

SUBMISSION

FROM

DALE COLE & ASSOCIATES PTY LTD

TO

**SENATE RURAL & REGIONAL AFFAIRS AND TRANSPORT
REFERENCES COMMITTEE**

REPORTING ON

**THE INCREASING USE OF SO-CALLED FLAG OF
CONVENIENCE SHIPPING IN AUSTRALIA**

August 2015

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1.0 Introduction

Dale Cole & Associates Pty Ltd (**DCA**) notes the e-mail requesting feedback from the Senate Rural & Regional Affairs and Transport Committee (**the committee**) was addressed to Dale Cole in his former role as Executive Chairman National Bulk Commodities Group Inc (**NBCG**). The NBCG ceased to function as a shipping industry entity on 30 June 2013.

However, DCA's on-going interest in the economics and efficiency of Australian coastal shipping and the drivers which determine how and with whom a shipper or consignee transports their commodity remains a critical issue. DCA notes that the domestic shipping freight task is approximately five per cent (5%) of the total domestic freight task. As shipping should be the most economical and efficient mode of domestic transport, DCA is critical that a greater effort is not being mounted to ensure such a meagre outcome is not substantially increased.

The authors' of this submission have over 110-years' experience in the maritime industry, which has equipped them to make a reasoned, sensible and informed contribution to the committee's inquiry.

Appendix A and B lists the curriculum vitae of the authors. It is this industry experience that has shaped their responses to the questions articulated in the committee's terms of reference.

Each question will have a section heading and some questions will be subdivided into their own sub-section.

2.0 The Effect on Australia's National Security, Fuel Security, Minimum Law Standards and our Marine Environment

2.1 The Effect on Australia's National Security

Much has been said and written about the need for an Australian flagged fleet being available to transport, troops, military supplies and personnel at a time of military conflict.

The reality is that since the Korean War allied planners have relied on ships under different flags which have been sourced through international ship brokers. This policy has enabled flexibility in the selection of vessel type when determining horses for courses. The best example of a country exploiting this flexibility was the Falkland War where British planners chartered in a number of "roll on" / "roll off" vessels from Scandinavian countries to transport tanks, artillery, supplies and personnel from United Kingdom to the Falklands.

No medium power has the budget capability to maintain on stand-by a fleet of appropriate sized and designed transport vessels to meet their military needs at short notice.

2.2 Fuel security

On the basis that no new oil fields are discovered, in 2013 Australia imported ninety-one per cent (91%)¹ of its bulk liquid fuel requirements. Such dependence can only be mitigated by either new discoveries or building significant tank farms capable of storing at least 60-days of our national consumption (similar to the current position in the USA²).

In addition, the number of productive refineries within Australia is being closed; leaving Australia totally dependent on international imports of refined fuels principally from Singapore.

Most fuel distributors in Australia have followed this template for years. These arrangements have served our national interest and allowed fuel demand to be met without interruption and at competitive prices. Clearly the international market has worked extremely efficiently and effectively for the benefit of both suppliers and consumers.

DCA does not envisage any change to the current supply chain as the major oil companies appear to have lost their appetite for significant investment in replacement refineries in what is a small market by international standards.

2.3 Minimum law standards

Australia is a member of the International Maritime Organisation (**IMO**). IMO regulates international shipping industry and once conventions, regulations and amendments are adopted by the United Nations General Assembly the Australian parliament adopts or amends our national laws and / or regulations to comply with these IMO conventions, amendments or regulations.

These arrangements are replicated by all 171 member states and three associate member states³.

The maritime community is not supportive of national legislators introducing national laws that are in conflict with IMO conventions or regulations simply because these dissenting national laws are confusing to international participants as well as being inefficient and open to abuse.

As Australia's maritime industry complies with IMO conventions and regulations so do the other 170 members and three associate members. Consequently it is difficult for Flags of Convenience (**FOC**) vessels to comply with conventions and regulations that don't apply to Australian registered vessels.

As with everything in life, there are some laws that are not followed to the letter either by the ship or shipowner. Such non-compliance can equally apply to Australian registered ships as it can to FOC vessels.

To assist member state regulatory authorities [equivalent to the Australian Maritime Safety Authority (**AMSA**)] enforce compliance IMO have set in place

¹ NRMA report 2013

² USA Strategic Petroleum Reserve. Reserve equates to 727 million barrels

³ IMO 2015

a compliance arm known as Port State inspectors whose role is to check and enforce all IMO conventions and regulations. These checks are carried out, in Australia, using risk assessment techniques.

In Australia the major charterers of FOC dry bulk ships⁴ are able to use the commercial vetting services of a commercial entity - RightShip. This entity specialises in providing charterers, shippers or buyers with back-ground checks on the status of a ship's compliance with IMO conventions and regulations.

DCA understands that over ninety per cent (90%) of the vessels vetted and approved by RightShip are FOC vessels.

3.0 The general Standard of Flag of Convenience vessels trading to, from and around Australian ports, and methods of inspections to ensure they are seaworthy and meet required standards

3.1 The general Standard of Flag of Convenience vessels trading to, from and around Australian ports

A FOC vessel trading to, from and around Australian ports has a number of inspections / surveys that are enforceable. These surveys are no different to those required of an Australian registered vessel. Summarised such surveys are:

1. Flag State compliance surveys mostly undertaken by Class⁵ on behalf of the Flag State.
2. Port State Control (**PSC**) inspections undertaken by a regulatory surveyor employed by the Maritime Safety Authority of the country visited. In Australia it is AMSA surveyors who carry out these inspections.
3. Compliance surveys to ensure a vessel is complying with its Ship Management Systems (**SMS**) and Marine Execution Plans (**MEP**). The surveyors are usually Class surveyors, but can be specialist compliance surveyors.
4. Compliance surveys to ensure a vessel is complying with its Procedure Manuals. The surveyors are usually Class surveyors, but can be specialist compliance surveyors.
5. Class surveys.
6. Cargo surveys.
7. Draft surveys.
8. Protection and Indemnity (**P&I**) surveys.
9. Managing all aspects of IMO's International Ship and Port Facility Security Code (**ISPS**) to ensure crew members comply with international security obligations.
10. Inspections by Customs and Quarantine officials.

DCA is aware that one foreign flagged vessel calling at a Papua New Guinea port underwent 17 compliance surveys during its 48-hour port-call.

⁴ Over 40% of all vessel calls at Australian ports are dry bulk ships.

⁵ Non-government organisation with over 50 known Class Societies. The major Class societies, of which there are 12, are known as IACS (International Association of Class Societies) members.

The above surveys are common to all vessels irrespective of their flag. A random check of AMSA's website for December 2014 showed 295 foreign flagged (over 90% of which are FOC vessels) vessels were found to have deficiencies, 19 were detained giving a percentage of deficiencies over detentions of 6.44%. In the same period 7 Australian flagged vessels were found to have deficiencies and 1 was detained giving a percentage of deficiencies over detentions of 14.28%.

DCA is of the opinion, as the above percentages clearly show the likelihood of FOC vessels failing a survey in Australia is statistically no greater than an Australian flagged vessel.

3.2 Methods of inspection to ensure ships are seaworthy and meet required standards

PSC surveys (inspections) are an imitative of the IMO. The protocols under which these surveys are conducted are known as the Paris MoU.

The purpose of a PSC survey is to verify the competency of the master and officers on board and the condition of the ship and its equipment comply with international conventions.

AMSA surveyors (inspectors) undertake PSC surveys on vessels that are identified as being a risk following an assessment using AMSA's risk assessment profiler.

DCA contends that FOC vessels calling at Australian ports are treated no differently to Australian registered vessels, as their design, construction, operation and manning have to comply with IMO conventions and regulations.

4.0 The employment and possible exposure to exploitation and corruption of international seafarers on Flags of Convenience Ships

4.1 The employment and possible exposure to exploitation and corruption of international seafarers on Flags of Convenience ships

Given the capacity of human nature to seek advantage wherever possible DCA has no doubt that some foreign national seafarers are exploited on FOC vessels. It is also possible for Australian seafarers to be exploited on Australian registered ships.

DCA has found no evidence that link FOC crews to greater exploitation, on a percentage basis than Australian crews on Australian registered ships.

Similarly the question of corruption is difficult to quantify. Using DCA's seagoing experience we are not convinced that Australian crews are any less or more corrupt than foreign crews sailing on FOC vessels.

4.2 Countering corruption and exploitation

For the past seven years profitability has been illusory and ship operators⁶ have been under severe financial stress.

In such commercial circumstance the temptation to look for savings is immense.

To ensure seafarers are not exploited the IMO and International Labour Organisation (**ILO**) have put in place a number risk minimisation strategies.

Such strategies include PSC inspections, ship visits by shore based International Transport Federation (**ITF**) officials with the power and resources to investigate claims / allegations of corrupt or exploitative behaviour, contact with the ship's agent or agents, contact with seafarers' welfare organisations as well as contact with any visitor who visits the ship.

In addition most crew members have mobile phones, which empower the seafarer either to contact the ship's operators, crew management company or Australian or country of origin union official or officials.

5.0 Discrepancies between legal remedies available to international seafarers in state and territory jurisdictions, opportunities for harmonisation and the quality of shore based welfare for seafarers working in Australian waters

5.1 An observation

The aim of every ship operator, shipper or consignee / receiver is to limit the time a vessel spends in port. To this end the aim is to maximised ship turn-around times to no more than 24-hours. Improvement in loading and discharge rates for container cargo, as well as wet and dry bulk cargoes has made this goal achievable in Australia.

Consequently crew members involved in the loading, discharging of cargo, taking bunkers and stores or attending to surveyors wishing to inspect the vessel⁷ have little time to partake in shore leave. In DCA's experience senior officers are so busy managing the ship in port that some senior officers do not step off the gangway during their entire swing, which could be as long as one year.

The normal practice on most foreign flagged ships, which are responsible for carrying over 99.5% of Australia's imports and exports, is to maintain sea watches whilst their ship is in port.

Manning levels on non-passenger ships have declined significantly over the past 50-years. Five decades ago the average crew employed on much smaller ships was between 27 and 33 persons. Today the average is between 18 and 20 persons.

⁶ Ship operators include owners, ship managers and charterers

⁷ Refer to Section 3.1 of this submission

Complicating the capacity to go ashore for even exercise has been the introduction of the ISPS Code. To conform to the requirements of the ISPS Code seafarers must hold valid Maritime Security Identification Cards (**MSIC**) and go through all the security checks applicable at the berth or port the ship is visiting. Such procedures are a significant disincentive for a crew member to even walk the length of the wharf.

5.2 Shore based welfare organisations for seafarers

For those seafarers fortunate enough to enjoy shore leave some find their way to shore based welfare organisations, as well as other attractions that have historically appealed to seafarers thousands of nautical miles from their familiar environment.

For welfare organisations to remain relevant they must be based in a secure area easily assessable to the modern seafarer. DCA suggests that they should provide, on request, pastoral care as well as providing an alternative relaxation environment to that available on-board a non-passenger modern liner or tramp⁸ ship.

6.0 Progress made in this area since the 1992 House of Representatives Standing Committee on Transport, Communications and Infrastructure report: *Ships of shame inquiry into ship safety*

6.1 An observation

Since the 1992 House of Representatives inquiry into *Ships of shame* there has been a significant improvement in the quality of FOC ships and the competence of their crews.

The *Ships of shame inquiry* galvanised the maritime community to lift its game – not only with FOC ships, but also ships of recognised flag states, i.e. Australia.

The Australian parliament can be justifiably proud of its role in improving safety on board all merchant vessels and ensuring the level of crew competencies meet industry and community expectations.

6.2 Why the improvement?

DCA suggests improvements in ship management and crewing can be traced to the following:

- Increased community awareness of the conditions under which seafarers are employed and better attention to maintenance by ship operators.
- Increased regulations by IMO to ensure the ideals of crew welfare and ship safety are applied.
- The introduction and support for PSC inspections, which are largely followed by all 171 IMO members.
- Oversight of PSC by Australia's elected representatives and surveyor support and training administered by AMSA.

⁸ Ship which is not on an advertised schedule

- The presence of ITF representatives whose oversight minimises the risk of ships and / or crews falling between the cracks.
- Improvement in communication which allows senior officers to easily communicate with their head offices.
- Improved awareness by Class of their role in protecting ship and crew safety.
- The insurance industry, both Hull & Machinery and P&I, have encourage operators to improve performance through premium discounts.

7.0 Any related matters

7.1 History of trading on the Australian coast

Up until 25-years ago Australian flagged vessels operated within a privileged environment. As costs escalated so did freight rates, with overseas suppliers kept out of the Australian market through a vigorous tariff protection regime.

Consequently Australian coastal shipping was protected, although a few foreign flagged and foreign crewed vessels did participate in the Australian economy through a permit system and generally in specific roles that were commercially unattractive to local operators.

Once tariffs were removed, the concept of a global economy became a reality. In addition free trade agreements were signed with some of Australia's major trading partners. Consequently the opportunity for domestic manufacturers to source raw materials from international suppliers at more competitive prices developed. This development has resulted in Australian ship operators being unable to automatically pass on cost increases, which are commonly freight rate increases, because local manufactures have an alternative source of supply usually from China but not exclusively from China.

7.2 The effect of globalisation on domestic shipping

According to the International Chamber of Shipping (ICS) there are approximately 50,000 sea-going vessels trading world-wide in 2015. These vessels are crewed by 466,000 officers and 721,000 ratings. Numerically Chinese seafarers are the most prolific, but they mainly crew Chinese ships. Crews from the Philippines make-up the second largest nationality grouping and are predominately employed on FOC vessels.

With few exceptions crews on board FOC vessels are remunerated in accordance with outcomes, known as International Transport Federation (ITF) agreements, which are geographically specific i.e. crews on FOC vessels whose ships are operating on the Australian coast receive ITF Pacific rates of pay and conditions.

As a generalisation, officers ITF wages are not dissimilar to the Australian Shipping Industry Award (SIA) Part A. However ITF rating wages are lower than SIA Part A wages for Australian ratings. ITF conditions of employment are different to SIA Part A conditions, and can be described as less onerous for FOC operators.

Whilst crew conditions on Australian flagged vessels are underpinned by SIA Part A wages and conditions the reality is Australian crew negotiate an Enterprise Bargaining Agreement (**EBA**) with their employer. The rates of pay under these conditions can be as much as twice the rates of pay embedded in a SIA Part A agreement.

It has to be remembered that an operator of an Australian registered vessel employing an EBA crew is required to employ at least 2.0 persons for each berth. By contrast FOC owners only employ one person per berth.

Consequently the wage differential between EBA wages and conditions and ITF wages and conditions is significant and add substantial cost pressures to an operator's ability to be internationally competitive. Crew costs are the biggest costs centre in an Australian registered ship's operating budget⁹.

Australian shippers and receivers do not have the capacity in a global competitive world to absorb cost increases, because of the ever present threat of international competition. Australian manufacturers are continually seeking product which is price competitive and such raw materials inevitably are sourced from overseas. This response reduces the demand for coastal shipping.

The effect of Global supply on local markets is best illustrated by the demise of Penrice Soda Products Pty Ltd (**Penrice**). This company sold Soda Ash for glass manufacturing in Newcastle NSW from its plant in Adelaide South Australia. Penrice shipped their Soda Ash on a dedicated FOC vessel¹⁰.

Following the introduction of:

- The Coastal Shipping Act¹¹, which came into force in June 2012; and
- SIA Part B in January 2012.

Penrice could no longer compete on price with suppliers from Portland Oregon. This led to the closure of Penrice as a Soda Ash supplier in June 2013.

A significant factor in the closure of this business was the increase in freight rates associated with changes to the coastal shipping act and the introduction of the SIA Part B remuneration arrangements.

7.3 Can the decline in Australian flagged shipping be reversed?

It is often forgotten senior management have a fiduciary responsibility to manage their business in the most cost efficient manner possible. Therefore if a competing product becomes available on the market of the same standard, availability, but more cost competitive, then management has the

⁹ See submission by National Bulk Commodities Group's to this Senate committee November 2012

¹⁰ Australian management and international crews

¹¹ *Coastal Trading (Revitalising Australian Shipping) Act 2012*

responsibility to seek this option. A manager's responsibility is to look after the best interests of his / her owners (shareholders).

Developed economies with shipping traditions have explored the possibility of second registries – in Australia's case the Australian International Shipping Registry (**AISR**). In an excellent article on second registers¹² Rodney Carlisle notes in the last paragraph: *"The analysis presented here suggests that the second registers did not entirely halt the problem of flagging out or the decline of the merchant fleets of the traditional maritime nations. The second registries were attempts to affect the changed dynamics in international shipping that only partly succeeded. The fact that several of them also evolved in the direction of open registries, accepting ships owned in a variety of nations, suggests the underlying dynamics of the internationalization of the business are difficult to resist."*

The above paragraph provides reasons why Australia's AISR has not attracted one owner / operator to take advantage of the tax, depreciation and crewing benefits on offer.

Over the past 30-years there have been numerous attempts to transform Australian coastal shipping into a dynamic cost efficient and competitive business. Regrettably most of these reviews did not achieve their objective. Although Australian flagged shipping is now at one minute to midnight in terms of relevance, survival is dependent on acceptance by all interested parties that change is mandatory. In DCA's opinion it would be helpful the Federal Government would chair a symposium (much like the tax summit) with the participants asked to leave their commercial and industrial self-interest at the door and focus on industry survival. It would be difficult, but not impossible. DCA has modelled several scenarios in the dry bulk sector and cost savings are possible if there is the will.

DCA offers the following suggestions to arrest and possibly reverse the decline in the number of Australian registered vessels trading domestically:

- Currently there are three maritime unions servicing a declining industry. These unions should be merged into one, thus eliminating the inter-union rivalry that has plagued the industry for decades. **Comment:** an Australian harbour tug crew of three are currently represented by three unions. A crew of 20 on board an Australian flagged dry bulk carrier are also represented by three unions. Such arrangements lead to significant and costly inefficiencies.
- A need to reduce the operating cost differential between FOC vessels and Australian flagged vessels. In DCA's view this can be achieved through reducing crew numbers, reviewing current conditions and changing the employee / employer culture. **Comment:** Australia could look to Norway for a model worthy of emulation.
- The current arrangements, without Federal, State or Territory Government support will see the end of the Australia's shipping industry with the

¹² Second registers maritime nations respond to Flags of Convenience

exception of a couple of niche players. **Comment:** DCA accepts that young Australians looking for a career at sea have the option of undergoing training on overseas ships usually FOC ships. This option has been open for at least two decades and many young seafarers have taken advantage of this opportunity. Australia needs qualified seafarers to fill a number of roles in the regulatory environment, academic postings, insurance and repair and survey sectors as well as ship management. Should a consensus develop that changes to the industry are too difficult, Government / industry may wish to engage with well-known and respected ship operators who are keen to train young Australians with the pay-off that some will find their way back home and contribute.

- There is sufficient evidence to suggest that young Australians do not see a seafaring career as an attractive option when considering their future employment options. DCA argues that engagement with South Pacific countries would fill this void as nationals from Australia's near neighbours have a long history for seamanship and an affinity with the marine environment.
- Assuming there are no changes to the current Australian shipping regime; DCA argues that for investment and sustainability reasons an operator wishing to place a FOC vessel on the Australian coast to carry domestic cargoes, should be granted a five (5) year trading license. This license will not only provide a ship operator with certainty, but will go some way to increasing the current 5% of domestic trade the maritime industry now accounts for. It must be in the national interest for shipping to increase this burden as rail and road are logistically inefficient.