MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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Regulatory impact statement

Regulation of competition in international shipping

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Agency disclosure statement

1. This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment.
2. It provides an analysis of options to strengthen the oversight of agreements between international shipping carriers. This is to reduce the risk of carrier agreements having anti-competitive effects that are not sufficiently offset by benefits in shipping supply. Where this risk eventuates the cost is borne by our exporters and importers in the form of higher shipping rates, reduced frequency and reliability of services, and less efficient vessels and operating practices. These outcomes weaken New Zealand's international competitiveness with flow-on effects through the rest of the economy.
3. The key limitation of the analysis is the lack of detailed information about actual negotiated freight rates, terms and provisions of service contracts, relationships between operating costs and freight rates and the nature of arrangements between carriers. Any analysis would assess arrangements to see whether they raised competition concerns and where they do, investigate the costs and benefits to New Zealand associated with the restrictive trade practice. As there is no effective regulatory oversight of these agreements, there is no public record of them or any analysis of their actual effect.
4. The starting point for this analysis is the New Zealand Productivity Commission's 2012 International Freight Transport Services Inquiry that recommended strengthening the regulation of competition in international shipping. The analysis also draws on submissions to the Commerce Committee as part of consideration of the Commerce (Cartels and Other Matters) Amendment Bill in 2013. Officials have built on this analysis by considering:
   a. Views from stakeholders, gathered through meetings and correspondence;
   b. A review of the economic literature on the liner shipping industry; and
   c. Experiences of regulatory regimes in other countries and in similar industries.
5. The preferred options relating to applying the Commerce Act to international shipping would use an established framework to strengthen the regulation of competition in the provision of liner shipping services to and from New Zealand. The benefits of these options are not able to be quantified, but it is assumed that the greater that application of the Commerce Act to agreements, the more likely that any risk of detriment from anti-competitive behaviour would be minimised.
6. Any additional compliance costs on shipping lines in complying with the Commerce Act regime are also difficult to quantify. The recommended option assumes that these compliance costs are likely to be justified given the benefits from a more robust regulatory oversight. Furthermore, steps such as the production of guidance material should mitigate these costs. The alternative option of a block exemption including a regulation making power in the Commerce Act would reduce the compliance costs for shipping lines, but may impose some risk of anticompetitive detriment if the exemption is not well-specified.

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3 November 2016

1 Status quo and problem definition

Background

7. In March 2011, the Government asked the Productivity Commission to undertake an inquiry into international freight transport services. The context for the inquiry was that increasing international trade is a critical part of achieving productivity growth for New Zealand. Given that freight transport costs currently represent a sizeable proportion of international trading costs for New Zealand firms, it is important to ensure that New Zealand's infrastructure and regulatory regimes are effective in promoting accessibility and efficiency in international freight transport services.

8. The Chair of the Productivity Commission, in his foreword to the report, noted that New Zealand importers and exporters spend about $5 billion on freight services each year. The Productivity Commission looked at whether the efficiency of these services could be improved. For businesses this would mean more competitive exports and higher profits. For consumers it would mean cheaper prices and greater spending power. He identified that as the most remote developed country in the world, having highly efficient international freight services is crucial for New Zealand's economy and for the wellbeing of its citizens.[1]

9. The terms of reference included a request to the Productivity Commission to consider the effectiveness of current regulatory regimes for international sea freight services and the potential costs and benefits of alternative regulatory regimes with international comparisons. The Productivity Commission found that the performance of the freight system could be improved by strengthening the competition regime in international shipping. The Productivity Commission recommended:

    a. Removing the Commerce Act exemption for ratemaking agreements, which are agreements that fix prices, or limit capacity with the intent of raising prices. This would allow the Commerce Act's authorisation mechanism to be used to assess whether these agreements are in the public interest, and

    b. Continuing to exempt non-ratemaking agreements but making the exemption conditional on filing the agreements on a public register.

10. While the Productivity Commission noted that the defining characteristics of a rate-making agreement is that it include agreement to set or manage freight rates on a route and/or to limit capacity in order to raise rates above what they would be absent the agreement, it never defined what constitutes a non-ratemaking agreement.

11. A non-ratemaking agreement may be an agreement that is not a ratemaking agreement, although this is not explicit. Alternatively, in discussing non-ratemaking agreements, the Productivity Commission may have been referring to consortia or operational agreements that are widespread in international shipping. These cover a range of operational matters including agreements between carriers to jointly operate a network of services, to share vessels on a

[1] Productivity Commission, *International Freight Transport Services Inquiry*, April 2012, p iii.

service and/or to buy or swap container slots on vessels.[2] Such agreements may limit capacity albeit not with the purpose of raising rates above what they would be absent the agreement.

12. This paper continues to use the terms ratemaking and non-ratemaking but notes that there is no settled definition of the terms, nor do the terms distinguish between conduct that it pro or anti-competitive or conduct that restricts output and conduct that enhances output.

Why international shipping was exempt from the Commerce Act

13. The Productivity Commission report noted that:

Collaborative agreements are often protected from the normal competition scrutiny that countries apply to all other industries. Many governments around the world exempt liner shipping collaboration from the full application of domestic competition laws (or 'anti-trust' laws). Each jurisdiction has taken a slightly different approach (Ministry of Transport, 1983; Appendix D).

New Zealand is one of the countries that offer exemption. Shipping lines that run freight services to and from New Zealand are exempt from the Commerce Act 1986.

The basis for the exemption is a judgement of net benefits. Governments have judged that liner collaboration is likely to deliver benefits that outweigh the cost of less competition. The net benefits are considered to be clear enough to justify a 'block exemption' for all collaboration of a certain type, rather than a provisional exemption that requires shipping lines to prove the benefits of their collaboration on a case-by-case basis.

A number of governments (not including New Zealand) have reviewed the basis for these competition law exemptions over the past decade or so. In particular, these governments have questioned whether agreements that set rates and limit capacity (mainly conference agreements) deliver clear net benefits.[3]

14. In its 2002 report on *Competition Policy in Liner Shipping*, the OECD noted that co-operative behaviour in liner shipping has historic origins in the late 19th century where the introduction of fast steamships brought about instability in the relatively young liner shipping sector. The industry was characterised by cutthroat competition between sailing ship operators and new and emerging steamships. There was further competition between steamship operators and shippers (including exporters and importers) took advantage of overcapacity in the industry to obtain lower freight rates.

15. Rather than limit shipping services to those instances when carriers could expect compensatory returns (e.g. by providing irregular services based on full ship-loads), the liner operators opted for formal arrangements between themselves to limit capacity and fix rates. In this way, they thought they could still provide the value of a fixed port rotation while reducing their exposure to destructive competition.[4] Despite economic, political and social changes, these formal arrangements still characterise the industry today.[5]

16. Shipping lines argue that the industry is unique in that there is a real need for capacity control and rate-fixing to ensure stable international shipping services. More particularly:

    a. Shipping lines operate a service where ships must sail at set times irrespective of the amount of cargo they have on board;

    b. Failure to provide such a regular service would undermine the value to shippers;

[2] A service is a group of vessels operating on a single route according to a fixed schedule. For example a typical weekly service to Singapore requires 6-8 vessels.

[3] Productivity Commission, *International Freight Transport Services Inquiry*, April 2012, p226.

[4] Competition is said to be 'destructive' when it leads to prices below costs (in other words, marginal cost pricing is inadequate to recover large fixed costs) and thus generates market instability.

[5] OECD, *Competition Policy in Liner Shipping,* 2002, p18.

c. In order to provide scheduled services at frequent intervals, carriers must be able to field several similar ships on any given trade route;

d. Purchasing and operating these ships requires a substantial capital outlay;

e. Carriers face unbalanced trade flows and therefore capacity deployed in sufficient quantity for the dominant flow will often be far in excess of the amount needed for the return leg; and

f. Shipping lines operate in a relatively uniform product market where there has traditionally existed little differentiation between operators.[6]

17. The special characteristics of the liner shipping industry were noted by the International Container Lines Committee (ICLC) in its submission to the Commerce Committee.

18. To date the exemption for international shipping seems to have been given on the basis that there would be risk in New Zealand being out of step with its trading partners and that this might result in a deterioration of the quality or frequency of service. There does not appear to have been any analysis of whether there are competition implications of the arrangements and to the extent there are, whether the arrangements can be justified on the basis that they provide such benefit to New Zealand that a block exemption should be granted.

Status Quo and Problem Definition

19. In its submission to the Commerce Committee, the ICLC put forward:

No case has been made that there is a problem with the status quo i.e. the existing system with broad exemption and sector-specific intervention powers with the Ministry of Transport works adequately.[7]

New Zealand’s regulatory approach is an outlier and provides insufficient oversight

20. New Zealand is relatively well served by liner shipping operators; with 20 international container line shipping companies operating in New Zealand, including eight of the 10 largest shipping companies. In general, these shipping companies operate regular services to and from New Zealand, visiting up to 10 ports. These services are generally on a fixed day, weekly basis between ports in New Zealand and our main trading partners, or via hub ports. New Zealand shippers can also charter vessels as required.

21. Annex 1 shows the container trade routes to and from New Zealand and the main services provided on these routes.[8] It can be seen that there are many services available to the New Zealand market, though the number of choices and destinations differs from port to port. Tauranga and Auckland in particular have a wide range of options available.

22. In comparison with most other countries, New Zealand’s existing regulatory regime is an outlier. Although many countries still provide some form of exemption to international shipping, New Zealand’s exemptions apply widely and without the limiting conditions found elsewhere.

23. The exemptions for international shipping are provided in section 44(2) of the Commerce Act 1986 and section 14 of the Shipping Act 1987, and collectively exempt the international carriage of goods by sea from Parts 2 and 4 of the Commerce Act.

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[6] OECD, *Competition Policy in Liner Shipping*, 2002, p18.

[7] International Container Lines Committee, *Submission to the Commerce Select Committee on the Commerce (Cartels and Other Matters) Amendment Bill*, 18 October 2012.

[8] Ministry of Transport, *Transport and Trade Report July 2016.*

24. Sector-specific regulation is provided by sections 4-10 of the Shipping Act 1987. This regulation seeks to promote fair dealing and safeguard competition in New Zealand's outward shipping services. However, this regime is ineffective in achieving this purpose and has never been used because:

- It gives the Minister of Transport an ability to investigate unfair practices but sets a high threshold for initiation of an investigation.
- It contains only limited powers for the Minister to remedy any problem. There is no ability to impose penalties or conditions. The Minister can only direct carriers to provide information and to enter into negotiations with exporters.
- The provisions only apply to outward shipping - it provides no oversight of competition in import shipping.
- Institutionally, the Ministry of Transport has no standing investigative capacity or procedure.

25. As a result of the inadequate regulatory regime, there is no oversight of competition in the industry and international shipping is essentially unregulated.

The lack of effective oversight exposes exporters and importers to a risk of anti-competitive outcomes

26. By exempting all international shipping activities from competition law and operating a weak sector-specific regime for export shipping only, New Zealand is exposed to the risk that agreements between carriers have anti-competitive outcomes that are not sufficiently offset by benefits in shipping supply.

27. If the risk eventuates, the cost is borne by our exporters and importers in the form of higher freight rates, reduced frequency and reliability of services, and less efficient vessels and operating practices. These outcomes reduce New Zealand's international competitiveness with flow-on effects through the rest of the economy.

What do we know about competition (or lack thereof) in international shipping?

28. In its report on Competition Policy in Liner Shipping, the OECD observed:

29. *The difficulty in assessing the validity of the pro- or anti-exemption position has always been the availability (or lack thereof) of the detailed information necessary regarding actual negotiated freight rates, terms and provisions of service contracts, relationships between operating costs and freight rates and the nature of arrangements among carriers. In an ideal world, a regulatory agency would be able to proceed in a logical fashion to investigate the benefits/disadvantages of anti-trust arrangements. This would entail making an assessment as to these practices, impacts on competition, the net balance of benefits and dis-benefits flowing from these measures and an investigation of alternative approaches to achieving the benefits resulting from these actions*.[9]

30. These observations were consistent with those of the Australian Productivity Commission in its review of the regulatory regime governing competition in international liner shipping. The Australian Productivity Commission noted that attempts to establish that agreements enable

[9] OECD, *Competition Policy in Liner Shipping,* April 2002, p11.

carriers to exploit market power and earn above normal rates have been hampered by a lack of available data.[10]

31. The Australian Productivity Commission's recommendations were therefore based on the following sources:

- Views from stakeholders;
- A review of economic literature on the liner shipping industry;
- Experiences of regulatory regimes in other countries, particularly the EU; and
- Experiences of regulatory regimes in similar industries i.e. those that offer regular scheduled services and have relatively high fixed costs.

32. In the absence of a regulatory regime that would enable access to required information, this analysis has drawn on the same sources as the Australian Productivity Commission.

Stakeholder submissions to the New Zealand Productivity Commission and Commerce Committee

33. Submissions were made by a range of exporters: large firms, small firms and industry bodies such as Export New Zealand and the New Zealand Shippers' Council.

34. Kotahi (a joint venture between Fonterra and Silver Fern Farms) in a submission to the Productivity Commission, noted:

Collaborative Vessel Sharing Agreements between shipping lines had enabled an increase in average vessel size calling New Zealand, reducing the average cost per unit of capacity to the carrier. However, this has been at the expense of freight owner choice in service delivery. Carrier collaboration has also arguably been used to artificially constrain capacity creating an environment whereby a reduction in the cost to serve has rarely translated directly into a price to service reduction to freight owners.

It should be noted that use of collaboration to artificially constrain capacity is a relatively recent phenomenon. Historically the ability for carriers to collaborate has served NZ well, facilitating the introduction of scale operations and reducing the volatility of supply by improving the financial sustainability of services for the carrier community. This highlights that carrier collaboration can and has worked but given the increased global financial pressures facing lines, NZ would benefit from additional protection from carriers obtaining unfair advantage.[11]

35. The New Zealand Shippers' Council, a body representing exporters and importers, submitted to the Productivity Commission:

Collaborative agreements are necessary to guarantee levels of service to and from countries like New Zealand at reasonable cost. The problem for importers and exporters occur when price and capacity information is exchanged is it allows the opportunity for uncompetitive behaviour. It is likely that such behaviour has occurred…

36. Similarly, Export New Zealand in its submission to the Productivity Commission noted:

One of the benefits to exporters of Shipping Line Conferences is that the shipping lines cooperate on dispatch of ships, which means we get more frequency of service than we might otherwise get in NZ and a better utilisation of space. Frequency of service is important to exporters who are trying to get goods to customers in a timely fashion and particularly for perishable goods that have a limited shelf life.

[10] Australian Productivity Commission, *Review of Part X of the Trade Practices Act 1974: International Liner Cargo Shipping*, February 2005, p83.

[11] Kotahi, Submission to the Productivity Commission's Issues paper, response to question 20.

On the negative side of the ledger, the consolidation of capacity after the global financial crisis could mean that shipping lines have more market power than was previously the case.[12]

37. Other evidence that could indicate that the market for liner shipping is not as competitive as it could be, includes:

- The Productivity Commission also did a case study comparing prices for containers from Australia and New Zealand to the same third-country ports (Singapore, Shanghai and Long Beach California) and found evidence of considerably higher sea-freight rates on New Zealand services compared with Australian services. These price differences were not fully explained by plausible estimates of cost differences.
- Several submitters to the Commerce Committee noted recent price increases of $1,500 per refrigerated container. This was introduced by one shipping company and shortly after adopted by others, without obvious justification for the increase. Submitters noted that the price increase was significant given the global overcapacity of refrigerated containers that has existed since 2008.
- Shippers have indicated that the prices for refrigerated containers from New Zealand are high relative to other countries at a similar distance from markets. One example provided of prices for South Africa and New Zealand to the same third-country Asian ports (Hong Kong, Singapore, Port Klang Malaysia), showed reefer rates out of New Zealand to cost up to 149 percent more.
- Shippers noted that prices are based on the type of cargo carried rather than on carrying costs plus a competitively derived margin. For example, apple exporters pay around twice the rate that a butter exporter would per container. This may indicate that carriers are charging what the market will bear, rather than for the costs of providing the service.
- Shippers noted that since the global financial crisis, New Zealand prices have remained consistently higher, and shown less volatility in downward pricing, than in other countries.

38. Finally, in discussions with officials, representatives of the International Container Lines Committee mentioned that the average return on routes that service New Zealand was between 3 percent and 4 percent return, whereas across the global network the return was 1 percent. While these figures alone do not demonstrate that anti-competitive rents are being earned, rather they demonstrate that the routes to and from New Zealand are relatively profitable.

Review of the economic literature on the shipping industry

39. It has been argued that the liner shipping industry has economic characteristics, which differentiate it from other industries, particularly in relation to cost structures. These characteristics are said to render the industry susceptible to instability and deserving of an exemption from competition law.

40. The Australian Productivity Commission reviewed the literature in relation to these arguments and found that while there are theoretical arguments in favour of 'destructive competition', the empirical evidence is not compelling. Competition is said to be 'destructive' when it leads to prices below costs (in other words, marginal cost pricing is inadequate to recover large fixed costs) and thus generates market instability.

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[12] Export New Zealand, *Submission to the Productivity Commission regarding the Enquiry into International Freight Transport Services*, 31 August 2011, para 4.1 and 4.2.

41. More particularly, the report found:

- The importance of economies of scale in liner shipping means that price discrimination between cargoes and/or between shippers, as opposed to solely cost reflective pricing, can be an efficient mechanism for recovering high fixed costs.
- The industry is characterised by the widespread use of surcharges, such as for bunker fuel, terminal handling and peak season. Surcharges can be a means of passing on unavoidable costs associated with container shipments to shippers. However, they can also enable carriers collectively to impose price increases on the market. Surcharges are generally not subject to negotiation with shippers.
- Concern about 'destructive competition' has been a powerful argument used in support of allowing ocean carriers to confer and form conferences to control the supply of shipping capacity and set freight rates on trade routes. However, there is a lack of evidence to support that concern.
- Shipping lines enter into agreements for the purpose of limiting competition and/or realising operational efficiencies. While some agreements – those involving vessel sharing agreements, slot swaps and slot charter agreements may be appropriate responses to industry cost structures and characteristics of shipper demand, agreements that limit competition (such as discussion agreements) appear less justifiable on efficiency grounds.
- Operational agreements have the potential to benefit carriers and shippers through cost reductions and greater flexibility in service delivery, however, benefits will only be passed through to shippers under competitive conditions.

42. In relation to competitive conditions, the report found:

- Barriers to entry to a new route are not especially high and may be limited to redeployment of ships, marketing and administration. However, factors such as high worldwide demand for capacity, the desire to maintain networks and strategic conduct by incumbents, may raise these costs and reduce the degree of contestability on a route.
- While the liner shipping market, like any market, needs to be well informed to function properly, the high level of exchange of commercial information on price and quantity among carriers can be a means of enforcing collusive agreements and may result in a limiting of competition.

Experiences in other countries

43. In recent years, reviews overseas have generally recommended narrowing the scope of block exemptions for shipping. This is generally done by imposing conditions (such as market share thresholds, as in Singapore and the European Union) or limiting the kinds of agreements that can benefit from the block exemption (such as the draft determination in Hong Kong, which exempts vessel sharing agreements but does not exempt voluntary discussion agreements).

44. Table 1 (page 12) provides a summary of the types of shipping agreements that are exempted in other countries.

45. A number of jurisdictions appear to have never exempted shipping from their competition laws including China, South Africa, Brazil, Russia and Turkey. However, of those that have, there has been a trend towards narrowing the scope of the exemption, including in the United States, European Union, Singapore and Israel, and subjecting the exemptions to a regular review.

European Union

46. The EU reviewed its exemption for international shipping with changes coming into force in 2009. The EU approach is informative as it seeks to focus on the substance of the arrangements, not the form. The Regulation states that the legal form of the arrangements is less important than the underlying economic reality.[13] As discussed in paragraphs 10 to 12, ratemaking and non-ratemaking agreements are not defined terms and tend to focus on the form of the arrangement rather than the substance.

47. More specifically, the EU revised the exemption so that shipping lines are no longer able to fix prices or capacity. The new exemption draws a distinction between arrangements that are efficient and generally help to improve the productivity and quality of liner shipping services and those that represent an unjustified limitation of capacity and sales, including through the joint fixing of freight rates or market or customer allocation that are unlikely to bring any efficiency. This new exemption was extended again in 2014 until 2020.

48. The EU Competition Commission, in a letter to the New Zealand Productivity Commission, noted that:

- The EU had not experienced 'destructive competition' in the three years since repeal of its exemption. Rather there are still many carriers on EU trades and they offer even more capacity than before the repeal.
- The liner industry is no different from other fixed-schedule, high-fixed-costs transport industries that function well under the standard competition law regime.
- The EU repeal has not led to significantly increased concentration. In any event, consolidation (subject to merger control) is preferable to cartels, as it can improve efficiency and increase competition.
- The argument that without a cartel exemption, the carriers would reduce investment in their key assets (i.e. container ships) does not hold. The EU has observed that a number of carriers are expecting the delivery of many large vessels earmarked for the Asia-Europe trade. Moreover, regardless of any liner cartel exemption or repeal, the prospect of operating newer, larger and more efficient vessels can act as a strong incentive to invest in new vessels.[14]

49. In 2012, the US Federal Maritime Commission published a report assessing whether the repeal of the conference block exemption in the EU has had any negative impact on the liner shipping industry in the United States. It was found that no significant change in rate levels occurred between the EU and United States due to the repeal of the block exemption. The block exemption did not appear to have put United States shippers at a disadvantage to EU shippers in Far East Trades.[15]

United States

50. Prior to the passage of the United States Ocean Shipping and Reform Act (OSRA) in 1998, there were strong impediments to individual Conference carriers' ability to negotiate rates with shippers. Conferences were required to publicly post tariffs and negotiated individual services contracts with the Federal Maritime Commission (FMC). The transparency of rate information meant that rival carriers knew the terms and conditions that were being offered by their conference partners.

51. The reforms abolished the requirement that service terms be made public. The effect of the reforms was that shippers and individual carriers could negotiate confidential services

[13] European Union, Commission Regulation (EC) No 906/2009, Official Journal of the European Union.
[14] European Commission, Directorate-General for Competition, Letter to Murray Sherwin, 24 February 2012.
[15] Federal Maritime Commission (2012). Study of the 2008 repeal of the liner conference exemption from European Union Competition Law. Washington DC. January 2012.

agreements. The reforms were designed to encourage competition between carriers. As a result, very little traffic now takes place directly under conference terms.[16]

Hong Kong

52. Hong Kong has only recently adopted competition law. The Competition Ordinance came into full force on 14 December 2015 and the new Competition Commission commenced operation on the same day. One of the first administrative matters before the Hong Kong Competition Commission was an application by the Hong Kong Liner Shipping Association for a block exemption for liner shipping agreements.

53. On 14 September 2016, the Hong Kong Competition Commission published its draft determination. This draft determination is very similar to that adopted by the EU. In particular, the Commission intends to issue a block exemption for vessel sharing agreements, being agreements between liner shipping lines for joint operation of services and to exclude voluntary discussion agreements and agreements that fix prices, restrict output or allocate markets.

54. The draft determination also includes conditions: (1) the combined market shares of the parties to the agreement must not exceed 40 percent; and (2) parties to the agreement must be free to withdraw from the agreement without penalty upon reasonable notice.

55. Submissions on the draft determination are due by 14 December 2016, and the Hong Kong Competition Commission is expected to make its final decision in 2017.

Australia

56. Australia has undertaken a number of reviews of the regulatory regime that governs competition in international liner cargo shipping.

57. In the 2005 Australian Productivity Commission review it was found:

The wide variety of agreements registered have varying potential to provide a net benefit for Australia, depending on the nature of the agreement and the impact on competition in the trade routes on which they operate.

- *Agreements on operational matters, such as joint scheduling and use of shipping assets, can, in principle, offer significant cost saving and pose little anti-competitive risk.*
- *Agreements which fix prices and control the supply of shipping to a trade route pose the greatest anti-competitive risks.*

Evaluation and selective registration of agreements is therefore necessary if Australia is to be confident that only those that provide a net public benefit are allowed to operate.[17]

58. The Australian Productivity Commission considered that the most effective way to do this would be to repeal the registration regime and, as occurs for other industries, rely on the general authorisation regime. The Australian Competition and Consumer Commission (ACCC) would assess agreements individually and authorise them where there is a net public benefit to Australia. The recommendations were not implemented but officials understand that the Australian Department of Infrastructure and Transport agree in principle with the Australian Productivity Commission's recommendations but due to the time lapse since the completion of the report, consider that it would be prudent to undertake further consultation prior to making any legislative changes. In 2012, the Australian and New Zealand Productivity Commissions in their joint report on "Strengthening trans-Tasman economic relations" recommended that "The Australian and New Zealand Governments should remove —

[16] OECD, *Competition Policy in Liner Shipping,* 2002, p 22-24.
[17] Australian Productivity Commission, *Review of Part X of the Trade Practices Act 1974: International Liner Cargo Shipping*, 23 February 2005, p xxvi.

preferably on a coordinated basis — the exemption for international shipping ratemaking agreements from legislation governing restrictive trade practices."

59. The 2015 Australian Competition Policy Review ('the Harper Inquiry') included a recommendation to repeal the existing regime (Part X of the Competition and Consumer Act 2010), and grant a block exemption for liner shipping agreements that meet a minimum standard of procompetitive features. It was recommended that agreements that did not meet this standard should be subject to individual authorisation. The Australian Government responded openly to this recommendation, agreeing to introduce a general class exemption power into the Competition and Consumer Act. Before this can occur however, the Government reported that extensive consultation is required to make sure shipping routes to and from Australia continue to be reliably and competitively serviced and that the costs to obtain a class exemption are not burdensome.

60. While New Zealand's proposed targeted block exemption is likely to be implemented in advance of changes to the Australian regime, if Australia does proceed with a block exemption, there would be potential for trans-Tasman coordination at that time and in any subsequent evaluation of the Commerce Act provisions.

Table 1 – Shipping agreements exempted in other countries

All agreements exempted (includes rate making agreements)	Vessel sharing agreements exempted (excludes price fixing or capacity restraints or sharing of confidential information)	No exemption (subject to generic competition law)
United States – specialist maritime regulator can investigate harmful conduct and impose conditions. **Australia** (current law) – agreements must be registered, with some conditions. **Singapore** – agreements exempt if market share of parties is less than 50%. Conditions imposed include parties must be free to withdraw without penalty.	**European Union** – exempt agreements if market share of parties is less than 30%. Those agreements must also be efficient and help improve productivity and quality. **Hong Kong** (draft determination) – exempt if market share of parties is less than 40%. Parties must be free to withdraw without penalty. **Malaysia** – exempt but agreements must be published.	**Brazil** **South Africa** **Chile** **Turkey** **Russia** **Vietnam** **Indonesia**

Enforcement action in other countries

61. Overseas, there have been a number of significant convictions against cartel behaviour in the past two years.

Price signalling in Europe

62. In 2013, the EU Competition Commission opened formal antitrust proceedings on its own initiative to investigate the practice of publishing General Rate Increase announcements by liner shipping companies. In order to address the Commission's concerns, the companies offered a number of commitments including to stop publishing and communicating General Rate Increase announcements. Any price announcements will be published in a way that is useful to customers, and will not be published more than 31 days before their entry into force.

63. The EU Competition Commission exercised its power to make the commitments offered by liner companies legally binding. If a company breaks such commitments, the Commission can impose a fine of up to 10 percent of the company's worldwide turnover, without having to find an infringement of the EU antitrust rules.

Car carrier cartel on Oceania route

64. In 2015, Japanese liner shipping company Nippon Yusen Kabushiki Kaisha (NYK) admitted to customer allocation, bid-rigging and price fixing in the United States, agreeing to pay fines of USD59.4 million.[18] As of July 2016, four shipping companies had been charged in the United States, with fines totalling USD234 million. Four individuals have also been charged with cartel conduct in the United States, including one NYK employee, who was sentenced to 15 months imprisonment.[19]

65. Australia introduced criminalisation for cartel behaviour in 2009. In July 2016, NYK pleaded guilty to charges of criminal cartel conduct in the Federal Court of Australia.[20] Sentencing is scheduled for September 2016 and NYK faces the greater of AUD10 million, three times the value of the benefit attributable to the commission of the offence or, if the attributable benefit cannot be determined, 10% of its annual turnover connected with Australia.

66. In Japan, a total of seven executives, including two from NYK, have been sentenced to prison. NYK was also fined JPY13 billion (around USD59 million) by the Japan Fair Trade Commission in March 2014. In South Africa, NYK has been fined ZAR104 million (around USD8.5 million). In China, NYK received first-in immunity from the National Development and Reform Commission and has avoided paying a fine.

Regulatory regimes in similar industries

67. The Australian Productivity Commission found that there are strong parallels between transport industries such as airlines, road transport and rail freight, which offer regularly scheduled services and have relatively high fixed costs.

68. In many OECD countries, moves to deregulate these industries have been opposed on the grounds that it would give rise to 'destructive competition'. Yet deregulation of these industries has typically been successful. The OECD found:

> *The cost structure of the industry is not significantly different from that of other transport industries and returns in liner shipping are similar to those of other scheduled transport providers. While it is true that ships cost considerably more than say, a new lorry or locomotive, each ship can also earn significantly more revenue. Seasonal and directional trade imbalances are not unique to the liner sector and must be faced by most transport service providers – in some cases these imbalances pose much more of a problem since some vehicles are not as standardised as container ships. In the end, liner shipping is about as 'different' from other industries as, for example, trucking is to freight air services or freight air is to rail freight – with the exception that price-fixing is allowed in liner shipping and nearly universally disallowed in these other industries*.[21]

69. There are many similarities between airlines and liner shipping. Airlines maintain a scheduled service irrespective of the number of seats filled and often operate with excess capacity. Fixed costs are extremely high and operating costs are low, which gives rise to similar load factor

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[18] United States Department of Justice, 'Third Ocean Shipping Executive Pleads Guilty to Price Fixing on Ocean Shipping Services for Cars and Trucks', 10 March 2015. Available at: https://www.justice.gov/opa/pr/third-ocean-shipping-executive-pleads-guilty-price-fixing-ocean-shipping-services-cars-and.

[19] United States Department of Justice, 'Fourth Ocean Shipping Executive Indicted for Price Fixing and Bid Rigging' 7 June 2016. Available at: https://www.justice.gov/opa/pr/fourth-ocean-shipping-executive-indicted-price-fixing-and-bid-rigging.

[20] ACCC Press Release, 18 July 2016. Available at: https://www.accc.gov.au/media-release/australia%E2%80%99s-first-criminal-cartel-charge-laid-against-nyk

[21] OECD, *Competition Policy in Liner Shipping*, April 2002, p75.

management issues to those in liner shipping. Airlines practice price discrimination and peak load pricing. The industry is said to be subject to low rates of profitability. Finally, airlines can benefit from economies of network size and scope.

70. Previously the way in which airlines cooperated was through a tariff setting mechanism and associated arrangements agreed through the International Air Transport Association (IATA). These arrangements are similar to conference and discussion agreements in the shipping industry but have been phased out as the industry has evolved.

71. Today alliances and joint ventures are prominent features of the airline industry. Code share agreements allow an airline that does not provide a direct flight to a location to provide transit for its customers through a number of interconnecting flights provided by codeshare partners. Codeshare agreements allow an airline to benefit from network economies and differentiate their service, without committing a large amount of capital.

2 Objectives

72. The overarching public policy objective is to promote open and competitive markets in international shipping for the long-term benefit of consumers in New Zealand, including businesses, exporters and importers.

73. To achieve this, the regime should have the following characteristics:

    - Minimise risk of detriment resulting from anti-competitive behaviour.
    - Enable shipping lines to engage in collaborative activity that enhances productivity.
    - Ensure that the benefits of collaborative activity are shared between shipping lines and users or acquirers of shipping services. Benefits might include decreased cost, which may be passed through as a decrease in price. Other benefits might include increased network coverage, or increased frequency and reliability of service.
    - Achieve its purpose in a way that minimises business compliance costs and government administration costs.

3 Options and impact analysis

74. Five options were considered to strengthen the oversight of competition in international shipping. These options include:

    - Retaining the status quo where international shipping is essentially unregulated (option 1);
    - Adopting the Productivity Commission recommendations, which would remove the Commerce Act exemption for ratemaking agreements and exempt non-ratemaking agreements provided they are registered with the Ministry of Transport. Non-rate making agreements would continue to be subject to the unfair practices regime under the Shipping Act (option 2);
    - Strengthening the Shipping Act (option 3);
    - Applying the full generic competition regime in the Commerce Act to international shipping (option 4); and
    - Applying the Commerce Act to international shipping, but including a targeted block exemption in the Commerce Act for provisions in international liner shipping agreements relating to joint or coordinated liner shipping activities, such as vessel sharing (option 5).

75. Table 1 assesses the options against criteria reflecting the objectives in paragraph 73 above.

Table 2 - Analysis of options to strengthen the oversight of competition in international shipping

Options	Criteria				
	Minimises risk of anti-competitive detriment	**Enables shipping lines to engage in collaborative activity that enhances productivity**	**Ensures that the benefits (price and quality) of collaborative activity are shared between shipping lines and users or acquirers of shipping services**	**Regime minimises government administrative costs**	**Regime minimises business compliance costs**
Option 1: Status Quo Overseas shipping exempt from Commerce Act, but subject to regime in Shipping Act 1987	~ The regime in the Shipping Act does not provide effective protection against anti-competitive behaviour nor does it provide effective remedies.	~ Shipping lines can engage in cartel and collaborative activities. If competition is limited, there are no incentives for collaboration to enhance productivity.	~ Does not distinguish between cartels or collaborative activities. There is a significant risk that benefits may be retained by shipping lines and not be passed through to customers.	~ Regime is not used thus no costs are incurred. However, if invoked, it would require the development of procedures and commissioning of investigations.	~ Regime is not used so no costs are incurred. However, if invoked, carriers may be subject to ministerial directions in providing services.
Option 2: Productivity Commission recommendations: Rate-making agreements subject to the Commerce Act. Non-ratemaking agreements would be exempt if registered.	✓✓ Offers protection against rate making, but focuses on the form of the agreements and not the substance. Non-rate making agreements can also give rise to anti-competitive outcomes, including higher prices, reduced frequency, reliability and innovation.	✓✓ Likely to improve on status quo but this depends on how non-ratemaking agreements are defined. Shipping lines can engage in non-rate making activities, but as the exemption focuses on the form of agreements, it risks being too broad, thereby limiting incentives to enhance productivity.	✓✓ Protection of individual service agreements facilitates some contestability. But as a form-based exemption risks being too broad, there is a risk that the benefits of collaboration may be retained by shipping lines and not be passed through to customers.	✗✗✗ Costs increase due to the Ministry of Transport being required to operate a registry and assess eligibility of non-rate making agreements prior to registration. Dual enforcement regime as Commerce Commission also oversees rate making agreements.	✗✗✗ All non-rate making agreements must be registered and the costs of the registry will likely be recovered from the industry. Agreements will need to be assessed to see whether they meet the criteria for registration, and some agreements may need to be amended to comply with conditions relating to allow for parties to provide individual services.
Option 3: Strengthen the Shipping Act regime Minister's ability to investigate suspected unfair practices strengthened, penalties introduced, regime extended to imports.	✓✓ Offers additional protection if sector-specific regime were amended to minimise risk of anti-competitive behaviour. Amended regime would likely seek the same outcomes as under general competition law.	✓✓ Sector-specific regime could be amended but would seek the same outcomes as general competition law i.e. that anticompetitive behaviour is prohibited and can only be authorised where it is in the net public benefit. Likely to improve on status quo.	✓✓ Action could be taken to strengthen competition, but investigative function in the Ministry of Transport at risk of being crowded out by competing policy priorities.	✗✗✗ Costs increase in line with strengthened Minister of Transport's powers.	✗✗✗ Costs will depend on the design of the regime.
Option 4: Apply the full competition regime in the Commerce Act to international shipping	✓✓✓ Established generic framework that seeks to distinguish between collaborative activities that are pro and anti-competitive. This would significantly minimise the risk of anti-competitive detriment.	✓✓✓ Greatest potential for enhancing productivity as the established generic framework seeks to distinguish between collaborative activity that enhances productivity and activity that restricts productivity.	✓✓✓ Greatest potential for ensuring outcomes that promote competition or are in the long-term benefit of users of shipping services and consumers more generally.	✗✗ Administration costs increase, reflecting a more robust process, however, the regime is administered by the Commerce Commission so administrative costs would only increase at the margin. There is likely to be an increase in the number of shipping clearance and authorisation applications until precedents develop.	✗✗✗ Agreements will need to be assessed to see whether they raise competition issues. Shipping lines may seek clearance or authorisation from the Commerce Commission at some cost. Sector-specific guidelines could minimise increase in compliance costs.
Option 5: Targeted block exemption framework in the Commerce Act Provisions of agreements relating to joint liner shipping are exempt, but all other shipping activities are subject to the Commerce Act	✓✓ Will minimise risk of anticompetitive detriment but some risk that the exemption is defined too broadly. This can be managed in part by monitoring and reviewing the exemption from time to time, particularly if market conditions change.	✓✓ Will improve on status quo but there is a risk that some collaborative activities that do not enhance productivity will be exempt. Activities that fall outside the scope of the exemption will be subject to the established generic framework in the Commerce Act.	✓✓ If the market is not competitive, the benefits of collaboration may be retained by shipping lines and not be passed through to users or acquirers of shipping services.	✗ The regime is administered by the Commerce Commission so administrative costs would only increase at the margin. The vast majority of collaborative agreements are exempt, which would likely minimise the number of clearance applications to be determined.	✗ Agreements will need to be assessed to see whether their provisions fall under the block exemption. Clear expression of the type of activities caught by the exemption will minimise business compliance costs.

Key: ✓✓✓ significant improvement on status quo; ✓✓ improvement on status quo; ✓ some improvement on status quo; ~ no real impact relative to status quo;
✗ some deterioration relative to status quo; ✗✗ deterioration relative to status quo; ✗✗✗ significant deterioration relative to status quo.

Discussion of options

Option 1: Retain the status quo – competition in international shipping unregulated

76. As set out in the discussion of the problem, the status quo is that international shipping lines are essentially unregulated. This means that there is significant risk that arrangements that are entered into between shipping lines are hard-core cartels.

77. As the OECD has previously noted:

Cartels harm consumers and have pernicious effects on economic efficiency. A successful cartel raises prices above the competitive level and reduces output. Consumers (which include businesses and governments) chose either not to pay the higher price for some or all of the cartelised product that they desire, thus forgoing the product, or they pay the cartel price and thereby unknowingly transfer wealth to the cartel operators.[22]

78. From the point of view of New Zealand exporters and importers there is a risk that:

- prices charged by shipping lines are above those that would be expected in a competitive market;
- the frequency and reliability of the service is less than what would be expected in a competitive market;
- some marginal products may not be exported or imported due to the cost of transport being above the competitive cost;
- goods sold in international markets are not as competitive as they could be, this is especially problematic where inputs into the production process are also imported.

Option 2: Adopt Productivity Commission's recommendations

79. The key difference between Option 2 and the Commerce Act options is that it retains an industry-specific regime for all non-rate making agreements. Non-rate making agreements are the bulk of agreements on New Zealand's shipping routes. Discussions with the International Container Lines Committee suggest that there are two or three discussion agreements (these cover non-binding discussions on prices and capacity) and between 25 to 35 operational agreements. With option 2 all non-rate discussion agreements and operational agreements, if registered, would be exempt from the Commerce Act.

80. Conceptually option 2 appears to have merit, as it attempts to focus Commerce Act scrutiny onto conduct that is likely to be intentionally detrimental, i.e. price fixing and capacity limitation to increase price. However option 2 is not favoured as it takes a form over substance approach. Non-rate making agreements can give rise to anti-competitive outcomes, including higher prices, reduced frequency, reliability and innovation.

81. This was recognised by the EU in the development of its current exemption. That exemption aims to exempt arrangements that give rise to efficiencies but not those that are an unjustified limitation on capacity and sales.

82. The risk associated with non-rate making agreements is also evident from:

- Fonterra's experience reflected in the Kotahi submission to the Productivity Commission that stated: "Collaborative vessel sharing between shipping lines have enabled an

[22] OECD, *Hard Core Cartels: Recent Progress and Challenges Ahead*, p 8.

increase in the average vessel size calling New Zealand, reducing the average cost per unit of capacity to the carrier. However, this has been at the expense of freight owner choice in service delivery. Carrier collaboration has also arguably been used to artificially constrain capacity creating an environment whereby a reduction in the cost to serve has rarely translated directly to a price to serve reduction for freight owners."

- The APEC study on non-rate making agreements,[23] which indicates that some aspects of these agreements can be anti-competitive including the ability to: restrict competition from current or potential competitors; influence the behaviour of agreement members; increase market concentration and market share, and to exchange information on confidential contracts.
- The high market shares of some parties to discussion agreements, which may or may not be specified as non-rate making agreements. For example, two main rate discussion agreements cover the trade between the U.S. and Australia and New Zealand. Seven carriers with a combined market share of 80 percent participate in the *United States/Australasia Discussion Agreement* covering the U.S. outbound trade; and five carriers with a combined market share of 94 percent participate in the *Australia and New Zealand-United States Discussion Agreement* covering the U.S. inbound trade. All carriers serving the trade provide direct service through vessel sharing and space charter agreements.[24]

83. Further, Option 2 would be inconsistent with the way the Commerce Act regulates other sectors where competition scrutiny focuses on the outcomes of agreements between competitors (e.g. having the effect or likely effect of restricting output), rather than the form or type of agreement.

84. A registration regime could be carefully designed so that only pro-competitive, efficiency enhancing arrangements are registered; however, this would essentially duplicate the clearance regime in the Commerce Act. The Ministry of Transport would be required to assess every non-rate making agreement to determine its eligibility to be registered. This option also appears to retain the weak regime in the Shipping Act in relation to international shipping, which would be administered by the Ministry of Transport. This would create uncertainty as to the interface with the Commerce Commission in investigations against price fixing.

85. Furthermore, if poorly designed there is a risk that arrangements that give rise to anti-competitive detriment are allowed or that pro-competitive arrangements are discouraged. As alluded to in paragraph 83, this would be more likely where the definitions of ratemaking and non-ratemaking were based on the form of the arrangement rather than the substance.

Option 3: Strengthen the regime in the Shipping Act

86. In the same way that adopting the Productivity Commission's recommendations could be made to work, it would also be possible to strengthen the Shipping Act. Again the objective would look to deter anti-competitive behaviour in international shipping and consequently the regime would look to distinguish between behaviour that is pro and anti-competitive. Such a regime is likely to be closely aligned with the principles underlying the Commerce Act.

87. The disadvantages of this option would largely be institutional. The Ministry of Transport would be responsible for carrying out the competition assessment rather than the Commerce Commission, and they may not have the same competition expertise. The boundaries between the industry-specific regime in the Shipping Act and the Commerce Act could also raise some

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[23] Liner Shipping Competition Policy: Non-Ratemaking Agreements Study, APEC Transport Working Group, November 2008.
[24] United States Federal Maritime Commission, 54th Annual Report for Fiscal Year 2015, page 33

complexity. For example where shipping agreements impact on non-shipping markets, such as the provision of port services, the boundaries of responsibility may not be clear.

Option 4: Apply the Commerce Act in full

88. Options 2, 4 and 5 could draw on concepts that are already well established under general competition law. As a result, our preference is not to duplicate regimes but rather to rely on and apply the Commerce Act to international shipping.

89. This option would apply for the full Commerce Act regime to international shipping. The Commerce Act seeks to distinguish between pro and anti-competitive conduct. The prohibitions in the Commerce Act focus on harm to competition. The Act also recognises that some arrangements may limit competition but result in such efficiencies that they would result in benefit to the public. The Act therefore provides a procedure for authorisation of these arrangements.

90. The amendments in the Commerce (Cartels and Other Matters) Amendment Bill have been designed to facilitate collaboration between competitors where the purpose of the collaboration is to achieve efficiencies or increase productivity. This is achieved primarily through clarifying the scope of prohibited conduct, that being hard-core cartel conduct. It does this by introducing an exemption for collaborative activity.

91. The new collaborative activity exemption is broad and focuses on the substance of the activity, not the form of the arrangement. As a result, it should apply to all pro-competitive collaborations, including those entered into by shipping lines. By this means it recognises the value of cooperation between carriers to achieve cost efficiencies but it also ensures that the benefits of any collaboration are shared with importers and exporters. Where firms come within the exemption they are not acting as a hard-core cartel. Anticompetitive conduct, such as price fixing, would be subject to the Commerce Act in the normal way.

92. The collaborative activity exemption has been designed so that businesses can assess for themselves whether their proposed collaboration falls within the exemption. However, the main concern identified by interested parties with the transitioning international shipping to the full Commerce Act regime is that it would impose additional compliance costs on carriers to assess their compliance.

93. Depending on the complexity of the collaborative activity and the amount of management time required to make an assessment, officials estimate that the cost of such an assessment is likely to range from $500 to $15,000. This self-assessment would need to occur for each agreement when it is entered or amended and, to a lesser extent, when it is given effect to (particularly if there has been a material change in market conditions since the agreement was entered into). We understand that there are approximately 30 agreements between international liner shipping companies which relate to New Zealand, and the vast majority of these are vessel-sharing agreements (refer Annex 1).

94. If a firm decides to apply for clearance, officials estimate the costs associated with applying for clearance would range from less than $50,000 to $200,000 for complex arrangements, based on estimate in relation to merger clearances. Officials estimate that routine authorisations may cost as little as $150,000; however, more complex authorisations can cost upwards of $500,000.The Commerce Commission should assess a routine clearance in less than 30 working days but may take up to 60 working days where the proposed activity raises complex issues. Authorisation generally takes longer.

95. Mechanisms that would help manage compliance costs include:

- A two year transitional period from the date of enactment of the Cartels Bill which would allow time for carriers to check their existing agreements are in order.

- Allowing shipping lines to approach the Commerce Commission for its view on whether a collaborative activity raises competition concerns. In particular, parties will be able to apply for clearance or authorisations. Extending the clearance regime so that during the two year transitional period, shipping lines will be able to test all agreements with the Commerce Commission, not just proposed agreements.
- Following clearance decisions, it is the Commerce Commission's practice to release written reasons for its decisions. Over time the body of written reasons should allow shipping lines to better understand the Commerce Commission's analytical framework and how it applies to collaborative arrangements in the industry.
- Inviting the Commerce Commission to provide guidance to interested parties on how the Commerce Act would apply to international shipping. The Commerce Commission has developed (draft) guidelines on the 'collaborative activity' exemption. An additional fact sheet could be prepared that addresses any shipping specific issues.

96. While it is difficult to forecast with much accuracy, for the purposes of the 2013 Cabinet decisions we previously estimated about 10 applications for clearance and a further 3 applications for authorisation out of the total of 30 known agreements. We consider that these costs are small relative to the private benefits from these agreements.

97. In addition, contrary to ICLC concerns, we do not believe that it would be necessary for carriers to obtain Commerce Commission clearance for every agreement. Clearance is usually reserved for those arrangements at the margin that result in some lessening of competition but it is not clear if the net impact is substantial. Also if clearance is obtained, it is possible to structure the transaction so that operational arrangements are also covered without the need to apply for a new clearance for every variation.

98. To summarise, we estimate that the costs of ensuring all existing agreements are compliant with the Commerce Act under this option are likely to be in the order of $1-4million:

    a. 30 self-assessments, costing $500 to $15,000 each ($15,000 - $450,000);

    b. 10 clearance applications, costing $50,000 to $200,000 each ($500,000 - $2,000,000); and

    c. 3 authorisation applications, costing $150,000 to $500,000 each ($450,000 - $1,500,000);

99. This cost is only an indication and does not factor in delays associated with time taken to respond to clearance and authorisation applications. However, this could largely be mitigated by the two year transitional period.

100. Most of these costs will be one-off, however, there will be some ongoing self-assessment costs required if agreements are amended and when they are given effect to.

101. The benefits of this option are not able to be easily quantified. However, the proposal would minimise the risk of detriment from anticompetitive behaviour such as has been identified in Australia with the recent criminal prosecution against a Japanese car carrier. In addition, the proposal would allow a full competition assessment focused on the substance of the activities. The additional compliance costs of $1-4million discussed above are likely to be justified given the benefits from a more robust regulatory oversight.

The extent to which the Commerce Act could deter beneficial international shipping activity

102. The Productivity Commission noted some concerns amongst its submitters that removing the exemption could discourage carriers from New Zealand and New Zealand a more onerous jurisdiction to deal with.

103. It is our view that these concerns are unlikely to eventuate for the following reasons:

- The changes being made to the Commerce Act by the Commerce (Cartels and Other Matters) Amendment Bill will make it easier for businesses to undertake efficiency-enhancing collaborative activity without risk of breaching the Commerce Act.
- New Zealand's shipping routes are typically more profitable for carriers than other routes.
- All carriers are familiar with operating in jurisdictions where competition law applies to carrier agreements.
- Total ship capacity serving New Zealand has increased since the Commerce (Cartels and Other Matters) Amendment Bill was reported back from the Commerce Committee in 2013, which may indicate that its pending enactment has not been influential on carriers' decisions.[25]

104. As previously noted, the Commerce Act, as amended by the Commerce (Cartels and Other Matters) Amendment Bill, does not prevent any international shipping activities where they enhance outcomes relative to that which would otherwise be provided. Nor are any associated compliance costs likely to prevent shipping lines from approaching the Commerce Commission for clearance or authorisation if needed.

Option 5: Repeal the broad exemption and introduce a new block exemption for international shipping in the Commerce Act

105. This option seeks to address the industry concerns with Option 4 relating to high compliance costs to assess compliance with the Commerce Act for operational agreements, like vessel sharing arrangements. The key difference between Option 5 and Option 2 is that Option 5:

- continues to repeal the industry specific regulation contained in the Shipping Act, and transition international shipping to the Commerce Act regime with oversight by the Commerce Commission. This makes clear that the Commerce Commission, rather than the Ministry of Transport, is responsible for competition enforcement in relation to international shipping; and
- seeks to target the Commerce Act block exemption to specified activities that are likely to improve efficiencies, rather than focusing on the form of the arrangements. It is effectively seeking to identify shipping specific 'collaborative activities' that would likely meet the generic exemption.

106. This Option also retains many of the benefits of Option 4 as any international shipping activities that are not covered by the block exemption will be subject to the full provisions of the Commerce Act. In relation to these activities, shipping liner companies would still be required to undertake self-assessment, and possibly apply to the Commerce Commission for clearance and/or authorisation. However, we understand that the vast majority of agreements are operational and therefore the relative compliance costs would be lower.

107. As such, the value of Option 5 is that it would be comparatively low cost for industry compared to Options 2 and 4.

- By clearly setting out what conduct is caught by the exemption, shipping lines will be able to engage in joint services without the need to make a self-assessment as to whether the agreement is a collaborative activity and not for the dominant purpose of lessening competition as set out in Option 4. For example, based on our previous estimate of number of applications for clearance and authorisations, this Option could save on

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[25] Ministry of Transport, *Transport and Trade Report*, July 2016, page 32.

compliance costs from applying for approximately 10 clearances and for carrying out self-assessments for the remaining 18 or so vessel-sharing agreements.

- Unlike Option 2, it is not proposed to require registration of agreements that fall under the exemption. This will reduce costs on both Government and industry.
- Block exemptions from competition laws for international shipping 'non-rate making agreements' are relatively common amongst New Zealand's major trading partners, and therefore should be more familiar to the industry.

108. The main disadvantages of this option are:

- While vessel-sharing arrangements can result in cost savings to carriers, if the arrangements relate to a high proportion of the market, they may reduce incentives on the parties to be responsive to customers. Carriers may not pass on any cost-savings;
- There are difficulties in defining a block exemption to only provide for pro-competitive collaborations, as it is not possible to consider all possible scenarios for collaboration and the different circumstances on each route;
- It treats international shipping differently to other sectors, which is contrary to the principles of the Commerce Act for regulatory neutrality; and
- Any different treatment makes administration of the Commerce Act more difficult as the Commerce Commission and the courts must consider the interface between the sector-specific and generic provisions. The proposed amendment to ensure the Commerce Commission is not prevented from using its mandatory information-gathering powers despite the block exemption is one means to manage these costs.

109. Of the options that provide for transitioning international shipping to the competition regime under the Commerce Act, this is our second best option. While this would be a lower cost option, and provides benefits through bringing price fixing agreements under the Commerce Act, we have placed emphasis on minimising the risk of anticompetitive conduct; as such we have not preferred this option overall. This risk could be mitigated by ensuring the block exemption is well-targeted and remains relevant over time.

4 Consultation

Consultation with government agencies

110. The options in this RIS are discussed in the Cabinet paper. The Treasury, Ministry of Foreign Affairs and Trade (MFAT), Ministry for Primary Industries, Ministry of Transport, Ministry of Justice and the Commerce Commission were consulted on the Cabinet paper. The Department of Prime Minister and Cabinet were informed.

111. **MFAT** considers that Option 5 enables the government to respond to industry concerns in a measured way. However, they encourage officials to ensure that any block exemption is well-targeted at pro-competitive conduct. In addition, if the Australian Government does proceed with a proposal for a block exemption in its competition law for international shipping, consideration should be given to opportunities for coordination at the stage at which the Australian block exemption is developed or the Commerce Act provisions are reviewed.

112. The **Commerce Commission** confirms its view that, as outlined in its submission to the Commerce Committee in its consideration of the Commerce (Cartels and Other Matters) Amendment Bill, the Commerce Act is sufficiently flexible to deal with issues in international shipping agreements. The Commerce Commission supports Option 4 to transition these industries to a competition regime that is governed by the Commerce Act 1986. While the Commission does not support Option 5, if Option 5 is to be adopted, the block exemption should be sufficiently detailed to ensure that it only exempts pro-competitive activities.

113. **Treasury** does not support the recommendations and prefers that shipping be subject to the Commerce Act on a similar basis to other sectors, as provided for under the current Cartels Bill. The recommendation to amend the Cartels Bill creates a risk that New Zealand businesses and consumers are exposed to anticompetitive outcomes through collusive activity. Treasury considers the onus should be on carriers to show that arrangements to share capacity or coordinate activity are not anticompetitive.

114. The Cartels Bill creates sufficient flexibility for shipping lines to structure collaboration arrangements to suit their needs, providing the arrangements are pro-competitive. The regime was designed so that businesses can self-assess the need to obtain clearance or authorisation, leaving considerable implementation flexibility. Treasury acknowledges that compliance costs are likely to increase and that the lack of transparency around existing arrangements makes it difficult to predict how many agreements may require clearance or authorisation. The Treasury nevertheless considers that the risk (of these costs outweighing likely benefits to New Zealanders from greater ongoing competitiveness and efficiency) is low. Officials are not aware of overseas jurisdictions experiencing declines in capacity following removal of general competition law exemptions. A transition period and the publication of guidelines by the Commerce Commission, as is standard practice in overseas jurisdictions, would provide extra reassurance.

Consultation with external stakeholders

115. The Productivity Commission had previously undertaken two rounds of consultation with a wide range of stakeholders in the freight sector on the issues addressed in this RIS.

116. The Commerce Committee called for public submissions on the proposals to transition international shipping to a Commerce Act-only regime. Ten written submissions were received in response with three opting to appear before the Committee.

117. The Committee also authorised officials to seek further views from submitters on the potential impact of the proposals. Officials had 12 subsequent meetings with individual stakeholders and informed parties.

118. In terms of stakeholder views, shipping lines favoured maintaining the exemption for international shipping for the following reasons:

- The shipping industry should be treated differently from other industries because of the large capital investments, high fixed operating costs, maintenance of regular schedules, volatile peak and off-peak demands, structural overcapacity problems on routes, and the high risk of 'rate wars' threatening viability of routes.
- There is no evidence that there is a problem with the status quo. The market for shipping services is currently competitive and all agreements operating on New Zealand routes are beneficial to New Zealand.
- The sector-specific regime outlined in the Shipping Act is satisfactory, and provides potentially very intrusive powers to the Minister to intervene if any market abuse is identified. Carriers note that no complaints have been made under this regime.
- Removing the exemption would be out of step with virtually all other Asian and Pacific Rim countries and major trading partners.

119. In subsequent meetings and correspondence with officials and the Minister of Commerce and Consumer Affairs the ICLC also outlined their concerns with the full application of the competition regime to international shipping (option 4):

- There will be significant compliance costs for the shipping industry to determine whether the agreements fall under the collaborative activities exemption, which will flow on to exporters and importers.
- Self-assessment could be considered too risky for the industry in light of the potential penalties. Shipping lines consider that they would have to apply to the Commerce Commission for clearance every time an agreement is entered into, altered, or given effect to, which would add considerable legal costs.
- The time taken for the Commerce Commission to process a clearance or an authorisation application will result in significant delays for the industry.
- Costs are likely to be ongoing as the diverse nature of liner shipping agreements makes it difficult for precedent to develop.
- There would be a long-term reduction in competition in the New Zealand international liner shipping industry.

120. However, the ICLC advised the Minister of Commerce and Consumer Affairs that it would be willing to accept the Productivity Commission recommendations (option 2) to provide that rate making agreements were subject to the Commerce Act.[26] We have not consulted publicly on Option 5 specifically, however, we anticipate that it would address the ICLC's concerns.

121. All other stakeholders were of the view that ratemaking agreements should not be automatically exempted from the Commerce Act. Export New Zealand stated that the lack of transparency around rate setting currently leads to speculation among exporters that there is a lack of competition in how rates are set.

122. However, the great majority of these stakeholders did not support a regime that imposed high compliance costs or impeded efficient operational agreements. They were concerned that regulation of these agreements could discourage operational cooperation causing the shipping

[26] Letter from ICLC dated 3 August 2015.

lines to lose economies of scale which could discourage carriers from serving New Zealand. These outcomes would reduce services and choices for shippers. This would be particularly severe for routes to the Pacific Islands where trade volumes are even smaller than New Zealand's.

123. Some stakeholders also raised concerns that removing the exemption would put New Zealand's regulatory system out-of-step with most of its trading partners.

124. However, a minority supported removing the exemption for operational agreements, as these agreements can achieve the same outcomes as ratemaking agreements. For example, if the agreements restrict capacity to achieve higher prices. Other views expressed were that there does not appear to be any reason why the shipping industry requires more latitude than other industries. The proposed collaborative activity exemption in the Commerce (Cartels and Other Matters) Amendment Bill will provide the necessary flexibility for shipping lines to enter into bona fide collaborations regarding the capacity and frequency of services.

125. If Option 5 does proceed, we intend to undertake further limited consultation on the detail of the block exemption before it is finalised.

5 Conclusions and recommendations

126. To strengthen the oversight of competition in international shipping the Ministry of Business, Innovation and Employment recommends removing the existing exemptions from the Commerce Act and repealing the alternative regime provided by the Shipping Act. This option is currently reflected in the Commerce (Cartels and Other Matters) Amendment Bill and is outlined in Option 4.

127. While the benefits are not able to be quantified, the new regime outlined in Option 4 would enable some oversight of shipping agreements in order to identify and deter anti-competitive conduct. Such conduct may include fixing prices to shippers, limiting capacity (other than in response to changes in demand), or allocating markets or customers. Also some efficiency gains of collaboration by carriers may not be shared with shippers.

128. This anti-competitive risk is exacerbated when the firms concerned are facing financial pressures caused by the global economic downturn. If this risk eventuates, the cost is borne by importers and exporters, with flow on costs to the wider New Zealand economy. Regulatory economics and international experience shows that an exemption from competition law is not required for international shipping carriers to provide an effective sea freight service.

129. Our second best option is a targeted exemption should be introduced in the Commerce Act to allow for joint liner shipping services (option 5). This option will impose lower compliance costs on carriers, while achieving many of the benefits of bringing price fixing conduct under the Commerce Act regime. However, whether or not the full benefits of this regime will be achieved, will depend on the exemption being well-targeted at pro-competitive conduct.

6 Implementation plan

130. The transition of international shipping to the Commerce Act would be effected through the Commerce (Cartels and Other Matters) Amendment Bill. It is expected that this Bill will be enacted during 2017. However, International shipping would not be transitioned to the Commerce Act immediately on enactment. Rather it is proposed that the Commerce Act apply two years from the Bill's enactment date. This would give the container lines two years to self-assess whether their agreements are likely to comply with the Act, or any new block exemption, as relevant. If unclear, carriers will be able to seek a clearance or authorisation from the Commerce Commission.

131. The Commerce Commission has issued draft guidelines explaining how it intends to interpret the new provisions in the Act. The Commerce Commission may also provide additional guidance specific to international shipping and the steps container lines can take to ensure compliance. These guidelines would illustrate the types of agreements that are likely to require a clearance, or an authorisation, as well as those agreements requiring no action other than a self-assessment.

132. The Commerce Commission has also, and will continue to, undertake publicity to ensure carriers are aware of the Commerce Act regime.

7 Monitoring, evaluation and review

133. The Commerce Commission records and reports on its clearance and authorisation activity through its quarterly reporting. This reporting would include its activity related to international shipping that has resulted from the proposals in this RIS.

134. This reporting would enable the Ministry of Business, Innovation and Employment, as part of its monitoring function, to report to the Minsters of Transport and Commerce on any issues arising during the transition period.

135. Once the proposals have been fully implemented, a qualitative assessment of the effectiveness of the Commerce Act regime for international shipping would be undertaken as part of the wider assessment planned for the initiatives in the Commerce (Cartels and Other Matters) Amendment Bill.

Annex 1: Container Trade Routes – June 2016

Service	Days between visits	Avg weekly TEU	Type
Oceania - North Asia			
CMA CGM/OOCL/PIL/CSCL -- ANL/COSCO/PDL/US Lines - ANZEX	7	4379	NZ-
NYK/Hamburg Sud/MOL/COSCO -- Alianca/Hapag-Lloyd - NZJ/CNZ	7	4064	Aus-NZ-
Swire Shipping - North Asia Loop 1 mpc	40	600	NZ-
Swire Shipping - North Asia Loop 2 mpc	36	800	NZ-
Oceania - South-east Asia			
PIL/ANL/NYK/OOCL/APL -- CMA CGM - NZS/KIXANL	7	4458	Aus-NZ- Aus-
Maersk Line -- COSCO/Hapag-Lloyd - Northern Star	7	2943	NZ-
Maersk Line -- COSCO/Hapag-Lloyd/MOL - Southern Star	7	4215	Aus-NZ-
Maersk Line -- Hapag-Lloyd - Triple Star	7	4000	NZ
MSC - Capricorn Service (Asia-Oceania)	7	3164	Aus-NZ-
PIL/ANL/NYK/OOCL/APL -- CMA CGM - NZS/KIXANL	7	4458	Aus-NZ-
Swire Shipping - East SE Asia Loop 1 mpc (Asia-Oceania)	31	730	NZ-
Swire Shipping - East SE Asia Loop 2 (Asia-Oceania)	32	800	NZ-
Oceania - Europe/North America			
Hamburg Sud/ANL/Hapag-Lloyd -- Alianca/CMA CGM/MSC/PIL/USL - PSW	7	3690	NZ-Aus- NZ-
CMA CGM -- ANL/Marfret/US Lines - RTWPAN	14	1400	Aus-NZ-
Hamburg Sud/Hapag-Lloyd -- Alianca/ANL/CMA CGM/USL - PNW/WAN	14	1309	NZ-Aus- NZ-
Hamburg Sud/Maersk Line -- Alianca/CMA CGM/Hapag/MSC/SeaLand - Oceania Service	7	3426	NZ-Aus- NZ-
Swire Shipping - West Coast North America mpc (Oceania-WCNA)	35	820	Aus-NZ-
Oceania to oceania			
ANL -- CMA CGM/Maersk Line/US Lines - TRANSANL	7	1740	
MSC - New Kiwi Service	7	1063	
Swire Shipping - Trans Tasman Service mpc	17	400	
MSC - New Kiwi Service	7	1036	
PDL -- Maersk Line/NPL/Sofrana - New Zealand/Fiji	7	842	
PDL - New Zealand/New Caledonia/Fiji/Vanuatu mpc	21	220	
PDL -- PIL/Sofrana - New Zealand/Tonga/Samoas	14	470	
PDL -- Swire Shipping - New Zealand/Tahiti	16	360	
Sofrana -- Maersk Line/PDL - New Zealand/Australia/Papua New Guinea Loop 1	36	180	
Sofrana -- Maersk Line/PDL - New Zealand/Australia/Papua New Guinea Loop 2	36	180	
Sofrana - New Zealand/Australia/Papua New Guinea Loop 3 mpc	34	125	

Column groups (marked with shaded cells in the original chart): To/from zones outside Oceania (North Asia, China/Hong Kong, Sth East Asia, Caribbean/Nth of Sth America, Central America, North America, Nth Europe); To/from Oceania – Australia (Brisbane, Newcastle, Sydney/Kembla, Melbourne, Adelaide, Fremantle); Pacific (Fiji, Tonga, New Guinea, Tahiti, New Caledonia, Samoa, Cook Islands, Other, Hawaii); New Zealand ports (Marsden Point, Auckland, Tauranga, Napier, Centreport, Nelson, Lyttelton, Timaru, Otago, Bluff).

Source: Compair

(*) the entire nominal ship TEU capacity shown may not be available due to containers pre-loaded in Australia and/or the heavy average weights of New Zealand export containers.