An Assessment of the Competition Implications Regarding Tank-Weld's Ownership and Operation of the Rio Bueno Port in Trelawny

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1. BACKGROUND

Tank-Weld Limited ("TWL") operates at various levels of the construction industry. It imports, manufactures, wholesales and retails materials used in the construction of buildings, roads, bridges, etc. It also provides related services such as civil engineering, heavy duty haulage and equipment rental.

TWL acquired property that currently houses the wharf facility at the Rio Bueno Port located in Trelawny. In September 2006, the Ministry of Finance and Planning issued a licence for the facility to be operated as a sufferance wharf. The licence allows TWL to handle cement, lumber and steel; but prohibits TWL from handling any third party cargo. This means that TWL is the licenced exclusive user of the wharf.

The anticipated gains from the facility, as indicated by TWL, include: (i) reduced traffic congestion; (ii) reduced costs associated with fuel and vehicle maintenance arising from transporting building material by the roadway from the Corporate Area to the northern and western ends of the island; and (iii) more convenient and cost-efficient product delivery in northern and western Jamaica.[1]

Arguments have been expressed by stakeholders in the local construction industry suggesting that exclusive access to the wharf is affording TWL an unfair competitive advantage. The objective of this note is to assess the merit of this argument.

2. CONCEPTUAL FRAMEWORK

The acquisition of the relevant property and the receipt of the requisite operational approval are assessed within the framework of a vertical integration. A vertical integration by way of an acquisition or merger involves a transaction between businesses which share an actual or potential supplier-customer relationship.[2] In a vertical merger one business acquires either a supplier or a customer. Businesses, such as TWL, which import bulk building materials, are customers of operators of wharves, such as Kingston Wharves Limited and Montego Freeport

[1] Information obtained from http://www.tankweld.com accessed on April 17, 2009.
[2] For a useful review of the competitive issues arising from vertical integration, see Chapter 12 of Carlton, Dennis and Jeffrey Perloff. 2005. *Modern Industrial Organization:4e*, Pearson Addison Wesley: New York.

Limited. TWL's acquisition of the port in Rio Bueno is therefore categorized as a vertical integration.

Vertical integration may result in significant efficiencies. Such efficiencies include the reduction in uncertainty over the availability and quality of supplies and the improved alignment of the various activities required to get a product or service to the final customer. In general, a vertical integration is potentially beneficial to businesses as it could reduce costs of doing business, which would result in a more efficient use of resources. Vertical integration is also potentially beneficial to consumers as it leads to more competitive prices for final consumers.[3]

Vertical integration does not lead to a loss of direct competition between the merging parties, nor does it affect the number of businesses operating at any level of the supply chain.[4] It may, however, change patterns of industry behaviour and thereby could have anti-competitive effects. The potential competition concern is that vertical mergers may lead to foreclosure of competitors thereby affecting their ability to compete.[5] This in turn may result in a negative impact on consumers, through higher prices and reduced choices.

There are two forms of foreclosure: input foreclosure and consumer foreclosure. Input foreclosure involves the situation in which a business acquires a supplier thereby cutting off supply to rival businesses or otherwise negatively affecting rivals' access to supplies.[6] For example, TWL exclusive use of the wharf may result in a foreclosure effect for the rival distributors of cement, lumber and steel which would be unable to access wharfing services from the Rio Bueno Port in Trelawny.

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[3] Vertical integration, for example, leads to more efficient pricing through the internalization of external pricing decisions or by the elimination of what economists describe as *double-marginalization*. Double marginalization is defined as the exercise of market power at successive levels in a supply chain.

[4] This stands in contrast to horizontal integration which refers to mergers and acquisition among businesses which sells competing products and therefore, would result in fewer competitors.

[5] Foreclosure refers to any instance which encourages the exit of rival businesses; discourage entry of potential competitors or any such instance where rivals' access to supplies or markets or reduced as a result of the action of the merger, thereby reducing the ability and incentive of rivals to compete.

[6] Input foreclosure incorporates the "raising rivals' costs" theory.

The degree of foreclosure and therefore the competition effect of a vertical merger depend on the market power of the integrated business.[7] The effect may be more severe where the integrated business has a substantial degree of market power at any level of the distribution chain (for example if the integrated business is the monopoly supplier at one level of the distribution chain). Where there is an absence of substantial market power, the effect of the vertical integration may be benign to competition.

Consumer foreclosure involves the situation in which a business acquires one of its customers thereby denying or limiting access by rival businesses to the customer.

3. ASSESSMENT OF TWL'S CONDUCT

This assessment focuses on the likely effect of TWL's conduct – the acquisition and operation of a private wharf; and not on the 'least restrictive alternative' use of the facility in terms of ownership and operation.

The competition concerns in this matter relate to the theory of raising rivals' costs. TWL's acquisition and operation of port facilities amounts to a business involved in international trade integrating into the wharfing services market.[8] TWL purchased property which, hitherto, was not offering wharfing facilities. It subsequently obtained the relevant approval and licences required to operate said property as a sufferance wharf. It is instructive to note, therefore, that TWL did not purchase a port facility that was providing commercial services to businesses. Accordingly, TWL's acquisition is unlikely to have any (input) foreclosure effect since the Rio Bueno Port in Trelawny was not offering wharfing services prior to the acquisition. Further, TWL's integration into wharfing facilities does not prevent rival businesses from seeking alternative facilities.

The licence requirement that Rio Bueno Port be used exclusively by TWL and for the handling of only specified products raises competition concerns, in terms of the company's incentive and

[7] Market power is defined as the ability of businesses to profitably maintain prices above competitive levels for a sustained period of time. See Carlton and Perloff (2005, 406-412) for a discussion on the role of vertical integration to eliminate, acquire, maintain or extend market power.
[8] International trade refers to the importation of products into Jamaica and or the exportation of products out of Jamaica.

ability to innovate.[9] Such a requirement may be unduly restrictive; and potentially could result in the inefficient use of the facility. Ideally, the owner and operator should have the option to appropriately respond in a timely manner to changes in market conditions.

Additionally, the licence provision requiring the exclusive use of the wharf may have anticompetitive effects if the wharf is a "bottleneck" or "essential" facility; that is, a key resource for which there is no economically feasible alternative.[10] The relevant question is therefore whether the Rio Bueno Port could be considered an essential facility in an appropriately defined market. There are currently three major public ports in Jamaica: the Kingston Container Terminal; Port of Montego Bay; and Port of Ocho Rios. The substitutability between these ports and the Rio Bueno Port will depend on (i) the services being offered; and (ii) their location. Such a determination would require substantial data and a detailed analysis of the demand pattern of the users of wharf facilities.

4. CONCLUSION

Based on the relevant economic theories and the information available to us, it is our opinion that TWL's acquisition of the facility, receipt of the relevant licences and the attendant benefits derived from operating the facility are unlikely to result in anticompetitive effects, since TWL's actions are unlikely to create or enhance input or customer foreclosure in any relevant market. TWL's integration into the port facility market does not affect access to existing wharves by other suppliers in the market; nor is it likely to affect the price of port services.

Given that the integration is unlikely to have any anticompetitive effects, we do not envision that it could therefore cause any reduction in the supply of construction materials or any increase in their prices.

[9] In addition to lower price, higher output levels and quality, innovation is one of the outcomes of the competitive process.

[10] The essential facility doctrine is invoked only in limited circumstances. Caution must be exercised; and not all investment made by businesses should be open to third party access. Making access mandatory has the serious potential to stifle or even eliminate the incentives of businesses to invest.

