

Unclassified

DAF/COMP/WP2/M(2015)1/ANN2/FINAL

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

25-Nov-2015

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Working Party No. 2 on Competition and Regulation

SUMMARY OF DISCUSSION OF THE ROUNDTABLE ON COMPETITION ISSUES IN LINER SHIPPING

19 June 2015

This document prepared by the OECD Secretariat is a detailed summary of the discussion held during Item IV of the 59th meeting of Working Party No. 2 on 19 June 2015.

More document related to this discussion can be found at: <http://www.oecd.org/daf/competition/competition-issues-in-liner-shipping.htm>

Please contact Ms. Cristiana Vitale if you have any questions regarding this document [E-mail: cristiana.vitale@oecd.org].

JT03386974

Complete document available on OLIS in its original format

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

DAF/COMP/WP2/M(2015)1/ANN2/FINAL
Unclassified

English - Or. English

COMPETITION ISSUES IN LINER SHIPPING*

Summary of Discussion

1. **The Chairman** began the roundtable by pointing out the peculiarity of the regulatory history of the liner shipping sector, which has been governed by agreements among competitors for a very long time. For instance, in the US, the first statutory antitrust exemption allowing agreements in liner shipping date back to 1916. Since then, exemptions from the antitrust laws for ocean shipping carriers to engage in rate discussion and price fixing (under the so called “conference” agreements) were granted in several countries.
2. The economic rationale for the exemptions to these conference agreements is mainly based on the fixed-cost nature of providing scheduled services. The costs were considered to be fixed because once a schedule had been defined on a given route, the cost for a service connecting port A and port B was no longer variable. As a result, the industry was said to be prone to inefficient competition with aggressive price-cutting and loss making, jeopardising profitability and service regularity. Given the high value attributed by shippers to service regularity, maritime conferences were perceived as avoiding destructive price wars which could endanger sustainability and service regularity. The argument was thought to have a sound economic underpinning and these exemptions continued for many years without being questioned.
3. However, recently, these exemptions were called into question. Some experts argued that many markets characterised by very similar cost conditions could operate profitably without similar “cartel like” agreements between competitors. Against this however, it was often argued that liner shipping could be distinguished conceptually from sectors which *prima facie* exhibited the same cost conditions (e.g. aviation), as shipping capacity was essentially a pure commodity product and hence competition took place only via prices with no quality dimension or product differentiation. The proponents of conferences argued that this meant that the original argument was still valid.
4. The current situation seemed to reflect these conflicting arguments in that although pure price fixing had by now been considered illegal in some jurisdictions, many alternative arrangements were in place, namely consortia agreements and strategic alliances. This roundtable was therefore particularly devoted to pricing mechanisms and alternative agreements.
5. The roundtable began with a presentation by Ana Rodrigues, from the OECD Secretariat, on some of the key structural features of the supply side of the industry, based on the Background Note for the Roundtable that she had prepared together with a number of co-authors. This presentation was to precede the discussion on behavioural strategies.
6. **Ana Rodrigues** thanked the Chairman and explained that liner-shipping services were defined as services provided by carriers to shippers through the operation of container vessels on a regular schedule between ports. Containerisation occurred in the 1950s and changed the industry profoundly so that nowadays container vessels transported the majority of global cargo.

* <http://www.oecd.org/daf/competition/competition-issues-in-liner-shipping.htm>.

7. In the liner shipping sector, while there are several carriers, liner shipping services are nonetheless very concentrated on the hands of a few top carriers. The top five carriers in the market - Maersk, MSC (Mediterranean Shipping Company), the CMA-CGM Group, Hapag-Lloyd and Evergreen line - account for about half of the market capacity, with the remainder being dispersed among many smaller players. The fleet of larger carriers and smaller carriers differs significantly, with larger carriers typically operating larger sized vessels than those operated by smaller carriers.

8. In what concerns costs features, the industry is characterised by high fixed costs and economies of scale in vessel size. Economies of scale in vessel size drove one of the most important trends in the industry – a trend towards increasing vessel size. On the main routes, the large vessels of the larger players competed with each other whereas on other routes, competition took place between larger and smaller vessels. Between 2000 and 2014, the industry experienced a trend towards cost consolidation and increasing concentration, such that the capacity share of the top 5, top 10, top 15 and top 20 carriers in the industry has been increasing.

9. **The Chairman** thanked Ana Rodrigues for the initial industry description and recent trends. He then explained that the roundtable would be organised in two parts: the first on **maritime conferences** and the second on **strategic alliances and consortia, including vertical alliances**, e.g. between carriers and infrastructure providers such as container terminals.

10. The **Chairman** wished to begin with **Australia**, where between the late 1990s and 2012 a number of government-led studies were carried out in the context of regular industry reviews, to analyse the need for continued antitrust exemptions in the liner shipping industry. In 1999, the so-called Productivity Commission of the Australian government suggested to maintain the antitrust exemptions, as their elimination was perceived as likely leading to consolidation in the industry, market power and higher prices. Market outcomes seemed satisfactory, with cooperation offering better services. However, in 2005 in a new study, the Productivity Commission proposed to eliminate the exemptions. The Chairman was interested to hear what brought about the change in policy.

11. **The delegate from Australia** explained that the Productivity Commission in its 2005 review found that there were a number of fundamental changes in the market, leading to a change of assessment relative to 1999. Firstly, other jurisdictions, including the US and the EU, had narrowed the scope of their immunities without any adverse consequences. Secondly, agreements covering operators with high market shares had emerged on many of Australia's trade routes. Thirdly, in the early 2000s, tighter international market conditions highlighted the negative price effects of collaborative price setting agreements and Australian shippers were becoming critical of the antitrust exemptions.

12. **The Chairman** wished to address Japan. Japan was still maintaining the conference system and the Japan Fair Trade Commission (JFTC) participated in the process of rate determination to ensure that the rates were not unduly set against the interests of users. Given the general conceptual difficulty in defining “fair” prices, the Chairman wished to know which standards were used to analyse whether rates were indeed “fair” and whether the delegate from Japan believed that the system was effective in disciplining prices for liner shipping services.

13. **The delegate from Japan** thanked the Chairman, clarifying that International ocean shipping agreements were exempted from the Antimonopoly Act of Japan as long as they were notified beforehand to the relevant minister. If the JFTC deemed that these rates unduly impaired the interests of users, it could demand the responsible minister to mandate carriers to alter the contents of the agreements or prohibit acts based on the agreement. JFTC does not, however, take a part on the rate determination process that is done before the agreement is notified.

14. The JFTC thought that the arguments generally brought forward in favour of conferences, namely rate stability, did not seem to hold anymore and the system seemed to go against shippers' interests. However, in 2010 the relevant ministry effectively overruled the JFTC regarding the abolition of the system of exemptions, arguing that Japan's major partners had exemption systems and the abolition in EU would lead to fluctuations in freight rates. It was decided to review the situation again in 2015 and see if the JFTC was still in favour of abolishing the old system of exemptions.

15. In 2014, the JFTC investigated an automobile shipping services cartel case. Given the findings, such as the fact that the tariffs stipulated in the exempted agreements were rarely or never applied to actual transactions, the JFTC considered that these agreements might not comply with the requirements for exemption from Antimonopoly Act. Accordingly, the JFTC requested the ministry to take the necessary measures on the exempted agreements in ocean shipping services for automobiles, including their abolition. Given the above facts, the JFTC concluded that the system of notification was not necessarily functioning effectively in disciplining the prices of liner shipping services.

16. **The Chairman** thanked the delegate from Japan and wanted to ask the delegate from the US how the Federal Maritime Commission assessed whether rates in liner shipping were unreasonable and what standard was applied.

17. **The delegate from the US** thanked the Chairman. He explained that the Federal Maritime Commission was part of a two-part system. The Federal Maritime Commission only evaluated rates in conjunction with a given agreement. Agreements had to be filed in order to have a chance to receive antitrust immunity. If the agreement was filed and had gone through the necessary steps, it would receive antitrust immunity. Examples of relevant factors for deciding whether rates are reasonable are the costs of the service and the barriers to entry. However, it is generally very difficult to determine competitive rates.

18. **The Chairman** thanked the delegate. The Chairman turned to Chinese Taipei, where shipping administration authorities are required to consult with the competition authority, the FTC, for freight trades or fares set by "standing international organisations" or "non standing alliances". He wished to know how many requests regarding these issues the FTC had received and whether it had developed a practice in assessing the rates.

19. **The delegate from Chinese Taipei** explained by way of background that such consultations had only recently been introduced – as a result of the amendment of the Shipping Act in 2013. Maritime board operators or shipping companies that wanted to join or set up international joint service organisations needed to obtain approval of the shipping authority, which in turn consulted with the FTC. However, since 2013, no shipping company had applied for the approval of setting up an international joint service organisation. It was important that an agreement was beneficial to the economy as a whole and of interest to the public at large. Market shares, the flexibility of the freight rates, efficiencies and the specifics of the cooperation were also taken into consideration. It was also important that the agreement would not impose undue restrictions. For example, carriers forming an agreement could not refuse other qualified shipping companies from joining the agreement, i.e. they could not create market power through the agreement and then abuse it. In general, the FTC would review shipping regulation and policies, market structure and the competitive situation regularly as well as social and economic changes in order to promote competition.

20. **The Chairman** wished to know from the European Union whether the elimination of the block exemption regulation for liner shipping had led to what could be considered excessive rate fluctuation.

21. **The delegate from the EU** began with defining the terms “conferences” and “consortia” as these are in his view, not necessarily clearly defined. Essentially, “conferences”, according to the definition used in the EU, are binding price agreements. Where the agreement was not binding it was usually called a “discussion agreement”. A “consortium” or an “alliance” or “vessel sharing agreement” (“VSA”) are an operational type of cooperation, i.e. cooperation on ships or on joint services – but not on price.

22. The EU then identified the three most important economic factors determining competitive conditions in this sector. Firstly, the sector exhibited significant returns to scale – each carrier believed it could gain a cost advantage by ordering bigger ships as these had generally lower unit costs if the capacity was utilised. Consequently, new orders of larger vessels added to the total supply in the market. Therefore, the individual carrier achieved a cost advantage but this was not beneficial for suppliers as a whole. Secondly, the sector should be perceived as an oligopolistic market, in the sense that there were typically only a few effective suppliers in a trade. Even though the number of carriers could *per se* be large, there were some large carriers and a few very large alliances, which essentially set capacity. For example, on the Asia-Europe trade half of the capacity is operated by only five carriers. Thirdly, in some situations buyer power is strong (e.g. large companies like Sony and Adidas managed to negotiate very different terms from the rest of the shippers).

23. The delegate explained that until 1986 the EU antitrust law did not cover the liner shipping sector, although the EU Competition law had existed since 1962. From 1986 onwards, the sector was in principle covered, but conferences were then immediately de facto exempted. In 2008, the EU abolished its block exemption for liner conferences. In 1986 it was believed that liner conferences provided a stabilizing effect and fostered the provision of reliable and efficient services. However, these effects were in fact never achieved. There is ample evidence that there were massive fluctuations in prices over time during the conference regime. Typically, a conference announced a very large price increase and over the following weeks the price would rise to the new set level but thereafter the carriers would start lowering prices individually and so renege on the agreement until the prices had eroded again down to the initial level. Conferences could therefore not protect against price fluctuations. This was evidenced, for example, in a 2002 OECD report and several EU studies based on this report. Between 1986 and before 2008, the fluctuations could also not be explained by massive demand shocks.

24. Moreover, evidence showed that customers preferred a situation without conferences regardless of the prospect of higher price stability, because they believed it would lead to a lower price level. This was in fact the case as evidenced by the data post-crisis, i.e. of the last five years. Also, the quality of service, i.e. the reliability and punctuality of the service, the customer service, the frequency of the trade and the product innovation, was not more favourable in the conference regime.

25. **The Chairman** then addressed the submission from Costa Rica. Like in Japan and in many other jurisdictions, the competition authority thought that fixing rates by maritime conferences did not serve consumer objectives. Maritime conferences were allowed since 1974 despite the fact that in 1995 Costa Rica enacted a competition law. The Chairman wanted to know how the competition authority reached these conclusions and what had happened after this.

26. **The delegate from Costa Rica** answered that exporters had brought this matter to the attention of the competition authority. The competition authority then clearly expressed its disagreement with maritime conferences. However, maritime conferences were an aspect of maritime law and stood above competition law.

27. **The Chairman** addressed the delegate from Spain. In Spain, there were a number of cases where the Competition Authority intervened to block price agreements in national cabotage services. The Chairman was interested in knowing what were the effects on quantities and prices and what initiated proceedings.

28. **The delegate from Spain** elaborated that the internal cabotage services related mostly to passenger services and sometimes cargo and vehicle transportation. These cases were legally complex, with no evaluation of price or quantity changes but evidence of successful cartel activity suggested that prices had been higher than otherwise would have been. There was one case where it was a public authority that requested the competition authority to initiate the investigation. Some of these services were closely monitored because of public service obligations. This explained why public authorities were very interested in the evolution of prices. In another case, where a public authority had brought forward a complaint, the competition authority could ex officio initiate another case because of the information it had received in the first case.

29. **The Chairman** now wished to address Russia. In its submission, Russia had referred to a case of a price agreement, which had been initiated by the competition authority together with the Ministry of Internal Affairs in 2013. The case was brought against 14 Russian companies, which were agents of the largest shipping companies on the South Asia-Far Eastern-North Europe route. Did this mean that there were no exemptions in Russia for rate fixing by conferences or had this been a different type of cartel? Also, why was this case initiated together with the ministry of internal affairs?

30. **The delegate from Russia** clarified that the competition authority, together with the Ministry of Internal Affairs, conducted dawn raids at these companies to collect information but that only the competition authority initiated a case, as only the competition authority had the power to do so. The consideration of the case had been suspended because the competition authority had to investigate the market in detail. This examination was expected to be completed in the middle of 2015 and the case potentially be resumed. Liner shipping is a very important sector in the Russian economy and the Russian antimonopoly legislation prohibited all forms of price setting agreements.

31. **The Chairman** referred to the USA. In the US, price fixing by conferences still benefited from an antitrust exemption but following the Ocean Shipping Reform Act of 1998 (OSRA), individual members of a conference were now able to freely negotiate prices confidentially with shippers and the conference group was prohibited from any retaliation. As such, while a conference agreement could exist, deterrence was prohibited upon deviating behaviour. This system was said to be working well – it efficiently reduced the influence of price fixing by conferences. Why then was antitrust exemption being held up? Was there any prospect that in the future it would be eliminated?

32. **The delegate from the US** by way of background described the type of agreements and the legal setting of agreements. There was a distinction between different kinds of agreements. In the USA the term “conference” meant agreements on both pricing and capacity obligations, so true cartels. This was different to the EU, where conferences meant any sort of pricing discussion. There are also discussion agreements, i.e. rate-discussion agreements that allow parties to exchange information on prices without necessarily reaching an agreement. Effectively, these discussions agreements represented a free exchange of information on prices between competitors. There were 20 of these agreements but thirty or forty years ago, this number was significantly higher and these agreements had a larger impact. Moreover, there are operational agreements with a considerably smaller impact. Operational agreements are the outcome of carriers' efforts to continuously decrease costs and to optimise their use of capacity.

33. In terms of the legal setting, the delegate confirmed that the Shipping Act of 1984 was the general regime in place in the US trades. The Shipping Act of 1984 meant a change in the process for obtaining acceptance for an agreement: previously, the Federal Maritime Commission (FMC) had to affirmatively approve any agreement. After 1984, if an agreement was filed it would become effective within 45 days unless the FMC successfully obtained an injunction.

34. Once an agreement had become effective, monitoring continued. The parties, where necessary, could be ordered like under a subpoena to provide information, such as minutes of the parties' meetings, the information exchanged and additional periodic reports (e.g. container movements between certain trade lines). Dawn raids are possible. Overall, the Shipping Act required the FMC to evaluate whether an agreement was likely to lead to a lessening of competition, akin to US merger control. This made it possible to discuss prospective agreements with the parties and to amend them and impose remedies. When evaluating the agreements five, well known competitive forces are considered; entry barriers, alternative sources of services, group cohesion and independent service contracting. The last factor is important in understanding the effectiveness of an agreement: if independent contracting is a viable option, price agreements are bound to be less effective – this had been found in some of the larger transpacific trades where competition is relatively strong despite the information exchange. Also, it is looked at whether the agreement entails capacity management.

35. The OSRA further developed what had been set up in 1984, i.e. the statutory obligation to file each and any agreements with the Federal Maritime Commission (FMC). The effect of the OSRA was also considered to be highly deregulatory because it led to individually agreed prices in deviation of conferences. Although carrier agreements retained their antitrust immunity, and members could still publish voluntary collective service guidelines under their agreement authority, the OSRA permitted individual members to confidentially negotiate independent confidential service contracts with shippers, and prohibited the group from taking any retaliatory action against shippers or carriers that did so. As a result, independent service contracts now dominate the carrier operations, including those that belong to rate agreements and conferences (to the extent they were even relevant to international competition). Since 2000, no new commercial conferences had been filed in the US.

36. A repeal of the antitrust immunity in the US akin to the 2008 repeal of the EU liner block exemption was not likely to substantially increase competition in the US. This was because of the deregulatory measures already in place due to the OSRA, which had made conferences much less effective in raising prices. Instead, nowadays operational agreements were dominant. In terms of the effect of the repeal of the EU block exemption, it was clear that volatility could increase but it was not clear yet whether this did any harm to market participants. Interestingly, a study had been carried out by the Korean authority, which found that the EU repeal of the block exemption had a broadly positive impact on the Asia-Europe trade – there was no significant impact on concentration levels and a small positive impact for customers, on prices.

37. The three key issues for the future were whether there would be parallel behaviour as markets continued to concentrate, through alliances or outright consolidation and whether that would have an impact on exports.

38. **The delegate from the EU** noted that, however, technically it had been very difficult to measure the impact of the repeal of the block exemption in a before-and-after approach, in terms of finding the appropriate data and methodology (e.g. a differences-in-differences approach) and to account for the financial crisis. There had been attempts nevertheless, by the FMC of the US and a Korean study, but no EU study.

39. It was stressed that the US system of maritime antitrust rests on different pillars. There is regulation, which makes certain prescriptions to shippers and in this respect the OSRA in 1998 had a truly pro-competitive effect. The second pillar is the negotiation with the carriers before an agreement comes into force, where the FMC can extract some concessions. The third pillar is enforcement in the courts. The enforcement record of the FMC gave it the credibility to engage in the informal negotiations.

40. **The Chairman** thanked the delegates and had a question for the US. He wished to know more details about an on-going investigation by the Department of Justice on a single worldwide conspiracy involving price fixing, bid rigging and market allocation in international shipping services. He wondered why these agreements were not covered by the exemption and whether other competition authorities were involved.

41. **The delegate from the US** explained that in this case, three firms pleaded guilty and fines of USD 136 000 000 were imposed. The investigation was on-going and therefore it was difficult to say very much about it. It was alleged that some agreements were not filed as they should have been. There were several other jurisdictions involved, for example the Japanese and the Chilean authorities had brought submissions regarding this case.

42. **The Chairman** turned to the expert Christa Sys, from the University of Antwerp, for a description of how the competitive conditions in liner shipping had evolved and on whether more regulation was needed. Christa Sys considered that there were a number of recurring themes in container liner shipping regarding pricing, concentration, market entry and exit, product development/differentiation and deregulation/competition which determined the behaviour of carriers. Given the recent changes in regulation, notable OSRA in 1998 and the repeal of the liner shipping block exemption in the EU in 2008, the question was whether competition was currently sufficient and whether alliances provided better competitive outcomes than the conference system.

43. Christa Sys discussed recent price developments after the abolishment of the liner block exemption in 2008. Post-crisis, the level of prices, for example on the important routes between Shanghai and various destinations in Europe, had been very volatile, with a large drop in 2015. It is difficult to attribute this evolution to any specific factor as many different aspects of the market are currently changing. Sys was also of the opinion that it is not clear whether the currently low average margins (e.g., liner shipping barely succeeded in concluding 2013 profitably, with average operating margins close to zero and very variable) would become positive or healthy again. On the one hand, ever increasing vessel size lowers average costs and pushes out less efficient capacity. Also, lower bunker prices reduced costs. Both factors could increase profitability at least for the owners of large vessels. On the other hand, the introduction of new services, an increase in overcapacity and a decreasing demand due to the slower Chinese economy contribute to a decrease in overall profitability.

44. Another way to look at the situation in liner shipping markets is to assess the degree of concentration in the market. Despite considerable merger activity, the markets, i.e. the different trades, are not very concentrated if one considers that markets with a Herfindahl-Hirschman Index below 1.000 are not concentrated – a rule-of-thumb applied by the US Department of Justice. There have been significant increases when Maersk joined with Sealand in 1999-2000 and when Maersk took over Royal P&O Nedlloyd in 2005-2006. Other measures of concentration also suggest that the industry, as well as some important trade routes, can be characterised as “loose” oligopolies.

45. **Christa Sys** has also stated that another approach to assess the degree of competition in an industry is to examine changes in market shares, with large changes in market shares suggesting competitive dynamics. Sys argued that there were large changes in market shares in liner shipping due to recent merger activity. However, this depends on the merger’s impact on a given route and the variability was often larger with smaller than with larger players.

46. Christa Sys has also emphasised that the industry is increasingly being characterised by consortia and alliances rather than conferences. The issue was hence whether these new forms of cooperation raised competition concerns. The most recent cooperation agreement was 2M, a vessel-sharing agreement between the two largest global carriers, Maersk and MSC. Other examples were the G6 (APL, Hyundai Merchant Marine, Mitsui, Nippon, Hapag Lloyd, OOCL). Christa Sys expressed her opinion that, in the future, mergers, rather than alliances, could be expected to raise profitability

47. In some cases, these cooperations had brought about some freight rate stability. Nevertheless, where competition for market share is strong, there can also be considerable instability and downward pressure on rates. As a result, smaller players concentrated on niche trades. Sys concluded that currently no new regulatory measures were needed but that it is important to keep monitoring the market, namely price levels, concentration ratios and market share variability, to understand the impact of an increase in alliances. Furthermore, additional merger activity could result in tighter oligopolies.

48. **The Chairman** now wished to have a discussion on conferences and alliances.

49. **The delegate from the EU** first wanted to address Christa Sys on terminology. The most important distinction was rate-making versus non-rate making agreements, i.e. price agreements vs. operational agreements. Some agreements were both price and operational agreements, but this did not change the key distinction between price and operational agreements.

50. The second point regarded consolidation. Consolidation was often regarded as an important feature of the sector and a source of concern. The delegate from the EU did not share this view: while there has been a slight trend towards concentration, the sector is still fragmented. For example, in 2002 there were 22 carriers between in Asia and Europe and currently there are about 18 to 20 carriers. This did not represent a large increase over the course of 15 years.

51. The third point regarded a common view that antitrust exemptions allowing price agreements were a good thing because otherwise, if the market was liberalised and competition introduced, there would be consolidation and concentration. It was firstly not clear that this was true as this was not borne on evidence, e.g. on the Asia-Europe route. Moreover, in general, mergers should be preferred over a cartel, as mergers can bring efficiencies.

52. The fourth point was about profitability. In the EU delegate's view, the profitability of a sector should not be a guide to designing the competition rules that applied to those sectors. Sectors with very low profitability do not necessarily deserve exemptions from general competition law. It solely matters whether there is still supply and investment.

53. Christa Sys agreed with the delegate from the EU on the issue of profitability. Sys added that the market is indeed working, with large ship-owners managing to survive over long periods of time. Carriers found solutions to address periods of over-capacity through cooperation agreements aimed at reducing costs, and ensuring enough capacity for moments of peak demand, when profits are large.

54. **The Chairman** thanked the discussants and wanted to make one comment on mergers. Mergers do not always lead to more efficiency but are in principle better than cartels, even legal ones. Cartels never lead to efficiencies. The only advantage may be that a cartel can be dissolved, thus providing more flexibility, but nevertheless a merger is at any rate better than a stable conference.

55. **The Chairman** announced the beginning of **the second part of the roundtable discussion, which focused on consortia and alliances**. The technical progress regarding increased vessel size is one of the determinants of the current re-organisation of the industry. Very large ships need to operate with a high load to be cost-efficient. Consortia and alliances are part of the solution, as well as ports organised along hub-and-spoke systems.

56. On this topic, the Chairman asked **BIAC** to share their views, namely on i) the business purposes of consortia and alliances and ii) given claims that consolidation is needed, whether consortia, alliances or mergers would not hamper competition. BIAC had not made a submission regarding the issue of consortia and alliances. However, Camilla Holtse, the chief legal counsel and head of competition compliance at Maersk, who was part of BIAC's delegation in the roundtable, addressed the topic with the disclaimer that her position should not be regarded as BIAC's position.

57. **Camilla Holtse** wished to speak about developments since 2002 when the last OECD report was published. Holtse argued that, in the recent past, the liner shipping market had been highly competitive with freight rates decreasing on average by 4.1% in nominal terms every year from 2008 to 2014. Due to the financial crisis, average vessel utilisation was very low, i.e. there was large overcapacity in a very fragmented market with 20 different carriers on the important East-West trades. On many individual trades, markets were not concentrated. Barriers to entry were low, shipping capacity was a commodity and large buyers had complete price transparency. Camilla Holtse stated that industry returns are at a record low and that in this kind of industry and environment, the only thing carriers could do to improve profitability was to reduce costs. Apart from investing in bigger vessels, cost reductions could be achieved by vessel-sharing agreements.

58. Camilla Holtse argued that to explain the efficiencies generated by consortia, the so-called vessel sharing agreements (VSAs) or alliances, one has to consider that when a shipping line served a trade, there would typically be various customer demands. Customers typically want frequent sailing for flexibility in their supply chain as well as low freight rates. Frequent sailings would, for a given amount of cargo, generally mean smaller vessels or not fully utilised vessels, both of which entail higher costs. On the other hand, infrequent sailings would generally mean larger vessels with lower costs and better capacity utilisation but bad service. If two lines had a vessel sharing agreement, they essentially agreed to share space on each other's vessels. In this scenario, carriers were able to offer more frequent sailings while deploying larger vessels than would be individually profitable, half of which each shipping line would fill up on the more frequent service. Extensions of this rationale meant that, for example, more port-to-port pairs could be serviced.

59. Camilla Holtse thus stated that, in her view, this kind of arrangement was good for competition: costs decreased and the quality of service improved relative to the original scenario. The substantial environmental benefits from VSAs and alliances were also highlighted. Holtse further stated that cost savings were passed on to customers, highlighting that in the last ten years costs had decreased on average by 1.5% every year, the averaged rate had decreased even more (1.7%) and that this trend was likely to continue.

60. In what followed, Camilla Holtse addressed the four major alliances that were established in the industry, which are, in essence, consortia covering multiple services, and the question of whether these developments could lead to a reduction of competition in the market. Holtse expressed her view that there is competition between members of the same VSA or members of the same alliance. The cost reductions of the VSA or an alliance allowed more players to be present in the market, especially smaller ones, which would not be viable on their own. As a result, transpacific freight rates had been in decline by 2.7% each year in the presence of an increasing tendency to form alliances on this trade – these covered 75% of the market. Camilla Holtse thus considered that VSAs or alliances were pro-competitive and that some trades had less VSA or alliance coverage and lower rate reductions. Furthermore, in the future, low profitability could lead to more VSAs, alliances or consolidation. However, in Holtse's opinion, atypical industry

features, namely the fact that many businesses were family or government owned and may not always act in a commercially rational way, could imply less VSAs or alliances than would otherwise be expected. Holtse further emphasised that consolidation should be encouraged as there were potentially further cost savings which could only be achieved through mergers.

61. To conclude, Camilla Holtse stated that there should be no competition concerns with VSAs, alliances or mergers: VSAs or alliances are purely operational, merely entailing vessel sharing but no commercial co-ordination - as, in principle, pricing strategies remain independent, and no cost sharing - as every carrier pays for his own vessel, his own fuel (etc.). Having a VSA or an alliance would therefore not lead to cost alignment or coordination, rather on the contrary, competition was likely to intensify because the product became more of a commodity as essentially two carriers were offering the same product. With regard to prospective mergers, merger control provides a safeguard. Holtse finished by stating that accordingly, it was appropriate to calculate concentration measures ignoring the VSAs or the alliance.

62. **The delegate from the EU** questioned Camilla Holtse as to the extent of the advantages that VSAs or alliances have for large players, if the main rationale for these agreements is to gain scale.

63. Camilla Holtse replied that the efficiencies stemming from VSAs or alliances equally applied to larger operators with larger vessels. Given the large vessels that large carriers tend to operate, these operators also face the risk of overcapacity if they offer the frequency in shipments that the market values. Nonetheless, Holtse stated that these cooperation agreements could be regarded as specially benefiting smaller and marginal carriers, by preventing their exit from the market.

64. **The Chairman** wished a clarification on whether there was no payment between carriers of a VSA or an alliance.

65. Camilla Holtse explained that in a perfect world there ought to be no payment. Of course, there were slot costs; however, this would have been calculated in advance on the basis of estimated costs and not actual costs, i.e. based on indices of bunker and charter rates.

66. **The delegate from the US** had a further question for Camilla Holtse: whether she thought that in future there would also be cooperation in other aspects, such as joint acquisition of terminal services.

67. Camilla Holtse thought that this could generate benefits, by allowing carriers to obtain higher volume discounts from terminal providers, but that she expected that such acquisitions would need to be discussed with regulators who would likely be concerned about excessive bargaining power. Holtse informed that Maersk had not pursued such a strategy, although it could be interesting.

68. **The Chairman** now wished the expert Luis Ortiz Blanco, from Garrigues Law Firm, to speak on the future of the liner shipping industry and particular consortia and alliances.

69. **Luis Ortiz Blanco** explained by way of background that he had written a book entitled "Shipping Conferences under EC Antitrust Law" from the time as an official at the European Commission. The European Commission had initially supported liner conferences that were consolidated into a block exemption regulation, which has been in force until 2008. The OECD Secretariat had prepared a report in 2002 and thus had initiated a debate within the EU about the need to maintain liner conferences. A review took place, as a consequence of which the block exemption regulation was repealed. The block exemption for liner conferences by the EU was primarily adopted because of the UN code of conduct for liner conferences, which was to foster large, profitable fleets and thus was to reduce competition. Ortiz Blanco expressed his view that conferences were no different from orthodox cartels. Therefore the block exemption could not be seen as consistent with EU competition law, especially with Art. 101 of the Treaty of the Functioning of the EU.

70. The situation in the US had been different. The Shipping Act 1916 was modified in 1984, and later on there was the Ocean Shipping Reform Act (OSRA) in 1998. Effectively the USA had seen a deregulation of its liner shipping markets by means of liberalising the regulation of service contracts in shipping conferences.

71. In terms of how these developments had affected the industry, in both cases – in the EU and the US competition had increased after these regulatory changes. Information exchange made possible by the conferences had a clear role to play during the conference system. Information exchanges were now much more difficult given that they fell under EU competition law. It could therefore be expected that the “stabilising” role information exchanges had played was no longer present. In some trades it was conceivable that there were now too few players, but each trade had to be considered in isolation and with care. In general, in his view, the recent developments were beneficial for competition.

72. In the EU and elsewhere, the abolition of the block exemption regulation had moreover led to an increase in maritime consortia and alliances and long-term and/or individual service contracts with shippers. The latter had effectively become the rule, not the exception like in the past. Consortia were very useful in the current situation and could be considered pro-competitive. They benefitted from a *per se* legality, i.e. a block exemption if the market shares of the parties were no higher than 30 %, that in itself signals that there should not be concern when market shares were low. With higher market shares, a self-assessment proving net pro-competitive effects was necessary.

73. The latest developments with regard to co-operations were global strategic alliances - 2M, Ocean 3, CKYH and G6, with some similarity with alliances in the aviation sector, i.e. One World, Star Alliance and Sky Team. Alliances were the means to achieve global coverage at efficient cost and enabled players to compete more effectively under current market conditions. Such alliances thus did not necessarily imply less competition. Alliances were not covered by a block exemption, so it was always necessary to self-assess. Alliances were not always allowed, the most prominent example being the planned P3 alliance between Maersk Line, MSC and CMA CGM. In this case the Chinese authorities did not clear the proposed alliance, while the US did not identify concerns regarding P3. The EU Commission had declared that it would not open proceedings for the time being.

74. **The Chairman** now addressed the delegate from the EU and asked if the delegate could provide some information on why a market share threshold was introduced in the block exemption regulation on consortia.

75. **The delegate from the EU** explained first that what EU antitrust law called consortia was elsewhere referred to as an "operational cooperation" or “vessel sharing agreement" (“VSA”). There was a whole spectrum of operational cooperation ranging from full cooperation on an integrated consortium and alliances on one side, and slot charters and unilateral slot sales on the other side, and an EU consortium was between these extremes. The rule of thumb was that if the cooperation allowed for launching a joint service, it would be considered to be a consortium, i.e. essentially a joint service.

76. In the EU delegate’s view it was not correct that these kind of cooperation only involved operational cooperation of the kind described by Camilla Holtse. In many of these consortia, the members also agreed on how many ships to run on a particular route, which could lead to capacity fixing or coordination. This was not to say that there could not be benefits and efficiencies that might redeem the cooperation. He therefore agreed that it was generally justified to have a block exemption for consortia in the EU.

77. The EU block exemption for consortia had been in place since 1995 and since then had always been renewed in 5-year intervals. A new interval had begun this year, i.e. the new interval was 2015 to 2020. Before 2020, there would be another review to decide whether the block exemption would be

renewed. Clearly, the threshold of 30 % for the block exemption was somewhat arbitrary and lacked basis in science. However, the key presumption was that below 30 % no competition problems could arise and that efficiencies outweighed the harm. Above the threshold, there could be a *prima facie* reduction in competition, which then had to be compensated by second round competitive benefits. There was to be no hard-core restriction imposed by a consortium, so for example price fixing or customer allocation would not be exempted.

78. The EU delegate commented on the analogies that had been drawn between airline and shipping co-operations. As it was well known, in Europe recently three airline alliances had been cleared (Sky Team, One World and Star Alliance). A key reason for the clearance was that the alliances produced efficiencies for connecting passengers (e.g. passengers came over to Europe from the US, and then, because of the alliance passengers could connect more frequently and more easily to the second leg of the flight, for example, from Frankfurt to Berlin, Prague, Warsaw, Kiev). By contrast, in shipping the consortia concerned primarily the main segment of the route and not trans-shipment.

79. The **Chairman** commented on the fact that the distinction the delegate had just drawn was very important: airline alliances were vertical types of alliances or consortia, whereas in liner shipping, the cooperation agreements concerned mainly horizontal agreements. He wished to ask the delegate from New Zealand about the latest developments in New Zealand where a 10-year contract between a port, a logistics company and Maersk had been agreed, the reasons underlying the contract and whether it raised any competition concerns.

80. **The delegate from New Zealand** explained by way of background that Cotahi was a major logistics company in New Zealand, created as a joint venture between New Zealand's two biggest exporters. Cotahi offered services to 30 other exporters as well. It had been formed to create a countervailing power to the shipping companies.

81. Cotahi had entered into two 10-year contracts. One of these contracts was established with the port of Tauranga and guaranteed that a minimum quantity was to be handled through this port over the next 10 years. This contract ensured that the port received an adequate return on the investment that it made in widening and deepening the channel to allow access to larger ships. The second 10-year contract was signed at the same time between Cotahi and Maersk, and guaranteed that Maersk would ship a minimum volume of containers. As part of this deal, Maersk had agreed to employ larger ships going to New Zealand. It was thus a three-way deal, which led to larger ships coming to New Zealand with the attendant benefits of lower costs. At the moment, the competition authority had no concern with the arrangement. It was expected that these contracts would generate benefits in terms of encouraging larger and more efficient ships to New Zealand.

82. **The Chairman** turned to South Africa. He wondered what happened if a smaller country like South Africa did not give an antitrust exemption to an international company which had exemptions elsewhere.

83. **The delegate from South Africa** explained first that the South African shipping industry is small in comparison to other countries but that South Africa is part of an important trade route. To illustrate this, one needed to consider that the port of Durban is the busiest port in the continent. Typically, however, smaller jurisdictions are merely an afterthought with international shipping companies. When they came to South Africa, they usually expected an automatic exemption whereas they were supposed to go through the normal process of applying for an exemption, and these exemptions were then studied in terms of the South African competition act. If they did not undergo this process, they would be liable for prosecution under the competition act. It was the delegate's opinion that larger jurisdictions could assist by consulting with smaller jurisdictions when they were considering exemptions, especially exemptions for players

operating trade routes with multiple jurisdictions. These issues need further engagement and a platform like the OECD could help in coordinating such engagements.

84. **The Chairman** now wished Claudio Ferrari, an expert in maritime and port economics from the University of Genoa, to speak. He was one of the co-authors of the Background Note and he would provide a general assessment of alliances and of vertical relationships with ports.

85. The expert **Claudio Ferrari** explained first that the main difference between consortia and strategic alliances is that the latter do not focus on a single service, but rather several services: they typically are not limited to a single trade and provide more opportunities to reduce costs.

86. The main economic drivers for consortia and strategic alliances are increasing efficiency by jointly achieving economies of scale through large vessels and high utilisation, sharing the risk of investment in bigger vessel and reducing oversupply. Another important driver for consortiums and strategic alliances is to enlarge the market served by each carrier, so that through these kinds of agreements, carriers can broaden their geographic scope offered to shippers, enter new markets and offer a high frequency of maritime services. But consortia and strategic alliances can also allow their members the possibility to have a better knowledge of the strategy and behaviour of competitors.

87. Vertical integration was identified as a new feature of cooperation among carriers. Ocean carriers had begun to acquire container terminal facilities in Europe. This process of vertical integration offered carrier alliances greater bargaining power with respect to seaports. The risk from the experts' point of view is that port authorities in the future could award container terminals to vertically integrated unit carriers and that this could entail disadvantages for competitors.

88. In terms of the market outlook, the biggest players are becoming ever bigger with regard to vessel capacity. In the past, growth took place via mergers and acquisitions. It was the expert's view that in recent years it occurred through internal growth, and that the future is likely to be characterised by a few very big carriers and many small carriers.

89. **The Chairman** thanked all participants and summarised the findings of the session: there were indeed important developments in liner shipping. In terms of price fixing agreements, many jurisdictions now effectively considered their elimination, for example Australia and New Zealand. Many competition authorities had intervened publically in the process of eliminating the exemptions for liner shipping conferences. The Chairman qualified these as positive signs. The second part of the discussion on consortia and alliances was important because it showed that there are benefits originating from consortia and alliances given the ever-growing size of vessels. However, there is a trade-off between the benefits from alliances and the market power that can originate from these forms of cooperation. On the other hand, competition authorities are well aware of this and it was heard that when antitrust authorities intervened they always balanced the benefits and market power effects. In terms of the evolution of liner shipping markets, it was the view of many experts that consolidation would take place. Since this was an industry with a large number of players, consolidation did at this stage not seem to raise competition concerns.