

COMPETITION AUTHORITY



Submission to the Department of
Communications, Marine and Natural Resources
on the findings and recommendations of
the High Level Review of Ports

Submission No. **S/03/003**

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1 INTRODUCTION

The Competition Authority welcomes the opportunity to respond to Minister Ahern's Consultation Policy Statement published on the 13th of May 2003. The Statement invites comments on the findings and recommendations of two Reports: the Report of the Task Force on the Development of Port Estates in Commercial Harbours, and the High Level Review of the State Commercial Ports operating under the Harbours Acts 1996 and 2000.

The Task Force was established by the then Minister for the Marine and Natural Resources. Its remit was to advise him on the potential for the development of port estates at commercial harbours operating under the Harbours Act, 1946 and the Harbours Acts, 1996 and 2000¹.

The High Level Review of the State Commercial Ports ("the High Level Review") was commissioned by the Department of Communications, Marine and Natural Resources. It was carried out by Raymond Burke Consulting, Posford Haskoning Consulting Engineers and Farrell Grant Sparks Corporate Finance with the following objectives:

- *"to conduct a detailed evaluation of the adequacy of the current model for the governance of the State port companies (including the advisability of appointing a regulator) taking into account a number of requirements²(...)"*; and
- *"to advise on the future role of ports in contributing to the optimum development of the transport sector in Ireland and appraise/recommend management/ownership options including enhanced private sector involvement"*.

These reviews have been taking place against the background of a draft EU Directive on Market Access for Port Services³. The draft Directive proposes a new regulatory framework to *"ensure equitable competitive conditions for all service providers, establish clear rules, and set up an open and transparent procedure for access to these services"*.

¹ Under the Harbour Acts 1996 and 2000, all the Irish commercial ports with the exception of Rosslare and Greenore are owned by the State, through the Department of Communications, Marine and Natural Resources.

²"Structures and approaches must be in place to ensure -

- that the ports are incentivised to deliver high quality port products to stakeholders, particularly users;
- that the ports have access to appropriate funding to provide for capacity requirements in the medium to long term;
- that appropriate competitive conditions exist within and between ports, which exert downward pressure on costs and charges for port shipping and other port related services;
- the avoidance of inefficient monopoly situations developing, with upward pressure on costs and charges;
- and
- that the shareholder/ management relationship is conducive to the development of a port sector which is fully supportive of the needs of our rapidly developing open economy."

³Opinion of the Commission on the European Parliament's amendments to the Council's common position regarding the proposal for a Directive on Market Access to Port Services 2001/0047(COD) COM (2003) Brussels, 15.4.2003

The Minister is particularly interested in hearing views as to what type of body should be designated as a *competent authority* under the draft Directive – for example whether this should be a Regulator or an Ombudsman. He also wishes to receive views on the possible merger of a number of regional ports. This submission will address both these issues, as well as the Reports’ findings and recommendations in relation to competition and regulation of the Ports sector.

The Authority particularly welcomes the High Level Review Report, which stresses the key role of competition in charting the way forward in relation to port development. This is in line with the views contained in the Authority’s Submission to the High Level Review, dated 12 July, 2002⁴.

2 PROMOTING COMPETITIVENESS THROUGH COMPETITION BETWEEN PORTS AND WITHIN PORTS

The reports recognise the vital importance of seaports in facilitating Ireland’s competitiveness. They stress the strategic and economic importance of ports for international trade both at present and into the future. Both reports stress that the ports’ commercial mandate allows them to maximize their contribution to the Irish economy.

2.1 The rationale for more competition

In markets, competition brings downward pressure on prices for the benefit of consumers. Competition also stimulates production efficiencies. In doing so, competition reduces waste and frees up resources for use in the production of other goods and services. Ultimately, competition benefits the economy as a whole: it provides incentives for productivity gains, innovation and supports non-inflationary growth.

More competition in the port sector will greatly benefit consumers and the Irish economy. Firstly, competition will bring transparency in the ports’ charging structure. Competition will exercise downward pressure on prices, reducing the scope for cross-subsidisation. The High Level Review suggests that transparency is needed in relation to port charges. For example it says that there is an “*apparent lack of clarity about the true mark-up and responsibility of each port’s costs*”⁵. Secondly, the Republic’s published port charges compare poorly with charges in Northern Ireland. The High Level Review Report show that charges for Dublin and Cork can be more than twice as expensive as those for Belfast. Thus, despite the fact that Dublin port is likely to have significant competitive advantage in terms of location, and access to consumers and facilities, the High Level Review Report shows that Belfast accounts for a third of the overall trade in the Republic.

⁴ S/02/002 - Submission to the High Level Review of the State Commercial Ports Operating under the Harbours Acts, 1996-2000.

⁵ Chapter 8, paragraph 8.17.3

In Ireland, geographical circumstances naturally limit the set of alternatives to shipping cargo by sea, with shipping by air being the only potential substitute and then only in instances where the value to weight ratio is favourable or if the goods have a very short shelf life. Given this situation, it is to be expected that Irish ports have a greater degree of market power than their counterparts in continental Europe, where rail and road transport can often offer viable alternatives. In this context, Irish ports probably have a greater ability to act independently from their rivals or their customers.

Port operators with a monopoly or a dominant position have an ability to engage in anti-competitive behaviour, driving out potential competitors and increasing charges for port users. Practically, this means that, in addition to the potential to engage in excessive pricing, a single port operator can be in a position to :

- raise entry barriers i.e. an operator may be able to erect hurdles and inhibit the entry of potential competitors;
- tie services i.e. an operator can extend its monopoly power from port operations to other areas of activity where competition might develop;
- impose exclusivity, i.e. an operator may require the supplier of one service to sell only to them, preventing a potential competitor from having access to the service; or
- price discriminate among clients on non-objective grounds i.e. an operator may lower prices for one or several clients on non-objective grounds to maintain its commercial advantage against its main competitors.

These issues are more likely to occur when port operators are vertically integrated i.e. when the port authority that provides access to a particular port facility also provides port services.

More competition both between and within ports will reduce the potential for the abuse of market power. Increased competition along these lines will also address three of the policy requirements set out in the terms of reference, namely:

- that ports are incentivised to deliver high quality port products to stakeholders, particularly users;
- that appropriate competitive conditions exist within and between ports, which exert downward pressure on costs and charges for port shipping and other port related services; and
- the avoidance of inefficient monopoly situations developing, with upward pressure on costs and charges.

For these reasons, the High Level Review's recommendation that competition between terminals within the port should be introduced where practical, is welcomed. The implementation of this proposal is essential to ensure the long-term competitiveness of Irish ports. It will provide them with greater incentives to increase efficiency, promote innovation and ultimately reduce prices.

2.2 The enforcement of competition law

Competition law enforcement and compliance plays a critical role in ensuring that competition works well for consumers. The need for competition law arises from the fact that firms have a strong incentive to restrict competition. Such restrictions can take different forms:

- firms can collude to fix prices, allocate markets or limit production;
- firms with a dominant position in the market can raise prices to an excessive level, foreclose markets or prevent competition emerging from entrants with innovative ideas and products;
- firms can substantially lessen competition as a result of a merger.

In relation to competition law enforcement, the High Level Review states that “*if one or several parties believe that they are aggrieved by a possible abuse of dominance, remedies can be sought through the Competition Authority*”. This assertion is not entirely accurate. Section 4 of the Competition Act, 2002, prohibits agreements that restrict or distort competition and section 5 prohibits abuse of a dominant position. While the Authority can investigate allegations that section 4 or 5, have been breached, it has no powers to impose remedies directly in relation to breaches of these sections, this being the role of the Courts. It is important to note that parties also have the option to seek direct redress via private Court action.

In the case of public transport infrastructure such as ports, which, in many circumstances have the characteristics of an essential facility, there is likely to be a stream of competition cases, absent direct regulation. Experience at the EU level has shown this to be the case. Neither the Courts nor national competition authorities will be able or willing to set and regulate access terms, tariffs etc. In these circumstances, consideration should be given to appointing a regulator.

3 THE DRAFT EU DIRECTIVE

The draft Directive on Market Access to Port Services is still in Proposal form, and it is difficult to frame comments on its effect, or how it should be implemented in Ireland – or, indeed, how its role should ‘fit’ with the Minister’s Review process. For example, it is still not clear what the final scope/coverage of the Directive will be. As a further example, the last *published* version⁶ proposed that the Directive should apply to ports with an average throughput of at least 3 million tonnes or 500,000 passenger movements in the most recent 3 years. It is, however, possible that this threshold may finally be lowered to 1.5 million tonnes or 250,000 passenger movements in the same period. In that case, the Directive would apply to Dublin, Cork, Shannon, Rosslare, Waterford and Dun Laoghaire.

The draft Directive aims to design a regulatory framework “*to ensure equitable competitive conditions for all service providers*”⁷. It also calls for authorisation of port

⁶ See Footnote 3.

⁷ See Footnote 3.

services and the allocation of scarce resources to be decided in an objective, transparent, and non-discriminatory manner. Where possible, competition within a port must be fostered. Vertically integrated port entities must ensure financial transparency through separated accounts and cost accounting separation. Finally, an independent competent authority should be designated to act as regulator.

4 – IMPLEMENTING THE DRAFT DIRECTIVE IN IRELAND

The main institutional feature of the draft Directive is the establishment of a competent authority to implement the new regulatory framework. In many cases not enough has been done to promote competition in advance the setting up of the regulator's office. Steps taken in advance to ensure that State companies have every incentive to promote competition will both benefit society and lighten the regulatory burden into the future.

4.1 Structural reform first

The High Level Review recommends that port companies move toward a landlord model: i.e. the port company should concentrate on port estate issues and independent companies should operate the terminals. As mentioned in the Authority's submission to the High Level Review⁸, this could entail the port authority:

- introducing new berths/terminals;
- dividing the existing port into terminals;
- dividing port operations within the terminal by –
 - assigning areas within the terminal to each stevedoring company; or
 - allowing stevedoring companies to control both the vessel stevedoring and yard/storage operation without any assigned areas; and
- making wider use of short term operating agreements, leases and management contracts between the port authority and service providers.

To implement this proposal successfully in light of the considerations raised in section 2.1, vertical disintegration of the port authorities is a necessary step to foster competition, and should be introduced where possible. This would enable the port authority to focus on overarching strategic issues whilst relying on competition within the port, and for the right to use space in the port, to ensure that society obtains the highest return from the activities of ports.

4.2 The creation of a competent authority

The draft Directive on Market Access to Port Services establishes a framework where the port authority, the port operators and the authority responsible for the implementation of the new regulatory framework (the “competent authority”) have a distinct mandate.

⁸ [See](#) Footnote 4.

The exercise of these responsibilities goes far beyond the role of an Ombudsman.

In the last decade, there has been a degree of regulatory proliferation. There are now independent regulators for the communications sector, the banking sector, the aviation sector, etc. However, more recently, new sectors have been added onto existing regulators rather than setting up new regulator offices, e.g. post was added to ComReg and gas to the CER. This presents a number of advantages. In particular –

- it reduces the long run costs of regulation in Ireland, costs that are inevitably higher in smaller economies;
- it curbs the incentives and opportunities for regulatory capture; and
- it allows advantage to be taken of economies of scale⁹ and scope¹⁰.

A number of issues such as capacity utilisation, future investment and development plans are currently addressed in airport regulation. These issues are also likely to be central to the forthcoming regulation of access to port services. It is, therefore, appropriate that responsibility for ports and port service regulation be assigned to the Commission for Aviation Regulation, as the Report recommends (page 177).

There may be benefits in extending the regulator's responsibilities to include dispute resolution between port authorities, port service providers and service end-users. A similar arrangement is currently in place in the communications sector.

4.3 Moving from ex-ante regulation towards ex-post regulation

The Authority is of the view that the new regulatory framework should be based on the assumption that any regulatory intervention should be determined by market conditions. When competition prevails, regulatory constraints should be rolled back and general competition law should be used to police potential abuses. Such a regulatory framework is currently being implemented in the Communications sector¹¹. If this process is successful, the Commission has expressed a desire to implement an analogous framework in all other sectors.

5 PORT MERGERS

The High Level Review makes a general finding (page 10) that “ports companies should be consolidated on a regional basis to reduce overheads, to focus on the strategic trade needs of the region and to rationalise investment plans”. It also specifically recommends the mergers of Dublin and Dun Laoghaire, Cork and Bantry, and Galway and Rossaveal (p180). However, while the Report lists a number of claimed benefits for such merged ports (pages 179/180), it does not address the potential risks that some mergers or sectoral ‘consolidations’ can pose to competition.

⁹ Economies of scale describe a situation where the average unit cost per unit of output decreases when quantities produced increases.

¹⁰ Economies of scope describe a situation where it is cheaper to produce two products together than to produce them separately.

¹¹ Further details can be obtained on http://www.comreg.ie/about_us/default.asp?S=2&NavID=134&M

The absence of this kind of analysis in the Report is a significant gap, and this needs to be addressed.

Among the potential risks are that such mergers –

- (1) can lead to the merged entity facing less competition for its services. This can give the port an incentive unilaterally to raise its prices and charges, thus hurting users of the port's facilities. This will eventually impact on consumers and raise the prices they face for goods transported through ports. This problem is likely to be worsened if the merged ports were formerly close competitors to each other.
- (2) can lead to a greater degree of collusion between ports as to the charges and prices they offer to users. Again, this will raise end-prices to consumers.
- (3) will, through a reduction in port numbers, and increases in charges levied by ports, lead to fewer goods being imported and a consequent reduction in the choice of goods available to Irish consumers.

Assessing risks of this kind in the context of a merger review is a complex exercise, and the Authority has published the methods it uses for this. These are contained in the Authority's *Notice in respect of Guidelines for Merger Analysis*¹², and comprise essentially the following steps:

- (1) Definition of the relevant market: the objective here is to determine the framework in which competition takes place both in terms of service provided and geographical market.
- (2) Analysis of the impact of the merger on market structure (in the case of ports, this analysis would take into account the fact that the port sector is characterised by high barriers to entry, as well as high customer switching costs).
- (3) Analysis of the immediate competitive effects and other potential effects. The objective of the analysis is to identify the immediate constraints on the exercise of market power by the merged party.

The Merger Review and other provisions of the Competition Act, 2002, exist precisely to address the potential risks to competition of proposed mergers, and there appears no reason to suppose that significantly different considerations apply to the ports sector than to many other sectors amenable to Merger Law. However, the fact that port mergers are specifically subject to the discretion (and indeed direction) of the Minister under the Harbours Act, 1996 and the Harbours (Amendment) Act, 2000 appears to take such mergers beyond the remit of the Competition Authority. Mergers proposed in the ports sector should be as amenable to review by the Authority as mergers in any other sector, and appropriate legislative action should be taken to bring about that situation. The Authority is willing to advise the Department further on how this might be done.

¹² Authority Decision No. N/02/004 of 16 December, 2002. A copy of the Guidelines is available on the Authority's Website, www.tca.ie, under "Authority Documents/Authority Notices"

In addition, and to avoid any legal doubt in the matter, such action would need to be accompanied by a policy direction by the Minister concerning inter-port competition. Underlying such a direction would be a concern that the organisation of seaports and the incentives facing their managements should be such that competition between them is facilitated and encouraged. This appears to be the approach adopted by the Government in recent announcements concerning the restructuring of the State Airports, and it would appear contradictory for a fundamentally different policy to be adopted for seaports.

6 - CONCLUSION

Port charges constitute a significant proportion of the transport costs of goods and passengers in and out of Ireland. Therefore, competition, both between and within ports, is of critical importance to maintain or improve Ireland's competitiveness.

The implementation of the draft Directive on Market Access to Port Services provides a unique opportunity to foster competition in the Irish ports sector. To maximise the potential benefits of the draft Directive and reduce the need for regulatory intervention, it is essential to move towards a "port landlord model". To do this successfully, structural reform should be introduced, in the form of vertical disintegration of the current port authorities.

A regulator should oversee the implementation of the Directive, when finally adopted, and should have a dual mandate: regulation where competition is ineffective, and arbitration to resolve disputes between the port authorities, port terminal operators, service providers and port users. These regulatory functions should be assigned as new functions to the (existing) Commission for Aviation Regulation, rather creating a new regulatory office created especially for seaports.

While the Report has identified a series of benefits which might be obtained from a number of port mergers, it has not addressed the issue of the potential risks to competition which these could pose. To ensure that this is done, port mergers should be brought under the remit of the Competition Authority, by legislative action if necessary.

The Authority is available, and would welcome the opportunity, for further discussion of the views expressed in this submission or any other relevant matters.