



THE CHINA NAVIGATION CO. LTD.

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BY FAX/EMAIL/POST

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Dear Sir,

This letter provides The China Navigation Co Ltd's (CNC Co) response to the Issues Paper, "PNG Shipping Industry", commissioned by the PNG Government as part of its 2006 Budget Strategy.

CNC Co is the deep-sea shipping division of the Swire Group, to which received numerous and often erroneous references were made in the Issues Paper. We welcome the opportunity to address what we consider to be misguided comments concerning the broader Swire Group's marine activities, which we consider to have supported PNG's economic development for many decades.

The Objectives of the Issues Paper

The objectives of the Issues Paper were clearly stated to be i) identification of impediments to the operational efficiency and competitiveness of PNG coastal shipping and ii) to seek suggestions for improvement without sacrificing safety and the interests of PNG's coastal communities. A laudable intent. Confusion arises when the Paper strays into seeking comments on International Freight Rates and International Conference Agreements. Neither would appear to have relevance when reviewing the PNG coastal shipping industry.

Whilst appearing to be outside the remit of the Issues Paper, we will seek to address the implied concerns in this response.

CNCo's PNG Marine Activities

The Issues Paper contains some factual errors concerning the Swire Group's activities, which this response seeks to correct.

CNCo first commenced trading from Asia to PNG in 1939 and in 1952 it established the New Guinea Australia Line (NGAL) linking Australia with PNG. These trades were the forerunners of New Guinea Pacific Line (NGPL) and Chief Container Service (CCS), which continue to serve PNG from Asia and Australia respectively.

Both NGPL and CCS have had a variety of partners over the years but during periods of poor economic returns, consolidations took effect and both trades are now effectively 100%-owned interests of CNCo. 20% of CCS is owned by NGAL, a PNG-registered and tax-paying company, which is in turn owned 100% by CNCo. Both trades provide extensive coverage of PNG outports – CCS had provided this coverage long before ANL's entry in 2001 as erroneously stated in the Issues Paper.

CNCo acquired The Bank Line in 2003 when its previous owners decided to exit from liner shipping due to poor returns. It is likely that this direct link to Europe would have terminated if CNCo had not acquired the service.

In early 2005 CNCo commenced a direct service from PNG to the US west coast; Indotrans Asia. The Issues Paper states there is no direct shipping link between PNG and North America.

CNCo or the Swire Group has no direct equity involvement in any PNG coastal operations. The Issues Paper makes a mistaken reference to one of the coastal sectors; "Non-liner commercial companies" being "associated with the Swire Group". This is incorrect.

Appendix D states that NGPL and AAL operate a joint service ex Singapore and Jakarta to PNG – this is no longer correct. NGPL operates this service on a fully independent basis.

International Freight Rates

It is important to note that there are zero barriers to entry for international shipping operators calling PNG and the level of rates and services are dictated purely by market forces. The economic performance of dedicated international shipping services to PNG has reflected the vagaries of the PNG economy and the broader influences of the international shipping market cycles, which dictate charter rates for vessels employed on PNG trades.

CNCo has invested in tonnage designed specifically to serve the draught and size constraints of PNG ports. These design features would have limited or no value if the vessels were deployed on other trades and represents a considerable financial commitment to serving PNG. The economic returns for these vessels employed purely

on PNG trades do not justify re-investment. The maintenance of service levels to PNG has only been possible by diversifying the services to reduce dependence upon PNG and introduce Trans-Tasman legs for CCS and Australia/Asia services for NGPL. In recent years the pure PNG legs of these services have made audited losses. International Freight Rates are highly competitive with a steady turnover of carriers over the years – this has produced pricing volatility, which cargo shippers have successfully exploited but has led to significant swings in capacity serving PNG as operators have withdrawn due to poor results. The steady churn of operators serving PNG should be borne in mind when considering the merits of opening the coast to international operators. Some might see the creaming of coastal cargoes as a support for their international operations but the longevity of such operators must be open to question and their withdrawal could lead to reduced capacity for coastal movements and an introduction of pricing volatility (if coastal freight rates are deregulated), which international cargo shippers have criticized in the Issues Paper.

International Conference Agreements

The Issues Paper concluded that International Conference Agreements are anti-competitive in nature, based on concerns over pricing collusion. The fiercely competitive pricing environment and poor economic returns, which has led to the high turnover of international carriers, belies this conclusion for International trades serving PNG.

The PNG trade has relatively low volumes and carriers have co-operated on slot or space exchanges to provide service levels that could not be justified on a standalone basis. Slot or space purchases have also facilitated new entrants that could not otherwise justify the commitment of dedicated tonnage.

The paper makes pointed and direct reference to the slot charter arrangement between PFL and CCS – but makes no reference to slot arrangements between ANL and Sofrana, AAL and PAS, and between NPL and AAL. A more balanced commentary would have been appreciated.

International Conference Agreements are seen to have little or no impact on the International trades calling PNG and certainly have no bearing on PNG coastal shipping.

Concentration of Market Power

John Swire & Sons, the parent company of CNCo also holds an approximate 72% shareholding in Steamships Trading Co Ltd. Steamships originally provided ship agency services for CNCo vessels calling PNG and the association and investment has grown over many years.

Steamships is a publicly listed company and commercial relations with CNCo's shipping trades are conducted on an arms-length basis. Steamships has divested its retailing and automotive interests and generates a relatively small volume of cargo for

the CNCo shipping trades. There is no cross-subsidisation of freight rates for Steamships by charging higher rates for third party cargoes – rather the issue has been to assure minority interests in Steamships that the “tied cargo” of Steamships is not charged above market rates.

Steamships has a 100% shareholding in Laurabada Shipping and a 33% shareholding in Consort Express Lines. The management of Laurabada Shipping is totally autonomous from that of the CNCo shipping trades and the interests of Laurabada are aligned to those of Steamships (again taking full account of minority interests in a publicly listed company), not CNCo.

Steamships does not have a controlling interest in Consort Express Lines, nor by extension does CNCo or Swire. Consort operates as an independent entity as evidenced by the vigorous competition with CCS on the Australia- PNG trade.

Steamships acts as agents for CNCo’s trades and provides stevedoring services again at rates negotiated at an arms-length basis to protect the interests of the minority shareholders in Steamships.

The development of CNCo’s international trades calling PNG reflect long historic trading connections with PNG that have been supplemented by organic growth (Indotrans Asia) and acquisition (The Bank Line) to better serve its customers that often have multiple geographic sources for their imports or markets for their exports. The development of these services was based purely on an assessment of market conditions and any other operator could, can and does enter these trades. The longevity of CNCo’s presence in these trades provides some security for shippers but they are free to switch their cargo support to competitors as they wish. There are no arrangements which tie shippers support of CNCo’s international services with the domestic services of Steamships and its associates.

PNG Coastal Shipping

CNCo will not directly comment on PNG’s coastal shipping arrangements in deference to the minority interests of Steamships and its partners in Consort, who will respond directly. Suffice to say that if the Government determined to relax the cabotage restrictions on PNG coastal shipping then the extensive and well-established CNCo International services would be well positioned to secure coastal cargo volumes between PNG main ports. It is unlikely that CNCo’s trades would extensively revamp their schedules to accommodate coastal cargoes – the carriage would be selective and confined to its existing range of ports. Based on experience in other trades, one could anticipate coastal cargoes being accepted on a space-available basis unless margins were sufficiently high (considered unlikely) to displace international cargoes when capacity became constrained (noting that the International and Coastal seasonal peaks tend to coincide).

Commitment to PNG

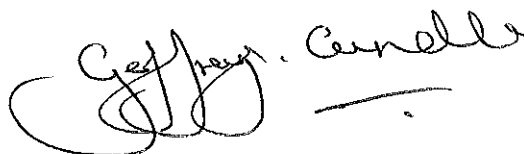
The tone of the Issues Paper came as a considerable disappointment to the Swire Group, which has been a steady investor in the PNG economy since its ships first called in PNG more than 50 years ago. Through its association with Steamships, Swire indirectly employs approximately 2500 Papua New Guineans and has supported the continual training and development of its staff.

CNCo employs Papuan New Guinean seamen on CCS, had its own training school for seamen, supports the PNG Maritime College and provides valuable overseas experience for PNG officers and crew.

A recent example of CNCo's commitment to the economic development of PNG was the re-opening of Kieta to international shipping. NGAL (the PNG-based, CNCo subsidiary) played a leading role in surveying and clearing underwater obstacles at Kieta port thus allowing The Bank Line to provide a direct call for copra exporters. Similarly NGAL has assisted Gamadoudu Mill with direct calls by CCS to load timber exports.

CNCo and the Swire Group has a long and proud association with PNG and its maritime industry - I take the liberty of forwarding a recently published book that Swire funded to honour this long history. I hope this response can address concerns that the Swire "entrenched position" (as described in the Issues Paper) has any negative connotations for PNG - but rather goes some way to reflecting the commitment that we have made to serving PNG and its economic development.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'G.L. Cundle', with a horizontal line underneath.

G.L. Cundle
Managing Director

Cc : Mr W.L. Rothery, JS&S Pty
Mr G.W. Harvey, JS&S Pty
Mr D. Reid, JS&S Pty
Mr D. Young, Steamships Shipping & Transport