RESPONSE TO
THE PRODUCTIVITY COMMISSION DRAFT REPORT
OF THE REVIEW OF PART X OF THE
TRADE PRACTICES ACT 1974

Submission by the
Australian Horticultural Exporters Association Incorporated
to the
Productivity Commission

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ABBREVIATIONS

ACCC	Australian Competition & Consumer Commission
AESA	Australian Exporters' Shipping Association
AHEA	Australian Horticultural Exporters' Association Inc.
APSA	Australian Peak Shippers Association Inc.
ASC	Australian Shippers Council
DPSB	Designated Peak Shipper Body
FCL's	Full container loads.
MLS	Minimum levels of Service
SHIPPERS	Exporters and/or Importers
SMA's	Statutory Marketing Authorities
TPA	Trade Practices Act 1974
TPC	Trade Practices Commission

1 EXECUTIVE SUMMARY

The comments made in relation to the productivity Commission's Draft Report relate only to the containerised liner trade and conventional shipments in relation to Australian horticultural exports.

The AHEA does not support the repeal of Part X, which will subject liner shipping to the general provisions of the TPA Part VII, and is surprised at the commissions change of position given its avid support for Part X after the 1999 review.

The use of Part X maintains a certainty of regular Liner services, and the risks associated with the removal of Part X are that Liner services may be reduced to only those ports that offer volume trade. Ports such as Fremantle, Adelaide and Bell Bay (Tasmania) may have services drastically reduced or removed completely.

It believes that Part VII is too cumbersome to be commercially practical for these purposes, and an open market response would see the removal of most conferences and the formation of off shore alliances that would dictate terms to Australian shippers. It is expected that this will lead to a decline in scheduled liner services and an increase in freight rates.

The current use of Part X obliges parties to Agreements to discuss freight rates with shippers , compliance with negotiated minimum levels of service and other issues that may arise pertaining to an Agreement.

Australian shipping is unlike other trades such as Europe, as it is geographically distant from major shipping routes in the northern hemisphere such as the east – west trades, has long distances between ports, and has relatively low volumes of trade going northbound, (Australia estimated at 3 million FCL's lifted per annum compared with Europe 40 million FCL's and USA 30 million FCL's) and has a net import trade of goods predominantly dry goods not requiring refrigerated equipment.

Consequently, Australian shippers do not have the luxury of numerous shipping lines "*passing the door*" as do Europe, Asia and America. As such, any selective comparison is therefore theoretical and not relevant.

It is therefore imperative to retain Part X to encourage shipping lines to continue to provide regular scheduled liner services in a sufficiently attractive commercial environment.

The AHEA supports modifications to the retention of Part X, such as the removal of Discussion Agreements that are seen as anticompetitive and not delivering a net public benefit. Shipper interests are aligned with the national interest. The AHEA also supports modifications to Agreements where a fixed ceiling rate is negotiated which is an "*all in rate*". Currently lines offer a negotiable blue water rate, then add additional charges which are not negotiable and are considered subversive of increasing rates.

If Discussion Agreements` were allowed to remain under Part X, and designated Peak Industry bodies simply chose to ignore them in rate negotiations, information sharing between Lines would continue to discourage competition in the market place.

Australian horticultural production is less than 2% of world supply in any specific commodity. There have been the major change in the industry since 1999 and had the greatest influence on the decline in effectiveness and usefulness in Part X. However the AHEA believes that price setting provisions should be retained in agreements exempted under Part X to provide a safety net for the large number of small exporters that do not have the volume to negotiate competitive freight rates while allowing substantial exporters the ability to negotiate private contracts with shipping lines that reflect their volume of business.

The existing arrangements to promote a balance of power between shippers and Lines is not working largely because of the influence of the recent emergence of Discussion Agreements which have monopolised trades particularly to North and to South East Asia making negotiations with conferences a rubber stamp.

Further, freight rates should be offered at a fixed rate in Australian dollars, as most Australian horticultural exporters incur their costs in and conduct their business in Australian dollars.

Provisions to agreements between parties to a registered agreement and a designated shipper body should be binding for the period of the agreement, as has been the case with conferences and consortia in the past, but not the case with Discussion Agreements.

A code of practice should be developed to cover future negotiations between parties to an agreement, and enforcement provisions should be strengthened to encourage parties to an agreement to meet their obligations.

2 Overview

These further comments to the Productivity Commission are submitted by the Australian Horticultural Exporters Association Inc. (AHEA) which:

- is the designated secondary industry shipper body for horticultural products under Part X of the Trade Practices Act 1974 (TPA)
- is a member of and strong supporter of APSA
- represents all Australia's horticultural shipping exporters generally.

The comments made in relation to the productivity Commission's Draft Report relate only to the containerised liner trade and conventional shipments in relation to horticultural exports.

The Australian horticultural exporters are increasingly dependant on shipping to export, and the interests of Australian shippers must be balanced against the interests of foreign multi-national carriers. The interests of carriers and shippers are never the same.

The Australian horticultural export industry remains a unique and diverse group of businesses, who are largely uncoordinated and who are direct competitors with each other into their foreign markets. Unlike their global competitors, horticulture in Australia represents about 1% of global production and obviously lacks scale. Its structure is uniquely fragmented with little involvement from multi-national corporations and lacks the concentration of volume of cargo to allow forceful negotiation of freight rates with foreign multi-national carriers.

On the other hand, the foreign multi-national carriers have considerable resources at hand with global turn overs often in excess of Australia's total horticultural exports, and thus power through their global market size and shipper conference arrangements, which have enabled them to develop an international overview of shipping arrangements, and is the means by which they co-ordinate their conduct in dealing with Australian shippers when playing them off against each other and against exporters in other markets such as New Zealand.

This is particularly important for refrigerated cargo, which is a smaller proportion of the total cargo trade, and is regularly thrown at exporters in negotiations with carriers as a threat, that "*carriers are making decisions at head offices offshore about where they position refrigerated containers to gain the best returns*" …and if Australian exporters don't accept rate increases then "*containers will be repositioned in alternative markets*". This will lead to a shortage and ultimately a reduction in the level of services to exporters.

The foreign multi-national carriers remain in a powerful and advantageous position and with this in mind the negotiating imbalance in their favour needs to be redressed towards a more balanced position.

For horticultural exporters, the use of Part X of the TPA is as much about a guaranteed regular scheduled liner service with adequate equipment to support the service, as it is about competitive affordable freight rates.

3. Commentary on main issues raised by the PC Draft report

Alternative to Part X

Draft Recommendation 8.1

The Commissions preferred stated option is to repeal Part X and require individual agreements under Part VII of the TPA.

The AHEA does not support the repeal of Part X, which will subject Liner shipping to the general provisions of Part VII of the TPA.

The AHEA's view is:

Part VII is too cumbersome

Authorisation via Part VII of the TPA is not a commercial alternative because:

- the period for ascertaining any public benefit can be lengthy.
- it is a costly exercise.
- any approval may be unworkable or at best unsatisfactory.
- any approval may be of limited validity.
- any approval can be revoked at short notice.

Open Market-based responses

If all the exemptions under Part X were removed, the effect on Conferences and Australian trades would be dramatic. Conferences would largely be removed and will cause the formation of offshore alliances and the trade will be dominated by very large monopolistic groups, who will set the rates and under supply to meet demand and sustain higher rates. Generally rates will increase and services will be reduced to major ports only, and to industry groups that can afford to pay higher rates. Horticulture will be low on the pecking order, and ports such as Adelaide and Bell Bay (Tasmania) can expect scheduled services to be reduced or stopped completely.

There will be a decline in the level of shipping services, which are vital to Australia's export programme. Currently, Conferences provide frequent and comprehensive services to Australia's major markets.

Uniqueness of Australian shipping.

- Australia is a nation of generally smaller shippers compared with the USA and Europe and the interests of Australian shippers must be balanced against the interests of 100% foreign owned carriers that service Australian ports.

- Foreign owned carriers have considerable power through their global operations and various conference arrangements which have enabled them to develop an international overview of shipping arrangements, and is the means by which they co-ordinate their conduct in dealing with Australian shippers.

- Part X exemptions are generally not dissimilar to those of USA and Europe.

- However, Part X does oblige Conferences to meet with shippers when requested to do so to discuss rates and service levels.

- Carriers must negotiate minimum levels of service agreements with shippers.

- Australia's distance from markets, volume of trade and long distances between main ports presents particular conditions unattractive to carriers. In addition, very few of Australia's main cargoes could be classed as commodity volume, making exports dependent on smaller shipments which require a regular scheduled service twelve months of the year.

- Because of Australia's remote geographical position it does not have the luxury of numerous shipping lines 'passing the door' as do countries in the East-West trades. It is therefore vital to retain Part X so that those shipping lines which are prepared to service Australia, are provided with the exemption from Part IV to form Conferences and Consortia.

Evaluation of Part X

Draft recommendation 7.1

The AHEA supports the Commission's principle objectives of:

- Facilitating efficient coordination and joint provision of liner cargo shipping services within a pro competitive framework.

- Assist shippers to have access to liner cargo shipping services of adequate frequency, and coverage, and reliability at internationally competitive freight rates.

"The essential benefit of costs savings from asset sharing and joint scheduling can be generated by consortia".

This is an attractive benefit for shipping lines and shippers alike, because it encourages the development of regular scheduled liner services into and out of Australia. Without exemptions under Part X, lines will need to seek exemptions under Part VII of the TPA, which is considered commercially cumbersome and time consuming for Lines to undertake. This may cause Lines to not seek an exemption, which would cause a dilemma.

The use of Part X obliges carriers to negotiate minimum levels of service agreements and to meet with shippers to discuss such issues when reasonably requested to do so.

Without the use of Part X there will be the risk of no competing regular services, and no guaranteed minimum levels of service. This will serve to allow Lines to restrict services to levels that force rates up, to compete with returns enjoyed in other countries such as New Zealand.

Australian does not have the shipping volume compared to northern hemisphere to sustain a competitive deregulated shipping industry against more competitive and rewarding global trades that are geographically located between more lucrative east – west trades.

These disadvantages need to be offset to some extent by Part X protection which allows Lines to share assets, maintain regular scheduled shipping services, with lower volume trade.

<u>It is not essential to include price setting provisions (in agreements) to achieve cost savings.</u>

Horticulture in Australia lacks scale and its structure is uniquely fragmented with little involvement from multi-national corporations and therefore lacks the concentration of volume of cargo to allow forceful negotiation of freight rates with foreign multi-national carriers.

Foreign multi-national carriers have considerable resources at hand with global turn-overs, often in excess of Australia's total horticultural exports and thus bargaining power through their global market size and shipper conference arrangements which have enabled them to develop an international overview of shipping arrangements, and is the means by which they co-ordinate their conduct in dealing with Australian shippers when playing them off against each other and against exporters in other markets such as New Zealand.

If Part X was to be retained, cost savings will be enjoyed by shipping lines under the protection of the provisions which allow asset sharing and pooling of scheduling, but any savings passed on to shippers will be dependant upon competition between each member line to the conference.
A fragmented export industry that lacks critical mass does not have the bargaining power to negotiate competitive freight rates and ironically the cost savings would tend to remain with the shipping lines.

The PC comparisons with agreements in Europe where the scope to include provisions to fix prices has been reduced considerably, is less relevant to the Australian situation where shippers do not have the volume of passing trade to compare market rates with, and where there is simply less competition.
Without some price negotiation between conferences and designated shipper bodies there will be the risk of a take it or leave it mentality.

<u>The existing arrangements to promote the countervailing power of Australian exporters and importers…. simply do not work.</u>

Prior to the development of Discussion groups in the main it was fair to say that the countervailing power of Part X provided a balance to freight rate agreements between conferences and designated shipper bodies, as was evidenced by the Productivity Review into Part X in 1999.

Once Discussion groups came into existence and started to exert their influence the competition between Conferences was reduced and increasingly negotiations between Conferences and designated shipper bodies became a rubber stamp for the Discussion Agreements.

There was then increasingly less evidence that Conference members were breaking rank and competing in the open market with lower freight rates to attract additional business as had been the experience for many years in the past.

The review and enforcement processes under Part X are not effective and if Part X is retained it should be strengthened.

While it was fair to say that the countervailing power of Part X provided a balance to freight rate negotiations between conferences and designated shipper bodies up until 1999 – 2000, legitimate complaints or threats of penalties under Part X have been ignored by shipping lines.

Some form of discrimination is needed between agreements to ensure that registration of agreements provides some net public benefit, and that agreements that fail to continue to provide a net public benefit are penalised.

Modifications to Part X

Balance of Benefits

Draft recommendation 7.2

The AHEA supports the strengthening of shipping agreements, by using a selective approach aimed at allowing only those agreements which are likely to provide a net public benefit to Australia, and agrees that distinguishing between agreements could be a viable option for modifying Part X.

Draft recommendation 9.1

The AHEA does not support the exclusion from eligibility for registration under Part X, Agreements that contain provisions that:

- Regulate or fix freight rates
- Allow discussion of rates between agreement members.

However the AHEA does support the exclusion of eligibility for registration under Part X, Agreements that contain provisions that:

- Seek to limit the maximum level of capacity on offer.
- Provide non binding regulation of rates

Draft recommendation 9.3

The AHEA supports the exclusion of agreements that contain provisions that:

- Prohibit individual service contracts
- Require disclosure of the terms of individual service contracts
- Allow non binding guidelines that relate to individual service contracts

Distinguishing between agreements

The AHEA agrees in part with the commission to distinguish between agreements, particularly where agreements seek to manage assets and or pool scheduling. However the AHEA believes that agreements that include some degree of price fixing should be a characteristic that is acceptable.

AHEA maintains that Part X has been instrumental in horticultural exporters being able to secure comprehensive scheduled shipping services and freight rates across a very wide range of destinations from a diverse range of Australian ports, with some form of price fixing terms in agreements.

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

Currently Part X is used by designated industry bodies to agree ceiling rates with and allows the operation of conferences, and Consortia agreements. However the introduction of Discussion Groups has had a negative effect on competition in some areas where such agreements reduce competition.

However, Part X facilitates the provision and formation of stable shipping services which are vital to Australia's horticultural export programmes. Carriers operate in a highly contestable environment and the continuing viability of more than one carrier group is highly desirable.

The fixing of ceiling rates allows market conditions and competition to adjust rates below the ceiling rates and for horticultural exporters to normally obtain competitive rates.

Draft Recommendation 9.2

The AHEA supports the exclusion of Discussion Agreements from eligibility for registration under Part X.

Discussion agreements be explicitly excluded.

Discussion agreements operate in all of Australia's outward trades except to Europe. Discussion agreements differ from traditional Conferences in that the results of negotiations with shippers are non-binding on the members of the Discussion agreement. In practical terms it means shippers have an agreement when there is not an agreement with the Discussion agreement members.

AHEA believes there are no strengths in these Discussion Agreements from an exporters' view and the main weakness is that they are strongly monopolistic, anti-competitive and non binding.

Discussion Agreements are formed to limit competition on price and capacity by combining Conference members and independent carriers in any particular trade where they can discuss issues such as the level of freight rates that each is charging. Australian shippers seek to end such agreements by taking away their right to operate with anti-trust immunity for these agreements.

AHEA has no problem with cost-savings and efficiency enhancing agreements such as vessel sharing agreements or space chartering agreements all of which operate in Australia's trades. Although issues discussed by members of discussion agreements are said to be non-binding on agreement members, there is a view that voluntary guidelines may not be truly voluntary and whether they actually interfere with individual carriers' behaviour, especially that of independent carriers or non Conference carriers. Additionally, shippers have had great difficulty in endeavouring to finalise freight negotiations because of the non-binding nature of these agreements.

Discussion Agreements were deliberately designed by them to allow the maximum protection under Part X but with the minimum or no obligations on behalf of the carriers to abide by any agreement.

The consequence of the removal of Discussion Agreements would be that shipping lines would have to revert to arrangements that were in place prior to the advent of discussion agreements. As an example, in the Australia to S.E. Asia trade, where currently all lines servicing the trade are part of a Discussion Agreement - they would revert to the situation where previously Lines were divided into three Consortia which competed for the trade.

There would be greater competition between shipping lines with the removal of Discussion Agreements, and there would be a great deal less risk of manipulation by the lines in areas such as the repositioning of empty reefer containers into the Australian trade leading to shortage of equipment.

Discussion Agreements should be removed for another reason, and that is their unhelpful involvement in freight negotiations.

Currently, Discussion Agreements meet with shippers before Conferences. The rates negotiated with the Discussion Agreements are non-binding and voluntary, but the result of those negotiations filter down to the Conferences and Consortia with whom shippers must have genuine binding negotiations for firm and workable arrangements.

The negotiations with Conferences and Consortia in this situation, are to all intents and purposes a complete sham and become a rubber stamp to the Discussion Agreements.

If Discussion Agreements were ignored, and designated Peak Industry bodies only negotiated with Conferences, the effect of information sharing through Discussion Agreements would continue to influence Conference rates and remain anti-competitive.

Requirement for all-in freight rates

The current “freight additionals mentality” began in 1973/74, when the Australian dollar was significantly devalued and the price of fuel oil doubled overnight. At that time APSA’s predecessor, the Australian Shippers Council, was forced into negotiating surcharges with Conferences known as “currency adjustment factor” (CAF) and the “bunker adjustment factor” (BAF). It was intended that these surcharges remain until shipping lines could adjust to these “cost shocks”. However, both these surcharges are still applied to current freight rates.

Additionally, with the introduction of Discussion Agreements, further extensive lists of surcharges are being applied today - all in the name of transparency. The effect is that, for example in the trade northbound to South East Asia, additional charges can be collectively greater than the freight rate.

The problem for exporters is that overseas buyers will not accept prices for our products qualified by various surcharges. Exporters must incorporate some allowance for surcharges in their sale price, but in the event that any particular surcharge increases during the validity of a sales contract, the exporter carries that increase. The majority of Australian horticultural trade is on CIF/C & F terms and contracted accordingly.

For example up until 8 July 2004, the BAF to the USA was US$75 per teu.
On 9 July 2004, the BAF jumped to US$180 per teu.

Shipping lines state that surcharging is a means of making freight costs more transparent for the shippers, however, as the lines have been told repeatedly, exporters have no interest in transparency because there is no way to ensure that the surcharges are truly transparent anyway. Shippers require all-inclusive rates.

Additionally, shippers have no input into negotiations between shipping lines and their service providers. For example who knows what is agreed in negotiations between P & O Stevedores and P & O Shipping.

AHEA has repeatedly rejected surcharges suggesting that shipping lines have at their disposal various hedging options, for example, to cover movement in currencies and fuel prices. However, the standard response from lines is that it is "too difficult" and at the end of the day the shipper carries the risk.

It is believed shipping lines are hedging, but at the same time claiming surcharges as well - a classic case of double-dipping! Therefore, immunities should extend only to the setting of all-inclusive freight rates ie: the collective setting of surcharges such as THCs, etc. should not be allowed

This is also common practice in New Zealand and South Africa where shippers receive an all in rate.

Freight rates to be offered in Australian dollars

The AHEA supports the mandatory use of Australia's sovereign currency for all quotations and negotiated freight rates.

At present freight rates are quoted to shippers by a number of lines in US dollars, with an agreed exchange rate locked in 7 days prior to arrival of the vessel.

However, additional charges or surcharges are charged in Australian dollars because they are local costs.

All costs of procurement for horticultural exports are in Australian dollars and therefore, most of them trade in Australian dollars with the local currency or using cross rates. Often there are cost advantages using cross rates rather than using US dollars, which makes Australian horticultural exports more costs competitive.

The imposition of US dollar rates by the SE Asia Discussion Group on the AHEA and horticultural exporters, without agreement with the AHEA, was seen as the commencement of the utilisation of Discussion Agreements to force conditions on shippers using monopolistic power, and the legislation supporting Part X did not provide for any protection for the designated shipper body against this kind of use of market force.

The AHEA supports the use of an Australian dollar rate in Australia for Australian exporters selling Australian produce to foreign markets. Shipping Lines are well positioned to manage their global costs of running and managing their fleets across many currencies, and should be made responsible for managing their own costs of dealing in different exchange rates.

Provisions of agreements between parties to a registered agreement and a designated shipper body to be binding

Currently most agreements between registered Conferences or Consortia and designated shipper bodies are binding. However, with the introduction of Discussion Agreements, non binding negotiations became the norm.
Where Part X was retained, the AHEA would support the deregistration of all agreements that had non binding clauses in them for its members.

Code of practice to be developed to cover negotiations between parties to a conference agreement and designated shipper body

The AHEA, as a designated secondary industry shipper body has had a number of instances over the last 4 years where negotiations with particular Discussion Agreement Groups has seen the emergence of forceful tactics, where conditions have been imposed on shippers such as US dollar rates, where no negotiated agreement was reached, but the S. E. Asia Discussion Agreement (TFG) simply forced the condition upon horticultural exporters.
In later negotiations with the North Asia Discussion Agreement (TFA), the negotiating team for the TFA refused to negotiate a freight rate for horticultural exports, and simply attempted to force a rate increase on the AHEA. The result was both parties ceased negotiation without an agreed freight rate.
The AHEA has complained to the Dept of Transport about the conduct of the TFA over these failed negotiations.

The AHEA would support a code of practice to be developed as part of the legislation, with clauses to enforce the code of practice.

Draft Recommendation 9.4

The AHEA supports changes to enforcement provisions in the event of a review that :

- Parties to a registered agreement demonstrate that the conduct under review will result in a net public benefit.

- Exceptional circumstances provision be replaced by material change provision from Part VII.

- Penalties and fines be introduced for breaches of procedural provisions of Part X.

- Use of deregistration be limited to where deregistration is threatened, and not used as a way to avoid fines for procedural breaches.

The AHEA does not support changes to enforcement provisions in the event of a review that:

- Inquiries be conducted by the ACCC as a consequence of a referral from the Minister, or be initiated by the ACCC if it establishes a material change in circumstance.

- Revocation powers of the Minister be transferred to the ACCC

The AHEA is satisfied with the continued threat of intervention by the Minister, where a Party to an Agreement undertakes misconduct.

Maxwell Summers CEO

Australian Horticultural Exporters Association inc.

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