



Part X Investigation

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

**Report to the Australian Government Minister
for Transport & Regional Services**

July 2004

Key Messages

- The Australian Competition and Consumer Commission (the ‘Commission’) has decided to recommend the Federal Government not at this time 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 view is that not all of the grounds have been established 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, which is 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 of introduction 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 2003. 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 Commission’s view is that the AADA used its exemption to lessen competition on the North East Asia to Australia trade. However, the impact of such conduct is difficult to discern in the market conditions that prevailed at the time – namely, burgeoning demand for imports from China and a scarcity of cargo vessels.
- The Commission acknowledges that the decisions of the AADA member lines to invest in capacity were influenced by a number of factors including some difficulty in obtaining suitable vessels at rates which would make the investment profitable. That said, the Commission also notes that the AADA member lines were slower than new entrants to add shipping capacity to the North East Asia – Australia trade.
- Given the current and anticipated developments in regard to capacity the Commission consider it unclear whether the conduct results in a detriment to the public that outweighs the public benefits of the conduct
- Notwithstanding the decision to not recommend deregistration, the Commission has also noted the high level of discontent amongst the customers of the AADA.

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 – Transshipment 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.

Transshipment – 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

E.1. 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 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 47¹ of the TPA 1974 and are legally allowed to discuss collective rate making.

The impetus for the Commission's investigation was a number of complaints from importers and freight forwarders, beginning in May 2003. These concerned a series of 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 throughout 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	1 July 2004	When vessels reach 100% utilisation	1 October 2004
\$US500 per TEU ²	\$US200 per TEU	\$US250 per TEU	\$US300 per TEU (Korea)	\$US250 per TEU	\$US500 per TEU	\$US300 per TEU	\$US250 per TEU
\$1000 per FEU	\$US400 per FEU	\$US500 per FEU	\$US600 per FEU (Korea)	\$US500 per FEU	\$US1,000 per FEU	\$US600 per FEU	\$US500 per FEU
Increase in base freight rates	Peak season surcharge until 1 February 2004	Increase in base freight rates	Increase in base freight rates	Increase in base freight rates	Increases in base freight rates	Peak season surcharge	Increase in base freight rates

Source: *Lloyds List Daily Commercial News various issues*

¹ With the exceptions of 47 (6) and 47 (7) relating to third line forcing.

² 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 as well as the additional imposition of a \$US200 per TEU Peak Season Surcharge. According to several shippers, the announced freight rate increases have succeeded in raising freight rates in the trade by 100 per cent.

More recent market inquiries conducted by the Commission in April 2004, in the wake of the 1 April rate increase reveal that freight rates for carriage of imports from Hong Kong were between \$US900 and \$US1,300 per TEU. Freight rates for imports from Shanghai were slightly higher at between \$US1,100 to \$US1,500 per TEU, while those sourced from other Chinese ports were in the range \$US1,300 to \$US1,600 per TEU. The market evidence suggests that freight rates did not increase as rapidly during the low season. Some shippers stated that the rate increases resulting from the 1 April 2004 rate increase nullified the cost decreases due to the removal of the peak season surcharge in February 2004. While the rate increases have slowed due to the low season, blue water freight rates appear to be still considerably greater than those applying in the June quarter 2003.

The Commission has also noted that growth in containerised import volume from North East Asia has slowed. In the financial year 2002-03, the number of full containers imported from North East Asia into Australia's five major ports increased by 33 per cent. By contrast, in the nine months to March 2004, the number of full containers imported from North East Asia increased by 15 per cent when compared to the nine months to March 2003. This is annualised to about 22 per cent growth in a full financial year 2003-04.³

The trade has also recently experienced some increases in capacity. On 17 May 2004 an additional liner service was established by a number of new lines to the trade, while a further liner service was commenced by lines party to the AADA on 30 June 2004.⁴ A further two liner services are expected to be established in July 2004. This implies a 50 per cent increase in vessel numbers and a 35 per cent increase in capacity.⁵

³ The June quarter represents the medium season for imports

⁴ LLDCN (2004) Coscon launches NCX service tomorrow electronic mail 29 June 2004

⁵ LLDCN (2004) ANL, China Shipping and OOCL top the slots May 6 2004 p 3, LLDCN (2004) CP Ships confirms new China –Australia shuttle June 16 2004 electronic mail

The steps taken by the Commission in its investigation are:

- release of an Issues Paper addressed to interested parties in November 2003;
- release of a questionnaire addressed to the AADA and to Project Asia Service in November 2003;
- receipt of 13 submissions in response to the Issues Paper and responses to questionnaires by early January 2004;
- the Commission released a Position Paper outlining its preliminary views concerning the market conduct of the parties to the AADA and its assessment according to the outlined criteria in early April 2004;
- By 30 April 30 2004, the Commission had received six submissions by interested parties in response to its Position Paper.

In addition, the Commission has undertaken consultation with the AADA, the IAA, shippers, freight forwarders, and shipping lines⁶ during the course of the investigation.

The Commission has concluded that the relevant statutory criteria cannot be fully established at this time. The Commission has formed this conclusion based on the following findings:

- The Commission has been unable to separately establish the effect of the AADA agreement in delaying investment in additional shipping capacity during the reference period from the broader market conditions of a global dearth of supply and increased charter rates.
- The Commission considers that recent entry and service expansion of the North East Asia – Australia liner trades liner will reduce the likelihood that the AADA could be used to constrain capacity or rapidly increase freight rates in the immediate future.

Consequently, the Commission is not satisfied that it can establish that exceptional circumstances apply at this time. Further, given the current and anticipated developments in regard to capacity the Commission considers it unclear whether the conduct results in a detriment to the public interest that outweighs the public benefits of the conduct.

⁶ Maersk Sealand, K Line, APL, PIL, MISC, RCL, and Hapag Lloyd.

E.2. Views of Interested Parties

A number of parties made submissions to the Commission's Issues Paper and to the Position Paper. The Issues Paper outlined the Commission's investigation and requested information that may be relevant. The Position Paper presented the Commission's analysis and the preliminary view that there were grounds to revoke the AADA's exemption from the price fixing provisions of the TPA.

E.2.1. Importers Association of Australia (IAA)

While prices could have been expected to increase because of the market conditions, the IAA's view is that the AADA allowed its members to increase prices more steeply and quickly than would have been the case in the AADA's absence. Further, the IAA's view is that the AADA does not provide any compensating public benefits.

E.2.2. 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.

E.2.3. Shippers

Most of the submissions from importers and importer associations focussed on the deterioration in service reliability and adequacy during 2003, as well as the significant increases in freight rates.

Issues of concern included:

- the vulnerability of small importers to price increases implemented by the AADA lines;
- the AADA has not contributed to more stable freight rates;
- the AADA's service standards have deteriorated, evidenced by shipment delays of containers, caused by insufficient capacity in the market;
- the AADA has demonstrated little regard to the business interests of shippers;
- the limited ability of small and medium size shippers to negotiate with AADA lines regarding freight rates;
- 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 Peak Season Surcharge has been applied by the lines without any augmentation of services provided.

In response to the Position Paper, the Commission received four responses from shippers, of which three were public and one confidential. The confidential response was from an importing business and requested that the ACCC act to remove the AADA's exemption from legislation prohibiting anti-competitive conduct. The CCIWA and the FBIA endorsed the Commission's preliminary view that there are grounds for the Minister to deregister the AADA. Independent Paper Group (IPG) also supported the findings set out in the Commission's Position Paper. In particular, IPG noted that partial deregistration of the AADA would still allow designated importer bodies to discuss minimum levels of service for the southbound liner trades from North East Asia.

E.2.4. Freight Forwarders

The Australian Federation of Freight Forwarders (AFIF) made a submission in response to the Commission's Position Paper. AFIF concludes that:

- The rate increases affect only a small amount (about 12-13%) of the total trade as "...all other cargo is under contracts, most of which are made in other countries by foreign companies who are not subject to Australian law nor are subject to the general rate increases"
- Fluctuations in supply and demand resulted in the price fluctuations observed during recent years, demonstrated that international shipping is a "genuinely free market";
- The "radical fluctuations in pricing recently experienced (are) bad for everyone involved in the trade (users and providers)";
- A forum needs to be established to allow open discussion on pricing and supply and provide a planned approach to increases in prices;
- Deregistration of the AADA may remove the ability to have a meaningful discussion with the lines regarding price stability.

E.2.5. Asia – Australia Discussion Agreement (AADA)

In its submission to the Commission's Issues Paper, the AADA stated that, in the absence of any common tariff agreed amongst AADA lines, competition prevails amongst 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.

In responding to the Commission’s Position Paper, the AADA queried the motives of the Commission in undertaking the investigation. The AADA argued that the Commission had acted on the basis of complaints from a small and insignificant sample of users and had not waited for other avenues under Part X (such as negotiation between the AADA and shippers) to be exhausted.

The AADA’s view is that the Commission did not model the most likely counterfactual scenario. In the absence of the AADA, it is argued that another registered agreement, the Australia New Zealand Eastern Shipping Conference (ANZESC), would have “commanded a significant influence in the marketplace” to the effect that “the extent and speed to which supply and demand factors would have become commonly known would not have been too (dissimilar) to that of the factual”. As such the AADA’s view is that “...all findings reached by the Commission that involve the use of the (Commission’s) counterfactual scenario should be treated as invalid”.

The AADA submission claimed that the public benefit of the AADA during the reference period was the attempt to restore freight rates to viable levels, leading to viability of continuing to provide existing services and the contemplation of an expansion of services to benefit of importers.

E.3 Characteristics of the North East Asian Trade

The Commission’s analysis has focused on a *reference period* spanning April 2003 to February 2004 as it is during that time which the coincidence of *announced* price increases and *actual* price increases appear to be highest

The Commission has made the following 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 appear to have competed vigorously in respect to capacity levels;
- the AADA’s competitors appear to follow the price leadership of the AADA lines; and
- AADA lines’ transit times and frequencies to Australian east coast ports are superior to services offered by PAS and transshipment services.

A number of explanations for these observations are possible. One possibility appears to be that, with such emphasis in the liner cargo industry placed on reliability, frequency and fast transit times, AADA lines’ competitive advantage and market share was sufficiently large to escape competitive pricing discipline from their rivals. Without perceived competitive threats in the market, AADA lines appeared capable of leveraging their market power more effectively during the period between June 2003 and December 2003. Relatively low entry and exit barriers imply market contestability and potential entrants appear to be the only material competitive constraints on the AADA lines’ market power. Whether the AADA lines chose to

withhold from investing in additional capacity to facilitate higher prices is considered later in this Report.

However, it is important to note that, to a significant degree, the above observations may be explained by increasing (and unanticipated) excess demand in the second half of 2003. This would have been expected to lead to a large jump in spot and renewed contract rates. Such a jump would occur even in a highly competitive market. The overwhelming source of the excess demand reflected unanticipated levels of high growth in demand for imports from North East Asia.

Further, excess demand conditions arising from unanticipated shifts in demand make conclusions regarding whether increases in freight rates are due to a lack of competitive discipline difficult to separately identify and substantiate. This does not mean that the market is not being influenced by collusive elements that increase prices but rather that, when there is excess demand, large price increases can also result from market clearing forces. As a result, the impact on the market may be similar: collusive conduct and excess demand both result in price rises. The former restricts demand while the latter eliminates excess demand. In the following analysis, this Report seeks to distinguish the effects of the AADA from those market conditions that exist independently of the AADA.

E.4. Criteria by Which the Conduct is Assessed.

The Commission has conducted this investigation in terms of the criteria referred to 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 and Regional Services to respond to a recommendation from the Commission.

This Report finds that the criteria are not all satisfied. Most significantly, the Commission cannot definitively conclude on the basis of the evidence, that the anti-competitive detriment of the price setting powers contained in the agreement (AADA) outweighs the benefit flowing to shippers.

However, the Commission does conclude that the other elements set out by the Minister in respect to determining whether exceptional circumstances exist are satisfied. That is, the AADA may be accorded market power in times of excess demand on the basis of its extensive market coverage of the southbound North East Asia – Australia liner trade. The parties to the AADA were also to a large degree unreasonable in the manner in which they increased freight rates even though it is recognised that it was during a time of a demand boom. However, as a result of its investigation the Commission has not identified that exceptional circumstances exist at this time.

Consequently, since not all of the criteria referred to in section 10.45(1)(a)(viii) are satisfied the Commission is not in a position to recommend that the Australian Government Minister for Transport and Regional Services direct the Registrar of Liner Shipping to revoke the registration of the Asia-Australia Discussion Agreement.

E.5. The Commission’s Assessment Methodology

This investigation assesses the conduct of shipping lines in the North East Asia – Australia southbound trade. The competition analysis has been conducted via an *ex-post* (backward looking) appraisal. The Commission has approached its analysis of the impact of the AADA by comparing observations in the market in which the AADA operated (the *factual*) to a hypothetical alternative where no AADA existed (the *counterfactual*). Such analysis allows the effect of the AADA on, for example, prices to be distinguished from the more general shifts in market conditions.

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 authorisation under Part VII of the TPA.

In forming a recommendation to the Minister on whether grounds exist to deregister an agreement, the Commission is required to establish that, looking forward, the conduct associated with that agreement is likely to continue to be detrimental to the public. For this reason the Commission has also taken into account developments in the North East Asia – Australia trade that have occurred subsequent to the *reference period*.

E.6. The Assessment of the Commission against the Criteria.

This section summarises the assessment of the Commission on the basis of the statutory criteria set out at E.4. (above).

E.6.1. The AADA agreement includes a provision that has the purpose of substantially lessening competition

- 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 purpose or likely 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.⁷ 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 Report 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. However, it is acknowledged that the market structure has changed considerably since May 2004 due to a reorganisation of existing services, the entry into the direct liner trade by four new lines and the establishment of four new

⁷ Excerpt from Asia- Australia Discussion Agreement article 4 (Agreement Authority) December 2002 p 1.

services. This Report assesses the likely differences in the conduct of market participants in the trade (North East Asia to Australia) in both factual and counterfactual scenarios.

The Commission has interpreted the market structure of the counterfactual scenario as follows. It consists of a seven line conference (ANZESC), which can set rates collectively, two consortia ⁸(FESCO/ HSDG / HMM and MSC/MSL) as well as an independent carrier COSCO. The combined capacity share of the parties to conference ANZESC is estimated to be about 40 per cent. Four of the consortia and COSCO are of roughly equal capacity⁹ size and share (each between 14 and 21 per cent), while FESCO's capacity share is smaller at 7 per cent.

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 providing its own vessels that offers 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.¹⁰

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,¹¹ the price competition that would arise in this counterfactual scenario is as follows:

- there would have been greater competitive impetus due to the fact that there are four rivals in the market instead of four 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

⁸ The parties to consortia do not discuss or collectively set freight rates.

⁹ At between 90 to 100 per cent average vessel utilization at present, the capacity shares are roughly equivalent to market shares.

¹⁰ Evergreen Marine is technically party to the AADA, but is a non-performing member that never attends meetings of the AADA. Another non-AADA carrier, Hapag Lloyd, buys allocated slot space from Evergreen Marine.

¹¹ 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 48 per cent in 2002/03.

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.¹²

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 question of whether there would have been greater investment in additional and or / larger vessels in the counterfactual scenario is more problematic.

In a situation of 'normal' global trading conditions the Commission considers that in the counterfactual scenario, the individual conference/ consortia and carriers would have more likely to have invested in additional and or larger vessels, than that which occurred in the *reference period*. However, there is also market evidence that suggests that during the *reference period* individual carriers or consortia may have been constrained from investing in additional and/or larger vessels in the short term. This is due to the following reasons:

- according to the AADA, the financial profitability of the average (representative) carrier, participating on the North East Asia – Australia liner trade was only at break-even levels by September 2003. This followed four years of financial losses.
- charter rates for suitably sized vessels have increased significantly in response to increased demand for vessels driven by the global boom in demand for Chinese exports.¹³
- Market inquiries tend to confirm the difficulty of procuring vessels in entering the North East Asia – Australia liner trade. In fact the average size of the vessels that the new entrants have introduced to the trade is lower than the average size of vessels currently in the liner trade, despite the significant increase in demand.¹⁴

Finally, according to both the AADA and the individual carriers, investment decisions are made at the company level and not within the confines of the AADA. Notwithstanding this, the Commission's view is that that the carriers have an added incentive to defer investment when they can collectively raise rates within the AADA. In this respect that Commission notes that the announcement of an expansion in services to be introduced in July 2004 by several of the parties to the AADA has lagged the commencement of services by new entrants.

To conclude, the Commission considers that there would have been greater price competition between the individual conference / consortia and carrier groupings in the

¹² 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.

¹³ Clarksons (2004) *Container Intelligence Monthly* May 2004 p 4

¹⁴ LLDCN (2004), Tonnage squeeze forces lines to juggle Asia- Europe box fleets. Configuration of seven ships instead of eight reflects desperate lack of vessels, Thursday May 20 2004

absence of the AADA. This would have resulted in a slower increase in freight rates in response to the growing demand. However, once vessel utilisation rates for individual consortia / carriers have approached 100 per cent most lines would be aware that the demand conditions are generally of one of a boom. Thus lines would realise that the increased demand that they face is not due to its individual price setting in the market but due to an overall growth in demand. Consequently with constrained supply the overall magnitude of freight rate increases would have been similar in the counterfactual to that which occurred. The timing of the increases however, would have been steadier due to greater short term price competition.

The Commission has considered the effects of increased charter rates, increased difficulties in obtaining vessels and profitability of investment in additional capacity in assessing the timing and pattern of new investment by individual carrier and consortia groups during the *reference period*. It has also noted that, following the *reference period*, additional capacity was provided first by new entrants, rather than AADA members. It is considered possible that a greater degree of quantity competition would have prevailed in the counterfactual scenario.

E.6.2. The Parties to the AADA gave effect to an anti-competitive provision

- 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.

Having reached a view that Article 4 of the Agreement is likely to have an anti-competitive effect under certain conditions, 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.

E.6.3. The Effect of the Conduct

- 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**

On balance, the Commission has reached the view that it cannot be established with certainty that the anti-competitive detriment that resulted from (or is likely

to result from) the *conduct* has outweighed a benefit to the public that may have arisen or may arise indirectly from that *conduct*.

The participation of the trade's major carriers in one discussion forum – the AADA – during the *reference period* is likely to have weakened the competitive tensions between its members. *Prima facie*, if a number of potential competitors cooperate in a single information sharing discussion agreement it potentially increases market concentration and suggests a substantial lessening of competition where circumstances limit the threat of market entry. 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 lessening of competition attributable to the AADA.

The Commission considers it likely 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. Substantial entry into the trade – initially by lines not party to the AADA – during 2004 indicates to the Commission that the AADA members may have had a lower incentive to expand 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.

Public Benefits

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 to 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 that flows to *shippers*. In considering public benefits and anti-competitive detriment the Commission has adopted a broad consideration of possible public benefits.

In its submission to the Issues Paper, 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".¹⁵

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.

Public Benefits and Liner Profitability

The objects of Part X make no specific mention of liner profitability as a public benefit. Technically, liner profitability is a private benefit accruing to shareholders of shipping lines. The Commission notes that despite increasing profitability during the reference period, there was no significant investment in new tonnage by the AADA-member lines, apart from the replacement by China Shipping Company of two smaller vessels with two larger vessels. Thus, during the *reference period*, the public benefits that the AADA associated with the market conduct of the AADA members did not materialise.

Public Benefits in the Reference Period

The Commission has found that there are no significant public benefits that can be attributed to the conduct of the AADA's members in discussing and collectively setting prices during the *reference period*.

Conclusions on Public Benefits and Anti-competitive Detriment over the reference period

The Commission has assessed that some lessening of competition resulted from the conduct of AADA members using the AADA agreement during the *reference period*. When considered in the light of prevailing market conditions, the amount of any consequential detriment is difficult to separate from the effect of other influences on the market. Over that same period, it is not obvious that public benefit can be directly attributed to the conduct of the AADA members. On balance, the Commission has reached the view that it cannot be established with certainty that the anti-competitive detriment that resulted from (or is likely to result from) the *conduct* has outweighed a benefit to the public that may have arisen or may arise indirectly from that *conduct*.

¹⁵ AADA₂ Submission, op cit p.10.

E.6.4. Exceptional Circumstances

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

The Commission's view is that, on balance, grounds are not sufficiently established for the Minister to be satisfied that there are exceptional circumstances that warrant the giving of a direction under subsection 10.44(1).

The Commission is required to consider whether there are exceptional circumstances that warrant the giving of a direction under section 10.44(1). In considering this matter the Commission gave consideration to the guidance provided in the Second Reading Speech and the Explanatory Memorandum, which suggested that exceptional circumstances may exist in 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.

Market Power

The AADA played a key role in coordinating freight rate increases during the *reference period*. These freight rate rises were sustainable due to the significant increases in demand for imports from North East Asia to Australia and an apparent lack of threat of new entry. Under such circumstances, the AADA is accorded a degree of market power. In addition, the AADA members represent a substantial majority of lines on the trade and a substantial majority of capacity.

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. The reaction of the AADA-member lines to this increase in demand is important. 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 AADA-member carrier increasing its capacity. The possibility remains that the AADA had the effect of delaying the introduction of additional capacity by its members.

Reasonableness of Freight Rate Increases

On the question of the reasonableness of freight rate increases, southbound liner freight rates from North East Asia 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. While the freight rate increases have enhanced the viability of the AADA member services on this trade, they may nevertheless be regarded as “unreasonable” to the extent that the AADA worked to increase rates faster than would have been likely in the AADA’s absence.

Anticompetitive Detriment

The Commission’s view is that some degree of anti-competitive detriment flowing from the lessening of competition associated with the AADA has been established. This detriment has coincided with a period in the North East Asia – Australia trade where demand increased rapidly and, to some extent unexpectedly, and the sourcing of additional vessels in the short term was problematic. This coincidence of market conduct and global conditions makes difficult the measurement of detriment that can be separately attributed to the AADA. For this reason, the Commission has been unable to establish with reasonable certainty the degree of anti-competitive detriment.

Furthermore, the Commission’s view is that, going forward, it is uncertain whether the anti-competitive detriment of the AADA will outweigh any public benefit. Specifically, there is significant uncertainty about whether the conditions which led to a period of lower contestability in the North East Asia – Australia trade will persist into the future. This indicates that, although anti-competitive, the detriment flowing from the AADA’s existence is likely to be lower in the foreseeable future.

Notwithstanding the Commission’s finding on detriment, the Commission’s view is that the public benefits that could be attributable to the AADA (and would not have occurred in its absence) have not been persuasively made out.

Conclusion

The Commission’s view is that, on balance, grounds are not sufficiently established for the Minister to be satisfied that there are exceptional circumstances that warrant the giving of a direction under subsection 10.44(1).

E.7. Commission Recommendation

Based on current evidence the Commission is not satisfied that it could recommend at this time that the Minister make a direction under section 10.44(1) to cancel the registration of the AADA registered conference agreement (including in respect to a particular provision, party or conduct).

Relevantly, the Commission is not satisfied that sections 10.45(3)(c) and (d) apply. The Commission forms this conclusion based on the following findings:

- The Commission has been unable to separately establish the effect of the AADA agreement in delaying investment in additional shipping capacity during the reference period from the broader market conditions of a global dearth of supply and increased charter rates.
- The Commission considers that recent entry and service expansion of the North East Asia – Australia liner trades liner will reduce the likelihood that the AADA could be used to constrain capacity or rapidly increase freight rates in the immediate future.

Consequently, the Commission is not satisfied that it can establish that exceptional circumstances apply at this time. Further, given the current and anticipated developments in regard to capacity the Commission considers it unclear whether the conduct results in a detriment to the public interest that outweighs the public benefits of the conduct.

Table of Contents

Key Messages	i
Abbreviations	ii
Glossary of Terms	v
EXECUTIVE SUMMARY	viii
E.1. Background and Introduction	viii
E.2. Views of Interested Parties	xi
E.2.1. Importers Association of Australia (IAA)	xi
E.2.2. Australian Peak Shippers Association (APSA)	xi
E.2.3. Shippers	xi
E.2.4. Freight Forwarders	xii
E.2.5. Asia – Australia Discussion Agreement (AADA)	xii
E.3 Characteristics of the North East Asian Trade	xiii
E.4. Criteria by Which the Conduct is Assessed	xiv
E.5. The Commission’s Assessment Methodology	xv
E.6. The Assessment of the Commission against the Criteria	xvi
E.6.1. The AADA agreement includes a provision that has the purpose of substantially lessening competition	xvi
E.6.2. The Parties to the AADA gave effect to an anti-competitive provision	xix
E.6.3. The Effect of the Conduct	xix
E.6.4. Exceptional Circumstances	xxii
Table of Contents	1
1. Introduction	4
1.1 Background to the Asia – Australia Discussion Agreement matter	4
1.2 Commission initiated Part X investigation	5
1.3 Investigation Procedure	5
1.4 Structure of this Report	5
2. Background to Part X	7
2.1 Anti-competitive conduct and Part X of the Trade Practices Act	7
2.2 Role of ACCC under Part X	7
2.3 Objectives of Part X	8
2.4 How does Part X achieve its objectives?	8
2.5 Registration of agreements	9
2.6 The Commission’s Investigation	10
2.7 Other key aspects of Part X Relevant to the AADA Investigation	11
2.7.1 The Negotiation Process Provided for by Part X	12
2.7.2 Negotiation requests	13
2.7.3 Obligations relating to an authorised officer	13
3. Views of Interested Parties	14
3.1 Importers Association of Australia (IAA)	14
3.2 Australian Peak Shippers Association (APSA)	15
3.3 Shippers	16
3.4 Freight Forwarders	18
3.5 Asia – Australia Discussion Agreement (AADA)	19
Response to Issues Paper	19

Response to Position Paper.....	20
4. Market Characteristics of Liner Shipping Services in the North East Asia- Australia Trade.....	22
4.1 Characteristics of Supply of Liner Shipping.....	22
4.1.1 Geographic Description of Liner Supply.....	23
4.1.2 Consortia and Liner Services.....	24
4.1.3 Description of Direct Liner services between Australia and North East Asia.....	25
4.1.4 Australian port coverage of consortia / carriers.....	26
4.1.5 North East Asia port coverage of consortia / carriers.....	26
4.1.6 Provision of specialised services (reefers).....	27
4.1.7 Changes to Direct Liner Services in May 2004.....	27
4.1.8. Description of Transshipment Liner services between North East Asia and Australia.....	29
4.1.9 Asia – Australia Discussion Agreement & Australia New Zealand Eastern Shipping Conference.....	33
4.1.10 Market Definition.....	34
4.1.11 Competition among shipping lines.....	35
4.1.12 Breakbulk liner services and air freight operators.....	36
4.1.13 The Geographic Market.....	36
4.1.14 Significance and Direction of the North East Asian Liner Trade.....	37
4.1.15 The AADA and the North East Asia – Australia Southbound Liner Trades.....	38
4.1.16 Recent Trends in Liner Supply from North East Asia to Australia....	39
4.2 Global Trade Factors.....	41
4.2.1 Global demand for liner cargo shipping services.....	42
4.2.2 Global supply of liner shipping.....	42
4.2.3 Recent Movements in Global Freight Rates.....	43
4.3 Barriers to Entry / Exit.....	44
4.3.1 Regulatory Barriers to Entry.....	44
4.3.2 Sunk costs and contestability of the North East Asia – Australia Liner trades.....	44
4.4 Characteristics of Demand.....	45
4.4.1 Imports and Exports by Volumes and Value.....	46
4.4.2 Export Volumes.....	49
4.4.3 Trade Imbalances and Seasonality.....	50
4.4.4 Capacity utilisation in southbound liner trades.....	51
4.4.5 Countervailing Power of Importers.....	52
4.5 Freight Rates.....	54
4.5.1 Trends in Southbound Liner Freight Rates.....	54
4.5.2 International Competitiveness of Freight Rates on the North East Asia to Australia Liner Trade.....	58
4.5.3 Findings on Freight Rates.....	60
4.6 Costs and Profitability of the Lines.....	61
5. Findings on Characteristics of the North East Asian Trade.....	61
6. The Commission’s Assessment.....	63
6.1 Legislative Criteria Relevant to the Commission’s Investigation.....	63
6.1.1 The Commission’s decision to investigate.....	64
6.1.2 Jurisdiction.....	65
6.2 The Commission’s Assessment Methodology.....	65

6.2.1	Criticism of the Commission’s methodology	66
6.3	Does the AADA Agreement Include a Provision that has the Purpose or Effect of Substantially Lessening Competition?.....	66
6.3.1	The terms of the Agreement	66
6.3.2	The effect of the Agreement on Competition	68
6.3.3	Views of the Commission.....	68
6.4	Did the Parties to the AADA engage in conduct that gave effect to the anti-competitive provisions of the Agreement?	69
6.4.1	Observations from the trade.....	69
6.4.2	Capacity differentials.....	70
6.4.3	Differences in the levels of freight rates.....	72
6.4.4	Differences in the speed of freight rate increases.....	73
6.4.5	Service standards	74
6.4.6	Frequency.....	74
6.5	Findings on anti-competitive detriment.....	75
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?	75
6.6.1	Public Benefits and Liner Profitability	76
6.7	Conclusions on Public Benefits and Anti-competitive Detriment.....	78
7.	Exceptional Circumstances.....	79
7.1	Did the AADA provide its members a substantial degree of market power?..	80
7.1.1	Did the AADA facilitate a situation of tight supply?	81
7.2	Reasonableness of Increases in Freight Rates	82
7.2.1	Reasonableness from the perspective of Australian importers.....	82
7.2.2	Movements in average freight rates for other Australian liner trades	84
7.2.3	Reasonableness – the lines’ perspective	85
7.2.4	Unreasonable withdrawal of liner services.....	86
7.2.5	Conclusions on reasonableness of freight rate increases.....	86
7.3	Has the public benefit from the operation of the AADA agreement been outweighed by the anti-competitive detriment?.....	86
7.3.1	Potential public benefits of discussion agreements and other types of registered agreements.....	87
7.3.2	Economic theory of benefits associated with anti-competitive agreements.	89
7.3.3	The current approach of international regulators and other interested parties concerning the public benefits of anti-competitive agreements in liner shipping.	91
7.3.4	Has the AADA provided a public benefit in the form of adequate frequency and reliability of services?	92
7.3.5	Has the AADA provided a public benefit in the form of stable services?	93
7.3.6	Concerns of Importers.....	98
7.3.7	Commission’s view on stability.....	99
7.4	Findings – Exceptional Circumstances.....	100
8.0	Commission Recommendation	102
	Bibliography	103
	APPENDIX A: Assumptions underlying liner profitability analysis.....	107

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 conclusion of this investigation is this Report to the Australian Government Minister for Transport and Regional Services on whether it considers grounds exist for deregistration of the discussion agreement.

Part X provides that the Minister may, if satisfied of certain matters set out in Part X, direct that the registration of a conference agreement should be completely or partially cancelled.

This Report presents the Commission’s findings and conclusions that it has reached as a result of its investigation. It provides a recommendation to the Australian Government Minister for Transport and Regional Services not to deregister the Asia-Australia Discussion Agreement at this time.

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 lines¹⁶ that operate on the southbound North East Asia (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 Commission’s 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(1)(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.¹⁷ 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.

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

¹⁷ 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 2003 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 an 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 subsection 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 set out its preliminary views in a Position Paper. The Commission received six submissions in response to its Position Paper. The Commission also sought further market information from shippers, liner companies and the AADA. These responses were taken into account by the Commission in reaching the final position contained in this Report.

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 conclusions are presented in Section 8.

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 minimum 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 Report, 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.¹⁸ 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 body¹⁹, 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 reports 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

¹⁸ 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.

¹⁹ 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).

Guidance as to the meaning of “exceptional circumstances” is contained in the revised explanatory memorandum given by the Minister when introducing the International Liner Shipping Cargo Bill (TPA amendment 2000) into Parliament.²⁰ 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.

²⁰ 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 body²¹. 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 shippers 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.

²¹ 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 and to the Position Paper. The Issues Paper outlined the Commission's investigation and requested information that may be relevant. The Position Paper presented the Commission's analysis and preliminary conclusions, and invited responses.

3.1 Importers Association of Australia (IAA)

In responding to the Issues Paper, the IAA argued 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, transshipment 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.²²

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.

²² In response to the Commission's Position Paper, the AADA argued that this commentary amounted to an "inference that (the AADA) has been negligent or obstructive in its responsibilities under Part X". However, in the Position Paper and in this Report the Commission has not accorded blame to either party for this failure to negotiate. (see Section 4.4.5 – *Countervailing Power of Importers*.)

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.

The IAA also provided a brief response to the Commission's Position Paper supporting its findings and proposed course of action. The IAA put the view that the AADA lines' response to increasing demand was to increase prices rather than augment capacity. While prices could have been expected to increase because of the market conditions, the IAA's view is that the AADA allowed its members to increase prices more steeply and quickly than would have been the case in the AADA's absence. Further, the IAA's view is that the AADA does not provide any compensating public benefits. The IAA also notes that the AADA members propose a series of additional price increases during 2004.

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.

APSA did not respond to the Commission's Position Paper.

3.3 Shippers

In response to the Issues Paper, the Commission received submissions from 13 shippers. Four asked that confidentiality be maintained.

Most of the importers' submissions did 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 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.²³

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 their effect in the market. Finally, the CCIWA does not consider that the AADA had a role to play in maintaining service stability.²⁴

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.²⁵

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.²⁶

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.

²³ Food and Beverage Importers of Australia (2003) Submission to ACCC p 2

²⁴ Chamber of Commerce and Industry of WA (2003) Submission to ACCC p 5

²⁵ Importers Association of Australia (2003) Submission to ACCC p 8

²⁶ Gifts and Homewares Australia (2003) Submission to ACCC p 9

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.

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.

In response to the Position Paper, the Commission received four responses from shippers, of which three were public and one confidential. The confidential response

was from an importing business and requested that the ACCC act to remove the AADA's exemption from legislation prohibiting anti-competitive conduct.

CCIWA reiterated the views expressed in response to the Commission's Issues Paper and added that although Western Australian importers do not have the benefit of direct services from North East Asia they are still suffering freight and surcharge increases. Such increases are either passed on to customers or absorbed by the importers, which the CCIWA regards as "entirely unacceptable". CCIWA argues that the Part X arrangements "...provide little if any protection to Exporters and Importers in Western Australia by way of level of service and no comfort that the Lines are committed to meaningful negotiation on the level of freight and surcharges". Regarding the decision making in the AADA, the CCIWA's view is that "...In actual practice the Australian representatives play a major role in determining and introducing policies that establish the freight structure and the timing of increases". The CCIWA concludes by endorsing the Commission's preliminary view that there are grounds for the Minister to deregister the AADA.

The FBIA's response to the Commission's Position Paper noted that, while price increases in shipping rates could be expected in times of increased demand, it is concerned about the "frequent, sharp increases" introduced by AADA members. Commenting on public benefits, the FBIA stated that benefits flowed to AADA members but not their customers, remarking that "...(w)e had thought that one of public benefits of arrangements such as this AADA was to provide stability and predictability in freight rates. This has not occurred for southbound liner trade from North East Asia." The FBIA also notes the further increases are proposed for 2004 and supports the findings and the proposed course of action set out in the Commission's Position Paper.

Independent Paper Group (IPG) supported the findings set out in the Commission's Position Paper. In particular, IPG noted that partial deregistration of the AADA would still allow designated importer bodies to discuss minimum levels of service for the southbound liner trades from North East Asia.

3.4 Freight Forwarders

The Australian Federation of Freight Forwarders (AFIF) made a submission in response to the Commission's Position Paper. AFIF claims membership of "...in excess of 85% of organisations offering global logistics services to and from Australia" and represents a majority of service providers involved in the import and export of manufactured items transported in sea freight containers. AFIF is also a designated secondary shipper body pursuant to Part X.

AFIF, referring to the purpose of Part X, notes that without liner conference agreements to "rationalise capacity and drive a common policy of Government, shippers and the lines" international shipping would experience "gross inefficiencies, short-sighted developments and prohibitive freight rates".

With regard to the recent increases in freight rates and the Commission's investigation, AFIF notes that the most important influence on the market has been

the continuing level of increased demand for shipping space from mainland China. The AFIF submission also suggests that the appreciation of the Australian dollar against the US dollar has provided an opportunity to increase freight rates. AFIF argues that the “current rate of increase is unsustainable and appears to be an attempt, by the lines, to recover from an equally unsustainable period of freight rate price cutting...”.

The AFIF submission notes that both unsustainably low or high rates “...were not in the overall interest of all parties and an improvement in the checks and balances for this trade is of utmost importance”. The submission notes that the commercial and regulatory environments in place in Europe and North America have provided such checks and balances (largely by providing users of the lines’ services with some countervailing power).

AFIF concludes that:

- The rate increases affect only a small amount (about 12-13%) of the total trade as “...all other cargo is under contracts, most of which are made in other countries by foreign companies who are not subject to Australian law nor are subject to the general rate increases”
- Fluctuations in supply and demand resulted in the price fluctuations observed during recent years, demonstrated that international shipping is a “genuinely free market”;
- The “radical fluctuations in pricing recently experienced (are) bad for everyone involved in the trade (users and providers)”;
- A forum needs to be established to allow open discussion on pricing and supply and provide a planned approach to increases in prices;
- Deregistration of the AADA may remove the ability to have a meaningful discussion with the lines regarding price stability.

3.5 Asia – Australia Discussion Agreement (AADA)

Response to Issues Paper

In its submission to the Commission’s Issues Paper, the AADA stated that, in the absence of any common tariff agreed amongst AADA lines, 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.

Response to Position Paper

In responding to the Commission's Position Paper, the AADA queried the motives of the Commission in undertaking the investigation. The AADA argued that the Commission had acted on the basis of complaints from a small and insignificant sample of users and had not waited for other avenues under Part X (such as negotiation between the AADA and shippers) to be exhausted. Moreover, the AADA questioned whether the Commission had "...simply used any complaints as a ready excuse to pursue its well publicised quest of reigning (*sic*) in all perceived forms of cartel behaviour and ultimately, in the context of liner shipping, the repeal of Part X of the TPA".

The AADA's view is that, in arriving at its preliminary view, the Commission had been "selective" in its use of evidence and noting that the European Commission recently delivered an open finding on a shipping investigation because evidence presented to it had been inconclusive. The Commission's methodology of using a counterfactual analysis to gauge the effect of the AADA on the market amounted to, in the AADA's view, a "make believe world" applied by the Commission to "invent reasons justifying the partial deregistration of the AADA".

In considering the objectives of Part X, the AADA submission states that the Commission's Position Paper overlooked two significant objectives: the requirement for "liner cargo shipping services of adequate frequency and reliability at freight rates that are internationally competitive"; and that liner services should be "economic and efficient".

Responding to the views expressed by users and reported in the Commission's Position Paper, the AADA rejected any inference that it has been negligent or obstructive in relation to its responsibilities under Part X. The AADA also notes that the Commission's Position Paper did not respond to the information provided by the AADA that dealt with international jurisdiction issues.

The AADA's view is that the Commission did not model the most likely counterfactual scenario. In the absence of the AADA, it is argued that another registered agreement, the Australia New Zealand Eastern Shipping Conference (ANZESC), would have "commanded a significant influence in the marketplace" to the effect that "the extent and speed to which supply and demand factors would have become commonly known would not have been too (dissimilar) to that of the factual". As such the AADA's view is that "...all findings reached by the Commission that involve the use of the (Commission's) counterfactual scenario should be treated as invalid".

The AADA submission urges the Commission to consider a broader view of public benefit. The public benefit of the AADA during the reference period was the attempt to restore freight rates to viable levels, leading to viability of continuing to provide existing services and the contemplation of an expansion of services to benefit of importers. To support the view that agreements between lines may resolve market failure problems associated with the supply of liner shipping services, the AADA submitted a consultant's report titled "Economics of Liner Shipping Conferences".

The AADA submission concludes that "...the Commission's determination of its conduct (is) factually deficient and theoretically unsound". The Commission is urged to recognise that the majority of users who pay the AADA's charges have not complained and that investing in additional capacity requires an expectation of a reasonable return on that investment.

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 southbound²⁷ 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.²⁸ However, in addition to the direct liner trade, there are a number of carriers that offer transshipment 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 transshipment 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 transshipment 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)²⁹ 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 a particular liner service to the trade. From July 2004, there will be 22 shipping lines, which provide a total of twelve liner services to the direct liner trade between North East Asia and the East coast of Australia. Additionally, all liner services between North East Asia and Fremantle are transshipment operations through Singapore, as Fremantle is geographically close to Singapore. A total of fifteen lines employing four separate services tranship imports via Singapore to Fremantle from North East Asia.³⁰

²⁷ FESCO FNZL service calls at Brisbane southbound on its way to New Zealand.

²⁸ FESCO – FNZL sails northbound via New Zealand and PAS calls at Lae (PNG) on its way to Australia from Shanghai.

²⁹ 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.

³⁰ Chamber of Commerce and Industry of WA (2003) Submission op cit p 4

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 are in general slot swapping or chartering agreements, with each of the carriers within a consortium providing a vessel or jointly providing a vessel and then swapping container space between each others vessels within the consortium. The shipping lines within the consortia do not set freight rates collectively between the consortia. However, up to May 2004, all of the consortia are members of the AADA which does announce freight rates increases on a collective basis, albeit voluntarily.

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. Hapag Lloyd charter slot space on the Evergreen Marine vessels within the NAX consortium.

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.

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 between October 2002 and September 2003.

Table 4.1: Services in the Direct Liner Trades between Australia and North East Asia Oct 2002 - September 2003³¹

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/MSK	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

³¹ 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/MSK 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 Maersk / 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/MSK, PAS, and FESCO –FAL) while two services call at Keelung (NEAX and NAX). For South Korea, four liner services call at Busan (Maersk/MSK, NEAX, NAX and PAS). Finally, for Japan, four liner services call at Yokohama (Maersk/MSK, NEAX, NAX and PAS), while three liner services call at Nagoya and Osaka (Maersk/MSK, 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 in the direct liner trade is close to 100 per cent. Transshipment operators would also carry reefers to Australia via Singapore and the market share of the AADA lines of the total reefer market southbound is lower, though still considerable. 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 Changes to Direct Liner Services in May 2004

There are a number of additional services from East Asia which came on stream in May 2004 and more that are expected to commence in July 2004.

In summary the new services are:

American Presidents Line (APL), Pacific International Line (PIL) and ZIM (collectively known as ACX) commenced a new service on 17 May 2004;

Evergreen Marine / Hanjin / Hapag Lloyd (NAX) commenced a new service on 22 May 2004, replacing its old NAX services that were supplied in partnership with ANLCL (under the NAX heading);³²

In early July, the AAJA consortium (NEAX) will add another Australia – North China string with their partner COSCO;³³

In early July, the AANA group comprising China Shipping Company, ANLCL and OOCL will add an additional service loop between North East Asia and Australia; and³⁴

³² LLDCN (2004), Evergreen and Hanjin target east Asian boom, Thursday April 29 2004 p 3

³³ LLDCN (2004), Partners confirm another new China string, Thursday May 12 2004 p 3

³⁴ LLDCN (2004), Three new southbound services boost east Asian capacity by 20%, ANL, China Shipping and OOCL top the slots, Thursday May 6 2004 p 3

Lykes Line is reported as having begun marketing a fifth new service string to be launched in the near future³⁵.

According to the AADA the additional capacity will add about 35 per cent to existing theoretical raw slot capacity in a given year. There will be an additional 18 vessels participating on the trade, representing a 50 percent increase and there will be an additional 182 sailings per annum, a rise of 54 percent.³⁶

The new service structure of the consortia that participate on the North East Asia – Australia liner trades is as follows:

For East Asia – Australia:

China Shipping Company / OOCL (collectively known as ACE);
China Shipping Company / OOCL/ ANLCL (collectively known as AANA);
Maersk Sealand (MSL) / MSC;
ZIM/APL/PIL (collectively known as ACX);
Evergreen Marine/ Hanjin/ Hapag Lloyd (collectively known as NAX);
FESCO/ Hyundai Merchant Marine/ Columbus Line; (2 loops FAL and FNZL)
K Line/ P&O Swires/ NYK/ MOL/ COSCO (collectively known as AAJA).

The lines operating independently of consortia on this trade comprise COSCO, Lykes Line and PAS.

In the East Asia – Australia liner trades, NEAX, 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 consortia that serve the North Asia – Australia liner trades are:

K Line/ NYK/ Mitsui OSK Line (MOL)/P&O Swires Containers (collectively known as NEAX);
Maersk Sealand / MSC;
Evergreen Marine / Hanjin/ Hapag Lloyd (collectively known as NAX);. and
ANLCL/ China Shipping Company/ OOCL (collectively known as AANA).

In addition there are independent liner services provided by PAS and Lykes Line.

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

New Australian port rotations

The Port of Melbourne will be served by ten of the available twelve liner services, with the exception of FESCO-FNZL and Lykes Line, while Sydney Ports will also served by ten of the available twelve liner services with the exception of FESCO-

³⁵ LLDCN (2004) CP Ships may be the latest in North East Asia service rush electronic mail Friday May 20 2004 p 1

³⁶ AADA pers comm

FNZL and PAS. Brisbane will be served by all twelve 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 trade varies. Four services (ACE, NEAX, COSCO, and Maersk / MSC) call at Sydney first followed by Melbourne and Brisbane. One service (Lykes Line) will call at Sydney first followed by Brisbane. Five services (FESCO-FAL, NAX, AAJA/ COSCO, AANA, ACX) call at Melbourne first followed by Sydney and Brisbane. One service (PAS) calls at Brisbane first, followed by Newcastle, Adelaide, Hobart, Port Kembla and Newcastle.

New North East Asia port coverage of consortia / carriers

With the introduction of several new services the port coverage particularly in East Asia has significantly expanded, with several new Chinese ports now receiving calls. In addition, lines such as K Line, P&O Swires, NYK and MOL are now participating directly in the China – Australia liner trade, rather than via slot sharing. On the other hand, China Shipping Company and OOCL will now participate directly in the Australia – Japan / Korea liner trades and the NAX consortium has quit the Australia – Japan liner trade.

In the Peoples Republic of China, eight of ten services will call at Hong Kong and six of ten services will call at Shanghai (PAS, COSCO, ACE, AANA, ACX, NAX). Two services will call at Chiwan (ACE, ACX), Yantian (Lykes Line, FESCO-FAL), Xiamen (COSCO, AANA), Qingdao (AANA, AAJA/COSCO), and a broader range of Chinese ports will receive calls from one liner service. These are Huangpu (COSCO), Dalian (AAJA/COSCO), and Ningbo (AAJA/COSCO).

In Taiwan, seven of the twelve services will call at Kaohsiung (ACE, NAX, Maersk/MSK, PAS, FESCO-FAL, ACX, AANA), while one service drops its Keelung call, leaving only one liner service (NEAX).

For South Korea, six liner services will call at Busan (Maersk/ MSC, NEAX, NAX, PAS, Lykes Line and AANA). Finally for Japan, Yokohama will be served by five liner services (Maersk/MSK, NEAX, PAS, Lykes Line and AANA), while three liner services will call at Osaka (Maersk/ MSC, NEAX and AANA). Two liner services will call at Nagoya (Maersk/MSK and NEAX) and PAS calls at Kobe and Fukuyama.

4.1.8. Description of Transshipment Liner services between North East Asia and Australia

Apart from the direct liner trades there is the possibility for importers to use transshipment services to Australian ports via Singapore. Fremantle is serviced only by transshipment operators through Singapore, some of whom belong to the AADA.

All of the transshipment services to Fremantle operate on a fixed weekly basis. K Line / Maersk have a fleet of two vessels while MSC has a fleet of very small vessels of

125 TEU. These operate dedicated shuttle services between Singapore / Port Kelang and Fremantle. Neither of these services call at Australian ports other than Fremantle.

There are several other liner services that operate between Australian ports and Singapore / Port Kelang which do bring transhipped cargoes from East Asia. These are the AAX service (P&O Nedlloyd, APL, NYK, ANL and Djakarta Lloyd), the two loops of the AAA service (OOCL, MISC, MOL, PIL), and the ASA service (Lloyd Triestino, Hanjin and RCL). The Australia – European services of MSC and the CMA-CGM/ P&O Nedlloyd/Contship/Marfret consortia do not return to Australia via Singapore and therefore would not carry transhipped cargo from East Asia.

There are also a number of slot sharing arrangements among the transshipment (relay) operators. For instance, APL buys slots from K Line / Maersk service to Fremantle. It also appears that Hapag Lloyd buys slots from RCL on the ASA liner services, and on RCL's dedicated shuttle service between Singapore and Fremantle. MISC buys slots from PIL, while Maersk / K Line buy slots from RCL. Evergreen Marine and ZIM Line buy slots from the ASA service and Hyundai Merchant Marine (HMM) and ZIM buy slots from the AAA service.³⁷

For the transshipment trade to Fremantle, there are only five carriers that operate under the aegis of the AADA. These are MSC, Maersk Sealand (MSL), K Line, Mitsui OSK Line (MOL) and NYK.³⁸ The estimated market share of containerised imports into Fremantle from North East Asia of the five AADA lines for the period year ending September 2003 is about 65 per cent. The major competitor lines to the AADA in this market segment are APL, PIL, and OOCL, while the major lines within the AADA are K Line / Maersk Sealand, and MSC. The relay operators which import cargoes to the Australian East Coast from North East Asia are in competition with the direct operators and in particular with the parties to the AADA.

Table 4.2: Services in the Transshipment 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	NA	104	108,004 (Torres Loop only)	NA

³⁷ LLDN (2004), Focus on South East Asia: Trade sticks with proven partners, Thursday 29 April 2004 p 12

³⁸ Chamber of Commerce and Industry of Western Australia (2003), Submission to ACCC p 4

		only				
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

The market share of containerised imports which the relay operators ship to the east coast ports of Australia from North East Asia is difficult to discern, without knowing slot allocations that these have on the AAX, AAA and ASA services on the South East Asia – Australia liner trades.

An estimate of the market share of the relay operators is presented in Table 4.3 for the period October 2002 to September 2003 below. This shows that an estimated market share of the relay operators is about 6.7 per cent, while that for the AADA lines in the North East Asia – Australia liner trade to the East Coast of Australia is 86 per cent.

Table 4.3: Market share of direct liner trades and relay operators to East Coast ports October 2002 - September 2003.

	Full containerised imports to East Coast (TEUS)	Percentage
AADA lines	505,700	86.1
Evergreen / Hanjin Line * #	38,730	6.6
PAS	3,432	0.6
Total Direct Liner Trade	547,862	93.3
Transhipment (relay)	39,177	6.7
Total East Coast imports **	587,039	100.0

Sources: AADA Questionnaire response p 6, Sydney Ports Corporation, Melbourne Port Corporation, Brisbane Port Corporation, PAS Questionnaire Response

*Estimated by multiplying the annual capacity of the two Evergreen /Hanjin vessels by the average load factor of all of the AADA lines.

Includes Hapag Lloyd's slots on Evergreen Marine vessels.

** Containerised imports into Sydney, Brisbane, and Melbourne sourced from North East Asia

The major transhipment operators that compete with the AADA lines are APL, PIL, RCL and MISC. Depending upon the port configurations in East Asia and Australia, the transhipment operators may be up to a week slower than the direct operators to the East Coast of Australia. Transhipment operators calling at Southern Chinese ports appear to have similar transit times as the direct carriers from the Southern Chinese ports to the East Coast of Australia. Comparative transit times are indicated in Table 4.4.

Table 4.4: Scheduled Transit Times and Frequency of selected Liner services from Shanghai to Melbourne

Name of Service	Direct	Transshipment	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 4.4, the AADA services, ACE and COSCON Loop 2 offer faster transit times than their direct service competitor PAS and their potential transshipment 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 transshipment services. The longer transit time of the transshipment services reflects the greater sailing distances from North East Asia via Singapore and the waiting time between connections at the Port of Singapore.

It is expected that there will be changes to the structure of the transshipment operations through Singapore after the new entry by former transshipment operators, PIL and APL. Cargoes that were formerly brought via Singapore by these two carriers will be

transferred to the new ACX service and this will free up space on their South East Asian services for European and South / South East Asian cargoes.

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

Finally, on the southbound North East Asia - Australia liner trades, all³⁹ 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.⁴⁰

Prior to May 2004, there were only two carriers that do not belong to the AADA and participate on the North East Asia – Australia direct southbound liner trade. These are Project Asia Service and Hapag Lloyd. The latter line does not provide capacity to the trade as it buys slot space from Evergreen Marine. Consequently, the capacity share of the carriers that are parties to the direct liner trade into the eastern states is indicated by Table 4.1 at about 98 per cent.⁴¹ With the entry into the direct liner trade of new vessel providers PIL, APL and Hapag Lloyd in May 2004, the entry of Lykes Line in July 2004 and with no indication as yet of these lines joining the AADA, the capacity share of the AADA lines falls to 87 per cent of the direct liner trade.⁴²

The market share of the AADA lines in terms of volume lifted into Fremantle is about 65 per cent for the year to date September 2003, while the market share of the AADA

³⁹ Gold Star line is a fully owned subsidiary of Zim Line and therefore is also regarded as a member of the AADA.

⁴⁰ Asia Australia Discussion Agreement 24 December 2002, AADA (2003) Submission to ACCC p 4

⁴¹ If Hanjin and Evergreen Marine are not included within the AADA, the capacity share of the AADA is 91 per cent.

⁴² Lloyds List (2004), op cit, Thursday May 6 2004 p 3 if Evergreen Marine is not included within the AADA, the capacity share of the AADA is 82 per cent.

lines for volumes lifted to the East Coast ports of Melbourne, Sydney and Brisbane is about 86 per cent for the same period.

There several independent carriers offering transshipment services via Singapore in competition with the AADA lines, these include MISC, RCL, PIL and APL. The structure of the transshipment services of the latter two lines, APL and PIL, will change after May 2004.

ANZESC is a closed conference with price fixing powers and is registered under Part X. It consists of seven carriers and, according to the AADA, is mainly concentrated on North Asia – Australia liner trade.⁴³ However, the actual ANZESC agreement has geographical coverage of the entire North East Asian region. It is therefore possible that in the event that there was no AADA, the ANZESC group of lines would apply the ANZESC agreement to take effect over the entire North East Asian region.

The market share of the ANZESC group of lines of shipping volumes lifted from North East Asia to the Eastern seaboard of Australia of the year to date September 2003 was 37 per cent.

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.⁴⁴ Up until December 2003, neither companies' name appeared in the shipping press advertisements that announced forthcoming collective freight rate increases by parties to the AADA. However, since January 2004, Hanjin's name has appeared on all AADA notices of rate increases. 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.

4.1.10 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).

⁴³ AADA (2003) Questionnaire Response p 18

⁴⁴ Asia Australia Discussion Agreement (2003), Submission op cit_p 4

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.

4.1.11 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.⁴⁵ 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.

4.1.12 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 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.⁴⁶ However, this expansion is largely due to improved prospects in breakbulk rather than in containers.

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.

4.1.13 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.⁴⁷ In terms of the North

⁴⁵ M Brooks (1997) Sea Change in Liner Shipping Regulation and Managerial Decision Making in a Global Industry p 203

⁴⁶ Containerisation International (2003), Tonnage Injection provides PAS booster, February 2003 p 39

⁴⁷ Pirrong (1992) An application of core theory to the analysis of ocean shipping markets, Journal of Law and Economics 35 pp 89 -131.

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 transshipment 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 transshipment 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 constrained possibilities to arbitrage rates by using rail services from the east coast, Fremantle and the east coast ports lie in 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.⁴⁸ In addition, attempts to analyse liner shipping operations separately is complicated by the fact that several 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.

4.1.14 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.

⁴⁸ The AADA-member lines are large global operators and already have a market presence in PRC due to their participation on other liner trades.

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.

4.1.15 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. Prior to May 2004, there was only one shipping line that participated in the direct southbound liner trade from North East Asia to Australia that was 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 was 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.⁴⁹ 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.⁵⁰

The Australia New Zealand Eastern Shipping Conference (ANZESC) is a registered conference agreement among seven liner companies (also members of the AADA) operating on the southbound liner trades from North East Asia. In responding to the Commission’s Issues Paper the AADA advised that Commission that ANZESC’s main trade focus is North Asia (Japan and Korea). As such, the Commission assumed that, for the purposes of this position paper, ANZESC’s role across the North East Asia – Australia trade would not be as significant as those of the consortia.⁵¹ Indeed the AADA advised the Commission that in a situation where the AADA did not exist but ANZESC did, “...there is reason to believe that an uncoordinated approach to service requirements bases on market intelligence gathered by individual consortia would have a detrimental effect on ... provision” of stable and adequate services. Notwithstanding this earlier view, the AADA, in responding to the Commission’s Position Paper, the AADA put forward the view that, in the event that the AADA did not exist, the members of ANZESC would focus on East Asia in addition to North Asia. In effect, the AADA argued that ANZESC would act as a partial substitute for the AADA and have more influence on supply to the trade than would the consortia acting separately. This matter is further discussed in the Commission’s counterfactual analysis, below.

4.1.16 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

⁴⁹ Ibid

⁵⁰ AADA (2003) Submission op cit p 13.

⁵¹ 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.⁵² 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.⁵³ 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 \$US600.⁵⁴

In response to this oversupply, lines 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.⁵⁵ A modest increase in supply of capacity was reported in 2002.⁵⁶ 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

⁵² 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.

⁵³ LLDCN Asian carriers start the long march on rates Monday November 13 1999 p 1

⁵⁴ LLDCN Fundamentally the rates are shot but hopes grow that Asia has turned the corner Friday April 30 1999 pp 6-7.

⁵⁵ 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.

⁵⁶ 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.⁵⁷ 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.⁵⁸

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.⁵⁹ By the end of 2003, some reports were appearing in the industry press of possible entry by lines not currently operating ships in the trade. However, only in May 2004 did additional services commence. (Refer to Section 4.1.7, above.)

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.⁶⁰

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

⁵⁷ LLDCN, *Lines' performance: how they fared*, September 4 2003 pp 13-14

⁵⁸ LLDCN, *op cit* September 4 2003 p 11

⁵⁹ Containerisation International (2003), *Healing Powers* February 2003 p 37

⁶⁰ World Trade Organisation (2003), *International Trade Statistics* p 17 & p 19

world trade.⁶¹ These developments are reflected in demand trends for containerised trades in 2002.⁶²

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 2002.⁶³ 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 2005.⁶⁴ 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.⁶⁵

4.2.2 *Global supply of liner shipping*

In the four years to 2003, world supply of liner shipping increased by 446,000 TEUS in 2000, 623,000 TEUS in 2001, 640,000 TEUS in 2002, and 560,000 TEUS in 2003.⁶⁶ 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 2003.⁶⁷

⁶¹ WTO (2003) op cit p 1

⁶² 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 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

⁶³ LLDCN (2003) China's trade just keeps growing November 17 2003 (electronic mail)

⁶⁴ LLDCN (2003) Will 2005 be the year the box trades bubble bursts?, Thursday December 24 2003 p 4

⁶⁵ Mitsui OSK Lines (2003), Container Trade Supply / Demand Forecast for Three Major East-West Trades November 28 2003 p 4

⁶⁶ Mitsui OSK (2003) op cit p 1, Clarksons Research Studies (2002), Container Intelligence Quarterly 4th Quarter 2002 p 108, Clarksons Research Studies (2004), Container Intelligence Monthly, May 2004 p 9

⁶⁷ LLDCN (2003) Squeeze hits rates 1 May 2003 p 8

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.⁶⁸ The current order book comprises 473 vessels of about 2.7 million TEUS or 36 per cent of the existing fleet.⁶⁹ 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 2005.⁷⁰

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 2006.⁷¹ 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.⁷² 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.⁷³

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 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,

⁶⁸ Mitsui OSK (2003) Containerships New orders as of 12 December 2003

⁶⁹ 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

⁷⁰ LLDCN (2004) loc cit, BRS Alpha Liner (2003), Fleet Growth September 2003 p 8

⁷¹ 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

⁷² Ibid, LLDCN (2004) Broker's Boxship warning, Thursday January 22 2004 p 13

⁷³ LLDCN (2004) Shippers resist Asia rates, Thursday January 15 2004 p 9

charter rates have increased from about \$US7,000 per day in January 2002 to about \$US30,000 per day in December 2003.⁷⁴ 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;⁷⁵

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.⁷⁶

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.⁷⁷

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, other barriers to new entrants may exist.

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 the Commission's Issues Paper, the AADA submission stated that there was no expectation of new entry into this market.⁷⁸ However, since that time the picture has changed with a number of new entrants announcing and commencing services and, subsequently, some AADA members announcing and commencing expanded services (as set out in 4.1.7, above).

⁷⁴ 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

⁷⁵ AADA (2003) Submission op cit p 13

⁷⁶ LLDCN (2004) loc cit

⁷⁷ LLDCN (2003) Blockbuster Beijing turns world trade on its head 4 December 2003 p 13

⁷⁸ AADA (2003) Submission op cit p 17

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.⁷⁹ 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.⁸⁰ 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,⁸¹ 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 and strong market branding.

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.⁸²

4.4 Characteristics of Demand

This section will outline some of the demand characteristics of the North East Asia – Australia liner trades. Sections 4.4.1 and 4.4.2 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

⁷⁹ Trace K (1985) Contestable Markets Theory Applied to Australian Overseas Liner Shipping Arrangements, Maritime Studies, No 21 p 5

⁸⁰ 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.

⁸¹ Trace K (1985) op cit p 6

⁸² Productivity Commission (1999), op cit B8-9.

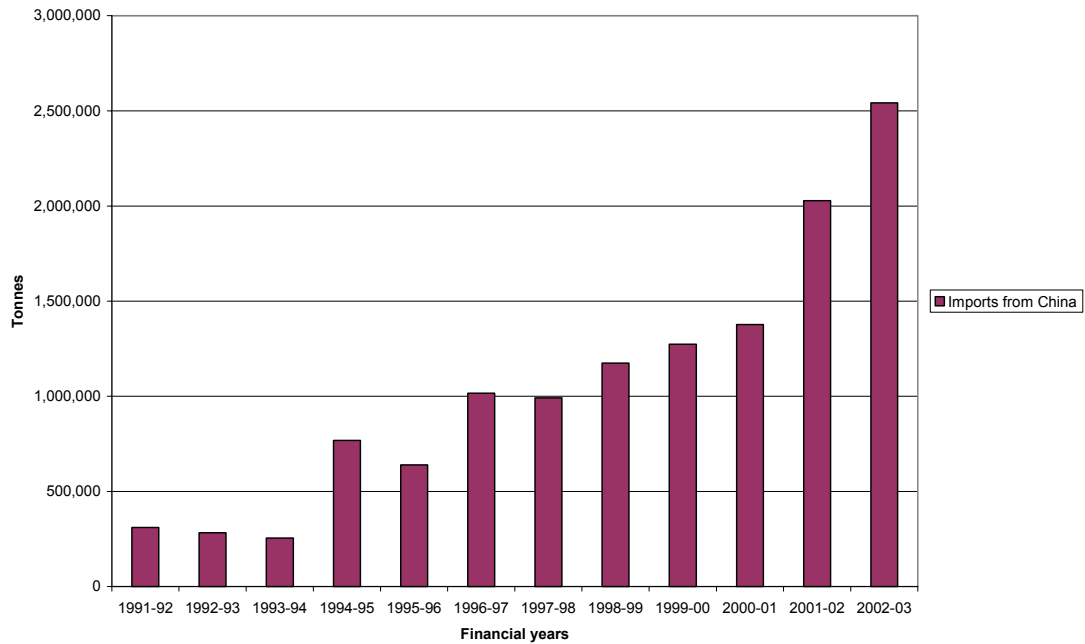
and its pronounced seasonality, when import demand spikes over the Australian spring and summer months. Furthermore, the divergent trends in capacity utilisation vessels operating on the respective northbound and southbound liner trades are shown in section 4.4.4.

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

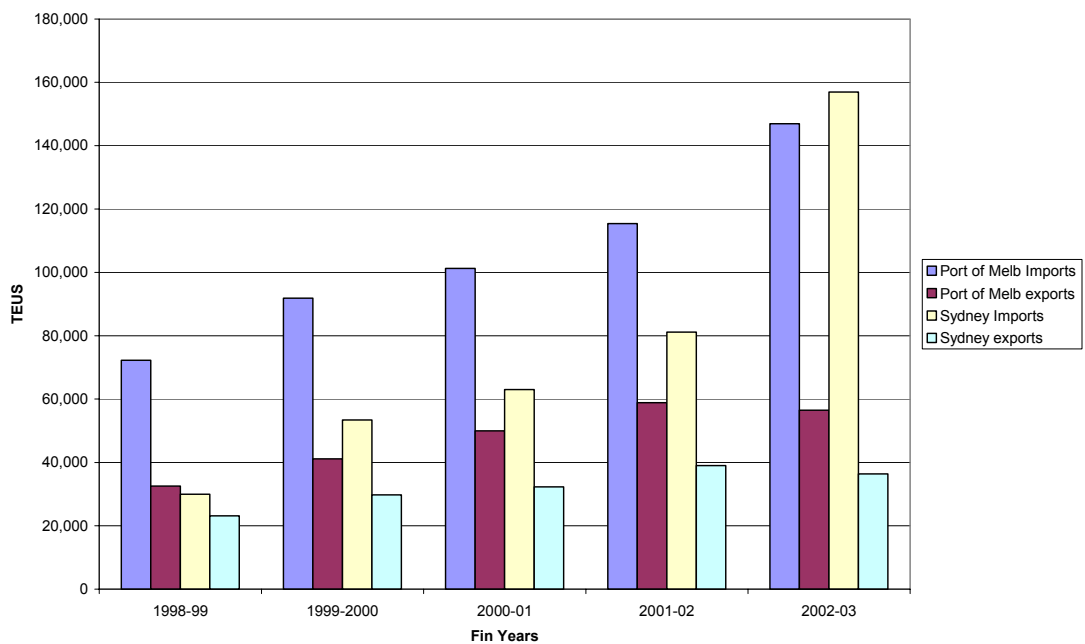
There has been a significant expansion in Australian demand for goods produced in the Peoples Republic of China (PRC) in recent years. In 2002-03, demand for liner imports sourced from the PRC in terms of weight increased by 25 per cent. This was the sixth consecutive annual increase since 1997-98. Since 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)



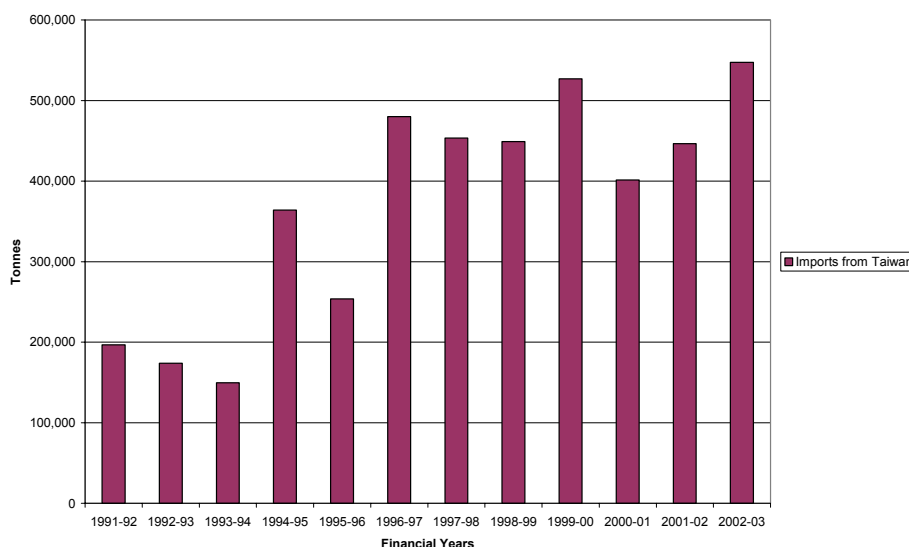
Source: Sydney Ports Corporation, Port of Melbourne Corporation (2003)

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. More recent figures indicate a slowdown in the increases in import volumes from PRC/HK through the three major Australian ports. In the nine months to March 2004, import volumes from China and Hong Kong to the Port of Sydney increased by 14 per cent when compared to that of the nine months to March 2003. Similarly, import volumes from China and Hong Kong to the Ports of Melbourne and Brisbane increased by 23 and 36 per cent respectively in the nine months to March 2004 when compared to the nine months to March 2003.

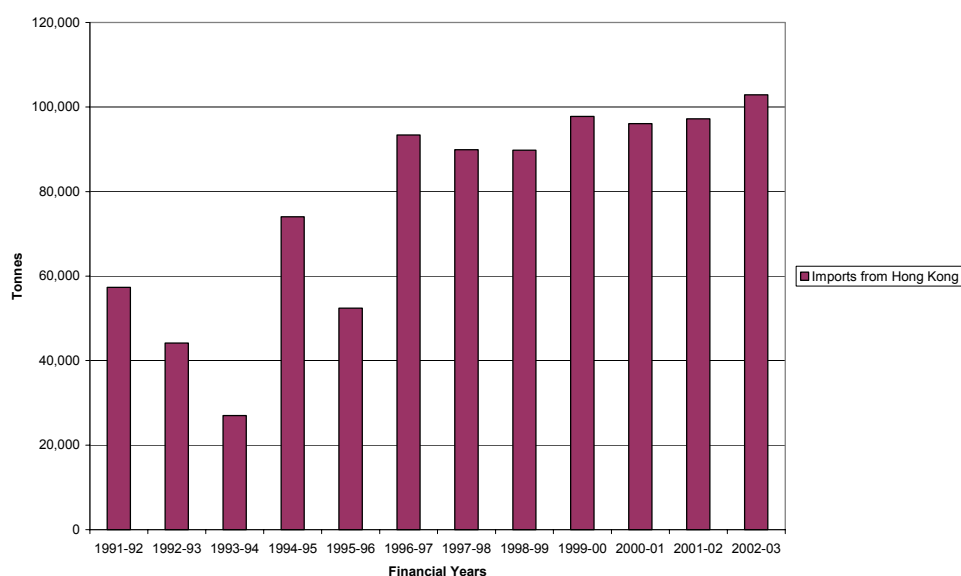
By contrast with import supply sourced from the PRC, trends in liner imports in terms of tonnage sourced from Taiwan and the Special Administrative Region, Hong Kong, have been more stable in recent years as shown in Charts 3.3 and 3.4. These charts demonstrate that although the Commission regards the 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. More recent figures suggest that containerised exports through the three major ports destined for North East Asia have grown slightly. In the nine months to March 2004, containerised exports to North East Asia through the Port of Melbourne and the Port of Brisbane grew by 4 and 1 per cent respectively, over the same time

period to March 2003. Containerised export volumes through the Port of Sydney remained stable over the nine months to March 2004 when compared to the nine months to March 2003.

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 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 4.5. 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.⁸³ 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 more than the PSS of \$US200 that was previously announced.⁸⁴ The AADA has recently announced an intention to implement a PSS of \$US300 per TEU “...to take effect when the vessels of the member lines reach a full loading situation”.

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

⁸³ AADA (2003) *Questionnaire Response* p 10

⁸⁴ AADA (2003) *Submission*, op cit p 9

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.

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. For the September 2003 quarter, however, the effect of seasonality may be somewhat confounded by the overall trend of increased demand.

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.⁸⁵

⁸⁵ Australian Bureau of Statistics (Dec 2002), International Merchandise Trade 5422.0 Feature Article Australia's Exporters and Importers 2001-02 p 18

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 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.⁸⁶ The IAA also stated that it believed that a handful of large firms could still negotiate discounts in the current market climate.⁸⁷ 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 Shippers Council, 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

⁸⁶ AADA (2003) Questionnaire op cit p 11

⁸⁷ IAA (2003), File Note Meeting with ACCC December 9 2003 p 2

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.

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 2004.⁸⁸

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 FEU	\$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

⁸⁸ LLDCN (2004), East Asia peak season surcharge to go Electronic Mail January 22 2004 p 1

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 increases have held in the market.⁸⁹ 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.⁹⁰ The AADA has also advised that its 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.

⁸⁹ 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

⁹⁰ 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 North East Asia – Australia 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 (from June 03 to November 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.⁹¹

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.

⁹¹ 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.⁹²

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.⁹³

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

⁹² IAA (2003) Submission op cit p 1

⁹³ 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.

In March 2004, the AADA announced a round of rate increases for 2004, with the first to take effect on 1 April 2004. Market inquiries suggested differing experiences by importers as to the extent that the announced increase of \$US250 per TEU was applied. Some importers reported that rates had increased by around \$US200 per TEU while others reported that rates had not increased significantly. Importers also commented that April was the “low season” so it could be partly expected that attempts to increase rates may be less successful than at other periods. Notwithstanding this, the AADA labelled the April 2004 increase as “successful” and reiterated an intention increase rates by \$US500 per TEU on 1 July 2004 and a further \$US250 per TEU on 1 October 2004.⁹⁴

4.5.2 International Competitiveness of Freight Rates on the North East Asia to Australia Liner Trade.

This section discusses the international competitiveness of the freight rates charged on the southbound liner trades from North East Asia to Australia. The question to be addressed is whether this changed significantly during the latter half of 2003 when Australian importers faced significant increases in freight rates, in particular for cargoes sourced from the Peoples Republic of China.

To determine whether Australian importers of products sourced from North East Asia have either benefited or lost ground relative to importers based in other countries who also source products from North East Asia, it is useful to compare the changes in the liner freight rates for exported cargoes from North East Asia to Australia with freight rates for exported cargoes from North East Asia to other destinations.

According to the AADA, the China – Australia liner trade is as internationally competitive as it was three years ago at similar points in the shipping cycle. In its submission, the AADA show that the average freight rate for cargoes transported from Asia to the US was \$US1950 per TEU in October 2000. Three years later, in October 2003, freight rates were slightly higher at \$US1995 per TEU, a rise of 2.3 per cent. By comparison, average freight rates for cargoes lifted from Asia to Europe were \$US1600 per TEU in October 2000 compared to \$US1670 per TEU in October 2003, a rise of 4.3 per cent. Average freight rates from China to Australia were at the same level in October 2000 and in October 2003 at \$US750 per TEU.⁹⁵ Thus the AADA’s view is that, as of October 2003, the China – Australia liner trade had not lost any competitiveness when compared to the larger East – West Trades ex-Asia, and that average rates are significantly lower than for these larger East – West liner trades in both October 2000 and in October 2003.

The Commission has attempted to analyse the relative competitiveness of rates on the China – Australia southbound liner trade and the larger East-West liner trades ex-

⁹⁴ AADA (2004) Notice to the Trade, dated 15 April 2004.

⁹⁵ AADA(2003) Submission to ACCC p 7

Asia to Europe and to the US as at October 2003.⁹⁶ The Containerisation International time series for freight rates for the large East-West liner trades represent all inclusive rates. These include currency and bunker adjustment factors as well as some terminal handling charges and inland rates.⁹⁷ By contrast, the China – Australia freight rate data which the Commission has reported on is a pure blue water freight rate. To make these comparable for October 2003, the following surcharges are added to the China – Australia freight rate of \$US750 per TEU as shown in Table 1.

Table 1: All inclusive China – Australia freight rate as of 1 October 2003

Charges per TEU	\$US	\$A or RMB	Exchange Rate #
Blue water freight rate	\$750		
THC (Shanghai)	\$ 90	370 RMB	\$1US = 4.11 RMB
THC (Australia)	\$146	\$A208	\$1AUD = \$US0.7046
Bunker surcharge	\$125		
Port Service charge (Sydney)	\$ 42	\$A 60	\$1AUD = \$US0.7046
Peak Season Surcharges	\$200		
Total	\$1353		

Source: AADA Questionnaire p 13

Exchange rates as of 1 October 2003 RBA Bulletin

This shows that as of October 2003, the all inclusive China – Australia freight rate was about \$US1350 per TEU. This compares to the average quarterly freight rate of \$US1979 per TEU for the Asia-US liner trade in the September quarter 2003. The average quarterly freight rate for the Asia – Europe liner trade was \$US1653 per TEU in September 2003. Thus, based on these numbers, it appears that during September / October 2003, Australian importers for Chinese products on average paid lower freight rates than US and European importers of Asian products.

The freight rate trends for the three above liner trades for the eighteen month period June 2002 to December 2003 further support the view that Australian rates appear to be internationally competitive. The period of June 2002 represents the bottom of the freight rate cycles for the Asia- Europe liner trade for the ten year period December 1993 to December 2003. June 2002 also represents the bottom between two peaks in both September 2003 and September 1999 for average freight rate quarterly trends on the Asia – US liner trades. Finally, the range of freight rates for the China – Australia liner trades in June 2002 was also low at between \$US575 and \$US650 per TEU.⁹⁸

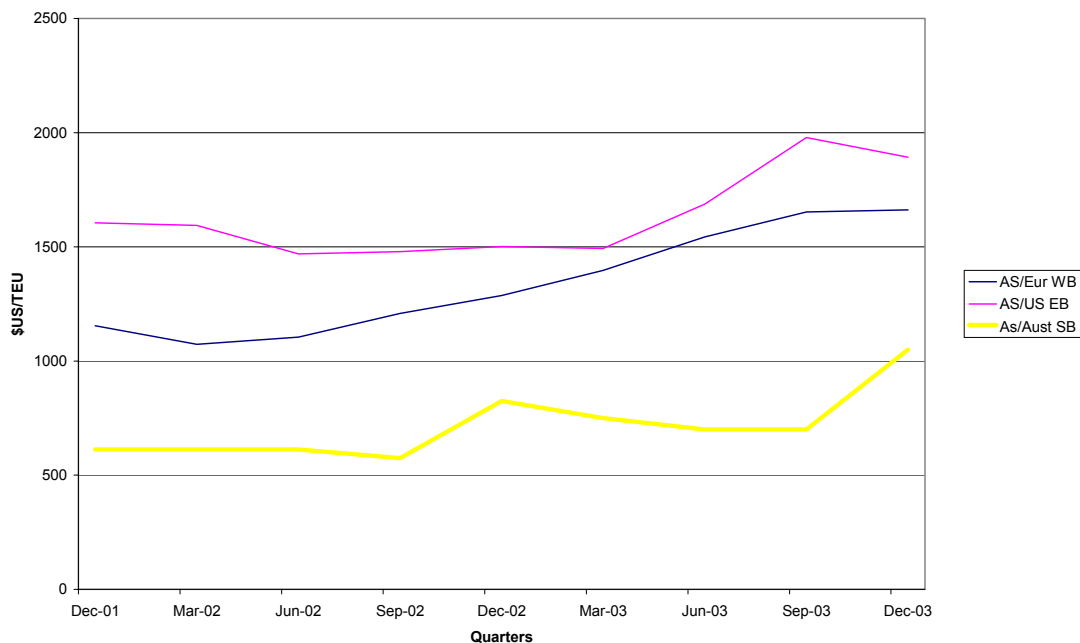
⁹⁶ Latest available freight rate and surcharge data in the Commission's possession.

⁹⁷ CI-online

⁹⁸ There is a caveat, the average quarterly freight rates for the Asia – US and Asia-Europe trades includes currency and bunker adjustment factors as well as terminal handling charges, whereas the China- Australia freight rate ranges do not. The comparison of the trends in these freight rates will be distorted by any changes in the latter three surcharges for the East – West trades under examination.

The results of this analysis are shown in Figure 1, below. Average quarterly freight rates for the Asia – US liner trades were \$US423 per TEU higher in December 2003, than in June 2002. By comparison, average quarterly freight rates for the Asia – Europe liner trades were \$US557 per TEU higher in December 2003 when compared to June 2002. Finally, the range of quarterly freight rates for the China – Australia liner trades is between \$US1000 and US\$1100 per TEU in December 2003. The range of quarterly freight rates for the China – Australia liner trades in June 2002 was between \$US575 and \$US650 per TEU. This represents an increase of about \$US425 per TEU. In absolute terms over the eighteen months to December 2003, the increases in average freight rates for Asia –US liner trades and for the China – Australia liner trades are roughly the same.

Figure 1: Trends in Freight Rates for the westbound Asia- Europe, eastbound Asia – US and southbound China – Australia liner trades December 2001 to December 2003 \$US / TEU



Sources: ACCC Informal Monitoring and CI on line accessed 28 May 2004

4.5.3 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 in large part 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 from Australia 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

The Commission has made the following 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 appear to have competed vigorously in respect to capacity levels;
- the AADA's competitors appear to follow the price leadership of the AADA lines; and
- AADA lines' transit times and frequencies to Australian east coast ports are superior to services offered by PAS and transshipment services.

A number of explanations for these observations are possible. One possibility appears to be that, with such emphasis in the liner cargo industry placed on reliability, frequency and fast transit times, AADA lines' competitive advantage and market share was sufficiently large to escape competitive pricing discipline from their rivals. Without perceived competitive threats in the market, AADA lines appeared capable of leveraging their market power more effectively during the period between June 2003 and December 2003. Relatively low entry and exit barriers imply market contestability and potential entrants appear to be the only material competitive constraints on the AADA lines' market power. Whether the AADA lines chose to

withhold from investing in additional capacity to facilitate higher prices is considered later in this Report.

However, it is important to note that, to a significant degree, the above observations may be explained by increasing (and unanticipated) excess demand in the second half of 2003. This would have been expected to lead to a large jump in spot and renewed contract rates. Such a jump would occur even in a highly competitive market. The overwhelming source of the excess demand reflected unanticipated levels of high growth in demand for imports from North East Asia.

Further, excess demand conditions arising from unanticipated shifts in demand make conclusions regarding whether increases in freight rates are due to a lack of competitive discipline difficult to separately identify and substantiate. This does not mean that the market is not being influenced by collusive elements that increase prices but rather that, when there is excess demand, large price increases can also result from market clearing forces. As a result, the impact on the market may be similar: collusive conduct and excess demand both result in price rises. The former restricts demand while the latter eliminates excess demand. In the following analysis, this Report seeks to distinguish the effects of the AADA from those market conditions that exist independently of the AADA.

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 *exceptional 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:⁹⁹

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.

6.1.1 The Commission’s decision to investigate

The AADA, in its response to the Commission’s Position Paper, made the point that 80% of freight on imports from North East Asia involve contracts entered into at place of origin and no formal complaints were received from any shipper or shipper organisation based in North East Asia. The related criticism is that the Commission used a small number of complainants upon which to base its case to initiate an investigation.

The Commission acknowledges that the only shipper organisations and shippers (importers and freight forwarders) that complained to the Commission were Australian based and that this represents only 20 per cent of the total volume of imports from North East Asia to Australia. However, there was no evidence presented to the Commission that freight rate increases were quarantined to those that were Australian eligible contracts. Similarly there is no evidence that the magnitude of rate increases applied to North East Asian exporters for shipment of cargoes to

⁹⁹ The Parliament of Australia (Senate), *Trade Practices Amendment (International Liner Cargo Shipping) Bill 2000* Revised Explanatory Memorandum p 6.

Australia was significantly lower than that applied to Australian importers. Under the most recent legislative amendments to Part X, the Commission is charged to investigate freight rate increases applying to the total trade and not just those that apply to eligible Australian contracts. The Commission considers that in the case of the AADA conference agreement sufficient grounds were identified for initiating an investigation under Part X.

6.1.2 Jurisdiction

In its submissions, the AADA identified the potential for jurisdictional conflict in the regulation of liner shipping. The Commission acknowledges the potential for jurisdictional conflict and notes that the Government was fully aware of the potential issues when introducing the amendments to Part X in 2000.¹⁰⁰ In particular, the Government recognised there was, in principle, no reason why Australia should not assert jurisdiction over inward liner shipping, but that measures would need to be taken to avoid conflicts of jurisdiction. These measures included introducing provisions that provided for the Minister to issue exemption orders in respect to the application of Part X to inwards liner shipping, and a recognition that that the Minister may need to engage in negotiations with countries of export to find mutually acceptable ways of dealing with conduct by parties to an inwards conference agreement.

In acknowledging these concerns the Commission notes however that the current investigation is confined to considering whether grounds exist for the Minister to be satisfied that the criteria set out under section 10.45(3) apply in respect to the AADA conference agreement.

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 have been 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 authorisation under Part VII of the TPA.

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.

¹⁰⁰ See the Second Reading Speech and Revised Explanatory Memorandum to the Trade Practices (International Liner Cargo Shipping) Bill 2000.

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 that comprises ANZESC with its existing membership, along with two consortia that have no registered agreements with ANZESC members and one independent carrier (the 'carriers') operating in the absence of the AADA (the 'counterfactual'). This model of the counterfactual takes into consideration the AADA's view that, in the absence of the AADA, the "...presence of ANZESC whose member(s) number nearly half of that of the AADA, and who are able under its agreement to agree on pricing, would have commanded a significant influence in the market place".

The estimated differentials between the two scenarios across several areas of competition (capacity, frequency, rates and service standards) 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.

6.2.1 Criticism of the Commission's methodology

In its response to the Commission's position paper, the AADA questioned whether the Commission had applied such a methodology as a device to "...invent reasons justifying the partial deregistration of the AADA".

The Commission regards the AADA's criticism as unfounded. The adoption of a methodology that compared an observable factual with a hypothetical counterfactual in terms of likely anti-competitive detriment and public benefit is designed to provide a transparent and accurate analysis of the matter under investigation. Specifically, the methodology allows a single focus on the effect of the registered conference agreement and controls for other effects on capacity and price, such as trends in underlying demand.

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 only Hanjin makes occasional appearances on the freight

rate restoration notifications. Furthermore, the AADA has informed the Commission that neither Evergreen or Hanjin formally participate in AADA meetings.

In its submission to the Commission's Position Paper, the AADA put the view that the Commission should have made clear that "...the scope of the IAA's influence under Part X is restricted to matters effecting (*sic*) eligible Australia contracts."

6.3.2 *The effect of the Agreement on Competition*

The AADA 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 to the Commission's Issues Paper argued 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 further contended that competition prevails between its members. The AADA lines are also subject to competitive pressures from non-AADA lines offering transshipment services and direct services.

In responding to the Commission's Position Paper, the AADA reiterated that it is the individual lines and consortia that determine capacities and schedules. The Commission's view that the AADA acted to decrease the level of competition between its members was rejected. It argued that such a view implied that:

the AADA members have conspired to restrict capacity and apparently agreed not to deviate from the application of the full amount of increases announced. Both assertions are utterly false and once more the Commission fails to afford adequate weight to the reality surrounding the unavailability of additional (affordable) tonnage and that no barriers existed preventing other carriers from entering the trade during the reference period. As such the AADA disputes the Commission's claim that it had been successful in deliberately lessening competition.¹⁰¹

6.3.3 *Views of the Commission*

The fact that the AADA 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

¹⁰¹ AADA (2004) Response to Position Paper, p.7.

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 in circumstances where the AADA members find themselves in a position of market power. Such circumstances appear to have prevailed in the latter half of 2003 when the contestability of the trade was affected by an apparently low threat of entry by lines that were not members of the AADA. The cost to the lines of providing additional tonnage is informative as it also reflects the cost to a new entrant.

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 under certain conditions, 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*". The Commission notes that this reference period included three important features: increasing costs of chartering vessels of a size suitable for the North East Asia – Australia trade; strong growth in Australian demand for goods from North East Asia; and strong growth in global demand for goods from North East Asia.

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 may 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 for the purposes of this analysis 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 **four** meaningful competitors to **one** since its formation. 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 four separate consortia/carrier groups 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 four separate consortia/carrier groups would have responded to increased cargo demand by expanding capacity.¹⁰² The likelihood of at least one of the 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 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 incentive to move away from those capacity levels that formed the basis of their program to increase rates.

¹⁰² Competing on capacity and increasing market share is a well-established characteristic of carriers, especially in expanding markets.

In affecting the responses of the member consortia/carriers to strong demand growth, the AADA may have had a distortionary effect 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. Further, subsequent to the *reference period*, the Commission has observed that it was new entrants, rather than existing AADA members, who were first to put significant additional liner capacity into the North East Asia – Australia trade.

The decision by lines to invest in additional capacity will be influenced by its cost and profitability. 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 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.¹⁰³ 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).

¹⁰³ 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.

Subsequent to the *reference period*, evidence of the profitability of additional capacity has also arisen in the form of market entry, including 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.

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.¹⁰⁴ The Commission's view is that during the *reference period* the competitive impact of non-AADA competitors operating in the trade (and especially to the Australian east coast ports) was 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 be 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.

¹⁰⁴ 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 competing consortia/carriers would have slowed the speed of rate escalation 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 contract rates will tend to reflect current and forward spot rates), the speed of price increases appears likely to have been 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 2003.¹⁰⁵

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 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.

On this point, the AADA has commented that the introduction of the Peak Season Surcharge by the AADA was a response to the actions of one carrier, OOCL, which all of the AADA lines elected to follow. Consequently, argues the AADA, in the counterfactual scenario, this charge would have been implemented by the individual carriers. The Commission acknowledges that the carriers in the counterfactual may likely have introduced Peak Season Surcharges in order to aid in the rationalisation of demand. However, the surcharges would have been introduced in a more staggered fashion by the individual carriers than that that did occur, according to the growth in

¹⁰⁵ On 24 March 2003 the AADA announced an intention to raise rates on 1 July 2003.

vessel utilisation that each carrier individually experiences in a seasonally high market.

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 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. Market inquiries carried out by the Commission has provided some corroboration of the AADA's contention that sourcing the appropriately sized vessels was problematic. However, the deployment of additional capacity into the trade subsequent to the reference period suggests that the cost of obtaining vessels did not preclude their profitable employment. The apparent profitability of entry was also modelled by the Commission based on information supplied by shipping lines. 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 possible that some 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 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 – during the *reference period* is likely to have weakened the competitive tensions between its members. *Prima facie*, if a number of potential competitors 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 where circumstances limit the threat of market entry. 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 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. Substantial entry into the trade – initially by lines not party to the AADA – during 2004 indicates to the Commission that the AADA members may have had a lower incentive to expand 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 to 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*. In considering public benefits and anti-competitive detriment the Commission has adopted an approach similar to that which it employs to assess applications for authorisation under Part VII of the Act. This requires the Commission to take broad consideration of possible public benefits.

In its submission to the Issues Paper, 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”.¹⁰⁶

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.

6.6.1 *Public Benefits and Liner Profitability*

This section discusses the Commission’s position on the role of liner profitability within public benefits.

The AADA’s response to the Commission’s Position Paper put the view that the public benefit of the AADA’s actions during the *reference period* had been underestimated. In the AADA’s view, the attempt to restore freight rates to viable levels would lead to the contemplation of an expansion of services to benefit of importers.

The objects of Part X (discussed above) make no specific mention of liner profitability. Technically, liner profitability is a private benefit accruing to shareholders of shipping lines. However, liner profitability is an indirect consideration for public benefits accruing to shippers. In order for liner shipping services to be provided, they must expect to be financially sustainable in the long term. This implies that lines should make sufficient profits in order to provide them incentives to invest and to continue provision of regular services. Without sufficient profitability carriers would not be willing to provide the adequate, reliable and stable services at internationally competitive freight rates.

The AADA has provided information to the Commission that the average (representative) carrier that participates on the North East Asia – Australia liner trade made losses in each of the four calendar years 1999 to 2002. For the period October 2002 to September 2003, the AADA provided evidence of a representative line

¹⁰⁶ AADA_ Submission, op cit p.10.

coming close to breaking even on its joint operations on the northbound and southbound liner trades between Australia and North East Asia.

Based on financial data provided by the AADA, the Commission has calculated that, during the December quarter 2003, the representative line that was party to the AADA made financial profits on its round trip operations between Australia and North East Asia.

The improvement in the profit outlook in book terms for the representative line on the North East Asia – Australia liner trades reflects the improving global fortunes of liner companies over 2003, due to a combination of increased volumes on the major East-West liner trades and increased realised freight rates on these trades and to a lesser extent the increased volumes on the north south liner trades.¹⁰⁷ It is acknowledged by the Commission that the many of the carriers that are party to the AADA did make losses over four consecutive years before the upswing in the southbound liner trade in 2002/03, and would still be only in a position of break-even on their annual results by September 2003. During those four years the representative party to the AADA provided a reasonably stable and reliable service to shippers, but they did not appear to be financially not sustainable. Thus the representative carrier provided public benefits as defined as objects of Part X, but at a loss. There is nothing within Part X that stipulates that lines should provide services that are not economic or sustainable.

If lines decide to stay participating in the North East Asia – Australia liner trade during years of excess supply, it is a commercial decision of the lines. It is not the intention of Part X to forestall lines from leaving a trade, nor is it the function of Part X to allow lines to collectively raise freight rates in an unreasonable manner during periods of demand boom in order recoup previous losses.

In the Commission's view, the first order effect of coordinated freight rate increases is to transfer income from shipper to the carriers. Shipper may be prepared to pay the increased rates due to their increased usage of the shipping services. However, the shippers do not get any immediate benefit for their increased cost burden in terms of improved services and reliability. In fact the opposite occurred with increased shippers complaints about increased congestion and delays. In terms of second order effects on the incentives on lines to invest, the market observation by the Commission was increased profitability (albeit from a position of financial loss making) and no investment by the parties to the AADA. There was no significant investment in new tonnage by the incumbent lines during the reference period apart from the replacement by China Shipping Company of two smaller vessels with two larger vessels. Thus, during the *reference period*, the above public benefits that the AADA associated with the market conduct of the AADA members did not materialise.

However, the Commission acknowledges that the increased profits made by the lines during the reference period (after September 2003) are likely to have affected the decisions of some of the incumbent carriers to plan increases in capacity to come on stream in July 2004 (two new services involving ten vessels).

¹⁰⁷ Clarksons (2004) op cit p 2, OOIL (2003) op cit p 23, P&O Nedlloyd Results Fourth Quarter 2003 4th March 2004 available at www.ponl.com

The Commission has found that there are no significant public benefits that can be attributed to the conduct of the AADA's members in discussing and collectively setting prices during the reference period.

6.7 Conclusions on Public Benefits and Anti-competitive Detriment

The Commission has assessed that some lessening of competition resulted from the conduct of AADA members using the AADA agreement during the *reference period*. When considered in the light of prevailing market conditions, the amount of detriment caused by the lessening of competition is difficult to separate from the effect of other influences on the market. Over that same period, it is not obvious that public benefit can be directly attributed to the conduct of the AADA members. On balance, the Commission has reached the view that it cannot be established with certainty that the anti-competitive detriment that resulted from (or is likely to result from) the *conduct* has outweighed a benefit to the public that may have arisen or may arise indirectly from that *conduct*.

7. Exceptional Circumstances

This Section assesses the information gathered by the Commission during its investigation against the criteria that guide the interpretation of 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.

In considering whether exceptional circumstances exist the Commission has discussed each of these elements in turn. The Commission recognises that although these elements are not determinative of the question as to whether exceptional circumstances apply, they do nevertheless provide guidance to determining the question. 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.¹⁰⁸ 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

¹⁰⁸ Mary Brooks (1997) op cit p 209.

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 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).¹⁰⁹ 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.¹¹⁰

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.

¹⁰⁹ Mary Brooks (1997) op cit p 210

¹¹⁰ OECD (2002) Final Report op cit p 68

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 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”.

7.2.1 Reasonableness from the perspective of Australian importers

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.¹¹¹

During the *reference period* there was only one non-AADA carrier, PAS. As PAS did not offer a fully competitive service in terms of frequency, transit times, or capacity, importer businesses had little alternative to using the services of AADA carriers.

Importers 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.¹¹² 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.¹¹³

¹¹¹ GHA (2003) Submission op cit p 6

¹¹² IAA (2003) meeting with ACCC staff op cit p 2

¹¹³ AADA (2003) Questionnaire op cit p 11

Finally, according to the IAA, the carriers are no longer offering contracts to the majority of importers of greater duration than three months.¹¹⁴

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 \$AUD1,850.¹¹⁵ 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.

The Commission maintains that 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.

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.

In responding to the Commission's Position Paper, the AADA made the point that the appreciation of the Australian dollar had increased the ability of shippers to bear price increases and therefore make lines' investment in additional tonnage affordable. However, the Commission does not consider an increased ability of the shippers to afford the significant rate increases due to a fortuitous appreciation of the Australian dollar is material to its assessment of benefit and detriment in this case. The fact remains that shipping costs in US dollar terms for Australian shippers increased significantly during the *reference period*. If the appreciation of the Australian dollar had significantly impacted upon the carrier's cost structure then this might be argued as some justification for increased freight rates. However, most carrier costs as well as the blue water freight rates and most surcharges are denominated in US dollars.

7.2.2 *Movements in average freight rates for other Australian liner trades*

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.

¹¹⁴ IAA (2003) Submission op cit p 1

¹¹⁵ AADA (2003) Submission op cit p 8

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.

Therefore, on the basis of a comparison with other Australian liner trades, the increases announced by the AADA appear to be high.

7.2.3 Reasonableness – the lines' perspective

In responding to the Commission's Position Paper, the AADA stated that the perspective of shipping lines should also be considered in assessing the reasonableness of the freight rate increases.

In its Position Paper the Commission considered the set of rate increases implemented during July to October 2003 were unreasonable from the point of view of shippers. The Commission identified that the increases significantly impacted on importers as importers lacked flexibility to change supply sources in the short term, and in some cases were locked into contracts with buyers.

In determining whether freight rate increases are unreasonable the Commission is required to give consideration to any relevant considerations. In this respect, in reaching its final decision the Commission has given consideration to the market context surrounding the increases, considered whether the rates are internationally competitive, reviewed behavioural and pricing history and trends, considered factors such as the magnitude, timing and notice period in respect to increases, and has also considered whether grounds can be established to support a view that the increases can in fact be justified as reasonable.

As noted above, the Commission in forming its preliminary view was substantially influenced by the impact the price increases had on importers (as a consequence of the magnitude and timing of the increases given the market conditions). The Commission has not been convinced otherwise by the AADA's submission. However, the Commission has also considered elsewhere in this Report the "reasonableness" of rate

increases in terms of whether or not they were brought about by anti-competitive conduct (and could therefore be considered to be “unreasonable”).

7.2.4 Unreasonable withdrawal of liner services

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.¹¹⁶ Missed connections and delays impose real costs on importers which either lose stock or are forced to sell it at reduced prices.¹¹⁷ 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.¹¹⁸

7.2.5 Conclusions on reasonableness of freight rate increases

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. From the importers perspective, the increases were therefore unreasonable both in terms of their magnitude and suddenness. However, whether those increases were unreasonable in the broader context of being brought about by the AADA is considered in the discussion below.

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

A further consideration in determining the exceptional circumstances criteria is to consider whether the public benefit from the operation of the agreement is outweighed by anti-competitive detriment. In considering this the Commission has adopted an approach not dissimilar to the approach adopted when looking at whether section 10.45(3)(c) applied. In that discussion the Commission focussed particular attention on the specified reference period. This section discusses the issue of public benefits and 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

¹¹⁶ GHA (2003) Submission op cit p 6, Babyco (2003), Submission op cit p 2

¹¹⁷ Food and Beverage Importers Association (2003) Submission op cit p 2, meeting between IAA and ACCC staff (2003) loc cit.

¹¹⁸ IAA (2003) Submission op cit p 5, GHA (2003) Submission op cit p 7, CCIWA (2003) Submission op cit p 5

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 AADA. The econometric evidence on the subject points to a moderating influence by conference agreements on freight rate competition in periods of excess supply.¹¹⁹

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.¹²⁰ 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 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:

¹¹⁹ Haralambides H et al (2003) Report to EU op cit p 102. In response to the Position Paper, the AADA put the view that the Commission has selectively quoted from the Haralambides et al 2003, Final Report for the European Commission without noting that European Commission maintained an "open verdict". The Commission acknowledges that the Haralambides report was inconclusive in its ultimate findings. However, the Commission still stands by the key assumptions set out above. In forming its view on these assumptions the Commission recognised that they had attracted some debate, as was also recognised in the Haralambides report.

¹²⁰ Asia – Australia Discussion Agreement Article 2 –Purpose p 1

- 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.¹²¹

The objects of Part X give guidance as to the broad nature of public benefits accorded by registered agreements to shippers. The most relevant object of Part X as prescribed in s 10.01 (1) in reference to the description of potential public benefits of the AADA is the fourth object:

as far as practicable, to extend to Australian importers in each State and Territory the protection given by this part to Australian exporters.

This protection is elucidated in the first two objects of Part X. These are:

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.

Consequently, the broad public benefits that should flow from the operation of the AADA are adequately reliable and frequent services at internationally competitive freight rates and stable access to sources of import supply in North East Asia. The latter criteria can be interpreted as provision of stable services with stable freight rates.

In its assessment of the public benefits accorded by parties to the AADA to importers, the ACCC discusses whether services provided by liner parties to the AADA have been reliable and frequent, and whether rates have been internationally competitive. Also, the Commission examines whether the AADA have provided stable services and stable freight rates.

The mechanisms by which discussion agreements achieve these public benefits in a generic sense are summarised as follows:

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

¹²¹ Productivity Commission (1999), op cit B10-B11

- 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.¹²²

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.¹²³

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.

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

¹²² Benefits of Carrier Agreements in World Shippers Council (2001), International Liner Shipping Regulation: Its Rationale and its Benefits p 25

¹²³ World Shippers Council (2001) op cit pp 21-22

theory is not well developed.¹²⁴ This discussion will refer to the theory of destructive competition and empty core theory.¹²⁵

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 (and can not in a sustainable way be) well-matched with demand. However, the data to determine whether there is an empty core problem on the North East Asia – Australia liner trade are not readily available.¹²⁶ Moreover, even if an empty core were to manifest in this trade, the theory indicates that it may be best rectified by allocating capacity across the entire trade under a fixed price. 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.¹²⁷

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 and capacity allocation stability.¹²⁸

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 the resolution of some of the 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 unsubstantiated any public benefit that may have arisen through the AADA's role in resolving such problems.

¹²⁴ Mainly due to a scarcity of reliable publicly sourced data.

¹²⁵ 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.

¹²⁶ 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.

¹²⁷ OECD (2002) op cit p 63, LLDCN (2004), Time to yield to the power of numbers, February 12 2004 p 11,

¹²⁸ 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.¹²⁹

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.¹³⁰ 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.¹³¹

However, the general acceptance that public benefits such as freight rate stability, service stability, reliability and possibly relative efficiency of service offerings may flow from agreement that involve otherwise anti-competitive character, especially of price fixing agreements, is increasingly being called into question by overseas regulators. In June 2003, the EC¹³² 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, in a net sense, were attributable to 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.¹³³

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.¹³⁴ The OECD questioned the applicability of economic theory used to support a link between the anti-competitive agreements and the benefits of stability.¹³⁵ 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.¹³⁶

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

¹²⁹ OECD (2002) loc cit, ESC (2001) loc cit

¹³⁰ 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.

¹³¹ OECD (2002), op cit p 77

¹³² (in its proposed review of Regulation 4056/86, the Liner Conference Block Exemption)

¹³³ Prof Mario Monti (2003), A time for change? Maritime competition policy at the cross roads, European Shippers Council, Antwerp 12 June 2003 p 2

¹³⁴ OECD (2002) op cit pp 11-13

¹³⁵ OECD (2002) op cit pp 54-63

¹³⁶ 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.¹³⁷

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.¹³⁸ 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.¹³⁹ 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.¹⁴⁰ 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 *instability* in freight rates and in services.¹⁴¹

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 revisions in international approaches to the regulation of liner shipping and the changing views of shippers regarding the benefits to them of anti-competitive agreements. These changes in perspective 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 adequate frequency and reliability of services?

Scheduled frequency of Liner Services

The six consortia members of the AADA, (COSCO, ACE, FESCO, NAX, NEAX and MSC/MSL) all provide fixed weekly sailings from ports in North East Asia to

¹³⁷ J-F Pons (2002), Competition in the maritime transport sector: a new era, EU Competition Policy newsletter No 1 February 2002 p 11

¹³⁸ Franck B (2003) op cit p 15

¹³⁹ Sjostrom W (2003) The Stability of Ocean Shipping Cartels, DRAFT April 2003 p 6

¹⁴⁰ Australian Peak Shippers Association (2003) Submission to ACCC p 3

¹⁴¹ ESC (2001) op cit pp 10-14, Haraloambides et al (2003) op cit pp 32-34

Australian eastern seaboard ports. Similarly, the five AADA member lines that ship cargoes to Fremantle provide fixed weekly sailings from Singapore. Regardless of changes to consortia membership and entry and exit to and from the trade, the AADA lines have been consistently providing fixed weekly liner services between Australia and North East Asia since 1999. However, China Shipping Company also provided fixed weekly services for two years to this liner trade before it joined the AADA in mid 2001. Before, the independent lines Kwoya Opal and Wallenius Wilhelmsen exited the trade in 2000 and 2003 respectively, they did not offer as frequent a service as the AADA lines. This is due to the small size of the Kwoya Opal and due to the complicated wayport nature of the Wallenius service.

Reliability of Liner Services

Several of the importer submissions to the Commission emphasise falling service reliability of the liner services, increased delays in shipping containers and lost boxes during the latter half of 2003. This may be due to the congestion pressure on the services as a result of significantly increased demand and this is out of the control of the AADA, in the short term. Importer concerns are further examined in section 7.3.6.

For several years, Lloyds List Daily Commercial News has been conducting an annual survey of reliability of liner operations between Australia and North East Asia. It compares the transit times and actual frequency of services, including arrival delays and missed port calls for all of the consortia and independent liner operators. This gives a general picture of the service performance of all of the participating carriers within the trade. The latest survey was reported on in September 2003 and refers to the six months to June 2003.¹⁴²

In 2003, the survey stated that three out of five consortia, which are also parties to the AADA,¹⁴³ have missed one scheduled sailing each out of a possible 25 or 26 sailings, in the first six months of 2003. These were due to a switching of vessels between lines in one consortium and the drydocking of vessels for repairs in the case of the two other consortia. In terms of missed port calls only two consortia did not miss one port call in the six month survey period, while one consortium missed both ports in Taiwan more than four times each and another consortium missed the Port of Melbourne three times and Hong Kong once. The reasons for missed port calls include delays and the need to catch up time on the schedule to the requirement for scheduled dry docking of vessels for repairs and maintenance.

7.3.5 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...”¹⁴⁴. The question therefore arises as to whether the AADA has provided such stability.

¹⁴² LLDCN (2003), North East Asia Trade Lines’ performances: how they fared, Thursday September 4 2003 pp 13 -14

¹⁴³ It did not mention if FESCO and its partners had lost any sailings.

¹⁴⁴ TPA, s.10.01(1)(b)

The OECD describes discussion agreements¹⁴⁵ such as the AADA (with its non-binding commitments and open membership) 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 actual membership, the 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.¹⁴⁶

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, the voluntary form of participation 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.¹⁴⁷

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.

7.3.5.1 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 services¹⁴⁸ 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

¹⁴⁵ OECD (2002) loc cit

¹⁴⁶ 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

¹⁴⁷ These include Maersk Sealand, MSC and Evergreen Marine.

¹⁴⁸ 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.

withdrawal of two services is not obviously directly attributable to the operation of 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 the AADA itself may have played in stabilising the supply of services amongst its members is not however clear, given its apparent non-binding wording of the Agreement. Given the voluntary nature of participation this role is likely to be minor and intermediate, being facilitated through improved information flows.

7.3.5.2 *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.¹⁴⁹ 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

¹⁴⁹ AADA (2003) Questionnaire op cit p 8

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 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 2001.¹⁵⁰ 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.¹⁵¹ 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

¹⁵⁰ Containerisation International (2003) *Healing Powers* February 2003 p 37

¹⁵¹ Haralambides et al (2003), loc cit

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 increase in freight rates that the AADA announced (over three occasions) during this period.¹⁵²

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.'*¹⁵³

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.¹⁵⁴ 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 role the AADA has in 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

¹⁵² AADA (2003), Submission op cit p 7 & Questionnaire op cit p 10

¹⁵³ AADA (2003) Submission op cit p 10

¹⁵⁴ AADA (2003) Questionnaire op cit p 18

consortia as rates are discounted in an attempt to increase market share in a declining market.¹⁵⁵ 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.

7.3.6 *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.¹⁵⁶

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 2000.¹⁵⁷ 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.¹⁵⁸

¹⁵⁵ 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

¹⁵⁶ FBIA (2003) Submission op cit p 2

¹⁵⁷ GHA (2003) Submission op cit p 7

¹⁵⁸ CCIWA (2003) Submission op cit p 5

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 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, presumably 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.¹⁵⁹

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.¹⁶⁰

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.¹⁶¹

7.3.7 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 and signalled 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

¹⁵⁹ IAA (2003) Submission op cit p 8

¹⁶⁰ GHA (2003) Submission op cit p 9

¹⁶¹ CCIWA (2003) Submission op cit p 8

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.

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

In considering whether exceptional circumstances exist the Commission has been guided by the discussion provided in the Second Reading Speech and the Explanatory Memorandum. Although not determinative of the question as to whether exceptional circumstances apply, they suggest that exceptional circumstances may exist in 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.

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

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. The reaction of the AADA-member lines to this increase in demand is important. 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 AADA-member carrier increasing its capacity. The possibility remains that the AADA had the effect of delaying the introduction of additional capacity by its members.

On the question of the reasonableness of freight rate increases, southbound liner freight rates from North East Asia 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. While the freight rate increases have enhanced the viability of the AADA member services on this trade, they may nevertheless be regarded as “unreasonable” to the extent that the AADA worked to increase rates faster than would have been likely in the AADA’s absence.

The Commission’s view is that some lessening of competition associated with the AADA has been established. The period during which competition was reduced has coincided with a period in the North East Asia – Australia trade where demand increased rapidly and, to some extent unexpectedly, and the sourcing of additional vessels in the short term was problematic. This coincidence of market conduct and global conditions makes difficult the measurement of detriment that can be separately attributed to the AADA. For this reason, the Commission has been unable to establish with reasonable certainty the degree of anti-competitive detriment.

Furthermore, the Commission’s view is that, going forward, it is uncertain whether the anti-competitive detriment of the AADA will outweigh any public benefit. Specifically, there is significant uncertainty about whether the conditions which led to a period of lower contestability in the North East Asia – Australia trade will persist into the future. This indicates that, although anti-competitive, the detriment flowing from the AADA’s existence is likely to be lower in the foreseeable future.

Notwithstanding the Commission’s finding on detriment, the Commission’s view is that the public benefits that could be attributable to the AADA (and would not have occurred in its absence) have not been made out.

The Commission’s view is that, on balance, grounds are not sufficiently established for the Minister to be satisfied that there are exceptional circumstances that warrant the giving of a direction under subsection 10.44(1).

8.0 Commission Recommendation

Based on current evidence the Commission is not satisfied that it could recommend at this time that grounds exist for the Minister to make a direction under section 10.44(1) to cancel the registration of the AADA registered conference agreement (including in respect to a particular provision, party or conduct).

Relevantly, the Commission is not satisfied that sections 10.45(3)(c) and (d) apply. The Commission forms this conclusion based on the following findings:

- The Commission has been unable to separately establish the effect of the AADA agreement in delaying investment in additional shipping capacity during the reference period from the broader market conditions of a global dearth of supply and increased charter rates.
- The Commission considers that recent entry and service expansion of the North East Asia – Australia liner trades liner will reduce the likelihood that the AADA could be used to constrain capacity or rapidly increase freight rates in the immediate future.

Consequently, the Commission is not satisfied that it can establish that exceptional circumstances apply at this time. Further, given the current and anticipated developments in regard to capacity the Commission considers it unclear whether the conduct results in a detriment to the public interest that outweighs the public benefits of the conduct.

Bibliography

Asia- Australia Discussion Agreement December 2002

Asia – Australia Discussion Agreement 2003, *Questionnaire Response to the ACCC Investigation into the market conduct of the parties to the AADA*

Asia – Australia Discussion Agreement 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

Australian Bureau of Statistics 2002, *International Merchandise Trade 5422.0, Feature Article Australia's Exporters and Importers 2001-2002*, AGPS Canberra

Australian Peak Shippers Association 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

BabyCo 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

Brooks M 1997, *Sea Change in Liner Shipping Regulation and Managerial Decision Making in a Global Industry*, Permagon, New York

BRS Alpha Liner 2003, *Fleet Growth*, September 2003 available at http://www.brs-paris.com/newsletters/liner_studies/no20/

Chamber of Commerce and Industry of WA 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

Clarksons Research Studies 2002, *Container Intelligence Quarterly*, 4th Quarter 2002

Clyde P and Reitzes J 1995, *The Effectiveness of Collusion under Anti-Trust Immunity: The Case of Liner Shipping Conferences*, Federal Trade Commission Staff Report

Containerisation International 2003, *Healing Powers* February 23 2003 p 37

Containerisation International 2003, *Tonnage Injection provides PAS booster* February 23 2003 p 39

Drewry 1998, *World Container Terminals Global Growth and Private Profit*,

European Shippers Council 2001, *Submission to OECD Inquiry into Liner Shipping*

Food and Beverage Importers of Australia 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

Franck B 2003, *Empty Core, Destructive Competition and the Future of the Liner Shipping Industry*, Conference Paper to Regional Cooperation and Economic Integration Korea

Gifts and Homewares Australia 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

Haralambides et al 2003, *Final Report for the European Commission*, November 2003

Importers Association of Australia 2003, *File Note meeting with ACCC staff December 9 2003*

Importers Association of Australia 2003, *Submission to the ACCC Investigation into the market conduct of the parties to the AADA*

Lloyds List Daily Commercial News 1999, *Fundamentally the rates are shot but hopes grow that Asia has turned the corner* Friday April 30 1999 pp 6-7

Lloyds List Daily Commercial News 1999, *Asian carriers start the long march on rates* Monday November 13 1999 p 1

Lloyds List Daily Commercial News 2002, *North East Asia trade: the same, done differently*, March 28 2002 p 3

Lloyds List Daily Commercial News 2002, *After the deluge*, September 26 2002 p 11

Lloyds List Daily Commercial News 2003, *Squeeze hits rates* May 1 2003 p 8

Lloyds List Daily Commercial News 2003, *Focus on the bottom line* September 4 2003 p 11

Lloyds List Daily Commercial News 2003, *Lines performance: how they fared*, September 4 2003 pp 13-14

Lloyds List Daily Commercial News 2003, *East Asia southbound trade goes for third hike of the year* September 16 2003 p 1 (electronic mail)

Lloyds List Daily Commercial News 2003, *East Asia trade to raise rates again* September 18 2003 p 6

Lloyds List Daily Commercial News 2003, *Currency revaluation to release pressure valve*, October 2 2003 pp 13-14

Lloyds List Daily Commercial News 2003, *Drewry paints upbeat picture of containership market* October 10 2003 p 1 (electronic mail)

Lloyds List Daily Commercial News 2003, *China's trade just keeps growing* November 17 2003 p 1 (electronic mail)

Lloyds List Daily Commercial News 2003, *Korea Imports rates to rise, Asian space to stay tight* November 28 2003 p 1 (electronic mail)

Lloyds List Daily Commercial News 2003, *Blockbuster Beijing turns world trade on its head*, December 4 2003 p 13

Lloyds List Daily Commercial News 2003, *Time right for more tonnage says shippers*, December 12 2003 p 12

Lloyds List Daily Commercial News 2003, *Will 2005 be the year the box trades bubble bursts?* December 24 2003 p 4

Lloyds List Daily Commercial News 2004, *Zim confirms east Asia talks*, January 15 2004 p 3

Lloyds List Daily Commercial News 2004, *Shippers resist rates*, January 15 2004 p 9

Lloyds List Daily Commercial News 2004, *Box rates will boom but time bomb beyond 2006 warns broker* January 21 2004 p 1 (electronic mail)

Lloyds List Daily Commercial News 2004, *East Asia peak surcharge to go* January 22 2004 p 1 (electronic mail)

Lloyds List Daily Commercial News 2004, *Brokers Boxship warning*, January 22 2004 p 13

Lloyds List Daily Commercial News 2004, *Time to yield to the power of numbers*, February 12 2004 p 11

Lloyds List Daily Commercial News 2004, *Box routes face chop as charter rates go sky high*, February 19 2004 p 14

Lloyds List Daily Commercial News 2004, *New Zim/APL/PIL Service Set for mid-May Kickoff* March 16 2004 p 1 (electronic mail)

Mitsui OSK Lines 2003, *Container Trade Supply / Demand Forecast for Three Major East – West Trades* November 28 2003 available at http://www.mol.co.jp/research-e/report/E_Container%20Trade%20Supply%20Demand%20Forecast%20for%202002-2003.pdf

Prof Monti M 2003, *A time for change? Maritime competition policy at a cross roads*, speech to European Shippers Council, Antwerp 12 June 2003

New Zealand Shipping Gazette 2004, *Take your partners for the next line dance*, No 3/04, February 2004, pp 20-22

OECD 2002, *Competition Policy in Liner Shipping Final Report*, Directorate for Science, Technology and Industry, Transport Division available at <http://www.oecd.org/dataoecd/13/46/2553902.pdf?channelId=34367&homeChannelId=33703&fileTitle=Final+Report+on+Competition+Policy+in+Liner+Shipping>

Pirrong S 1992, *An application of core theory to the analysis of ocean shipping markets*, Journal of Law and Economics 35 pp 89-131

- Pons J F 2002, *Competition in the maritime transport sector: a new era*, EU Competition Policy Newsletter No 1 February 2002
- Productivity Commission 1999, *International Liner Shipping Cargo: A Review of Part X of the Trade Practices Act 1974, Final Report*, AGPS, Canberra
- Project Asia Service 2003, *Questionnaire Response to the ACCC Investigation into the market conduct of the parties to the AADA*
- Scherer F and Ross D 1980, *Industrial Market Structure and Economic Performance*, Houghton Mifflan Co Boston
- Sjostrom W 2003, *The Stability of Ocean Shipping Cartels* Draft available at <http://www.ucc.ie/~sjostrom/research/grossmanchapter.pdf>
- 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 pp 285-301
- The Parliament of Australia (Senate) 2000, *Trade Practices Amendment (International Liner Cargo Shipping) Bill 2000, Revised Explanatory Memorandum*, AGPS Canberra
- Trace K 1985, *Contestable Markets Theory applied to Australian Overseas Liner Shipping Arrangements*, Maritime Studies No 21 p 1-11
- Volker N 1999, *Cartel stability under capacity constraints: the traditional view restored*, Discussion Paper No E1/23 available at <http://sticerd.lse.ac.uk/dps/ei/ei23.pdf>
- World Shippers Council 2001, *International Liner Shipping Regulation: Its Rationale and its Benefits, Submission to the OECD Inquiry into Liner Shipping*
- World Trade Organisation 2003, *International Trade Statistics*, available at http://www.wto.org/english/res_e/statis_e/its2003_e/its03_toc_e.htm

APPENDIX A: Assumptions underlying liner profitability analysis.

This Appendix sets out the assumptions that the Commission has adopted in modelling the profitability of liner operations in the North East Asia – Australia trade. These assumptions form the basis for the Commission's discussion of liner profitability in Section 6.6.1.

From June 2003 to December 2003, freight rates for carriage of import cargoes from East Asia have been reported by the AADA to have increased from about \$US650 per TEU to \$US1,050 per TEU. The average blue water freight rate for import carriage from East Asia during the period October 2002 to September 2003 was about \$US750 per TEU. In addition the average amount of peak season surcharge paid by importers during that period was \$US100 per TEU. By December 2003, the peak season surcharge applied was \$US200 per TEU and the bunker surcharge was reduced from \$US125 to \$US100 per TEU.¹⁶² There were no changes in the Australian dollar rates of the destination terminal handling charges nor in the Chinese Yuan rates of the origin terminal handling charges for Shanghai. The Commission does not have information on average freight rates for the December quarter 2003 of carriage of imports from North Asia. However, for the year ending September 2003, the average southbound freight rate was about \$US975 per TEU.

In October 2003, average freight rates for imports from North Asia had not changed from the levels of June 2003, and it is not known whether they changed in the last two months of the December quarter 2003. If they did not change then the average freight rate for the December quarter 2003 would be marginally higher than for the year ending September 2003 at \$US1025 per TEU. Over the financial year 2002-03, the import share of East Asia of the total North East Asian liner import trade to Australia's five principal ports was 74 per cent.

Thus comparing the 12 month period to September 2003 with the 12 month period to December quarter 2003, average blue water freight rates for carriage of imports from East Asia had increased by at least 40 per cent from \$US750 to \$US1050 per TEU and average peak season charges had risen from \$US100 to \$US200 per TEU. Also, average blue water freight rates for imports sourced from North Asia appeared to have increased marginally. Given the high proportion of East Asian sourced imports, the 40 per cent increase in freight rates and the 100 per cent increase in peak season surcharge for carriage of imports from East Asia would have resulted in significant revenue per TEU increases on liner import volumes sourced from North East Asia.

Given that the bunker surcharge movements mirror changes in bunker costs, then changes in bunker surcharges do not result in long term changes in profit for the liner company. Consequently it appears that by the December quarter 2003, average southbound revenues per TEU of the AADA lines would have increased significantly. Added to this there was fifteen per cent volume growth in full containers imported from North East Asia to the East Coast ports of Australia over the nine month period ending March 2004, as compared to the nine month period ending March 2003. The months October to December 2003 form part of the peak season when liner imports into Australia are seasonally high. This indicates a significantly increased revenue

¹⁶² LLDCN (2003) [AADA reduce southbound bunker surcharges](#), electronic mail December 8 2003

generated for the lines for southbound cargoes from North East Asia to Australia by December 2003.

By contrast, in the nine months to March 2004 liner exports to North East Asia from the East Coast ports of Australia did not grow at all when compared to the nine months to March 2003. Average freight rates for northbound cargoes bound for East Asia over the 12 months to September 2003 were in the range \$US250 to \$US300 (\$US275 per TEU). Over the same period average freight rates for northbound cargoes bound for North Asia over the year ending September 2003 were in the range \$US240 to \$US410 (\$US325 per TEU). According to the AADA, the average northbound blue water freight rate for exports to North East Asia in October 2003 was \$US250, a fall of \$US125 from the levels reached in June quarter 2003.

The Commission does not have information on what the trend in northbound liner rates has been since October 2003. However, assuming that these rates have not fallen further and there has been no decline or growth in liner export volumes, it could be assumed that northbound liner revenues have remained reasonably constant for the average line over the final quarter of 2003.¹⁶³ By comparison with the year ending September 2003, the average blue water freight rate for exports to North East Asia had fallen from about \$US300 per TEU to \$US250 per TEU, a fall of 16 per cent. Given the following factors:

- greater proportion of containerised imports to exports (60:40);
- the significant volume growth of imports compared to stagnant growth of liner exports and;
- the higher rate of increase in southbound liner freight rates compared to the decrease in northbound liner freight rates,

it can be reasonably assumed that revenues of the incumbent carriers participating on the North East Asia – Australia liner trade would most likely have increased significantly in line with freight rate increases and volume growth on the southbound liner trades from North East Asia.

In the Commission's estimation, cost movements of the representative carrier over the December quarter 2003 are likely to have been dominated by charter costs, which represent about 20 per cent of total liner costs. According to Clarksons, the charter cost for a 2,750 TEU vessel increased from \$US12,500 per day in January 2003 to about \$US30,000 per day in December 2003, an increase of 140 per cent. Since then it has risen to \$US32,000 per day by March 2004.¹⁶⁴ Similarly, the charter cost of a 2,000 TEU vessel increased from about \$US7,500 per day in January 2003 to about \$US18,000 per day in November 2003, an increase of 140 per cent.

The financial impact of these increases in charter costs upon liner profitability would be only become evident when a carrier renews an existing charter upon expiry and or

¹⁶³ For one line OOCL, reported an increase in revenues of \$US2.4 million due to an increase northbound volumes from Australia and NZ to Asia by 22 per cent and a 12 per cent fall in rates during the course of 2003. OOIL (2003) Annual Report p 26.

¹⁶⁴ Clarksons (2004) Container Monthly Intelligence Monthly Vol 6 No 5 May 2004 p 4

decides to introduce a new charter vessel into the liner trade. Over the three-month period October 2003 to December 2003, China Shipping Line replaced two vessels with larger vessels cascaded from the Asia – Pacific Liner trades.¹⁶⁵ These vessels do not appear to be new charters, and it is unknown whether any of the incumbent carriers participating in this trade renewed any charters for vessels within the final quarter of 2003. If there were no charter renewals for existing vessels during the last three months of 2003, in book terms vessel costs of the incumbent carriers would not have significantly changed during that period.

In analysing the cost movements over the December quarter 2003, the Commission has considered likely trends in other costs such as voyage costs, cargo costs and equipment costs. It is likely that equipment repositioning, repairs and maintenance (R&M) costs, and cargo costs would have increased in line with increases in volume throughput. However, on a TEU basis it is probable that increases in freight rates would have increased faster than average repositioning and R&M costs. Terminal charges, which form a large proportion of cargo costs are mostly recovered by terminal handling charges. Voyage costs would not have significantly increased in the December quarter 2003, as there were no increases in the number of sailings by the lines in this quarter and no changes to port dues in Australia or overseas. Bunker costs actually fell in the December quarter as evidenced by the fall in the bunker surcharge mentioned above.

On the basis of the above it is likely that average revenue growth of the representative carrier participating on the Australia – North East Asia trade routes would have been greater than increases in average costs during the December quarter 2003. Consequently, by December 2003, the Commission believes that the representative line would be in a position to be making positive book profits.

There is one caveat to this and this is the upward trend in charter rates which represents a significant increased cost when a charter agreement expires and the carrier renews the charter. Also, it represents an increased investment cost for both incumbent lines and for new entrants in their decision to add capacity to the North East Asia – Australia liner trades, through the mechanism of acquiring a charter on a vessel or vessels. Furthermore, the increased charter rates also represent an increased opportunity cost for the carriers for remaining in the North East Asia – Australia liner trade and therefore the profit needed by the carriers to induce them to stay may be commensurately higher. There have been reported falls in the numbers of vessels participating on the service strings of carriers operating between Australia and New Zealand and Australia and the US due the high costs of renewing charters.¹⁶⁶

¹⁶⁵ LLDCN (2003) Time right for more tonnage says shippers, Thursday December 4 2003 p 12

¹⁶⁶ LLDCN (2004) Tonnage drops as Tasman carriers rationalise Thursday January 8 2004 p 3.
LLDCN (2004) North American lines drop Adelaide direct call, Thursday January 8 2004 p 5