JCRA

JERSEY COMPETITION REGULATORY AUTHORITY

Shipping and Port Services

Advice to the Minister for Economic Development under Article 6(4) of the Competition Regulatory Authority (Jersey) Law 2001

31 January 2007

1. SUMMARY OF RECOMMENDATIONS

The recommendations in this paper can be summarized as follows:

(i) There is overall an economic benefit in regulating Jersey Harbours' pricing. Such regulation would be 'light-handed' in line with the States' regulatory policy and only involve, in the first instance, advance price notification to the JCRA.

(ii) The most appropriate way to ensure that stevedoring services in the Port are provided efficiently is to put the contract for the provision of those services out to competition.

(iii) As a condition of the tender for the provision of stevedoring services beyond October 2007, any bidder should not have cross-shareholding links with a provider of shipping services to and from Jersey.

(iv) Serious consideration should be given to whether pilotage, towing and mooring services should be put out to competitive tender, as part of the tender process in relation to stevedoring services recommended above, or whether it is more efficient for the services to continue to be provided by Jersey Harbours.

(v) There may be a case for extending the States' Service Level Agreement (SLA) with Condor for the northern route to include pricing and service-level safeguards for freight as well as passenger and car ferry services, particularly given the Island's strong dependence on this shipping link for imports. Consistent with our advice on passenger ferries on the southern route, the Minister may also wish to consider including freight in the pricing and service level provisions of any SLA on the southern route, at least until such time as successful and sustainable entry takes place on this route.

(vi) While the JCRA does not consider there is any immediate need for regulation of the freight-forwarding sector, this should be kept under review in the light of market developments.

2. INTRODUCTION

On 20 July 2006, the Minister for Economic Development (the Minister) requested the Jersey Competition Regulatory Authority (the JCRA) to undertake a broad enquiry into shipping and port services in Jersey. The full Terms of Reference may be found in the Appendix but the terms of reference relevant to this Paper are for the JCRA to enquire into, report and make recommendations on (to quote):

- *measures that could be taken under the Competition (Jersey) Law 2005 to increase the level of competition and efficiencies; and*

- *alternative measures that could be taken to improve efficiencies in sectors that are naturally monopolistic and not amenable to action under the Competition (Jersey) Law, including measures to regulate and monitor prices.*

The JCRA was asked to look at the following sectors:

- freight forwarding and haulage
- shipping services (including passenger, car ferry and freight services)
- port infrastructure (land, berths, cranes, warehouses, etc)
- stevedoring services
- pilotage, towing and mooring

In Sections 3 to 7 of this paper, we give our advice in respect of each of these sectors in turn.

The JCRA released an Issues Paper on 4 October 2006 calling for submissions on relevant issues. In line with the Terms of Reference, it was emphasised in the Issues Paper that the perspective of the enquiry was economic efficiency:

> *… the JCRA has been asked to essentially advise on whether the current structure of the shipping and port services sectors is sufficient to ensure that these services are provided in the most efficient or least costly manner*[1].

In preparing this advice, we have taken into account the States' policy on the circumstances where regulatory intervention is appropriate:

> *When, in economic terms, should government intervene? This question is critical for analysing the possible responses to particular problems and picking the right one. The answer focuses upon market failure. This term is used to describe circumstances where the market mechanism fails to deliver economic efficiency. The fact that this failure exists does not automatically mean that government intervention is justified. It is a necessary but not sufficient condition for intervention - it is also necessary to show that adopting any new policy could be expected to bring net benefits to society and more so than other policy options or doing nothing*[2].

The threshold concept in economic regulation is 'market failure'. Market failure occurs when markets fail to deliver economic efficiency. A common form of market failure is where markets tend towards monopoly, such as in the case of a natural monopoly.[3] Another form of failure is anti-competitive conduct such as price-fixing agreements and abuse of dominance.

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[1] *Shipping and Port Services Enquiry*, Issues Paper, JCRA, 4 October 2006, p 3.

[2] *Growing Jersey's Economy: An Economic Growth Plan*, Economic Development Committee, 1 March 2005, p 6.

[3] Natural monopolies occur where, because of economies of scale deriving from large up-front investments, a single firm can supply an entire market more efficiently than two or more firms in competition with each other.

3. THE HARBOUR AND PORT INFRASTRUCTURE

The Port of St Helier (the 'Port') is a virtual monopoly in the movement of passengers, vehicles and freight by sea – only a small amount of trade occurs outside of the Port (eg, from Gorey Harbour). Many of the issues covered in this Paper are competition issues which flow directly from this virtual monopoly. It is also the case that this virtual monopoly exhibits the characteristics of a natural monopoly, which is, as noted above, a form of market failure which may justify regulatory intervention.

The States owns the land, premises and certain facilities in the Port estate. Jersey Harbours, a State-run operation, is responsible for the operation of the Port and its infrastructure. Of particular relevance to this enquiry, Jersey Harbours has responsibilities to provide:

- facilities for transferring passengers, vehicles and freight between ship and quay side (such as cranes, roll-on roll-off linkspans and mechanical gangways); and

- navigation services (including pilotage and tug services).

Jersey Harbours also manages the Island's other coastal harbours and operates three marinas for local and visiting craft. It provides a coastguard service, and is responsible for other professional maritime services, such as Jersey Radio and the ships registry.

Jersey Harbours has a number of profit centres and we understand that each, other than the provision of coastguard services, is expected to trade profitably and provide a return to its owner, the States. Current States' policy in relation to the Port is to corporatise Jersey Harbours' activities.[4] Corporatisation (or 'commercialisation') of government- run owned business activities is a key instrument of competition policy: without corporatisation, it is difficult to create the incentives to improve efficiency and reduce costs to users.

However, corporatisation is not always in itself sufficient to create these incentives: competition is often needed to make prices efficient (i.e. to reflect costs). In the absence of competitive pressures the 'second-best' option may be regulation by the competition authority as a proxy for the absent competition. Particular areas for future regulation may be the commercial leasing of Port facilities to stevedores, the level of harbour dues, and any cross-subsidisation between commercial and non-commercial services (such as coastguard activities). Another issue is the form this regulation should take (eg, efficiency audits, accounting separation, price monitoring, etc). It is worth noting that, because Jersey Harbours is a commercial business center within the States governmental structure, there are already significant regulatory costs involved.

The JCRA believes that there is overall an economic benefit in regulating Jersey Harbours' pricing. Such regulation would be 'light-handed' in line with the States'

[4] *Future Air and Sea Transport Policy*, Consultation Document, Economic Development Committee, May 2005, para 5.18

regulatory policy and only involve, in the first instance, advance price notification to the JCRA. We are happy to discuss with the Minister how this could be achieved within the current regulatory framework. In addition, if the States is concerned to ensure that Jersey Harbours is being run efficiently and that its charges are not excessive, the Minister could request the JCRA to conduct an efficiency review pursuant to Article 6(4) of the Competition Regulatory Authority (Jersey) Law 2001.

4. STEVEDORING SERVICES

Current provision of Stevedoring services in Jersey

There is currently only one stevedore operating in the Port: George Troy & Sons Limited ('Troy'). It operates under a non-exclusive stevedoring licence which also grants Troy and its workforce (around 20 dockers) access to the Port facilities.[5] In consideration, Troy pays Jersey Harbour a nominal annual licence fee. There are no terms and conditions in the licence relating to how much Troy may charge for stevedoring services.

The main shipping companies which use the Port are Condor Ferries, Huelin, Channel Seaways, Manche-iles-express as well as the bulk cargo carriers. There is a high degree of cross-ownership between Troy and the two major shipping companies which service Jersey, Condor Ferries and Huelin. The majority of Troy's business is provided to its own shareholders. The same shareholders of Troy also own the ship's agent, St Helier Port Services.

While the general stevedoring licence granted to Troy is non-exclusive, in practical effect it has been the sole provider of stevedoring services in the Port for around the past 30 years. This raises the issue of whether the current arrangement restricts competition. The cross-shareholdings referred to above also raise competition issues.

In September 2005, the States and Troy agreed to extend the licence until 1 October 2007. Jersey Harbours will need to arrange for the provision of stevedoring services when the current licence extension expires no later than 1 October 2007. The issues are (a) how to arrange for the future provision of such services in the most efficient manner and (b) how to deal with the cross-shareholdings. We deal with each issue in turn.

Future provision of stevedoring services

In a small port like that of St Helier, there may be a natural monopoly in the supply of stevedoring services. Characteristically of natural monopolies, it is more efficient for one firm to supply the services than two or more in competition with each other. However, also characteristically of natural monopolies, there is the potential to abuse the monopoly through inefficient monopoly pricing which harms consumers and businesses using the Port facilities and the Jersey economy as a whole.

[5] Troy owns some equipment such as forklifts and tugmasters.

Where competition 'in the market' is not workable, competition 'for the market' through a tender process may be an effective option for protecting consumer welfare and economic efficiency. On the other hand, a small number of bidders particularly in a small port like that of St Helier may increase the risk of bid-rigging. Indeed, there may not be competing bids at all.

Another option is for Jersey Harbours to perform the stevedoring services itself. It owns the main facilities and in operating its own equipment, such an option would avoid the 'moral hazard' of operating someone else's equipment.[6] Efficiencies from vertical integration may also be realised. However, a major difficulty with such an option is that there are no competitive constraints on the pricing of the stevedoring services.

A third option is to allow each shipping company, if it chose to for commercial reasons, to do its own stevedoring in relation to its ships ('self-handling'). Self-handling may be particularly an option in respect of ro-ro ships but currently, the JCRA understands that only Troy stevedores can be used to drive trucks and trade cars on and off a ro-ro- ship. The JCRA is not aware of any particular reason why a ship's crew could not safely perform this activity, nor truck owners and operators or any other suitably credentialed person with a driving licence.

A fourth option is to extend the status quo beyond October 2007. Some argue that the current stevedores provide good service but, on the other hand, the JCRA is aware of a number of complaints about current service levels.

The JCRA consulted publicly on these options as part of this enquiry. In its response, Harbours pointed out that it is important to bear in mind the potential impact that any future Service Level Agreements (SLAs) applying to shipping operators serving Jersey may have on the demand for stevedoring services. Harbours comments that heavily regulated shipping services would demand a different type of service to a more fluid commercial environment as there would be less need for flexibility of port services.

Harbours observed that shipping services to Jersey are changing, not only through the consideration of SLAs but also through changes in the proportion of freight carried ro-ro and lo-lo. All these factors will influence the future provision of all port services, Harbours argued. Harbours noted that the 'East of Albert' Project, which is currently being prepared by the Waterfront Enterprise Board for the Council of Ministers, will also affect how the port operates in the future.

Harbours has indicated that it is currently conducting an operational review of the Port activities which will assess the impact of the changing market place (including the findings of this enquiry) and conclude on the most appropriate option for commercial options in the Port. Harbours has recently informed the JCRA that, in general, it favours the competitive tender option.

[6] The presence of incentives for individuals to act in ways that incur costs that they do not have to bear. For example, the user of equipment that he doesn't own will not have the same incentive to care and maintain the equipment that an owner would.

Troy has argued that, despite the Troy licence being non-exclusive, no-one has offered their services in competition, nor has a shipping company sought to self-stevedore. For Troy, this confirms that there is no serious dissatisfaction with the present situation of Troy being the only company offering stevedoring services. Troy would contend that because of the small market the most effective way to maximise economies and efficiencies of scale is by having one operator. It claims that there has been no evidence of abuse of the market in the past 30 years.

In relation to a tender process, Troy claimed that competition pressure in the market comes from self- stevedoring. As the addition of a tender process contributes expense and uncertainty, Troy questioned whether any useful purpose would be served by such a process. Accordingly, Troy argue to extend the status quo beyond October 2007.

Taking into account the differing comments made during this enquiry, and other information, the JCRA has come to the conclusion that the most appropriate way to ensure that stevedoring services in the Port are provided efficiently is to put the contract for the provision of those services out to competition. In particular, the JCRA is not satisfied that the interests of efficiency would be best served by renewing the existing arrangement with Troy beyond October 2007, or by Harbours itself performing stevedoring work. The JCRA takes the view that the only way that competition can exert its disciplines on stevedoring in the natural monopolistic characteristics of stevedoring in Jersey is through a tender process and neither option allows for this. The JCRA also recommends that it be consulted on the terms and condition of that tender.

Cross-shareholding issues

As noted above, Troy is currently the sole, though not exclusive, provider of stevedoring services in the Port. As also previously mentioned, there are cross-shareholdings between Troy and the two major shipping companies, Condor Ferries and Huelin Renouf. Such cross-shareholdings create incentives for Troy to favour Condor Ferries and Huelin Renouf at the expense of independent third party shipping companies in providing stevedoring services. The issue is whether cross-shareholdings between stevedores and shipping companies should be regulated in the interests of promoting competition and efficiencies in the provision of shipping services.

Only Troy made a submission on this issue. Troy stated that the holding of shares by shipping companies in Troy has never affected rates offered to shareholder customers or other port users. It also states that other shipping companies have previously been shareholders in Troy, or have had the opportunity to become shareholders.

Troy has argued that management does not allow shipping company shareholders (or Directors representing those shareholders) access to the rates offered to other customers. Rates for stevedoring services, Troy has further argued, are driven by the cost of the operation, and there is no incentive to the management to discriminate in favour of related downstream companies to the competitive disadvantage of independent third parties. In fact, according to Troy, the reverse could be said to be true as Troy's management is currently reliant on its shareholder for over 80 per cent of the company's income.

The JCRA notes that cross-shareholdings are a form of vertical integration between two levels of economic activity (in this case, between stevedoring and shipping). There are economies to be gained from vertical integration such as reduced transaction costs, greater information flows and co-ordination, and more synchronised investment in facilities and technologies.

However, where there is vertical integration between a non-competitive activity (such as stevedoring) with potentially competitive activities (such as shipping), there are clear incentives for the sole provider to discriminate in favour of its related downstream companies to the competitive disadvantage of independent third parties. Such conduct is called 'leveraging of market power' and may be prohibited under competition law but the law does not remove the underlying incentives.

There are similar issues discussed in the JCRA's recent advice to the Minister for Economic Development on the best way to structure Jersey Telecom in the interests of promoting competition in telecommunications and thereby, the economy as a whole. In that advice, the JCRA commented:

> *The most clear-cut solution is to remove the incentive to discriminate. This can effectively be done through 'structural separation' (ie, the complete ownership and management separation of the wholesale and retail arms so that there is no commonality of interest between the two).*[7]

In relation to stevedoring, the JCRA makes the same observation: efficiency is best promoted in stevedoring by not having vertical integration or cross-shareholdings between the shipping companies and the stevedores in a market which has natural monopoly characteristics. JCRA therefore recommends that, as a condition of the tender for the provision of stevedoring services beyond October 2007, any bidder should not have cross-shareholding links with a provider of shipping services to and from Jersey.

5. PILOTAGE, TOWING AND MOORING

These services are currently provided by Jersey Harbours. We recommend that serious consideration should be given to whether these services should be put out to competitive tender, as part of the tender process in relation to stevedoring services recommended above, or whether it is more efficient for the services to continue to be provided by Jersey Harbours. If the latter is the case, we would suggest that Harbours' charges for these services be included in any efficiency review of Harbours (see section 3 above).

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[7] *Proposed Sale of Jersey Telecom – Advice on the structure of Jersey Telecom which best promotes competition in telecommunications and thereby economic growth as a whole*, JCRA, 10 January 2006, p21.

6. SHIPPING SERVICES

We deal only with freight shipping services in this section as passenger ferry issues (including car ferry services) were dealt with in the JCRA's advice to the Minister of 6 December 2006.

Over 98% of all goods imported into Jersey come via sea transport and therefore seaborne freight is of major economic significance for the Island. In our *Ferryspeed/Channel Express* decision ('the Decision'), we concluded that the transport of goods to and from Jersey by air was not a substitute for transport by sea.[8]

On the northern route to and from the UK, which accounts for the vast majority of the freight imported to and exported from Jersey, freight shipping services are provided by three main companies, namely Condor, Huelin Renouf and (to a small extent) Channel Seaways.

In the Decision, however, we distinguished between 'roll-on, roll-off' (ro-ro) services and 'lift-on, lift-off' (lo-lo) services. Ro-ro shipping services offer the transport of goods in vehicles, whereas lo-lo services offer the transport of goods in containers. We concluded that for goods requiring transport under temperature-controlled conditions, ro-ro services were the only option because of the time-sensitive nature of the transport required, and lo-lo services were not an option. Condor provides ro-ro services, whereas Huelin Renouf and Channel Seaways provide lo-lo services.

For ro-ro services, therefore, Condor may have a natural monopoly, and it appears that this has been the case for a number of years. This may be due to the high barriers to entry to the market, and the limited demand in relative terms compared with other sea routes.

If so, and to be consistent with our advice on car and passenger ferry services, there may be a case for extending the SLA for the northern route to include pricing and service-level safeguards for freight as well as passenger and car ferry services, particularly given the Island's strong dependence on this shipping link for imports.

On the southern route, although Condor is currently the only major provider of freight shipping services on this route, a small private operator, the Autumn Glory has recently started providing freight services between Jersey and Granville, whilst HD Ferries is planning to start providing freight services, in March 2007 between Jersey and St Malo. Consistent with our advice on passenger ferries on the southern route, the Minister may wish to consider including freight in the pricing and service level provisions of any SLA on the southern route, at least until such time as successful and sustainable entry takes place on this route.

[8] Decision M005/05, at para. 33.

7. FREIGHT FORWARDING AND HAULAGE

In its *Ferryspeed/Channel Express* decision[9], the JCRA found that the proposed acquisition by Ferryspeed of Channel Express would substantially lessen competition in the market for the provision of seaborne temperature-controlled freight services between Jersey and the UK. However, the JCRA found that this effect could be avoided by ensuring that the additional warehouse capacity acquired by Ferryspeed was made available to a third party competitor. Ferryspeed has made the space available to DFDS, a new entrant in Jersey. The JCRA therefore believes that there is no valid case for regulation of this market at this stage.

In the market for non temperature-controlled (or ambient) freight services between Jersey and the UK, there are at least four operators (Condor, Paul Davis, DFDS and Ferryspeed), and therefore again there appears to be no valid case for regulation: any competition issues should be adequately addressable through the Competition Law.

On the southern route to and from France, Condor appears to be the only company which currently provides a freight forwarding service, as well as the only provider of the underlying sea transport service. Nevertheless, even on the southern route, we do not believe a case for regulation exists currently, given the relatively low barriers of entry to this market (subject to adequate warehousing space being made available).

While the JCRA does not consider there is any immediate need for regulation in this sector, this should be kept under review in the light of market developments.

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[9] Decision M005/05