



EUROPEAN COMMISSION

Competition DG

**LINER SHIPPING: MARKET DEVELOPMENTS AND GOVERNMENT ACTION –
THE EU PERSPECTIVE
COMPETITIVE POLICY PERSPECTIVE**

1st International Shipping Convention, London, 18-20 October 2000

Jean-François Pons*
Deputy Director-General

* The views expressed in this speech, to which Eric Fitzgerald (D.G. Competition) has greatly contributed, are those of the author and do not necessarily represent the views of the European Commission.

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Mr Chairman, Ladies and Gentlemen,

1. INTRODUCTION

I have been invited to provide an EU perspective on liner shipping and competition policy. I propose to do this by referring to what I see as being the main market developments in recent years, and in the near future, and by outlining the possible response of the competition authorities. I have prepared a written speech, which is too long for 20 minutes, so I will cut some developments that you will be able to find in the written paper if you wish.

The recent market developments in liner shipping reflect what has been happening in other industrial sectors. These developments, which I see as being primarily globalisation and concentration, together with the emergence of the internet, seem set to shape the course of liner shipping for the foreseeable future.

As in other sectors, change in liner shipping has come about not only as a result of increased competitive pressure in combination with new technologies, but also in response to government action.

This leads me to preface my remarks on market developments in liner shipping with a brief description of the Commission's more recent competition activities in this field.

2.

RECENT EU ACTION IN THE LINER SHIPPING SECTOR

There have traditionally been two major competition problems in this sector: price-fixing and capacity limitation – and often a combination of both.

Both problems have a clear connection with the traditional form of co-operation in the sector, that is to say the liner shipping conference. As you know, this form of agreement benefits from outright antitrust immunity in some jurisdictions (such as the US) and from an exemption in others (e.g. EU).

In the EU context, competition problems have arisen mainly, but not exclusively, when conferences have gone beyond what is permitted by the EU regulation providing for a liner conference block exemption. That regulation entered into force on 1 July 1987.

In the early years following the entry into force of the Regulation, the Commission's principal concern was to curtail the worst abuses of the conference system. It is in that light that one should see the 1992 decisions prohibiting abuses of conference power on the trades between Europe and West Africa. Thus, in the **CEWAL** decision – upheld by the European Court of Justice in March of this year – the Commission found that the CEWAL lines had used several practices, including so-called 'fighting ships', to exclude a competitor from the trade between Northern Europe and Zaire (Detrimental also to the developing countries concerned).

In subsequent decisions, the Commission has been more concerned to ensure that conference agreements, as such, stay strictly within the limits of the block exemption. Conference agreements have commonly provided for inland price-fixing and capacity management programmes. Both these activities have been condemned in successive Commission decisions, such as the **TAA** decision of October 1994, prohibiting inland price-fixing and capacity non-utilisation agreements. In that decision, the Commission found that the TAA had acted outside the scope of the EU liner conference block exemption by agreeing prices for inland haulage and by artificially freezing capacity in order to drive up prices. The TAA decision was followed by the **FEFC** decision of December 1994, which also prohibited inland price fixing.

The Commission's decision-making practice in the liner shipping sector culminated in the **TACA** decision of September 1998. This decision, which I am sure will be familiar to most of you, led to the Commission imposing fines of €273 million on the fifteen TACA parties for inland price fixing, the fixing of brokerage and freight-forwarder remuneration, and collusion and abuse concerning the terms and availability of individual service contracts. The Commission also found that the parties had attempted to alter the competitive structure of the market.

Also in 1998, the Commission had discussions with carrier representatives – in continuous consultation with shippers – with a view to resolving conflicts and to creating a more open and competitive environment in the liner shipping industry. Those discussions resulted in a tentative set of

principles, the most important feature of which, from the Commission's point of view, is that conferences operating on Community trades would

- place no restrictions on the right of their members to enter into confidential individual service contracts,
- no longer fix inland prices in Europe, but with the possibility of a not-below cost clause.

At the beginning of 1999, the Commission received the notification of the **Revised Taca Conference Agreement**, also known as TACA II. The most interesting feature of this agreement is the fact that, as you will be aware, it is a concrete result of the discussions that I have just mentioned.

While the Commission is still examining the maritime aspects of the agreement, it cleared the inland part of it, in particular the so-called "not-below-cost" rule, in August 1999.

One thing seems clear: liner shipping practices on trades to and from the EU have changed markedly. Inland price-fixing has been renounced, as far as I am aware, by all conferences serving EU trades. The change has however been most pronounced on trades between the EU and the US. On those trades, most market studies suggest that the combination of the EU rules and the liberalisation introduced by the Ocean Shipping Reform Act (OSRA) - on which Chairman Creel will speak later - has led to a dramatic increase in the number of individual service contracts and a concomitant decline in the amount of cargo carried at the conference tariff.

Despite the marked increase in competition on most trades to and from the EU, the Commission's enforcement activity has not waned. In 1999, the Commission adopted a decision in the *EATA* case, prohibiting a capacity management programme between conference and non-conference lines, which operated in combination with direct price-fixing agreements.

Earlier this year, we launched surprise inspections of shipping companies suspected of agreeing on prices outside the scope of the conference block exemption. In May, the Commission adopted the *FETTCSA* decision, condemning an agreement between conference lines and independents not to discount off published tariffs.

These more recent cases have a common theme, which is likely to be a key focus of our efforts in this sector, namely to ensure that competition to conferences from independent lines remains effective.

No description of Commission activities in this sector would be complete without some mention of the EU consortium regulation. This regulation, which was recently renewed, enables shipping lines to benefit from a block exemption for agreements to provide a joint container liner service, has been relatively uncontroversial, chiefly because both shippers and shipowners appear to agree that it has yielded substantial benefits. Whether this happy consensus will endure in the face of the growing size and geographical coverage of alliances is probably still too early to tell.

3. GLOBALISATION AND CONCENTRATION

3.1. Market developments

I would now like to turn to market developments in liner shipping. The most significant of these, to my mind, is the increasing trend towards globalisation and concentration.

3.1.1. Globalisation

‘Globalisation’ means different things to different people. To some of the protestors in Seattle and Prague it was a catchword embodying all the evils – real and imagined – of the prevailing capitalistic system. Liner operators, their customers, and competition authorities presumably have another understanding of the word. ‘Globalisation’ may to these parties conjure up the image of global shipping services meeting global demand from shippers. Does this image have any substance?

There is certainly a growing demand for global contracts. I have noted that several shipping lines in their marketing now give play to their ability to meet demand from shippers wishing to enter into global contracts.

It is also a fact that shipping lines increasingly operate on a worldwide scale, either as members of an alliance or as independents. Whereas previously alliances between carriers were usually confined to a single trade, these alliances increasingly span several trades. For obvious reasons it is usually more difficult for an independent to provide the frequency of service demanded by customers on a worldwide scale. Only the very largest liner shipping groups appear to be in a position to do so viably.

I think we can therefore conclude that ‘globalisation’ is not merely an abstract concept, but does indeed reflect the underlying realities in today’s liner shipping sector.

3.1.2. *Concentration*

This brings to me to the response to globalisation, that is to say concentration.

In the liner shipping industry, ‘concentration’, which is a term that I use in its broadest possible sense, has been driven by the need to achieve economies of scale and as a response to global clients. It has come about in two main ways:

- through mergers, and
- through the increase in the number, size, and geographical scope of consortia and other alliances.

Consolidation has been intense in recent years, with no fewer than eighteen major mergers having taken place in the period from January 1998 to December 1999.

The most notable recent example of a merger in the liner shipping sector is the Maersk SeaLand case. The most recent significant example of a consortium increasing its membership and geographic scope is the Grand Alliance consortium joining forces with Americana Ships on the transatlantic. The two phenomena may be complementary – e.g. a merged entity may also be a member of several consortia – but may also reflect

alternative market strategies, in the sense that it may be possible to achieve vital economies of scope and scale in either of these two ways.

In any event, the distinction between a merger and an alliance may not be as clear-cut as might appear at first sight. Mergers come in many shapes and forms. From an operational viewpoint there may not be much to choose between a company group encompassing a number of independent shipping lines, each operating under its own brand name and with its own customer base, and an alliance. The difference would seem to lie mainly in an alliance being normally less stable and durable than a merger. The term ‘concentration’, when applied to alliances, therefore refers mainly to the fact that there are fewer and fewer shipping lines operating as independents outside these alliances at any one time.

3.2. Competition authorities’ response

How then should competition authorities respond to globalisation and the attendant increased concentration within the liner shipping industry?

3.2.1. *Market definition*

First, as always in a competition context, there is the question of market definition. The fact that there is such a thing as demand for global contracts marks an interesting development, which may require competition authorities to re-assess their analysis of liner shipping markets. Currently this is carried out on a trade-by-trade basis, with each trade, in principle, corresponding to a relevant market for the purposes of applying competition law. The emergence of demand for global contracts may prompt authorities to consider whether the received market definition

should be re-thought or at least complemented by an additional product and geographic market definition based on such demand.

Continuing this thought experiment, the current perception of certain market actors, such as alliances and large independents, as enjoying a privileged, if not dominant, position on individual trades may also need to be reconsidered. It would no doubt be necessary for a competition authority to take account of the fact that only a very few of these actors may be in a position effectively to supply a global shipping service meeting demand for global contracts. Indeed, the number of groupings or individual lines in a position to do so may be so small as to amount to an oligopoly.

3.2.2. *Concentration*

With regard to concentration, I would note, first, that although the pace of consolidation has increased in recent years, the market structure of the sector is still relatively fragmented when compared to that of other industries. The Commission thus found, when examining the Maersk SeaLand merger, that even that merger, the largest so far in the shipping industry, would create an entity having no more than approximately 12% of the world's fleet capacity at that time. This is a modest figure when set beside the levels of concentration found in other sectors. On the narrower markets that the Commission has examined, specifically the EU-North America trades, the largest shipping group holds a market share of less than thirty percent. That too is a modest figure by the standards of some other sectors.

Secondly, there is a degree of fluidity and impermanence to the coalitions which form the other great source of concentration in the sector. Alliances change shape, if not on a monthly basis, then at least from one year to another.

3.2.2.1. Mergers

When assessing future mergers, a competition authority should obviously, as the Commission has done in the past, take account of the merging parties' membership of conferences.

If one of the parties to a merger is a member of a conference or conferences and the other party or parties are not, obviously a competition problem may arise. A merger between a conference line and a non-conference line may, if the merged entity chooses to remain within the conference, create or strengthen a dominant position for the conference.

If on the other hand, both merging parties were members of the same conference, one would have to assess whether the merger would have a reinforcing effect on the internal cohesion of the conference, leading to a reduction in competition between its members and a concomitantly increased singleness of purpose and conduct on the market. Such might be the case were the size of the merged entity to give it a critical mass sufficient to enable it to exercise a controlling influence over the conference.

3.2.2.2. Alliances

The Commission's experience of the functioning of the EU block exemption for consortium agreements has confirmed it in its view of consortia as being, on the whole, beneficial both to the shipping lines themselves and to their customers. These agreements allow the shipping lines to co-ordinate their services in such a way as to achieve the economies of scale and scope which could otherwise only be achieved through consolidation. This positive attitude towards consortia is reflected in the Commission's decision to extend the block exemption for consortia for a further five years.

Obviously, however, a competition authority may have cause for concern when a consortium agreement is concluded within the framework of a conference (something which is quite common). This concern would stem from the fact that the price-fixing activity of the conference might then be super-imposed on the forms of co-operation – chiefly co-ordination of shipping operations and joint marketing – permitted by the consortium block exemption. This concern could be addressed – as indeed it has been in the cases examined by the Commission – either by the conference expressly allowing its members to deviate from the conference tariff or by evidence of competition on service, as between the members of the consortium or between the consortium lines such and other conference and non-conference lines.

3.2.3. *Bilateral and multilateral co-operation*

Obviously, the increase in the number of global deals having an impact on several national markets makes it urgent to achieve a degree of co-ordination between competition authorities. This is true whatever the sector affected by the operation. Against the background of the considerable and increasing number of ‘transatlantic’ cases, mainly merger cases, the Commission’s main focus to date – in all sectors – has been on establishing a close relationship with the US competition authorities. This co-operation has borne fruit in the form of consistency with respect to the analytical framework and to converging decisions.

The Commission is eager to apply this model of co-operation to other bilateral relationships. It has already concluded a co-operation agreement with Canada and is seeking to deepen and strengthen bilateral relations with Japan in a similar manner.

In this context, I would like to address a concern that has been voiced from time to time by different commentators, i.e. the supposed conflict of laws between various competition regimes. This concern is, in my view, totally unfounded, at least insofar as it may relate to an alleged conflict between the maritime competition rules of the EU and those of the United States.

A conflict of laws arises where the laws of one country impose a choice of conduct that those of another country prohibit. I have difficulty in seeing where such a situation might arise in an EU-US context. To take an example: one commentator has suggested that because discussion

agreements are allowed under US law, while they are generally frowned upon by the EU, there is a conflict of laws. Not so, I would argue. US law does not impose an obligation on shipping lines to enter into discussion agreements, any more than EU law requires lines to form consortia. Shipping lines operating on trades between the EU and the US simply have to comply with the most restrictive of the two sets of rules, in this case the EU rules, which in effect – at least to my knowledge – is exactly what those lines have done.

I would also like to draw this audience's attention to the fact that EU legislation contains a mechanism for addressing real conflicts of laws. In Article 9 of Regulation 4056/86, the main regulation applying the EU competition rules to maritime transport, there is provision for the Commission to negotiate with the authorities of third countries to solve such conflicts as and when they arise.

As far as multilateral relationships are concerned, many among you will be aware that the OECD has launched a debate on regulatory reform. As part of this debate, antitrust immunity for conference agreements and other forms of co-operation between shipping lines has come under scrutiny, most recently at an OECD workshop in May of this year.

The Commission for its part has no plans at present to repeal or amend the existing EU block exemptions in the maritime sector. We are however following the debate closely. We will be particularly interested to see the arguments develop on whether the risk of instability on liner shipping markets has diminished as a result of changes in the market such as the

increased size and geographic coverage of lines, the development of yield management and the increased use of individual contracts. Which brings me to my next topic...

4. INTERNET

4.1. Market developments

The emergence of the Internet as a platform for business-to-business (B2B) and business-to-consumers (B2C) trade is undoubtedly one of the most exciting commercial developments to have occurred in recent years.

It is a development that appears to offer businesses considerable potential for rationalising their procurement and supply procedures; similarly it appears to have the potential to secure major welfare gains for individuals through quick and informed access to a greatly increased range of consumer products and services.

While it is no doubt still too early to assess the full impact of the Internet on the transport sector, we have noted the emergence of a substantial number of transport-related electronic marketplaces. Given the obvious attractions of such sites, more will surely follow.

4.2. Competition authorities' response

The response of competition authorities to the emergence of electronic trading sites, and in particular B2B sites, is not entirely unproblematic. On the one hand the sites offer the potential for significant efficiency gains, which, all other things being equal, should eventually benefit consumers.

These efficiency gains will increase, as is already the case for stock exchanges, in line with the number of users.

On the other hand, there is a risk that B2B sites may facilitate the exchange of sensitive commercial information between competitors, leading to distortions of competition. One answer to that particular problem could be to require the site to install ‘Chinese walls’ preventing the intentional or unintentional disclosure of such information. A solution of that kind was found in the *Volbroker.com* case, involving an electronic brokerage joint venture between six major banks, which was cleared by the Commission in July of this year.

There is also a possibility that access to a specific B2B site could become an essential pre-condition for being able to compete effectively on a particular market. There is then a risk, the extent of which again is difficult to gauge, that the businesses already having access to the B2B site might be tempted to deny a potential new competitor access to the site in order to exclude the new entrant from the market. In the *Volbroker.com* case, the notifying parties specifically undertook not to exclude a particular category of brokers.

It seems too early to see any maritime industry site taking on the character of an essential facility. This may change in the future, as individual maritime sites achieve critical mass. However, the risk of exchange of information is one that is always present, regardless of the size of the site. In this respect, the *Volbroker.com* case may provide a useful example of what could be done to prevent disclosures of sensitive information. This

could have particular relevance for the handling of individual contract information.

It will in any event be necessary to analyse very carefully the details of any future B2B trading system and its effects on the market. In view of the transatlantic scope of many B2B sites, the Commission intends to examine future B2B plans in close co-operation with the US authorities.

5. MODERNISATION

Before concluding, I would like to say a few brief words about the Commission's current proposals to modernise the way the EC competition rules are applied. These proposals, if adopted by the EU Council of Ministers, will have major implications for the liner shipping industry as well as for other industries.

The proposals have been put forward in response to the increasing burden that routine notifications place on the Competition DG's scarce resources. The proposals are an attempt to re-focus the department's efforts on the cases that raise serious competition issues by dispensing with the obligation to notify restrictive agreements for individual exemption and by giving greater powers to the competition authorities and courts of the EU Member States.

As far as the liner shipping sector is concerned, I should stress that the substance of the block exemptions for conferences and consortia will not be affected by the proposals. However, the proposals will in effect mean

that shipping lines will no longer have to notify these agreements to the Commission.

Lest it be thought that the Commission is utterly insensitive to the plight of maritime competition lawyers, so unjustly deprived of one of their main sources of income, I hasten to add that shipping lines would be well advised to continue to seek legal counsel before entering into restrictive agreements. It will be a feature of the new system put in place by the Commission's proposals, that the burden of ascertaining that an agreement fulfils the conditions for exemption will rest fully and squarely on the parties to the agreement – a responsibility not to be taken lightly.

An additional consequence for the liner shipping sector of the proposals is that which I have touched upon earlier in this presentation: i.e. an increase in the Commission's focus on cartel-fighting and assessing changes in market structure. We hope in this way to be able to deal more efficiently with the real competition issues, to the ultimate benefit of all industry participants.