can also negotiate other terms and conditions for eligible Australian contracts, such as the tariff levels as applicable to the small importer. However, since the IAA's inception in 2000, there have been no negotiations concerning tariff levels or minimum service levels between the IAA and the AADA. The AADA submission states that the AADA does not set a tariff level. The Commission notes that this differs to discussion agreements that participate on other Australian liner trades. The AADA has advised the Commission that the minimum levels of liner service (MLS) that the AADA parties are obligated to provide to the trade are set at 80 per cent of the current capacity. Despite the increasing tightness of the liner market from North East Asia there has not been any renegotiation between the IAA and the AADA about minimum service levels. It appears that the MLSs are currently determined by the current capacity that is in place, rather than by increasing levels of demand. However, even if the two parties (AADA and IAA) moved immediately to negotiate the MLS's, the negotiations may not be effective in increasing the capacity provided given the current climate of excess demand. The Commission notes that while Part X grants the shippers a right to negotiate, it does not require the parties to reach an agreement.

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[87] AADA (2003) Questionnaire op cit p 11
[88] IAA (2003), File Note Meeting with ACCC December 9 2003 p 2

Furthermore, countervailing power held by importers will be limited by the extent that customers of the AADA can reasonably seek alternative sources of supply. As discussed elsewhere in this paper, alternatives appear to have been particularly limited over the *reference period*.

4.5 Freight Rates

4.5.1 Trends in Southbound Liner Freight Rates

The impetus for this current investigation was complaints by importers concerning a steep increase in freight rates for cargos from PRC, Hong Kong and to a lesser extent South Korea. This increase occurred over a period of four months following the first announcement by the parties to the AADA of a general freight rate increase of $US500 from the 1 July 2003. Table 4.7 shows the increases in freight rates announced by the AADA over the period July 2002 to October 2003. From 1 July 2003 to October 2003, the cumulative announced increases amount to $U750 per TEU and $US1500 per FEU. In addition, a $US200 per TEU and $US400 per FEU peak season surcharge was applied from 1 August 2003. On 22 January 2004 the AADA announced that it was removing the peak season surcharge as of 1 February 2004.[89]

Table 4.7: Announced freight rate increases and application of peak season surcharges by the AADA

1 July 2002	**10 October 2002**	**10 October 2002**	**1 January 2003 ***	**1 July 2003**	**1 August 2003**	**1 October 2003**	**1 January 2004**
$US200 per TEU	$US100 per TEU	$US100 per TEU	$US100 per TEU	$US500 per TEU	$US200 per TEU	$US250 per TEU	$US300 per TEU
$US400 per FEU	$US200 per FEU	$US200 per FEU	$US200 per TEU	$US1000 per FEU	$US400 per FEU	$US500 per FEU	$US600 per FEU
Increase in base rates	Increase in base rates	Peak season surcharge to apply to 31 January 2003	Increase in base rates	Increase in base rates	Peak season surcharge to apply to February 1 2004	Increase in base rates	Increase in base rates applicable to Korea only

Source: Lloyds List Daily Commercial News various issues

This included an increase in freight rates ex Korea of $US250 per TEU and $US500 per FEU

Freight rates have increased sharply in response to the efforts of the AADA parties to jointly increase rates, because they have been supported by a southbound trade that has excess demand. Both carriers and the importers largely agree that the rate

[89] LLDCN (2004), East Asia peak season surcharge to go Electronic Mail January 22 2004 p 1

increases have held in the market.[90] The AADA has advised the Commission that the between 80 to 90 per cent of cargo on the trade is subject to contracts for 3 months, 6 months and 12 months. Consequently, the spot market is estimated to represent between 10 and 20 per cent of cargo. [91] The AADA has also advised that it members successfully sought increased prices for its contract cargoes in 2003.

The impact on average market freight rates of the announcements of increases by the AADA depends upon several factors, including:

- extent of excess demand (which currently appears to be high);
- the proportion of importers in the market who have lengthy time periods until contract expiration;
- the extent to which these contracts are currently renegotiated; and
- the degree of countervailing power that the importers may possess.

In their submissions various importers gave an indication of the scale of the recent increases in freight rates ex-China and the levels to which blue water freight rates have reached according to their experience. Table 4.8 shows the increases in these rates and the level of rates.

Table 4.8: Experiences of Individual Importers of increasing freight rates

Name of Company	Increase in rate (%)	Over what time period	Old level of freight rate	New level of freight rate
Importers Association of Australia	$US800-$US900 per TEU (160%) $US1300 per FEU	Sep 2003-Dec 2003	$US500-$US700 per TEU	$US1300 - $US1450 per TEU
Importer	Over 100%	6 months	NA	NA
Importer	100%	6 months	NA	NA
Importer *	50% (85%)	1 month August 5 – August 31	$US650 per TEU	$US1000 per TEU
Importer*	35% (59%)	About August 13	$US1700 per FEU	$US2300 per FEU
Importer*	62% (76%)	August 27 – September 8	$US1450 per FEU	$US2150 per FEU
Importer*	100% (120%)	July- September 30	$US1350 per FEU	$US2700 per FEU

Sources: IAA, Confidential Importer Submissions

* does not include introduction of Peak Season Surcharges of $US200 per TEU and $US400 per FEU on August 1 2003. Combined impact of introduction of PSS surcharges and increases in base freight rates is indicated in brackets.

[90] LLDCN (2003) East Asia southbound trade goes for third hike of the year Electronic Mail 16 September 2003 p1, LLDCN (2003) Korea Import rates to rise, Asian space to stay tight, electronic mail 28 November 2003 p 1, LLDCN (2003) Focus on the bottom line, September 4 2003 p 11, East Asia trade to raise rates again September 18 2003 p 6

[91] AADA(2003) Questionnaire op cit p 11

Gifts and Homewares Australia (GHA) conducted a survey of its 1400 + members on their experiences with freight rate increases on the Australia – North East Asia liner trades and had a survey response of 8%. The survey found that 89 per cent of the respondents employed carriers that are party to the AADA and of these 99 per cent had experienced cost increases resulting from freight rate rises. The average shipping cost increases of these respondents are reproduced in Table 4.9.

Table 4.9: Average Cost Increases faced by GHA members using AADA lines

Country of Origin	Average Increase in Shipping Costs (since June 03)	% who identified this as country of origin
China	77%	80%
Hong Kong	77%	56%
Japan	30%	1%
Korea	48%	1%
Philippines	49%	16%
Taiwan	68%	25%

Source: Gifts and Homewares Australia (2003) Submission p 3

It is noteworthy that most significant increases in average costs were freight costs sourced from China, Hong Kong and Taiwan.

There are a number of important points that GHA made in its submission. The average cost increases as shown in the above table mask significant variation in individual importer experiences of rate increases. GHA reported that there were several instances of freight increases of greater than 100 per cent and some of up to 300 per cent. Furthermore, 94 per cent of GHA members would be classed as small business and so would not be expected to have significant negotiating power in dealings with a line.

Care should be taken in interpreting the results of cost increases on goods sourced from Korea and Japan as only 1 per cent of the sample respondents identified these as country of origin. Finally, a small number of GHA members which employ non-AADA carriers as well as AADA carriers reported that average shipping costs for goods ex-China and ex-Hong Kong were 62 and 67 per cent respectively.[92]

The AADA has also presented the Commission of evidence of increasing ex-China average blue water freight rates, although it is noteworthy that the scale and timing of the reported rises is different to that reported by the importers. This may in part be due to the timing of contract expiration. As contracts fall due, importers are likely to face higher rates and so average freight rate trends will tend to lag the official announced rate increases.

[92] Gifts and Homewares Australia (2003) op cit p 3

Table 4.10: Index of trends in indicative freight rates for import carriage from Shanghai – Australia and Yokohama – Australia from June 1999 to December 2003 (high and low ends of a range, based on $US/TEU)

	Shanghai – Australia		Yokohama – Australia	
	Low	**High**	**Low**	**High**
June 1999	100	100	100	100
June 2000	108	107	80	80
June 2001	100	100	56	80
Dec 2001	88	87	56	80
Mar 2002	88	87	56	80
Jun 2002	77	80	56	80
Sep 2002	85	80	60	84
Dec 2002	115	120	64	84
Mar 2003	108	107	64	84
Jun 2003	100	100	80	84
Sep 2003	100	100	80	84
Oct 2003	108	107	80	84
Dec 2003 (prelim)	154	147	NA	NA
Dec 2003 (importers)	154	193	NA	NA

Sources: Confidential market inquiries, Submissions from importers

According to table 4.10, blue water freight rates ex-Shanghai did not increase in the September quarter 2003, but increased slightly in October 2003. A more significant increase of about 42 per cent was recorded in December 2003.

It appears that the market did not respond quickly to the announced freight rate rises over the period of July 2003 to October 2003 and average blue water freight rates only began to respond to the cumulative $US950 per TEU announced increases in a market characterised by increasing demand and static supply. This slowness in part can be explained by the timing of contract expiration. This lag could be expected to reduce if demand continues to increase. This is because of the general unavailability of 12 and six month contracts in the current market.[93]

The AADA has suggested that the inconsistencies in the evidence about the absolute levels of freight rates as well as its magnitude of increase in December 2003 is partly explained by the AADA by the fact that Shanghai is a direct load port and therefore commands a freight rate which is lower than those of other indirect load ports in China. The AADA suggested that the rates that the ACCC had received from market participants of between $US1000 to $US1300 per TEU were a mixture of origin freight rates from direct and indirect load ports.[94]

In addition to the above freight rate increases, one of the AADA lines, (Maersk), has sent importers notice of further freight rate increases to be implemented in 2004. In a cumulative sense these would result in a significant increase in freight rates over the

[93] IAA (2003) Submission op cit p 1
[94] AADA (2004) pers comm.

course of 2004. If the proposed prices are reflected in the market, they would represent a doubling of rate levels to those existing in 2003.

The AADA has recently set out its intended freight rate increases for 2004. The AADA will seek to increase rates by a further $US250 per TEU on April 1 2004, with a further two unquantified rate increases to follow in the third and fourth quarters of 2004.

4.5.2 Findings on Freight Rates

The Commission has found that southbound liner freight rates for carriage of imports from East Asia to Australia, in particular, from the Peoples Republic of China have increased significantly since June 2003. These increases are due to a significant demand boom for Chinese sourced products, which is not only affecting the North East Asia – Australia liner trades but other liner trades that connect China with the rest of the world.

4.6 Costs and Profitability of the Lines

There is a paucity of data concerning the profitability of the lines that operate on the North East Asia – Australia liner trades. The only data available to the Commission suggests that a representative shipping line participating on the North East Asia – Australia liner trade was making losses all through the period 1999 to 2002. Losses were particularly acute in 2001, and had returned to the levels of 2000 by 2002. The profitability information indicates that the typical liner company still was about break-even for its services over the period October 2002 to September 2003. This occurred during a period of steadily improving load factors southbound and some counteracting deteriorating load factors northbound.

The revenue streams included in the above analysis would include the effect of only three months of significantly higher rates that were implemented on July 1 2003 and of two months of Peak Season surcharge implemented on August 1 2003. However, it would also include the impact of steadily falling liner rates for export cargoes to North East Asia over the year to September 2003. They would not include the impact of the $US250 increase in rates that was implemented on October 1 2003.

On balance it would appear likely that a representative line would have returned to profitability as a result of the latest rate increases for southbound cargo, and that these increases overwhelmed the impact of a continuing decline in northbound freight rates.

5. Findings on Characteristics of the North East Asian Trade

With such emphasis in the liner cargo industry placed on reliability, frequency and fast transit times, AADA lines' competitive advantage and market share is sufficiently large to escape competitive pricing discipline from their rivals. Without competitive threats in the market, AADA lines appear capable of leveraging their substantial market power more effectively. Relatively low entry and exit barriers imply market contestability and potential entrants appear to be the only material competitive constraint on the AADA lines' market power. Listed below are some further observations relating to competition on the trade over the reference period:

- price-related competition between AADA lines diminished once aggregate cargo demand exceeded supply;
- consortia/independent carriers under the AADA umbrella do not appeared to have competed vigorously in respect to capacity levels;
- the AADA's competitors appear to follow the price leadership of the AADA lines;
- AADA lines' transit times and frequencies to Australian east coast ports are superior to services offered by PAS and transhipment services; and
- price coordination facilitated quicker rate increases than the Commission would have expected price competition.

6. The Commission's Assessment

6.1 Legislative Criteria Relevant to the Commission's Investigation

Pursuant to Part X of the TPA, the Minister shall not give a direction under subsection 10.44 (1) to cancel the registration of a conference agreement (in its entirety or partially) unless satisfied of the matters set out in s.10.45(1)(a).

One of those matters relates to the criteria set out in s. 10.45 (3), which essentially provides that the Minister could make such a direction if satisfied that:

> *the agreement includes a provision that has the purpose of, 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 be 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 purposes of s. 45, section 45(3) relevantly provides that:

> … "**competition**", in relation to a provision of a contract, arrangement or understanding … means competition in any market in which a corporation that is party to the contract, arrangement or understanding … supplies … goods or services.

For the purposes of this investigation, the Commission has also sought to clarify the meaning of *exceptional circumstances* mentioned, but not defined, in subsection 10.45(3)(d). Guidance as to what may constitute e*xceptional circumstances* was set out in the Second Reading Speech when introducing the *Trade Practices Amendment (International Liner Cargo Shipping) Bill 2000* to Parliament. The relevant statement regarding *exceptional circumstances* was as follows (at p 4):

> The increased (legislative) powers will only be used in 'exceptional circumstances', such as where the operation of an agreement results in an unreasonable reduction in shipping services and/or unreasonable increase in liner shipping freight rates, and where the public benefit from the conference agreement may be lost. In these circumstances the Minister will have the power to suspend, in whole or in part, such an agreement.
>
> As a guideline for exercising the additional powers, exceptional circumstances will be

taken to apply 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; and

- the anti-competitive detriment of the agreement outweighs the benefits to shippers flowing from the agreement.

Additional guidance for the Commission regarding the application of the *exceptional circumstances* provisions is available in the Revised Explanatory Memorandum that accompanied the *International Liner Shipping Cargo Bill (TPA amendment 2000)*. It states that *exceptional circumstances* would cover circumstances where: [95]

an agreement covers a substantial majority of shipping lines and capacity in a trade,

- and where the conduct of those shipping lines has led to, or is likely to lead to, an unreasonable increase in freight rates and/or an unreasonable reduction in services;

- with the result that the public benefit from the operation of the agreement is outweighed by an anti-competitive detriment.

The Commission notes that there are differences between the Second Reading Speech (the "SRS") and the Revised Explanatory Memorandum ("REM"). First, the SRS talks of a substantial degree of market power while the REM refers to a substantial majority of shipping lines and capacity on a trade. The Commission considers both of these measures in its analysis. Further, the SRS talks of "benefits to shippers" while the REM refers to "the public benefit". The Commission's analysis has proceeded on the basis that benefits to Australian shippers coincide with the public benefit to Australia. This is consistent with the methodology adopted by the Productivity Commission in its 1999 review of Part X.

6.2 The Commission's Assessment Methodology

This investigation assesses the conduct shipping lines in the North East Asia – Australia southbound trade over a number of years. The implications for competition therefore need to be approached via an *ex-post* (backward looking) appraisal. Consequently, the Commission has therefore approached its analysis of whether there has been a substantial lessening of competition consistent with the way it approaches investigations pursuant to section 45 of the TPA. However, in weighing up of public benefits and anti-competitive detriments the Commission has adopted an analytical approach similar to that which it employs to assess applications for authorising anti-competitive conduct, pursuant to sections 88(9) and 90(9).

This section focuses explicitly on the anti-competitive detriment flowing from the AADA's conduct. In this respect it is the anti-competitive detriment that flows from the substantial lessening of competition that is relevant.

[95] The Parliament of Australia (Senate), *Trade Practices Amendment (International Liner Cargo Shipping) Bill 2000* Revised Explanatory Memorandum p 6.

In assessing whether the AADA has substantially lessened competition, the Commission will form a view as to what the level of competition would have been in the absence of the AADA. Each area of potential anti-competitive detriment flowing with the AADA's conduct will be assessed in terms of the difference likely to have evolved between a world with the AADA (the 'factual') and a world with the five underlying consortia and one independent carrier (the 'carriers') operating in the absence of the AADA (the 'counterfactual'). The estimated differentials between the two scenarios across several areas of competition (capacity, frequency, rates and service standards) will form the basis of the Commission's assessment of any anti-competitive detriment connected with the conduct of the AADA.

The following discussion sets out the various "tests" against which the impact of the AADA will be assessed. These tests reflect the legislative criteria and the guidance provided thereon.

6.3 Does the AADA Agreement Include a Provision that has the Purpose or Effect of Substantially Lessening Competition?

6.3.1 The terms of the Agreement

The Asia-Australia Discussion Agreement (the "Agreement") defines itself as an "Agreement for discussion, consultation and development of consensus on a voluntary basis, to foster commerce, service and stability in the trade."

The geographic scope of the of the Agreement covers the carriage of cargo which travels from ports in Japan, Korea, Hong Kong, Peoples Republic of China (PRC), Taiwan and the Philippines to ports in Australia.

The Agreement provides for the parties to the Agreement to discuss, consult and develop a consensus on their:

rates;
charges;
classifications;
practices;
terms, conditions, rules and regulations applicable to the transportation of cargo in the trade;
notice periods for changing rates;
receiving and demurrage charges;
free time practices;
detention and demurrage;
container freight stations;
the time and currency in which the parties collect their rates and charges.

The Agreement stipulates that *any* carrier who regularly trades in the geographic scope of this Agreement may become a party by signing the Agreement or a counterpart copy thereof and furnishing the same to the other parties.

The Agreement indicates that there is no *voting* on issues discussed or consulted between parties to the Agreement. Rather a consensus is developed. For those parties not willing to comply to a consensus formed by other parties, the Agreement implies it is a matter of voluntary adherence only for those parties willing to agree.

The Agreement is drafted to continue in effect indefinitely until cancelled by the parties. Any party may terminate its membership to the Agreement by giving 30 days written notice to the other parties.

The Agreement provides that the parties to the Agreement agree to provide a minimum level of service to shippers (Australian importers) of 291 sailings per annum (including 456, 746 TEU dry capacity and 58,376 TEU refrigerated capacity). These capacity levels are designed as a 'floor', which in reality is well below what is supplied on the trade.

In the event of a controversy, claim or dispute of a commercial nature regarding the services offered by the AADA specified in the Agreement, shippers, acting through their designee (Importers Association of Australia), shall attempt to resolve the dispute with the AADA in an amicable manner, with the opportunity for direct discussions.

There are also provisions in the Agreement for shippers to make written requests and complaints relating to operations under this Agreement directly to the parties. The Agreement stipulates that the parties shall consider the complaints promptly and enter into consultations and discussions regarding such statements of complaint.

As mentioned previously, the AADA submission claims that Evergreen and Hanjin are not involved in a functional capacity with the AADA. Their names appear on the registered agreement but not on any of the freight rate restoration notifications. Furthermore, the AADA has informed the Commission that neither Evergreen or Hanjin formally participate in AADA meetings.

6.3.2 The effect of the Agreement on Competition

The AADA submission claims that the AADA's existence has neither hindered nor enhanced competition because:

- the AADA operates on a non-binding consensus basis;
- there are no obstacles to entry into the trade;
- the AADA does not demonstrate any prohibitive conditions barring entry to membership; and
- the AADA does not lay exclusive claim to particular cargo or customers.

The AADA submission argues that the AADA has not materially affected the behaviour of shipping lines now party to the AADA since its inception in 1999. Given the competitive environment that existed during the time of the AADA's registration under Part X, it signals that the AADA lines' view is that competition has continued.

The AADA submission contends that competition prevails between its members. The AADA lines are also subject to competitive pressures from non-AADA lines offering transhipment services and direct services.

6.3.3 Views of the Commission

The fact that the Agreement provides for potential competitors to discuss and reach a consensus on pricing is, of itself, likely to have the effect of substantially lessening competition where the members to that Agreement hold a degree of market power. Given the significant share of the trade held by members of the AADA, the Commission considers that any agreement that serves to limit rivalry between the members is likely to have the effect of substantially lessening competition in the relevant market. The lack of pre-requisites to entering the Agreement and the relatively liberal pre-requisites to leaving the Agreement do not of themselves negate the potential anti-competitive effects of the provisions regarding price. Further, the provision in the Agreement that sets out that any consensus is non-binding has not, in the past, prevented parties from forming and sustaining a consensus on various matters, including pricing. Should the parties to the Agreement recognise that complying with a consensus on pricing is in their own best interests then the provisions of the Agreement will facilitate that understanding.

The Commission's view is that the Agreement does contain a provision (Article 4) that has the likely effect of substantially lessening competition.

6.4 Did the Parties to the AADA engage in conduct that gave effect to the anti-competitive provisions of the Agreement?

Having reached a view that Article 4 of the Agreement is likely to have an anti-competitive effect, the Commission's view is that the AADA members have engaged in conduct to give effect to this provision. The Commission understands that AADA members have met on a number of occasions to discuss pricing. Furthermore, the public notices of price increases demonstrate that the members of the AADA collectively increase prices, and impose surcharges, by agreed amounts.

The Commission has further assessed whether the parties to the AADA have been successful in substantially lessening competition. For the purposes of this assessment, the Commission has identified the period from April 2003 to February 2004 as that during which the coincidence of announced price increases and actual price increases appear to be highest. This period will be referred to as the "*reference period*".

6.4.1 Observations from the trade

Prior to the emergence of the AADA, the southbound trade from North East Asia to Australian east and west coast ports appeared to be highly competitive, as reflected by significant capacity expansion and a forcing down of rates to very low levels for shipping lines. Considerable market entry by consortia and large independents between 1997 and 2000 expanded market supply well beyond aggregate cargo demand. The competitive outcome at that time did not appear to be sustainable as rates appeared to be relatively low for several years. This probably contributed to the break-down of the ANSCON agreement and subsequent market exit for other carriers.

Since the AADA's inception, it has attracted as members all the leading carriers that were either already in the trade or who later entered it. The AADA's ability to attract the membership of all significant market participants would have enabled the AADA to more readily reduce the significant vessel over-capacity on the trade to capacity levels that were roughly proportional to southbound cargo demand levels by April 2003. The Commission's view is that such an outcome could also have been achieved in the absence of the AADA. In the more competitive environment capacity levels may have been fractionally larger by April 2003, however the evidence is inconclusive. Thus the Commission has assumed that, at April 2003, the factual and counterfactual scenarios could have reached approximately similar market rate and capacity outcomes.

Prima facie, the evidence of the AADA's coverage of participants in the North East Asia to Australia southbound trade suggests it has substantially lessened competition. Encompassing all major carriers with competitive frequencies and capacities infers that the AADA has reduced competition from **six** meaningful competitors to **one** since its formation. Market aggregation from 15-20 per cent (individual consortia/carrier market share) to 93 per cent suggests that the likelihood of vigorous competition has been reduced. Despite the AADA submission claims of member lines maintaining discretionary rate setting powers, the Commission was not presented with any evidence of member lines' introducing rate increases that differed from those announced through the AADA during the *reference period*. Thus, there is circumstantial evidence that the AADA is associated with a substantial lessening of competition on the North East Asia – Australia southbound trade.

6.4.2 Capacity differentials

The Commission has also assessed whether capacity expansion during the *reference period* would have been more likely in the absence of the AADA. If six separate consortia/carriers each sought to maximise revenue and achieve optimal rates of return they would have been competing using both capacity and rates. In an industry that is in general regarded as competitive, it is likely that some of the six separate consortia/carriers would have responding to increased cargo demand by expanding capacity.[96] The likelihood of at least one of the six underlying consortia/carriers increasing capacity, and thereby seizing the first mover advantage by servicing some or all of the excess demand, appears to be more probable in a market where the AADA did not exist. In a forum such as the AADA allows, it is likely that each of the six consortia/carriers can recognise their mutual interdependence and, at least, be better informed (if not assured) about their fellow members' likely conduct. With the ability to discuss supply (individual and market) and demand conditions, and in the absence of immediate competitive threats, the AADA members would have less

[96] Competing on capacity and increasing market share is a well-established characteristic of carriers, especially in expanding markets.

incentive to move away from those capacity levels that formed the basis of their program to increase rates.

In affecting the responses of the six consortia/carriers to strong demand growth, the AADA may have had a distortionary affect on the market. In particular, the AADA may have distorted its members' incentives to invest in additional capacity.

In the absence of the AADA, each of the consortia/carriers' decisions to invest in additional or larger vessels is likely to focus on the benefits that can be captured by that consortia/carrier. In such a case, the absence of the capacity-related consensus from the AADA discussion forum could lead to a consortia/carrier choosing to expand capacity under circumstances in which, under the AADA, they would not. In the presence of the AADA, the six consortia/carriers would reasonably have a heightened awareness of their mutual interdependence and their prospects of higher profitability, at least in the short-term, through not expanding capacity. The Commission notes that under the AADA during the *reference period*, the various consortia/carriers chose not to invest in significant additional capacity.

The decision by lines to invest in additional capacity will be influenced by its cost. The extent of the global boom in aggregate demand for cargo from China appears to have caught the world's major shipping lines somewhat by surprise. Consequently, the construction and delivery of new ships has lagged behind the current level of demand for those ships. The profitability of market entry or incumbent expansion on the North East Asia to Australia trade from other trades would have been affected as the cost to lines of obtaining additional vessels increased. Clarkson's charter rate index shows that charter rates for the relevant sized vessels suitable for the North East Asia to Australia trade doubled during 2003. Thus, the Commission notes that, even in the absence of the AADA, there is *some* chance that the six consortia/carriers may have opted not to increase supply (because of actual and opportunity costs) to meet surging cargo demand.

However, the Commission considers it informative to examine the financial profitability of expanding capacity on the North East Asia – Australia trade during the *reference period*. Financial modelling undertaken by the Commission based on information provided by the AADA lines and using conservative assumptions indicates that the marginal addition of an extra vessel or the replacement of smaller vessels with larger vessels would have been profitable.[97] Under such conditions, the Commission would have generally expected to observe the consortia/carriers introducing additional capacity in an attempt to increase market share, revenues and ultimately profits. Although not conclusive, the Commission considers it likely that, in a world without the AADA, capacity would have been increased at a rate faster than that observed over the *reference period*. If this is the case, the logical implication is that rates would have remained lower in the counterfactual than the factual, as higher capacity typically drives rates lower (unless surplus demand absorbs all of the additional capacity).

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[97] The Commission's calculations were based on a round trip, which includes the revenues and costs associated with both the north and southbound trades. The Commission's assessment of revenue was conservative, with lower post-entry prices forecast than the December quarter rates show. The costs include the average roundtrip costs supplied confidentially by the AADA and factor in Clarkson's charter rates of $US30,000 per day.

Anecdotal evidence of the profitability of additional capacity has also arisen in the form of press reports of imminent market entry by one or possibly two consortia with five vessels each. The Commission contends that, had the AADA not been in place over the *reference period*, at least some of the consortia/carriers may have expanded capacity above the levels actually supplied. The benefits to those expanding capacity would have included an opportunity to gain a first-mover advantage, increase market share and capture higher profits. This could have been achieved by replacing smaller vessels with larger vessels or alternatively adding extra vessels onto the trade. The recently announced commencement of an additional service starting in May 2004 and comprising five vessels suggests that this would have been viable.[98]

Having taken account of the relevant market factors and broader supply and demand conditions, the Commission considers it probable that the capacity supplied to the trade in the absence of the AADA would have been higher than that observed during the *reference period*. The logical implication is that capacity is likely to have been constrained by the presence of the AADA during the *reference period*.

6.4.3 Differences in the levels of freight rates

During the *reference period* the only material constraint on the pricing practices of the AADA members appeared to come from the threat of entry, as actual non-AADA competitors only comprised seven per cent of capacity and trade volume. The relatively high market share held by the AADA members implies that the non-AADA competitors set their prices using those charged by AADA as a reference point. That is, the AADA members appear to be the price leaders in the market, while non-AADA members follow the lead of the AADA.[99] The Commission's view is that the competitive impact of non-AADA competitors currently in the trade (and especially to the Australian east coast ports) is limited, given that they control an insignificant capacity (seven per cent) and apply minimal price competition (as price followers).

Market freight rates are ultimately determined by relative demand and supply levels. It is reasonable to assume that demand would have not varied significantly between the factual and counterfactual scenarios. As such, it would expected that rates will be lower under that scenario where a higher level of capacity is supplied. As discussed above, the more likely higher level of capacity during the *reference period* in the absence of the AADA would have given rise to lower rates than those actually observed.

If capacity was added during the *reference period* in the counterfactual, the rate differential between the two scenarios would have increased from the time of capacity introduction and extended to the end of the *reference period*, assuming the persistence of strong demand. Inevitably, this type of development increases the anti-competitive detriment associated with the AADA's presence.

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[98] LLDCN, New Zim/APL/PIL Service Set for mid-May Kick-off, 16 March 2004.
[99] For example, the Commission understands that PAS sets its prices at a per cent discount to the market so as to still attract customers despite slower transit times (caused by calling at more ports). Hanjin and Evergreen are more likely to set rates at similar levels to AADA lines as their service standards and frequencies are similar.

6.4.4 Differences in the speed of freight rate increases

In the Commission's view, an important likely difference between the factual and counterfactual scenarios is the speed of the rate increases during the *reference period*. For instance, the rate increases and the implementation of the PSS in the factual scenario appeared to represent a vertical increase in prices. In the counterfactual, however, it is likely that price-related competition and uncertainty about market conditions amongst the six consortia/carriers would have slowed the speed of rate escalation substantially below that observed in the factual scenario. Although the Commission understands that changes in spot rates take time to filter through into contract rates (as contracts expire contracts rates will tend to reflect spot rates), the speed of price increases appears to be significantly quicker in the factual than that which is likely to have unfolded in the counterfactual.

The Commission has not attempted to quantify rate differentials resulting from the difference in their speed of application between the factual and counterfactual scenarios over the *reference period*. However, assessing the rate differentials over the *reference period* in a qualitative context provides some insights into the potential anti-competitive detriment attributable to the AADA members' conduct. The facts indicate that, by March 2003, the AADA members had identified that market supply and demand conditions would be able to support a $US500 increase by July 2003.[100] This raises a possibility of the AADA members withholding price increases prior to July 2003. A more competitive market may have increased rates prior to 1 July (when the AADA actually commenced implementing the higher rates) if at least one of the six consortia/carriers realised the extent of the cargo demand growth. If the consortia/carriers in the counterfactual recognised vessel utilisation rates were nearing full capacity between 24 March and 1 July 2003, it would appear rational for them to have raised their rates as strong demand meant the risk of reducing utilisation rates would have been relatively low.[101] Hence, rates in the counterfactual scenario *could* have been slightly higher than the factual scenario immediately prior to the AADA's first rate increase on 1 July 2003.

However, by facilitating the exchange of market information and by providing a forum in which the mutual interdependency of its members is recognised, the AADA allowed its members to introduce rate increases at a greater speed and magnitude than what would have been achieved in its absence. If the AADA had not been in place over the *reference period*, the Commission contends that uncertainty about market conditions and competitive pressure would have placed *some* restraint on increases in market rates.

Additionally, the existence of the AADA may also have contributed to the successful implementation of the $US200 PSS. It is open to question whether, in the more

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[100] On 24 March 2003 the AADA announced an intention to raise rates on 1 July 2003.

[101] As it is assumed capacity levels were at similar levels at the beginning of the reference period, it is also assumed that similar load factors would have existed in both scenarios over the initial part of the reference period.

competitive counterfactual world, the PSS would have been universally applied on top of the recently increased freight rates. To the extent that the PSS would not have been uniformly applied, the anti-competitive detriment, represented by the difference in total cost to shippers between factual and counterfactual worlds, increases.

A second vertical increase in spot rates of $US250 was introduced to the market by the AADA on 1 October 2003. At this point, the Commission considers the rate differential between the factual and counterfactual worlds would probably have reached its maximum. From this point until the expiration of the PSS on 1 February 2004, a gradual decline in the rate differential is likely to have evolved, as the six consortia/carriers in the counterfactual would have been likely to be still realising and capitalising on the extent of the demand surge (the extent of rate increases in the counterfactual would have been dependent on the extent of capacity expansion). Upon the expiration of the PSS, the Commission's view is that the rate in the factual *probably* would have still been higher on 1 February than in the counterfactual, predicated on capacity expansion in the counterfactual.

If capacity in the counterfactual expanded beyond levels observed in the factual, the rate differential would have widened (at the point of capacity expansion) and rates would have remained lower in the counterfactual at 1 February 2004. Given the reports in the industry press of market entry, the AADA submission's contention that sourcing the appropriately sized vessels is problematic appears less plausible. Potential market entry suggests access to vessels is possible and that their employment is profitable. Moreover, calculations by the Commission based on information supplied by shipping lines indicate that profits on the trade are verging on unusually high levels. Hence, rates in the factual scenario may have remained higher than the rates the Commission considers may have existed in the absence of the AADA.

6.4.5 Service standards

According to submissions made by shippers, the standard of service provided by the AADA members during the *reference period* has been poor. It is alleged that vessel capacity was insufficient to cater for aggregate cargo demand, resulting in numerous cargo delays for shippers. If capacity provided in the counterfactual was greater, service standards could also have been higher as the increased capacity would have serviced some of the excess demand, reducing shipment delays caused by insufficient vessel capacity in the factual scenario. The Commission considers that the more competitive environment in the counterfactual would have seen carriers taking greater precautions to minimise cargo delays, possibly through service competition or alternatively via increasing capacity to service the excess demand. It therefore appears likely that some anti-competitive detriment was experienced by shippers in relation to service standards as a result of the AADA.

6.4.6 Frequency

While there may be some anti-competitive detriment connected to the presence of the AADA in relation to frequency, this is not readily quantifiable. Transport markets will generally benefit from higher frequency, however, the Commission is not aware of any complaints from shippers regarding the AADA lines' frequencies. The Commission has noted the probable higher level of capacity that would be been provided in the counterfactual, although this capacity may be provided through larger ships, more frequent sailings, or both.

6.5 Findings on anti-competitive detriment

The participation of the trade's major carriers in one discussion forum – the AADA – appears to have weakened the competitive tensions between its members. *Prima facie*, if the six consortia/carriers cooperate in a single information sharing discussion agreement it potentially increases market concentration to 93 per cent and strongly suggests a substantial lessening of competition. The effect of such conduct has been illustrated by the freight rate and potential capacity differences estimated between the factual and counterfactual scenarios. The price coordination facilitated by the AADA's discussion forum allowed rates to escalate more quickly during the *reference period* than the Commission considers would have occurred in a more competitive market. The consequential rate differential between the factual and counterfactual scenarios throughout the *reference period* represents part of the anti-competitive detriment attached to the substantial lessening of competition attributable to the AADA.

The Commission considers that, absent the AADA, there would have been greater capacity supplied to the trade during the *reference period*. Cost information provided to the Commission by the lines indicates that capacity expansion on the trade would have been profitable, despite the escalating cost of chartering vessels. Further, press reports of substantial market entry during 2004 indicate to the Commission that carriers in a more competitive environment *could* have expanded capacity to service the demand from China to Australia. Capacity expansion in the counterfactual also implies that rates *could* have been lower than in the factual. This potentially represents further anti-competitive detriment to shippers during the *reference period*. Furthermore, capacity expansion *would* almost certainly improve service quality, as the additional tonnage would have helped service the excess cargo demand and assisted in reducing the length and number of cargo delays experienced during the *reference period*. Although not raised in submissions to the Commission, there may also be some anti-competitive detriment associated with the AADA lines' frequency of services being likely to have been lower in the presence of the AADA.

6.6 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?

In the course of this investigation the Commission is required to consider two tests of public benefit. The first test – as set out in s.10.45(3)(c) relates in a benefit to the public associated with the *conduct* that has flowed from the agreement. The second test, which arises in the context of the criteria of "exceptional circumstances", refers to the public benefits associated with the operation of the *agreement*. The Commission has interpreted the first test to mean public benefits associated with the conduct of the AADA members during the *reference period*. Therefore public benefits that may associated with the AADA but lay outside the *reference period* have not been taken into account.

However, in considering the criteria pertaining to "exceptional circumstances", the Commission has taken into account public benefits associated with the AADA that occur outside of the *reference period*, as they are considered to be associated with the agreement rather than the conduct. Given that the AADA, as a registered agreement, has existed since 1999, this requires the Commission to take a broader consideration of possible public benefits.

In its submission, the AADA members claimed that a number of public benefits can be attributed to the AADA. They include an enhanced ability for member lines to provide stable and adequate services, and a reduction in the likelihood that importers' requirements would be underestimated. Regarding the coordination of freight rates, the AADA submission states that the AADA "…has served to synchronise rate variations, which allows the trade a degree of stability relative to the (volatility) of freighting arrangements that would otherwise not exist".[102]

In the Commission's view, the causal link between stable services and the AADA members' conduct in coordinating significant freight rates increases during the *reference period* is not obvious. It would be reasonable to assume that in a period where demand growth has been strong and sustained that the discussion agreement forum would not be necessary to ensure adequacy of supply.

The Commission has therefore found that there are no significant public benefits that can be attributed to the conduct of the AADA's members in increasing prices during the *reference period*. Whether the AADA, as an agreement, provides public benefits in periods other than during the reference period is considered in the assessment of exceptional circumstances, below.

6.7 Conclusions on Public Benefits and Anti-competitive Detriment

The Commission has assessed that anti-competitive detriment resulted from the conduct of AADA members using the AADA agreement during the *reference period*. Over that same period, no public benefit can be attributed to that conduct. As a result, the Commission has reached the view in this position paper that the conduct has not resulted in a benefit to the public that outweighs the detriment to the public constituted by any lessening of competition.

[102] AADA, Submission, op cit p.10.

7. Exceptional Circumstances

This Section assesses the information gathered by the Commission during its investigation against the criteria that define exceptional circumstances. Exceptional circumstances mentioned, although not defined, at 10.45 (1) (a) (viii)

> d there are exceptional circumstances that warrant the giving of a direction under subsection 10.44 (1).

As described above, guidance provided in the Second Reading Speech and the Explanatory Memorandum suggest that exceptional circumstances cover situations:

- where an agreement has the effect of giving its parties a substantial degree of market power (which may be represented by an agreement covering a substantial majority of shipping lines and capacity on a trade),
- where the conduct of those shipping lines has led to or is likely to lead to an unreasonable increase in freight rates and or unreasonable reduction in services;
- with the result that the public benefit from the operation of the agreement is outweighed by an anti-competitive detriment.

Each element of this test will be discussed in turn. Section 7.1 will examine the degree of market power that the AADA may afford its members. Section 7.1.1 will assess the extent to which the recent increases in freight rates are attributable to the AADA. Section 7.2 assesses the reasonableness of recent increases in freight rates. Section 7.3 weighs the public benefit of the operation of the AADA against anti-competitive detriment associated with the AADA. Finally, section 7.4 presents the Commission's view as to whether the exceptional circumstances are satisfied on the basis of the Commission's investigation.

It should be noted that the Commission has not applied the test related to an unreasonable reduction in services. In the course of its investigation, the Commission did not discover any significant reduction in the number of vessels, the scheduled frequency or total vessel capacity over the *reference period*, although it does acknowledge that service quality has declined.

7.1 Did the AADA provide its members a substantial degree of market power?

As a general concept, market power refers to the ability of a business to act without immediate encroachment from competitors. Market power may be expressed through a range of conduct. For example, a firm's ability to raise prices but not lose customers to competitors may be a sign that the firm has market power. Market power may accrue to several firms if they are able to act collectively.

In relation to liner shipping, an indicator of potential market power is the market concentration of the parties to an agreement. This is suggested by the Revised Explanatory Memorandum which refers to an agreement covering a substantial majority of shipping lines and capacity on a trade. The AADA members' share of the North East Asia – Australia trade in terms of the numbers of containers (TEUS) shipped from North East Asia to Australia was over 90 per cent in 2002-03. The capacity share of the trade's capacity held by AADA members is 94 per cent. In terms of numbers of shipping lines operating on the trade, the AADA comprises 16 out of a total of 17.

For liner shipping companies, market power may be expressed through a sustainable ability to influence freight rates, as well as the relative freight rate level. Because the demand for liner shipping is derived from the demand for cargo, freight rates will tend to increase during periods of growth in economies and fall in periods of recession. As discussed above, growth in import volumes sourced from China / Hong Kong to Australia has increased significantly in recent years and this reflects a global trend. Coupled with this, the supply of ship capacity in response to changed demand is slowed due to barriers to exit and lengthy construction time of new vessels. This heightens the responsiveness of freight rates to changes in relative demand and supply.[103] Slow responsiveness of capacity supply in the context of significantly increased freight rates has also been observed for the North East Asia –Australia liner trades.

Since freight rates in a given market can increase due to a number of factors, including the exercise of potential market power by shipping lines, the Commission has examined the extent of these other factors at work in the current case.

It is the AADA's practice to collectively announce freight rate increases to the market. According to the pattern of the announcements of freight rate increases over the course of the existence of the AADA, several failed to raise freight rates by the intended amount while others were partially achieved. Information provided to the Commission indicates that the timing of the announcements in the cycle of demand for shipping and its resultant effect on freight rate levels are reasonably correlated.

It is reasonable to assume that the AADA members were supported in their efforts to raise freight rates by a tightening balance of demand and supply. It is also reasonable to assume that even in the absence of the AADA announcements, shipping lines would have increased their freight rates. The question is whether freight rates would have increased as quickly or by a similar magnitude in the absence of the AADA. The Commission has concluded (in Chapter 6, above) that, taking into account the broader influences on demand and supply, the effect of the AADA was to blunt competition which would have otherwise occurred between parties to the AADA, causing rate increases to be faster and rate levels to be higher.

The Commission is of the view that the AADA provided its members with the ability to increase rates more quickly (and perhaps to a higher level) than would have

[103] Mary Brooks (1997) op cit p 209.

otherwise been likely. As such the AADA provided its members with a substantial degree of market power over the *reference period*.

7.1.1 Did the AADA facilitate a situation of tight supply?

The Commission has also considered whether the AADA may have been used to constrain the supply of shipping capacity in the North East Asia – Australia southbound trade. If this were the case then it may be a further area of conduct that reflects the AADA providing its members with market power.

Firstly, while the AADA is a registered discussion agreement, it is not a capacity stabilisation agreement like the Transpacific Stabilisation Agreement (TSA).[104] It is well documented that capacity agreements such as the TSA can be very effective at allowing its parties to manage capacity in a market by removing vessels and then using this as the basis for raising rates at a future date.[105]

According to the AADA, members do not make decisions on the placement of new shipping capacity or reducing shipping capacity on the southbound liner trade from North East Asia within the context of that forum. Those decisions are the preserve of the consortia, whose members own and or charter the vessels themselves. However, the AADA facilitates the sharing of market information between the consortia members and reduces uncertainty for decision making about future investment or disinvestment in shipping capacity by those members. Moreover, the liner trade is a two way trade which implies that investment decisions about vessel capacity take into account the market conditions prevalent on both northbound and southbound liner trades. Similarly, decision making about future investment by carriers/consortia would be facilitated by market information-sharing for the northbound Australia – North East Asia liner trades within the framework of the Australia North East Asia Trade Facilitation Agreement (TFA). (The TFA is a group of lines with identical membership to the AADA, with the exception of Evergreen Marine and Hanjin Line).

Information provided to the Commission by the AADA showed that the supply of capacity to the trade has remained stable since 2001. Utilisation rates of vessels on the northbound trade have fallen from 88 per cent in June 2001 to 68 per cent in June 2003. Over that period northbound freight rates from $US600 per TEU to $US375 per TEU. It would be expected that this relatively poor performance of the northbound liner trade would have been an important factor in any decision by lines to introduce new tonnage.

Even having regard to the northbound trade, it appears to the Commission that incumbent carriers have been slow to increase capacity in response to the surge in import demand from East Asia and to the significant increases in southbound liner freight rates. In turn, these delays in introducing bigger and/or more vessels to the Australia – North East Asia liner trades could have contributed to the recent increases in freight rates over the *reference period*. In the competition analysis (above) it was found that on the balance of probabilities that the individual consortia would have

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[104] Mary Brooks (1997) op cit p 210
[105] OECD (2002) Final Report op cit p 68

been more likely to have reacted sooner by adding capacity had the AADA not been in place.

The Commission's view is therefore that the AADA acted to delay its members investing in additional capacity. An unwillingness to increase supply may be interpreted as a sign that the AADA members held market power during the *reference period*.

7.2 Reasonableness of Increases in Freight Rates

A further aspect of the criteria established for exceptional circumstances is whether the increase in freight rates was "unreasonable". The Commission's view is that the rate at which freight rate increases have been announced and implemented has not been reasonable from the point of view of import businesses. As shown in section 3.3, many importers have experienced freight rate increases in the order of about 100 per cent in a short period of time. In addition, these businesses report difficulties with passing on these cost increases to their customers due to the prevalence of fixed contracts and in many cases expectations by retailers that import prices should be decreasing due to the appreciation of the Australian dollar.

Information provided to the Commission reported that freight rates for imported goods from the PRC were in the range of $US500 to $US700 per TEU in September 2003. According to the Importers Association of Australia, freight rates in December 2003 were in the $US1300 to $US1450 per TEU range (Table 4.8). If accurate, this represents a rise of well over 100 per cent in three months.

In addition there was a $US200 peak season surcharge applied to cargoes imported from PRC, Taiwan and Hong Kong for which importers received no perceived benefits.

Summarising the major impacts of the sharp freight rate increases upon the importers businesses as follows:

- in the current tight demand / supply market importers which have a fixed contracted price with carriers does not guarantee space aboard a vessel and there are examples of cargoes being left behind in North East Asia;

- there was very little notice period given, in some cases 1 to 4 weeks, of proposed freight rate increases by carrier members of the AADA. This affords importers little time to adjust their pricing or budgeting;

- many importers sell to competitive domestic retailer businesses, such as supermarkets, and or have fixed contracts with their buyers with forward orders for up to 12 months. This makes it difficult for them to pass on the shipping cost increases due to rising freight rates;

- the sudden rise in freight rates directly impacts upon the cash flow of importer businesses with the up-front cost of bringing a container rising substantially;

- due to the rapid appreciation in the Australian dollar against the US dollar, the customers of importers may be expecting falls in import prices; and

- finally, the viability of importing low value items can be severely affected by the rises in freight rates.

GHA also stated that it is extremely difficult in the short term to change import sources to other countries. This is due to a number of factors including:

- contractual obligations with suppliers;
- forward orders with retailers;
- importers tied into ranges that require a lot of investment to change;
- major investment in finding alternative reliable overseas suppliers; and
- the growing dominance of Chinese manufactured products.[106]

Since there is only one non-AADA carrier, which does not offer a fully competitive service in terms of frequency, transit times, or capacity, importer businesses have little alternative to using the services of AADA carriers.

Importers have also submitted that it is difficult to get a contract on 30 days notice and that only a handful of very large importers are still in a position to obtain volume discounts with fixed contracts from the carriers.[107] According to the AADA, discounts remain available for large volume customers that are in a position to take advantage of a local situation of shipping oversupply.[108]

Finally, according to the IAA, the carriers are no longer offering contracts to the majority of importers of greater duration than three months.[109]

It therefore appears that importers are locked into facing significant freight rate increases which they cannot pass on, thus affecting their short-term cash flow position and their margins.

In its response to the impact on importer businesses of increased freight rates, the AADA stated that importers were in fact better off in net terms due to the appreciation of the Australian dollar against the US dollar. The AADA submission quoted the potential impact of an increase in the value of the Australian dollar from $US0.55 to $US0.70 on the value of goods in a forty-foot container. It found that a container which held $US200,000 worth of goods would have cost $AUD364,000 in July 2003 ($US0.55 to $AUD1.00). In December 2003 it would have cost $285,000 ($US0.70 to $AUD1.00). At the same time the freight rate for a forty-foot box was assumed to increase by $US1,300 or by $AUD1,850.[110] Therefore, the AADA argued, because the cost of goods sold declined more than the increase in shipping costs for importers, in net terms importer margins would have improved.

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[106] GHA (2003) Submission op cit p 6
[107] IAA (2003) meeting with ACCC staff op cit p 2
[108] AADA (2003) Questionnaire op cit p 11
[109] IAA (2003) Submission op cit p 1
[110] AADA (2003) Submission op cit p 8

However, the comparison is not correct because the importers are still facing an increase in their shipping costs of the order of 100 per cent and other offsetting cost movements are independent and irrelevant.

Even the impact on offsetting costs may not translate into higher margins for importers due to expectations by retailers, many of whom compete against importers in the same import markets, of falling prices for imported goods due to the appreciation of the Australian dollar.

Another test of the reasonableness of the freight rate increases for carriage of imports from East Asia is to compare it with freight rate movements for other Australian liner trades.

7.2.1 Movements in average freight rates for other Australian liner trades

The Commission has compared recent trends in average freight rates across Australia's major trade lanes. It appears that northbound liner freight rates for export cargoes to South East Asia have not increased in recent years due to weak demand for Australian exports in that region. On the stronger southbound leg, average liner freight rates for import cargoes from have slowly increased over the period March 2002 to June 2003 by between 80 and 150 per cent on a cumulative basis from a low base. Since June 2003, average liner freight rates for the southbound liner trade from South East Asia have remained steady.

Although data is somewhat limited, it appears that the recent freight rate increases that have occurred on the North East Asia – Australia southbound liner trade have been high when compared to those on other Australian liner trades. Furthermore, the proposed increases that have been implemented in 2003 by the AADA on the southbound liner trades from North East Asia have been greater than those of other discussion agreements and conference agreements on other Australian liner trades. The expected increases in freight rates to be implemented in 2004, as announced by the AADA and ANZESC for Japan and Korea are significantly greater than those announced by either SEATFA, or EANZC for southbound liner trades from South East Asia and Europe respectively.

Finally, the Commission has not addressed the alternative exceptional circumstances test – that of an unreasonable withdrawal of liner services. As no vessels have been removed from the North East Asia – Australia liner trade for over twelve months this test is not relevant in the context of the current investigation. However, the Commission notes that many importers commented upon a deterioration of the adequacy of liner services. It was put to the Commission that reliability of liner services have decreased in recent months. According to the GHA, the major problems are late arrival of containers, containers missing connecting relay vessels, and difficulty in securing slot space.[111] Missed connections and delays impose real costs on importers which either lose stock or are forced to sell it at reduced prices.[112] Also it is widely perceived amongst importers that the carriers are not reacting to the surge in demand by increasing capacity quickly enough and there is a pressing need for more capacity.[113]

In conclusion, the Commission finds that the recent implementation of rate increases by the shipping line party to the AADA has been carried out without due consideration for the impact on importers' businesses. They were therefore unreasonable both in terms of their magnitude and suddenness.

7.3 Has the public benefit from the operation of the AADA agreement been outweighed by the anti-competitive detriment?

The final test of the exceptional circumstances criteria is that the conduct under investigation must result in a public benefit from the operation of the agreement that is outweighed by an anti-competitive detriment. In interpreting this test, the Commission has taken the term "the operation of the agreement" to mean the historical operation of the agreement over its entire existence. Therefore, this section discusses the public benefits of the AADA over the period since its registration in 2000.

A detriment to the public arises due to the effect that the AADA has on its members that would otherwise compete. The anti-competitive detriment is represented by the effect of the loss of any competition between consortia/carriers on freight rates that may have existed due to the lessening of uncertainty facilitated by the AADA. Other aspects of the loss of competition include the loss of price dispersion and possibly a lower level of capacity provided.

The Commission's views of the detriment that arose from the conduct of the AADA members during the *reference period* were discussed in Section 6. The competitive detriment that flowed from the operation of the AADA over the period from 1999 to the commencement of the *reference period* in April 2003 is more difficult to assess. Competitive detriment can be taken as the lessening of price and quantity (capacity) competition between the consortia groups that would have existed without the AADA. It appears that there was price competition amongst the members of the AADA over the period 1999 to April 2003. That the AADA appeared to be unsuccessful in collectively raising rates after October 2000 points to price competition between member lines. This is consistent with a view that the AADA has little collective influence over freight rates in a period of excess supply. Nevertheless, it can be reasonably surmised that freight rate competition would have been greater without the

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[111] GHA (2003) Submission op cit p 6, Babyco (2003), Submission op cit p 2
[112] Food and Beverage Importers Association (2003) Submission op cit p 2, meeting between IAA and ACCC staff (2003) loc cit.
[113] IAA (2003) Submission op cit p 5, GHA (2003) Submission op cit p 7, CCIWA (2003) Submission op cit p 5

AADA. The econometric evidence on the subject points to a moderating influence by conference agreements on freight rate competition in periods of excess supply.[114]

In the context of the exceptional circumstances criteria, the Commission will compare such detriment against the public benefit associated with the AADA since its registration in 2000.

The AADA's stated purpose is to foster commerce, service and stability in the North East Asia – Australia liner import trade.[115] The purpose of this section is to examine the potential benefits to shippers, and to Australia generally, of allowing the shipping lines party to the AADA to act collectively in the import trades from North East Asia. The discussion will conclude with a determination on whether the benefits identified in this section outweigh the detriments attributable to the substantial lessening of competition.

This section will critically examine the arguments and evidence for the existence of public benefits that flow from the existence of the AADA.

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

In its 1999 public inquiry into Part X, the Productivity Commission argued that the benefits of agreements between carriers that accrue to the shipper community, both exporters and importers, coincide with the benefits that accrue to the wider public. This is due to:

- Australian importers and exporters are profit maximisers and as long as there is competition between exportable products and between imports and locally sourced products this implies that any reduction in freight rates will be passed on to domestic consumers and to domestic export producers.

- after the sale of ANLCL, Australia does not have any commercial interests in international shipping, and though it employs Australians which must be taken into account of in any welfare calculus, Australia is not a significant exporter of liner shipping services. [116]

What are the potential benefits for shippers of the carriers having the ability to collectively set rates and to share information relevant to the carriage of imports from North East Asia to Australia?

There are a number of claimed public benefits that are generic to discussion agreements that may also pertain to the AADA particularly. Indeed these have been used by the shipping industry as a rationale for the continuation of anti-trust immunity for liner conference agreements worldwide. They may be summarised as follows:

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[114] Haralambides H et al (2003) Report to EU op cit p 102
[115] Asia – Australia Discussion Agreement Article 2 –Purpose p 1
[116] Productivity Commission (1999), op cit B10-B11

- discussion agreements allow for exchange and discussion of market information which is necessary for the development of better forecasts and rational pricing;

- an agreement can improve capacity utilisation and diminish rate volatility. The tariff acts as a benchmark for collective and individual rate setting by agreement members for the non-tariff cargo;

- provides a market standard for surcharges to address fluctuating costs such as currencies and fuel costs and also provide a standard for contracting seasonal cycles;

- improves the quality of supply and demand forecasting and helps avoid exaggerated rate fluctuations in the face of demand and supply imbalances; and

- assist parties to agreements to respond promptly to impending increases in demand for capacity and equipment. [117]

Other types of agreements that exist among many of the parties that participate on the North East Asia – Australia southbound liner trades. These agreements are broadly known as asset sharing agreements and are argued to deliver benefits to shippers that differ to those resulting from discussion agreements. According to the World Shipper Council the benefits of asset sharing agreements such as slot (space) sharing agreements or vessel sharing agreements (VSAs) are as follows:

- offer operating efficiencies and reduce costs;

- optimize capital investment and reduce risk;

- make it easier for carriers to enter new trades and markets; and

- offer expanded network efficiencies and more choice of port rotation and routes for shippers. [118]

7.3.2 Economic theory of benefits associated with anti-competitive agreements.

A number of economic theories have been developed in an attempt to describe behaviour in the international liner shipping industry. The theories have sought to explain whether certain characteristics inherent in operating scheduled services in cargo shipping mean that services may not be supplied even though it would appear profitable to do so, or that would mean that services are withdrawn to such an extent that it is regarded as inadequate. The theories explored whether anti-competitive agreements are effective in over-coming these perceived market problems.

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[117] Benefits of Carrier Agreements in World Shippers Council (2001), International Liner Shipping Regulation: Its Rationale and its Benefits p 25

[118] World Shippers Council (2001) op cit pp 21-22

The underlying economic theory that supports the idea that anticompetitive agreements provide stability (and therefore a public benefit) is fairly contentious, and is disputed by some maritime economists. Further, the econometric testing of this theory is not well developed.[119] This discussion will refer to the theory of destructive competition and empty core theory.[120]

As set out in the competition analysis, above, the Commission's view is that the North East Asia – Australia southbound liner trade is reasonably (although not perfectly) contestable owing to lack of regulatory barriers, mobility of shipping assets, reasonable degree of non-carrier ownership of stevedoring terminals both in Australia and North East Asia, and low customer switching costs. There has also been a long history of entry into and exit out of this trade.

As a consequence the Commission does not find the destructive competition model as described here to be relevant to the North East Asia – Australia trade since the theory is not readily compatible with a reasonably contestable market, where there are no large sunk costs.

Empty core theory is a concept that, in lay terms, implies that supply to an industry is in a state of continual disruption because at any particular time supply is not well-matched with demand. However, the data to determine whether there is an empty core problem on the North East Asia – Australia liner trade would not be readily available.[121] Moreover, even if an empty core were to manifest in this trade, the theory indicates that it is best rectified by the application by fixing price and allocating capacity across the entire trade. As discussed above, the AADA does not appear to provide an effective price fixing mechanism in times of excess supply. This suggests that even if empty core problems arose in this trade, the AADA may not represent an effective contribution to resolving them. Further, it is possible there are other potential solutions such as greater prevalence of freight contracts, yield management, cargo reservation systems, which may be already addressing the empty core problem. [122]

There is little econometric evidence available in this area of economics. Some studies have however indicated that anti-competitive agreements are not the most effective means of achieving freight rate stability.[123]

To conclude, in the course of its investigation the Commission has not been presented with any arguments based on economic theory that links the existence of the AADA to resolution of any problems inherent in providing liner shipping capacity to this industry. Therefore, for the purposes of this investigation, the Commission has regarded as negligible any public benefit that may have arisen through the AADA's role in resolving such problems.

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[119] Mainly due to a scarcity of reliable publicly sourced data.

[120] There are other theories such as standard cartel theory, and excess capacity cartels as well as general oligopoly theory. Each of these theories can be used to justify removing anti-trust immunity from the liner companies.

[121] At a minimum, a test for the possibility of an "empty core" would necessitate a well specified model of carrier marginal and average costs, and demand changes and elasticities.

[122] OECD (2002) op cit p 63, LLDCN (2004), Time to yield to the power of numbers, February 12 2004 p 11,

[123] Haralambides et al (2003), op cit pp 104-105, Clyde & Reitzes (1995), op cit p 40

7.3.3 *The current approach of international regulators and other interested parties concerning the public benefits of anti-competitive agreements in liner shipping.*

The Commission has observed that there is a growing scepticism among international regulators and shipper organisations about the net public benefits provided by conference and discussion agreements. At the same time there has been some acceptance of the net public benefits flowing from consortia agreements, where a number of consortia operate on a trade.[124]

In international jurisdictions, liner companies enjoy varying degrees of anti-trust law exemptions for different types of anti-competitive agreements in return for compliance to regulatory scrutiny.[125] For instance, a discussion agreement such as the AADA would not be granted exemptions on European liner trades, such as the Transatlantic trade, under European competition law.[126]

However, the general acceptance that public benefits such as freight rate stability, service stability and reliability are associated with anti-competitive agreements, especially of price fixing agreements, is increasingly being called into question by overseas regulators. In June 2003, the EC[127] stated that it required the parties to conference agreements to prove a causal nexus between authorised competitive restrictions and alleged public benefits. This requires more than a demonstration that stable freight rates and stable scheduled services co-existed with conference agreements. Rather, it requires that these benefits were caused by the operation of the conference agreement. Furthermore, the parties to conferences need to prove that stability could not be achieved in any other way such as through use of consortia agreements without recourse to price fixing.[128]

Similarly, the OECD noted in its 2002 liner shipping competition policy review, the lack of solid evidence presented by the shipping lines and the shippers on the impact of anti-competitive agreements, including their potential public benefits.[129] The OECD questioned the applicability of economic theory used to support a link between the anti-competitive agreements and the benefits of stability.[130] In concluding, the OECD recommended that member countries, in their application of their competition laws to the international liner shipping sector, disallow rate making agreements.[131]

The OSRA reforms introduced by the US Government in 1999 brought US liner shipping competition regime more into line with the EU regime. Two significant reforms were implemented: confidential contracting between individual lines and shippers; and the abolition of a power that allowed conferences to prohibit individual

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[124] OECD (2002) loc cit, ESC (2001) loc cit
[125] Franck B, (2003), Empty Core, Destructive Competition and the Future of the Liner Shipping Industry, Conference paper to Regional Cooperation and Economic Integration Korea, pp 6-8.
[126] OECD (2002), op cit _p 77
[127] (in its proposed review of Regulation 4056/86, the Liner Conference Block Exemption)
[128] Prof Mario Monti (2003), A time for change? Maritime competition policy at the cross roads, European Shippers Council, Antwerp 12 June 2003 p 2
[129] OECD (2002) op cit pp 11-13
[130] OECD (2002) op cit pp 54-63
[131] OECD (2002) op cit p 78

contracting between lines and shippers. According to the US Federal Maritime Commission this has led to a significant decline in the number and importance of conferences on US trade routes.[132]

In summary, it appears that regulators in developed countries are becoming more critical of the liner shipping competition exemption regime in general and are moving towards reforms, which according to at least one maritime economist may see the end of liner conferences altogether.[133] In Australia, there is another review of the Part X regime scheduled for 2005. In light of developments in the EU and the US, it is appropriate that the claims of generic benefits be reviewed. At the least, any review should seek better empirical evidence of the public benefits that flow to shippers and by implication to Australia from the existence of the registered agreements. This is particularly the case for agreements involving collective rate making (discussion agreements and conference agreements).

The Commission has also observed a change in the views of shippers. Historically, an important feature of the institutional arrangements involving liner conferences has been its general acceptance by its customers, particularly small shippers.[134] The Australian Peak Shippers Association, in its submission to the 1999 review of Part X, was critical of price fixing provisions being included in discussion agreements. More recently, APSA has been more direct in its opposition to discussion agreement.[135] In submissions to both the EU review of regulation 4056/86 and the OECD competition policy review, the European Shippers Council (ESC) has argued that conference agreements actually promote *in*stability in freight rates and in services.[136]

In view of these shifts in attitude, the Commission notes that none of the responses to its investigation into the conduct of the AADA contained a robust causal relationship between the provisions of the AADA and public benefits. The Commission does however recognise that quantification of such benefits is problematic.

To conclude, the Commission has noted the recent international approach to the regulation of liner shipping and the changing views of shippers regarding anti-competitive agreements. These suggest that public benefits previously associated with such agreements are being increasingly called into question.

7.3.4 Has the AADA provided a public benefit in the form of stable services?

A public benefit may arise in the form of stable services being provided. Indeed, the one of the objects of Part X is to: "promote conditions in the international liner cargo shipping industry that encourage stable access to export markets…"[137]. The question therefore arises as to whether the AADA has provided such stability.

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[132] J-F Pons (2002), Competition in the maritime transport sector: a new era, EU Competition Policy newsletter No 1 February 2002 p 11
[133] Franck B (2003) op cit p 15
[134] Sjostrom W (2003) The Stability of Ocean Shipping Cartels, DRAFT April 2003 p 6
[135] Australian Peak Shippers Association (2003) Submission to ACCC p 3
[136] ESC (2001) op cit pp 10-14, Haraloambides et al (2003) op cit pp 32-34
[137] TPA, s.10.01(1)(b)

The OECD describes discussion agreements[138] such as the AADA (with its non-binding commitments) as a 'soft cartel' structure. As such it could be regarded as inherently unstable in its membership, due to the easy exit and entry conditions. However, in terms of its membership, AADA has been quite stable, having only three changes in membership since 1999 involving only three companies out of 16. The various consortia agreements whose members are party to the AADA have displayed far more instability in their membership since 1999. This may be attributed more to potential rivalries at the level of consortia than at the AADA.[139]

The relatively low levels of membership turnover in discussion agreements may be due to the low investment costs of involvement, the nature of the decisions to be made and the market intelligence advantages afforded to its members. It is noteworthy that several major global lines that act independently on other trades are members of the AADA.[140]

The following discussion examines the degree of stability the North East Asia – Australia southbound liner trade has been in terms of services and freight rates.

7.3.4.1 Stability of Liner Services in the North East Asia – Australia trade

The stability of liner services supplied to the North East Asia – Australia southbound trade has been assessed is examined in terms of the year by year changes in service provision by the consortia members of the AADA. It was noted in Section 3, above, that these consortia as well as then outsiders (China Shipping Company), reduced capacity in the trade by withdrawing several vessels over the period 1999 to June 2001. It would be expected that this capacity reduction would have impacted on service stability during those years. There were significant changes to loop structures, port rotations and vessel numbers.

The Commission has noted that there was a significant withdrawal of vessels over the period 1999 to 2001. Despite this, the average capacity of the vessels increased due to vessels larger cascading down from East – West liner trades. Since June 2001, the number of vessels provided by AADA member lines has remained constant at 30, whereas the withdrawal non-AADA services[141] resulted in the loss of about 10 vessels from the trade. Also noteworthy is that there was no new entry by vessel providers into the trades after May 1999.

In terms of liner service loop provision it appears that the North East Asia – Australia liner trade has been reasonably stable, particularly over the period 2000 to 2003. The withdrawal of two services is not obviously directly attributable to the operation of

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[138] OECD (2002) loc cit

[139] Consortia are similar to alliances, though they are restricted to one trade lane, Dong Wook Song et al (2002) A conceptual application of cooperative game theory to liner shipping strategic alliances Maritime Management Policy Vol 29 No 3 p 289

[140] These include Maersk Sealand, MSC and Evergreen Marine.

[141] The non-AADA services withdrawn had been operated by Wallenius Wilhelmsen and Kwoya Opal. Technically Wallenius Wilhelmsen did not withdraw any vessels from the trade, the company no longer carries containers in its vessels.

the AADA as those services were operated by lines not party to the AADA. Most of the service changes that were instituted by AADA members were of a minor nature.

With respect to liner service provision in terms of number of loops the AADA may have a role in terms of preserving their apparent stability that is not entirely obvious. Over the period since the AADA was first registered there has been significant supply instability in the North East Asia – Australia liner trade (as discussed in section 4.1.15). However, services provided by lines that are party to the AADA have remained relatively stable. Instability of services was largely associated with lines that were not party to the AADA. Just what role AADA may have played in stabilising the supply of services amongst its members in not however clear, given its apparent non-binding wording of the Agreement.

7.3.4.2 Stability of Freight Rates

According to the AADA questionnaire response, the AADA is not used to negotiate with the Importers Association of Australia a general tariff for the import trade from North East Asia.[142] This is unlike discussion agreements on other Australian liner trades. Rather, the AADA announces general collective freight rate *increases*, with varying degrees of success depending upon the balance of supply and demand.

The longer term trends in southbound liner freight rates are shown in table 7.1.

Table 7.1: Longer term trends in southbound liner freight rates for cargoes from East Asia

YEAR	1989 = 100
1993	100
1994	98
1995	102
1996	98
1997	100
1998	88
1999	70
2000	77
2001	69
2002	58
2003 (p)	71

Source: AADA

This shows that average liner freight rates for southbound cargoes from East Asia fell significantly in 1998 and 1999, in part due to a significant injection of new supply. Rates recovered briefly due to improved import volumes from East Asia and to steady withdrawal of vessel supply in 2000. In 2001, the growth in import volumes slowed and excess capacity persisted, particularly for the southbound liner trades as evidenced by an average 60 per cent load factor in June 2001 (see table 4.6). This contributed to a further fall in liner freight rates in 2001. In 2002, load factors improved for southbound liner trades due to stronger growth in imports from East Asia and only modest increases in liner supply. However, this apparently did not

[142] AADA (2003) Questionnaire op cit p 8

immediately translate into higher freight rates, which continued to fall in 2002, possibly due to a large proportion of contract rates that were negotiated at the low rates in 2001.[143] In 2003, there has been a marked rise in longer term freight rate trends, although according to the above table it is still less those rates reached in 2000.

In summary, the longer term trends show a 29 per cent fall in southbound liner freight rates from 1997 to 2003. This is despite a 22 per cent increase over 2003. Table 7.1 indicates that by 2003 freight rates that were at a similar level to those reached at the commencement of the AADA in 1999.

The Commission does not have sufficient data to perform an econometric analysis of stability similar to the Erasmus University study.[144] The data the Commission does have on freight rates is presented (in nominal price form) in Table 7.2. The major influences upon the stability of freight rates appears to be gradual improvement in vessel utilisation rates from June 2001, though with a lag and the seasonal trends in import demand from quarter to quarter

Table 7.2: Index of Quarterly Trends in Indicative Freight Rates for the Australia – NEA liner trades June 1999 – December 2003 (low and high ends of a range, based on $US/TEU).

	East Asia – Australia southbound liner trades		**East Asia – Australia northbound liner trades**	
	Low	**High**	**Low**	**High**
June 1999	100	100	100	100
June 2000	108	107	94	94
June 2001	100	100	67	67
Dec 2001	88	87	44	56
March 2002	88	87	44	56
June 2002	77	80	44	56
Sep 2002	85	80	28	33
Dec 2002	115	120	22	22
Mar 2003	108	107	22	33
June 2003	100	100	22	33
Sep 2003	100	100	22	33
Oct 2003	108	107	28	28
Dec 2003 (prelim)	154	147	NA	NA
Dec 2003 (Importers)	154	193	NA	NA

Source: Confidential market inquiries, submissions from importers.

The data in table 7.2 suggests that the AADA was not able to be used to prevent a fall in freight rates for the southbound liner trades that occurred in this period. Further, it also appears that the AADA was not successful in raising rates in the period immediately after the withdrawal of liner supply prior to June 2001. According to the AADA, the cumulative increase in average freight rates from December 2001 to June 2003 for imports ex-China was significantly less than the cumulative $US550

[143] Containerisation International (2003) Healing Powers February 2003 p 37
[144] Haralambides et al (2003), loc cit

increase in freight rates that the AADA announced (over three occasions) during this period.[145]

In the period since June 2003, the AADA's announcements of freight rate increases appear to have had more success in raising market freight rates. According to reports in the industry press, the latest round of announced collective freight rate increases since 1 July 2003 has raised freight rates by $US750. The major difference in market conditions in the two periods is that in the period up to mid 2001, there was excess supply of vessels serving the North East Asia – Australia liner trades. In the period mid June 2001 to now there has been a cumulative increase in demand by 70 per cent from China / HK and Taiwan, while there have been only modest increases in liner supply.

Consequently it appears that the AADA have had more success in raising freight rates collectively when market conditions are tight, than in slowing or halting a slide in freight rates when there is excess supply of liner services. This is consistent with the view of the AADA submission, which states that

> *'the AADA has a greater influence on the stability of freight rates in a market where there is excess demand. At times of excess supply of liner services, regardless of the existence of a discussion agreement in the trade, exporters from North East Asia will optimise such favourable circumstances in a manner typical of that prevailing in a buyers market.'* [146]

The question then becomes one of how effective the AADA is in stabilising freight rates in a period of excess supply.

According to the AADA, the mechanism by which the AADA contributes to freight rate stability is through the encouragement of member carriers to enter into fixed term rate contracts with carriers.[147] The Commission has not been able to determine the extent to which the proportion of the fixed-term contract use in this trade, or whether it responds to excess capacity. At present its proportion is estimated at 80 per cent fixed contract to 20 per cent spot. However, it is difficult to see what the role the AADA has this process either since even in the absence of the AADA carriers could be expected to offer fixed rate contracts in times of excess capacity as a method of controlling for a decline in rates.

The AADA submission indicates that, in practice, a common tariff is not set. The terms of the AADA Agreement would allow for the AADA to nominate a very low price floor which could possibly allow stability at times of excess capacity. However, at such prices, most lines would be likely to be incurring financial losses. In the Commission's view, the more likely result in an environment of excess supply is that the incentive of the AADA's members to cooperate with the AADA's announcements would be reduced. This expected result would then be price competition among the consortia as rates are discounted in an attempt to increase market share in a declining

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[145] AADA (2003), Submission op cit p 7 & Questionnaire op cit p 10

[146] AADA (2003) Submission op cit p 10

[147] AADA (2003) Questionnaire op cit p 18

market.[148] The fact that the AADA Agreement has no punitive power to enforce rate discipline among its members supports this view.

Thus given that the AADA does not contain provisions for the enforcement of decisions that its members have collectively made, a question arises as to whether the conduct of and incentives for individual liner members over the period 1999 to April 2003 (a period of excess capacity) would have been any different had the AADA not existed. Alternatively, how did the AADA affect the conduct of its members during the period of excess supply? To explore these questions requires reference to some of the economic theory presented above.

This *Position Paper* provides only a brief overview of the theoretical background and empirical testing of models that attempt to describe liner shipping markets. They are important to the Commission's analysis because the world without the AADA cannot be observed directly. Rather, the Commission has referred to the economic theory to ensure that public benefits that may be predicted to flow from anti-competitive arrangements between shipping lines are recognised.

7.3.5 Concerns of Importers

Most of the importer submissions do not explicitly address the issues of any long term benefits of the AADA in terms of its alleged provision of stable, adequate, reliable services and long term freight rate stability since 1999. Rather, submissions tended to focus on the deterioration in service reliability and adequacy during 2003, as well as the recent significant increases in freight rates. An example is the submission by the Food and Beverage Importers Association which states that none of the public benefits of the AADA are being delivered at the moment.[149]

The Gifts and Homewares submission investigated its member's opinions about the longer term service standards provided by AADA carriers. Only 15 per cent of its surveyed members stated that service standards of the AADA lines had improved, 31 per cent stated they had deteriorated, while 54 per cent stated there had been no change since 2000.[150] This could be construed as indicative of service stability provision by the AADA but, as the GHA points out, a significant number of members believe that standards have fallen.

The Chamber of Commerce and Industry of WA submission did not support the view that the presence of the AADA (or indeed any other discussion agreement amongst lines on Australian trades) contributed to freight rate stability. The CCIWA submission states that service standards have not changed with the movement from direct services to feeder services from Singapore to Fremantle. CCIWA's view is that the AADA did not play a role in maintaining service stability.[151]

The submissions from importers did not explicitly set out views of how the market would have developed in the absence of the AADA. However, the IAA did comment

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[148] Scherer (1980) Industrial Market Structure and Economic Performance p 206,
Volker Nocke (1999), Cartel stability under capacity constraints: the traditional view restored, Discussion paper No EI/23 p 3

[149] FBIA (2003) Submission op cit p 2

[150] GHA (2003) Submission op cit p 7

[151] CCIWA (2003) Submission op cit p 5

that it was concerned that in a counterfactual scenario, liner supply from North East Asia to Australia may be threatened were the AADA to disappear.

An indication of the longer term value of potential public benefits associated with the AADA may be implied from their recommendations to the Commission regarding remedial action.

The Importers Association of Australia, the Food and Beverage Importers Association and Gifts and Homewares Australia have all recommended that the collective rate making powers of the AADA be deregistered under 10.44 (1) (b) of the TPA *1974*. They do not seek deregistration of the AADA in its entirety, presumedly because they believe it can deliver them some level of benefits. According to the IAA, the potential benefits are:

- Addressing service standards to ensure sufficient capacity and frequency to meet importers needs; and
- Consultation with bodies such as the IAA on service standards.[152]

However, according to the GHA, the Commission should seek undertakings from the AADA to realise some of these benefits in the current market climate. These issues including transparent pricing, advanced notice of intended rate increases, greater consultation with Importer Peak Bodies and adequate service standards.[153]

The CCIWA submission goes further and argues that discussion agreements are not in the national interest but stops short of making a recommendation about deregistration.[154]

7.3.6 Commission's view on stability

The Commission has not been presented with a robust causal nexus that explains the relationship between the AADA and freight rate and service stability in the North East Asia – Australia liner trades.

It is noted that services in terms of vessel numbers and numbers of services was remarkably stable over the period 2001 to 2003. It is also noteworthy that, prior to the *reference period*, freight rates were reasonably stable albeit low and there is evidence of freight rate competition between carriers that are parties to the AADA.

Freight rate competition could have been more intense in the absence of the AADA due to the lack of focal freight rate pricing. It is unclear why some consortia members of the AADA did not exit the trade during the periods of excess supply, given that redeployment of vessels seemed possible, and the relative smallness of this liner trade would indicate that there would not be a large supply impact on other trades. Indeed, China Shipping Company (at that time a non-member of the AADA) withdrew eight vessels from the liner trade in a period of a weak global liner trade growth in 2001. The influence of the AADA on maintaining vessels in the trade cannot be ruled out.

[152] IAA (2003) Submission op cit p 8
[153] GHA (2003) Submission op cit p 9
[154] CCIWA (2003) Submission op cit p 8

It is also noted that the consortia membership is unstable at times, but its service structures and number of vessels has been stable by contrast.

There are several institutional factors that are apparent within the Australia – North East – Australia liner market that could contribute to the potential empty core problem, although the Commission notes that empty core problem has not been demonstrated to exist on this trade. The extent to which the AADA could have feasibly addressed any empty core would seem to however depend on the relationship between the AADA's influence on determining rates and the willingness of the consortia to invest in efficient shipping and network.

7.4 Findings – Exceptional Circumstances

The AADA played a key role in coordinating freight rate increases during the *reference period* April 2003 to February 2004. These freight rate rises are currently sustainable due to the significant increases in demand for imports from North East Asia to Australia. Under such circumstances, the AADA is accorded market power. In addition, the AADA members represent a substantial majority of lines on the trade and a substantial majority of capacity.

However, the AADA does not appear to have directly contributed to constraining the capacity supplied to the trade prior to June 2003. Rather, it appears that supply has remained constant through most of 2003 and the magnitude of the increase in import volumes from East Asia to Australia was not fully anticipated.

Southbound liner freight rates have increased significantly since April 2003 and these have had disruptive impacts upon importers both in terms of their magnitude and sudden application. Importers are locked into forward contracts with buyers and importers may not be in a position to pass these increases on to customers or to vary supply sources at short notice.

In terms of vessel provision, only one member of the AADA has introduced larger replacement vessels in order to alleviate excess demand. Until quite recently there has been no indication of any other member carrier increasing its capacity.

While anti-competitive detriment flowing from the substantial lessening of competition associated with the AADA has been established, the public benefits that can be attributed to the AADA (and would not have occurred in its absence) have not been made out. As such, the Commission's view is that the public benefit of the AADA has not outweighed its anti-competitive detriment.

The Commission's view is that, on balance, the exceptional circumstances criteria are satisfied.

8. Preliminary Conclusions

Based on its investigation into the AADA, the Commission has arrived at the following preliminary conclusions.

8.1 Investigation Criteria

The Commission has conducted this investigation in terms of the criteria applied under section 10.45 (1) a) viii) of the TPA *1974.*

The criteria are as follows:

a. 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

b. the parties to the agreement have engaged in conduct, or propose to engage in conduct, to give effect to or apply the provision; and

c. 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:

   i) has resulted, or is likely to result, from the conduct; or
   ii) would result, or be likely to result, if the proposed conduct were engaged in; and

d. there are exceptional circumstances that warrant the giving of a direction under subsection 10.44 1).

Additional criteria were adopted in that "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.

8.2 The Commission's Assessment

In assessing the effect of the AADA on the trade, the Commission has adopted a methodology that compares observations of the trade in the presence of the AADA (the "factual" scenario) with a hypothetical view of how the trade would have developed in the absence of the AADA (the "counterfactual" scenario).

The differences in terms of market conduct between the two scenarios stems from greater impetus for the carriers under the counterfactual scenario to compete during the *reference period*. This competition takes the form of both price competition and quantity competition, the latter being defined as the introduction of additional and / or larger vessels into the liner trade by the incumbent consortia. Given the significant increases in import demand that has been experienced in this southbound liner trade, price competition would have arisen in the counterfactual scenario.

The greater proclivity of the consortia in the absence of the AADA to compete on freight rates would have tempered freight rate increases and led to greater price dispersion in the short run. The greater proclivity of the consortia, in the absence of the AADA, to obtain a first mover advantage over their rivals and improve market share in a period of excess demand and tight world supply of vessels would have tempered the longer term increases in freight rates. In addition, it would have also addressed issues of deteriorating service standards, which have led to delays and cost impositions upon shippers.

The Commission has found that the AADA includes a provision (Article 4) which had the effect of allowing the parties to substantially lessen competition on the southbound North East Asia – Australia liner trade.

The Commission has further found that the parties to the AADA have engaged in conduct to give effect to the provision contained in Article 4 of the AADA agreement.

8.2.1 Assessment of net public benefit over the reference period.

The position paper makes the preliminary conclusion that there was no net public benefit accruing from the role or actions of the AADA over the *reference period*. In a period of excess demand there are no apparent "market failure" problems concerning supply capacity to the trade that an anti-competitive agreement could, in theory, be expected to address. In addition, freight rates would not be considered stable, as they were being driven higher by high demand.

The detriment that flows from the conduct of the parties to the AADA is that which flowed from the provision (article 4) of the agreement which the carriers have acted upon. This position paper concludes that in the counterfactual world there would have been greater proclivity by the individual consortia to compete on price and offer greater discounts in the short term. In the longer term, there would have been greater proclivity by some consortia to introduce additional or larger vessels or both to improve their share of the southbound trade from North East Asia. The AADA has also operating as a signalling device to the carrier members that, for the short term at least, it is more profitable not to break ranks and invest in additional shipping capacity for this liner trade. This has resulted in higher freight rates and greater shipper inconvenience in terms of delays and lack of service than would have been the case without the AADA.

However, the position paper acknowledges that the period of excess demand has strengthened the AADA member lines' inclination to adhere to AADA decisions. In a period of excess supply it is unlikely that the AADA would have achieved similar levels of rate increases.

The Commission is therefore of the view that the competitive detriment that flows from the market conduct of the AADA during the *reference period*, that is by collectively increasing freight rates by substantial amounts, outweighs the public benefits that flow from the same market conduct.

8.3 Exceptional Circumstances

8.3.1 Market Power

This position paper finds that in times of excess demand, such as during the *reference period*, the AADA possesses substantial market power. This is demonstrated by its ability to sustain a significant freight rate increase in the trade. Also, the AADA comprises a significant proportion of both the shipping lines and the liner capacity supplied to the direct southbound liner trades from NEA.

8.3.2 Reasonableness of Freight Rate Increases

This position paper finds these rate increases to be unreasonable in the context of the characteristics of the industry, and particularly due to the impact of the increases upon importers.

8.3.3 Reasonableness of withdrawal of capacity

Whilst the position paper does not consider supply reduction, because there has been no supply reduction by the parties to the AADA, it acknowledges that the importers are concerned that service standards have fallen due to the lack of supply response by the carriers to the situation of excess demand.

8.3.4 Assessment of the longer term net public benefit of the AADA

This position paper concludes that over the life of the AADA that the competitive detriment has outweighed the public benefit derived from the AADA. The position paper does, however, acknowledge the complexity and difficulty in determining public benefits in the liner shipping industry.

The claimed public benefit of discussion and conference agreements is the stability of services and stability of freight rates that it offers shippers over time. It is possible, although not demonstrated in this case, that the AADA offered the benefits of stability to shippers over the period 1999 to May 2003.

The Commission has found that freight rates have been reasonably stable in a narrow band over the period 1999 to June 2003, after which freight rates have increased substantially.

In the course of its investigation the Commission has not been presented with any arguments based on economic theory that links the existence of the AADA to resolution of any problems that may be inherent in providing liner shipping capacity to this industry. Therefore, for the purposes of this investigation, the Commission has regarded as negligible any public benefit that may have arisen through the AADA's role in resolving such problems.

Whilst the role of the AADA in affecting competition based on capacity decisions is difficult to determine, the Commission considers it possible that the AADA facilitated decisions by its members to not invest in additional capacity.

The Commission has reached the preliminary conclusion that the competitive detriment of the AADA associated with a diminution of price and quantity competition outweighed the benefits of the AADA in its provision of service and freight rate stability.

8.4 Commission View

The Commission's investigation has found that all of the criteria are satisfied. As such grounds would appear to exist for the Minister to cancel the registration of the collective price setting powers of the AADA under article 4 of the Asia – Australia Discussion Agreement pursuant to subsection 10.44 (1) (b) of the TPA *1974*.

9. The Commission's Position

The Commission's analysis is that over a period spanning mid-2003 to early 2004 (the *reference period*), the AADA allowed its members to increase prices at a faster rate than would have been likely had the AADA not existed. This represented a detriment to shippers that did not appear to be outweighed by any public benefit.

However, in considering an appropriate regulatory response to this conduct the Commission has considered whether the AADA may provide benefits to shippers that were not apparent in the *reference period*. In this respect the Commission notes that interested parties representing many Australian importing businesses have not called for the AADA to be deregistered.

The Commission's preliminary view is that, pursuant to section 10.44 (1) (b) (iii) of the Trade Practices Act *1974*, grounds exist for the Australian Government Minister for Transport and Regional Services to direct the Registrar of Liner Shipping to cancel the registration of the Asia- Australia Discussion Agreement (AADA) as far as it relates to permitting the discussion, collective setting and agreement of freight rates (including base freight rates, surcharges, rebates and allowances) and giving effect to any such agreements.

Pursuant to section 10.44 (6), the exemptions provided by Subdivision A of Division 5 should cease to apply in relation to this conduct. The Commission notes that any exemptions provided to the AADA by sections 10.17A (2) and 10.17A (4) would no longer apply, and that the direction will limit the exemption provided to conference members under section 10.17(2). The former mentioned provisions relate to exemptions from section 45 for the making of, and putting into effect freight rate charges in a freight rate agreement among parties participating on an inbound liner trade.

The Commission has formed its view on this matter on the basis of consideration of submissions received by the Commission in the course of conducting this investigation. The Commission has found that detriment has flowed from those provisions of the AADA agreement that allow for a consensus regarding pricing. Detriment that may have flowed from the non-pricing aspects of the AADA has not been the focus of this investigation. The Commission has also noted the views of most importers in not calling for the deregistration of the AADA in its entirety. A direction by the Minister in the terms set out above will still allow the IAA and the AADA to discuss minimum levels of service for the southbound liner trades from North East Asia and will also allow discussion of service provision to take place between the AADA and any designated secondary importer bodies in the future.

The Commission has also formed the view that the collective setting and discussion by parties to the AADA of surcharges should also be repealed. Firstly, this is to inhibit a potential collective increase by the AADA in shipping 'prices' paid by shippers through the mechanism of surcharge setting. This could effectively circumvent the intention of the Commission in its recommendation that the collective freight rate setting power be disallowed. Secondly, the prohibition on the discussion and collective setting of surcharges will encourage competition between the various consortia and carriers in the setting of surcharges to the benefit of shippers. In turn this may allow competition between the consortia and carriers to drive down those elements of costs that some of the surcharges are designed to recover.

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