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BY FAX & BY POST

Economic Development Branch (Division A)
Economic Development and Labour Bureau
2/F, Main Wing, Central Govt Offices
Lower Albert Road, Central
Hong Kong

Dear Sirs,

Re: Public Consultation on the way forward for
Hong Kong's Competition Policy
- Written Submission

This letter presents the response of Hongkong International Terminals Limited to the Government's public discussion document "Promoting Competition Maintaining our Economic Drive". The comments made in this submission relate to our concerns about what impact implementation of a general competition law across the board would have on the operations of our South China regional container terminal facilities located in Hong Kong.

Certain industry sectors require multi-billion dollar investments in large-scale infrastructure facilities and consequently have high levels of corporate risk. Examples include the airport, MTR, KCR, road tunnels, HACTL and container ports. Naturally, the number of potential participants is small. In addition, opportunities to enter the industry may be few and far between. It would be impractical and destabilizing to have frequent changes in industry players. After entry, the substantial commitments of the entrants have to be honoured. In such circumstances, it is inevitable that Government has to monitor the industry and set parameters for investment and operations. Indeed the visionary approach taken by the Hong Kong Government up to the present has worked well because the arrangements set out for participation by the operators take into account the special characteristics of each industry. A further critical factor in the port and with several other large-infrastructure facilities is that competition is not local, but regional and international. A Competition Law limited to Hong Kong makes no sense since it would have no remit to address regional competitive challenges. It could harm local players and thereby assist their regional competitors if such a law attempted to apply local competitive criteria to their essentially regional or global competitive activity. This suggests that a co-ordinated regional, or better still, a global approach to competition policy and law would be ideal, but that seems far off.

In this light, it is hard to imagine that a Competition Law would have any meaningful impact on the entry to and operations of such industries. As the Hong Kong Government already has arrangements to oversee large infrastructure projects, it is only logical that such operations should fall outside the ambit of a Competition Authority. Any specific points thought to be appropriate could be included in the separate arrangements for operations agreed between the Government and the HK operators.

It should be noted that the Hong Kong Government's forward thinking approach in monitoring the development and operation of container terminals in Hong Kong has, from its inception in the 1970s, provided an inherently competitive arrangement. Government provides the investment parameters and private enterprise delivers a competitive and efficient service.

Hong Kong's situation compares favourably with that of Europe where extensive legislation has been required to unravel the effect of decades of state control and investment. Since Hong Kong lacks such a legacy, the case for a Competition Authority to assist in unraveling state control is less persuasive, raising reasonable taxpayer concerns that the addition of a new layer of bureaucracy, and the costs involved, may not be so clearly justified. By historically having resisted the creation of large numbers of national Government-run monopolies, Hong Kong is arguably already at a position that others strive to achieve.

Perhaps with some of the above factors in mind, Singapore and the Mainland, which have recently introduced Competition Laws, have carved out major infrastructure industries, including container terminals, from their Competition Laws. The Hong Kong Government should do likewise.

In the following paragraphs, I have outlined the context in which the Hong Kong Container Terminal Industry operates. The points made strongly support the argument that on balance a new Competition Policy body may be unnecessary. However, if such a law were to be introduced, they would also point towards the exclusion of the industry from a general competition law.

1. Hong Kong Container Terminals Operate in Regional Markets

The first step to take in addressing competition issues is to define the market for each industry. It is becoming increasingly difficult with globalization and the relationship of the Hong Kong and Mainland economies, to consider a market being confined just to the boundaries of the HKSAR. This is particularly so for large infrastructure industries like Hong Kong Port's Container Terminals because they operate in regional markets - South China for direct export and import of containerized cargoes and South East Asia for ship-to-ship transshipment movements of containers.

The total ocean vessel container throughput for Hong Kong Port in 2006 was 17 million TEUs. Of this total only 2 million TEUs (12%) related to Hong Kong based cargo most of which was re-exported Mainland cargo. The vast majority of 15 million TEUs related to South China direct import and export traffic and international vessel to vessel transshipment.

Therefore, it is misleading to consider HK Port operators' "market share" of HK Port throughput in any discussion about competition within Hong Kong. HK operators face direct competition from several lower cost Shenzhen container terminal facilities for handling direct export of Guangdong manufactured cargo and imports of cargo and reprovisioning of empty containers. In addition, HK operators have to compete against several major lower cost and Government subsidized S.E. Asia ports for handling of ship-to-ship transshipment of shipping lines' containers. Consequently, the Container Terminal operators located in Hong Kong are subject to conditions, practices and competitive forces prevailing in China, Taiwan, Korea, Singapore, Thailand and Malaysia. Within the next several years, when it is expected that the Mainland customs procedures are further rationalized, many of the Shenzhen ports will increase substantially to offer very low prices for transshipment handling.

Therefore HIT which currently handles 50% of throughput of Hong Kong Port, handles less than 20% of South China throughput and less than 10% of regional transshipments at its Hong Kong facilities.

Certain provisions of any Competition Law enacted in Hong Kong, in particular those relating to perceived market dominance may well disadvantage Hong Kong Container Terminal operators in their ongoing quest to compete with regional operators that are not subject to such law. Why tamper with and potentially damage the industry when the regional market is already highly competitive?

2. South China Container Port Capacity is expanding at a dramatic pace and is beyond the influence of the Hong Kong Government

Until the mid 1990s Mainland ports were not capable of handling large transocean container vessels. Therefore Hong Kong Port acted as the international container port for Mainland China. Transocean vessels called at Hong Kong to load export containers destined for the US and Europe and deliver imports. Containers were trucked from Guangdong factories to Hong Kong or shipped by feeder vessels from Dalian, Shanghai and Xiamen. From the late 1990s Mainland ports had modernized and were able to offer direct transocean services thereby by-passing Hong Kong Port. This development is reflected in the projected container throughput capacities of South China Ports.

Guangdong Port capacity has increased from 5 million TEUs pa in 2000 to 24 million TEUs pa in 2006 thereby overtaking Hong Kong Port in the process (Hong Kong capacity 12 million TEUs in 2000 and 19 million in 2006). The prediction for 2010, based on planned developments and synergies, is that Guangdong Port capacity will reach 45 million TEUs pa, double Hong Kong's Port expected capacity of 22.5 million TEUs pa.

3. Regional market pricing of Container Terminal Services is controlled by International Shipping Line Associations not local container terminal operators

Due to intense regional competition and further improvements in operational efficiency, the Container Handling Charge (CHC) charged by the port operators on the shipping lines, has declined substantially over the past ten years. However the Terminal Handling Charge (THC), charged by the shipping lines on the shipper or buyer, has remained unchanged during the same period. Therefore the benefit of lower charges by the Hong Kong Container Terminal operators has not been passed on to the end user due to the decision of shipping lines' international associations. This inaction by the international shipping line associations has made Hong Kong Port less competitive within its regional markets.

However, the Hong Kong Government and container terminal operators are powerless to affect the pricing policy of international shipping lines. Therefore, cost savings passed on to international shipping lines are not enjoyed by their customers, the shippers and buyers.

4. Hong Kong Container Terminal Industry Access is controlled by the Government

Hong Kong is consistently rated as the world's freest economy. Its free market and pro-enterprise approach have been providing the vital incentives and natural safeguards for competition across the various sectors.

In the case of large infrastructure industries with a few suppliers such as railways, road tunnels, electricity and container terminals, the Hong Kong Government controls the structure of the industry, development of new facilities and many aspects of ongoing operations.

The supply of container terminal industry facilities in Hong Kong is controlled by the Hong Kong Government. It alone determines the extent and delivery time of new container terminal handling capacity. It does this by undertaking regularly a comprehensive regionally focused review of the needs of the industry from every stakeholder's point of view. The latest report entitled Master Plan 2020 was published in 2005. It concluded that there was sufficient container terminal capacity in Hong Kong to service projected demand until 2014. Periodic updates are performed to fine tune projections. The results of the latest review will be published in late 2007.

Once the Government determines that new supply of container terminal capacity is required, it will plan to dispose of the rights to develop the new facilities to private enterprise. Sufficient lead time for development of new facilities prior to requirement is provided.

In the case of previous disposals, the Hong Kong Government requests expressions of interest from potential investors. If the reaction is positive, a decision to dispose of the rights by public tender is made (e.g. Container Terminals 1, 2, 3 and 7). Where the reaction is mute (e.g. Container Terminal 6, 1984, poor economy and Container Terminal 8, 1990, Gulf War I), the Government discusses the disposal of rights with the existing operators to determine the most appropriate terms for investment. This situation provides the opportunity for rationalizing new and existing terminals in order to develop more efficient operations (e.g. Container Terminals 6 and 9).

The total cost of new container terminal facilities is determined by the market. Potential investors will estimate the costs of construction, equipment and fit-out and thereafter assess the land premium which they are willing to bid in order to achieve acceptable returns. Alternatively, where the Government negotiates terms for disposal of rights with the existing operators, it will consider, amongst other issues, the expected rate of return on the new facilities as a going concern.

Assessment of future rates of return inevitably requires a review of the South China container terminal industry for direct import and export of container cargoes and South East Asia for ship-to-ship transshipment of containers.

Once an award of development rights is made, the construction and operations are closely controlled by detailed Conditions of Grant until 2047. The Hong Kong Government has the ultimate right to repossess the facility in cases of serious breach of the Conditions.

Consequently, the entry of new container terminal operators in Hong Kong is entirely within the control of the Hong Kong Government.

.../6

5. Ownership of Hong Kong and International Container Port Facilities

- Original Hong Kong Model

  In the 1970s before the accelerated development of globalization and the formation of large capacity shipping line consortia, the approach taken by the Hong Kong Government was to dispose of each ship berth separately. The major differences were that the direct cargo throughput related to Hong Kong based exports and imports (there was no Mainland cargo) and the throughput volume was less than one tenth of today's levels.

- International Model

  With the phenomenal increase in international trade over the past decade, many international container ports are now owned and run by one operator.

  Sole-operator ports are able to reap the rewards of scale and provide customers with the most efficient and economical service. This advantage allows them to compete aggressively within their region for international ship-to-ship transshipment even where direct export and import of cargo is low (e.g. Singapore's PSA).

  Conversely splitting a port between several operators' results in an inefficient use of terminal facilities especially during peak periods. Where an operator has its berths occupied, overflowing vessel handling to a separate operator with spare berths requires costly repositioning of containers and may result in delays in handling vessels. It is far more efficient to follow the Singapore model and synchronize all berth operations under one management structure. It would be reasonable to expect cost savings of at least 25%-30% from consolidating all five Hong Kong Port operators into a sole operation.

- Present Hong Kong Model

  Unfortunately, Hong Kong has a present day model which is a mix of the original Hong Kong and existing international models.

The container terminals in Hong Kong are operated by five companies, two of which, HIT and MTL, handle 80% of throughput at 12 and 7 berths respectively. The remaining three operators manage one or two berths each. The larger number of berths operated by HIT and MTL are required to service the three largest consortia of shipping lines (Grand Alliance, New World Alliance and "CKYH"). Each alliance requires between four to six contiguous berths at the weekend peak period to accommodate consortia members' vessel loading and discharge patterns. Berths are required simultaneously as containers are needed to be moved from vessel to vessel promptly. Thus, the international model of one-operator container ports would be more appropriate for Hong Kong as effective competition flourishes at the regional not the local level.

In addition, multiple berths are needed to accommodate large independent shipping lines such as China Shipping, Evergreen, Wan Hai and Maersk which individually may require two to three berths simultaneously at weekend peaks.

Consequently, Hong Kong Port with its hodgepodge of operating units has to compete regionally with modern lower cost South China Ports such Shekou, Nansha and Yantian which are all efficiently structured sole operator facilities. It is ironic that many observers believe that more Hong Kong Container Terminal operators increase Hong Kong Port's competition position.

6. Dominant Position – determining abusive behaviour

The proposed general competition law outlined in the Competition Policy Review Committee's report of mid 2006 seeks to administer several types of negative behaviour within organizations namely price fixing, bid-rigging, market allocation, sales and production quotas, joint boycotts, unfair or discriminatory standards and abuse of a dominant market position. HIT's concern relates to the latter item and in particular how abusive behaviour is defined or determined. We agree with the CPRC's finding that using dominant market position should not be an offence per se, but rather, the particular conduct must be proven:

(a) to have been carried out with the intent to distort the market; or
(b) to have the effect of distorting normal market operations.

In the case of the container terminal industry, one should acknowledge that there is nothing that the Hong Kong operators could do to distort the regional market in any material way. As noted in section 2, South China Container Port capacity is expanding at a dramatic pace and is beyond the influence of Hong Kong.

The first of HIT's concerns is that it will be extremely difficult in many cases to prove intent to distort the market without resorting to making subjective assessments of the circumstances in each case. Detailed descriptions and examples of anti-competitive behaviour and case studies would help in a limited number of cases. However, each set of circumstances is different. Indications as to how intent and effect in relation to market distortions might be assessed, may well have partial application in a limited number of cases only. Again no two cases are the same.

An example of misinterpretation of intent is where Container Terminal operators overflow container throughput between facilities. This is a common industry practice to increase the efficiency of the port in peak periods where one-operator berths happen to be fully occupied due to, for example, previous delays in ship arrival times.

However, some critics may suggest erroneously that such action shows a desire to hold on to market share in an uncompetitive way or maintain higher prices. Such arguments might sound plausible to the uninitiated. It would be easy to structure a compelling case where two competitors co-operate in delivery of any service as there would always appear to be an ulterior motive. However, all arguments should relate to the regional market which is beyond the scope of any Hong Kong legislation.

7. The Hong Kong Government's Transport Department policy of not allowing China registered trucks to work in port services is anti-competitive and makes use of Hong Kong Port too expensive for Mainland based manufacturers

There is a discrepancy between the Hong Kong Government allowing China registered barges and Mainland crew to work in port services at Hong Kong Port but not allowing China registered trucks and Mainland drivers to deliver container cargo to the same location. In addition, some 800 licences allow mainland truckers to deliver freight vehicles to the Hong Kong Airport from boundary crossings.

The restriction ensures that only Hong Kong registered trucks may provide cross boundary trucking services between mainland factories and Hong Kong Port and protects the Hong Kong trucking business from competition from Mainland China's trucking business.

The impact of this Government imposed restriction on the cost of handling a container through Hong Kong Port is dramatic. While Mainland trucks deliver a container to a Guangdong Port for HK$900, the Hong Kong trucks charge HK$2,300 to deliver a container from the same factory to Hong Kong Port. The difference in cost consists of (four times) higher wage rates, Guangdong cross boundary licence fee and higher truck operating costs. Naturally no shipper directs its export containers to Hong Kong Port based on transportation cost.

.../9

Reasons for some shippers continuing to use Hong Kong Port relate to early release of Mainland customs rebates, re-invoicing of products in Hong Kong and re-exporting, quota usage and delaying payment of Mainland import duties by holding inventories in Hong Kong. Within the next several years many of these reasons will disappear as Mainland customs and related practices are reformed. As a result the restriction on China registered trucks operating in Hong Kong will have a critical impact on Hong Kong Port's container throughput. Direct export container cargo shipped through Hong Kong Port will continue to decline causing shipping lines to redirect more vessel calls to Shenzhen Ports. Such a move would reduce the amount of transshipment containers moved in Hong Kong Port. This impediment to competition must be removed if Hong Kong is to be cost competitive regionally and retain its reputation as a leading world international container port.

8. Conclusion

Hong Kong's distinctive competitive history – in particular the absence of Government-owned enterprises in need of dismantling – suggests that the case for new, more bureaucratic, and consequently more expensive Competition Policy laws is weak. The high cost of new arrangements may far outweigh any advantages that might be gained by modification or improvement of existing arrangements.

However, if a Competition Law is to be introduced, the Hong Kong Government should take the following action:

(i) Large-scale infrastructure industries including Hong Kong's Container Terminals (HKCTs) should exempt from Competition Law in Hong Kong. The reasons for such exemptions are discussed in this letter and are summarized as follows:

   (a) HKCTs operate in a regional and international marketplace;

   (b) less than 10% of HKCTs' throughput relates to Hong Kong import and export cargo;

   (c) entry to the industry is controlled by the Hong Kong Government which will regularly advocate the tendering of new facilities;

   (d) overseas operations are able to acquire Hong Kong facilities [e.g. Port of Singapore Authority, Dubai World Ports and previously CSX (US)];

   (e) pricing of service is determined by keen regional competition for shipping lines' business in international markets;

(f) shipping lines' international associations (not the container terminal operators) determine the actual price paid by the shippers and buyers for port services;

(g) large, preferably sole, operators at each port are best suited to compete in regional and international markets;

(h) HKCTs operators will not dominate the markets as the substantial increase in South China's container terminal throughput capacity is rapidly reducing their South China cargo market share; and

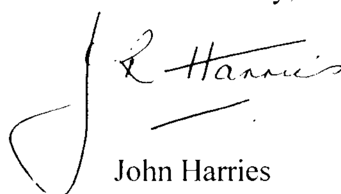
(i) there is a precedent in Singapore and the Mainland which exempts its container terminal operations from its Competition Law.

(ii) The anti-competitive practice of protecting the Hong Kong container trucking business in delivering containers between Guangdong locations and Kwai Tsing Port be removed. This could be done by issuing a temporary special permit through the Hong Kong Transport Department for Mainland registered trucks to travel directly from the Shenzhen boundary crossings to Hong Kong Port locations along pre-designated routes.

The existing restriction is having an adverse effect on volumes of Guangdong sourced containers passing through Hong Kong because it is HK$1,400 more expensive to truck a box to Hong Kong Port than a Shenzhen Port. On the other hand, the Hong Kong Government does allow mainland barges and crew to deliver and handle containers in Hong Kong Port facilities.

(iii) As part of the decision to increase the access of China registered container trucks to Hong Kong Port facilities, the Hong Kong Government should seek to have the Guangdong authorities to remove the levy from Hong Kong licensed container trucks working in the Mainland. The combination of allowing Mainland drivers to operate between the Boundary and Hong Kong Port facilities and removal of the cross boundary truck levy would open the cross boundary container truck market to all operators and allow Hong Kong Port operators to compete in the South China market on a more level playing field.

Yours faithfully,



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