

10th Annual EMLO Conference

International Maritime Competition Law facing up to Regulatory Change

London, Friday 18 June

The Review of the EU Competition Regulation for Maritime Transport

State of Play and next steps

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Chairman,

Ladies and Gentlemen

[Background of the review]

In March of last year the Commission started a process of reviewing Council Regulation 4056/86, the main EC competition regulation governing maritime transport (hereinafter the Maritime Regulation). The Maritime Regulation had a dual function. First, it enabled the Commission to apply Articles 81 and 82 of the EC Treaty directly to the maritime transport sector (procedural part). Secondly, it provides for a block exemption for liner conferences (substantive part). The first function has become redundant with the entering into force of Regulation 1/2003, that provides for competition enforcement rules for basically all sectors, including the maritime transport sector (with some exceptions). The substantive part of the Maritime Regulation however has not been changed until today. After the procedural changes, a logical next step is to review whether there is, in the current market circumstances, still a justification for the remaining substantive specific competition provisions in the transport sector.

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Liner shipping conferences have traditionally been granted some form of immunity from the competition rules by many jurisdictions. This immunity has been subject to review in several parts of the world and the EU is no exception. The Commission's review process has in particular been inspired by the OECD Secretariat Report, that was published in April 2002 and that has put into question the maintenance of the block exemption for liner shipping conferences.

The review is particularly important given that Maritime Regulation since its adoption 18 years ago has never been reviewed before, while the liner shipping market has changed. In particular, the role of independent operators on most routes has become more important, in addition operational forms of co-operation such as consortia and alliances have increased and furthermore there has been a substantial growth of long term contracting, such as individual service contracts.

[Review process]

It should be recalled that the review is a three step process, consisting of 1) fact finding, 2) a Commission paper and 3) legislation.

DG COMP started the review process with the publication of a consultation paper. A team of economists from Erasmus University Rotterdam was commissioned to assist DG COMP in processing the replies. The replies to the consultation paper and the final Erasmus report have been posted on DG COMP's website.

Following the public hearing which took place in December last year, we are now approaching the end of the fact-finding phase of the review. DG COMP has published a working document on its Web-site which takes stock of the outcome of the consultation phase and draws some preliminary conclusions. This document was already discussed with competition and transport experts of the Member States in an informal Advisory Committee on 28 May. It should however be emphasized that the document is a DG COMP document which does not represent a Commission position at this stage.

[Scope of the review]

The review essentially concerns the remaining substantive provisions of the Maritime Regulation. i.e. the block exemption for liner conferences, the provision for technical agreements and conflict of laws. It covers however also a specific procedural question concerning tramp vessel services and cabotage traffic. I will explain each of these issues

now in more detail starting with the core question whether there is still a justification for the current block exemption for liner shipping conferences.

[The block exemption for liner conferences]

The main substantive content of Maritime Regulation is the block exemption for certain specific agreements of liner conferences, in particular the fixing of rates and conditions of carriage, and as the case may be, one or more other agreements relating to control of supply, market sharing, cargo or revenue pooling.

The Court has at various occasions made clear that this block exemption is “wholly exceptional” and should be interpreted narrowly. Indeed, the agreements, which are exempted, are regarded under EU competition law as “hard core” restrictions of competition. And although Article 81 §3 does not exclude *a priori* certain agreements from its scope, severe restrictions are normally unlikely to fulfil the conditions of Article 81 §3.

The argument has been made that the liner shipping industry, because of its specific features [high fixed costs, high investment risks, inelastic demand and supply, asymmetries in demand etc] would be inherently unstable and that this would require special treatment under EU competition law. However, as the OECD Report pointed out, these market conditions, as a whole, are not unique to the liner shipping sector and they are faced by any capital intensive industry providing a guaranteed and/or scheduled service (e.g. air cargo). Carriers in particular fear that without capacity regulation and price-fixing arrangements, the industry would enter in a process of “destructive competition” which would result in a profoundly destabilised industry. The argument is not new. It has been advanced by carriers in various liner shipping cases that the Commission handled previously. In these cases (e.g. the 1998 TACA case) the Commission has explained why it is not convinced of the applicability of this economic concept to liner shipping. There is no concrete evidence that the liner shipping industry should be treated substantially different than other global capital intensive industries.

In any event, the argument that the liner shipping industry would require special treatment cannot imply that the cumulative conditions of Article 81 §3 of the Treaty do not apply. This argument would rather have to be addressed within the framework of Article 81 §3, notably its first condition. The core test of the review is therefore whether

the specific provisions for liner shipping could, in light of the conditions of Article 81 §3 of the Treaty, still be said to be valid.

As I will explain in more detail, DG COMP has come to the provisional conclusion that, on the basis of the various arguments and contributions provided to the Commission, the cumulative conditions of Article 81 §3 would not (any longer) appear to be fulfilled with respect to the specific activities referred to in Article 3 of the Maritime Regulation.

Efficiencies

The first condition of Article 81 §3 requires that the agreement produces economic benefits (efficiencies).

Carriers, in response to the consultation, have relied in this context mainly on the alleged price stability that conferences would achieve. The data which have been provided in this regard are however not conclusive. Shippers have even contested the relevance of the concept of price stability as such in the context of Article 81 §3.

It is questionable whether price stability as such could be regarded as sufficient for the fulfilment of the first condition of Article 81 §3. Price stability only becomes relevant if it is read in conjunction with the concept of “reliable services”, meaning the maintenance over time of a scheduled service providing shippers with the guarantee of a service suited to their needs. Rate stability would enable ship owners to forecast their income more accurately and thus make it easier to organise regular, reliable, adequate and efficient services. As the Commission has indicated in its recently published Guidelines on the application of Article 81 §3, there must be a sufficient and direct causal link between the agreement and the claimed efficiencies. Whatever may have been the force of the justifications that led at the time to the block exemption of price fixing by liner conferences, it is doubtful whether it can be maintained today that the provision of reliable services result directly from the conference price fixing. In this regard, it should be recalled that conference members increasingly offer services on the basis of long term service contracts. It is therefore not excluded that under the current market circumstances price stability and reliability of services are mainly brought about by such contracts. Moreover, the increase of both internal price competition within conferences and external competition by independent operators have not changed significantly the overall level of reliability of liner shipping services. It would therefore appear that the alleged causal link between the restrictions (i.e. price fixing, market sharing and output limitation) and the

claimed efficiencies (reliable services) is too tenuous to meet the first condition of Article 81 §3.

Consumer benefits

The second condition of Article 81 §3 requires that, if liner conferences were to achieve economic benefits, a fair share of these benefits should be passed on to consumers. Consumers must be compensated for the negative effects resulting from the restrictions of competition. In case of hard-core restrictions, such as horizontal price fixing, it is clear that the negative effects are serious and that any positive effect must therefore be very clear-cut.

None of the benefits that have been identified by the carriers would appear to at least neutralize the negative effects for consumers of conference price fixing. In this regard weight should also be given to the fact that consumers themselves fail to see any benefits of price fixing by conferences. The OECD Secretariat concluded in its report that conference price-fixing leads to rates being set at the level necessary to cover the average cost of the least efficient member of the conference. Under this system, efficient members of the conference reap benefits stemming from rates that are above their costs, while the cost savings and efficiency gains of these carriers are not passed on to shippers.

Indispensability

Under the third condition of Article 81 §3, even if there were economic benefits to the benefit of consumers, it will have to be established that the restrictions of competition are indispensable, i.e. reasonably necessary to produce these economic benefits. The test is basically whether there are less restrictive alternatives than conference price fixing which would assure reliable liner services to the benefit of consumers. But even if there were no less restrictive means to guarantee reliability of services, the restrictions must still be proportionate. This question should be examined in the light of the increase in the number of individual service contracts, the proliferation of operational co-operation agreements between shipping lines such as consortia and alliances and the growing importance of independent operators, which operate outside conferences on all main trades to and from Europe.

Service contracts may be assumed to contribute to stable and reliable services over the longer term. The same applies to consortia and alliances. These alternatives already

available on the market show that shipping lines do not need any longer to engage in price-fixing, market sharing or output limitation to provide reliable shipping services.

The argument has been advanced that the success of consortia is closely linked to the activities, which take place within conferences. Such argument is difficult to accept under EU competition law. The consortia block exemption does not allow horizontal price fixing and it covers both consortia operating within a liner conference and consortia operating outside such conferences. In competition policy terms the argument rather reinforces the general concern that the existence of the conference system combined with the growth in operational co-operation through consortia and alliances could possibly raise the potential for sensitive market information to spill over to other non-Conference market actors.

Non elimination of competition

Finally, the fourth condition of Article 81 §3 requires that the conference should remain subject to effective competitive constraints.

Competitive constraints on conferences can come from independent operators. Agreements between conference and non-conference members do not benefit from the block exemption and the Commission has in the past intervened to avoid that such agreements would undermine competition between independent and conference carriers. In general, independents have increased their market share on the main trades to and from Europe. However, the importance of the competitive constraints from independents on a particular trade depends also on their capacity to compete and their incentive to do so.

Service contracting between individual shippers and members of the conference is another source of competition. In the past liner conferences have sought to limit effective competitive constraints from long term individual contracting. The Commission has acted against this in order to ensure that there are no restrictions on conference members as regards their freedom to negotiate and enter into long term contracts with shippers (e.g. TACA decision of 1998). As a result, long term contracting has increased importantly in recent years, for example, on the transatlantic trade nowadays only 10 % of the cargo carried by the TACA conference members is moved under the conference tariff.

However, given the increasing number of links between carriers (i.e. consortia, alliances, vessel-sharing arrangements and slot-charters) determining the extent to which a particular conference is subject to effective, internal and external, competition can be a very complex exercise, even if the conference in question does not have a substantial market share. In any event, such an assessment would necessarily have to be made on a trade by trade basis.

[Other forms of liner shipping organisation]

Conferences are not the only form of liner shipping organisation. Other forms include stabilisation agreements, discussion agreements, consortia and alliances. It is useful to shortly discuss these forms as to their compatibility with EU competition law, in particular to test whether they could be considered as a valid basis for possible alternatives for the current system of conference price fixing, market sharing and output regulation.

Stabilisation agreements refer to agreements between conferences and their outsider competitors with the aim, *inter alia*, of freezing a part of their transport capacity. Such agreements are clearly not permitted under Community law and the Commission has acted at several occasions against such capacity freezes.

A more flexible form of agreement between conferences and outsiders is known as discussion agreement. It can be a sort of framework agreement by virtue of which shipping companies which are members of conferences and outsiders are able to co-ordinate flexibly their competitive conduct on the market in relation to rates and other service conditions. Under US law, carriers are permitted to enter into agreements to discuss, *inter alia*, rates, surcharges and capacity. By contrast, the compatibility of such agreements with Article 81 EC Treaty is highly questionable. No discussion agreement has ever been formally exempted by the Commission. Discussion agreements involve normally the exchange of sensitive business information between competitors and should therefore respect the established case law on exchange of information. More importantly, their inherent flexibility makes them attractive to traditionally independent lines. In that respect, discussion agreements could in competition policy terms be even worse than conferences, since they are liable to eliminate effective external competition to conferences.

Another difference between the US and EU law regimes lies in the treatment of so-called voluntary guidelines. The Ocean Shipping Reform Act of 1998 (OSRA) made it possible for conference members to negotiate confidential individual service contracts with a shipper at rates differing from the conference tariff. However, OSRA also allows conference members to adopt voluntary guidelines applicable to their members' individual service contracting. Such voluntary guidelines would not be compatible with EU competition law if they would relate to commercial matters, in particular pricing of individual service contracts. Purely technical guidelines would be unobjectionable.

I have already mentioned the growing importance of consortia and alliances. Liner consortia are industrial co-operation agreements between liner shipping companies aimed primarily at supplying jointly organised services by means of various technical, operational or commercial arrangements. In many cases, members of a consortium are also members of a conference. However, a consortium can also be composed entirely of otherwise independent lines or it can include both conference and non-conference members. Consortia are under certain conditions covered by the block exemption of Regulation 823/2000, provided that they do not fix prices. Thanks to consortia agreements, ship owners can organise jointly the services they supply (in particular container liner shipping) and thus provide users with a better service while rationalising their maritime transport activities and securing economies of scale and cost reductions. The Consortia block exemption will expire on 25 April 2005 and DG COMP has recently published a paper on its web-site in order to consult the industry and Member States on possible options for the future regime of consortia. The consultation paper is published against the background of the ongoing review of the Maritime Regulation. What possible consequences the on-going review process of the Maritime Regulation might entail for the Consortia Block Exemption cannot yet be foreseen. Accordingly and awaiting the results of the review of the Maritime Regulation renewal of Regulation 823/2000 [with only minor modifications that are independent from the review of the Maritime Regulation] would appear the most appropriate option at this stage.

The last decade has also seen the emergence of strategic alliances, which establish co-operation among a group of carriers over certain major trade routes, which can be described as global. These agreements cover a wide range of forms of operational co-operation, e.g. space chartering, slot charter and schedule/sailing arrangements and they aim at the integration of each participant's services into one whole. These alliances do however not include common pricing.

[Some provisional conclusions concerning the liner block exemption]

The assessment of the liner shipping block exemption within the current market and regulatory context leads to some provisional conclusions which should possibly guide us for the future:

First of all, the present block exemption for liner conference price fixing, market sharing and output limitation would seem not to be any longer justified. Moreover, more flexible co-ordination in the form of discussion agreements, where carriers can freely discuss all trade issues, including confidential rate and market information, and issue general voluntary guidelines for rate levels, are not less problematical under EU competition law.

Second, alternative strategies and industrial co-operation forms have become available to ensure stable and reliable liner shipping services. Consortia, slot chartering agreements and strategic alliances all seek greater operational efficiency and cost reductions. To the extent that these operational arrangements face effective competition on the market, they are also beneficial for shippers and therefore acceptable under Article 81.

In view hereof, it would appear justified to remove the current block exemption for the activities of liner conferences as laid down in Article 3 of the Maritime Regulation. However, the Commission remains open to consider any framework or arrangement, which would be presented as a possible alternative for the current block exemption. A discussion on alternatives should be based on the identification by the carriers of their specific industrial needs, in view of the already existing forms of co-operation and the current market conditions. Such discussion would also need to involve shippers.

[Technical agreements]

A second substantive provision for review concerns Article 2 of the Maritime Regulation allowing maritime transport providers to conclude agreements, which have the sole object and effect to achieve technical improvements or cooperation.

It follows from the case practice of the Commission and the case law of the Court that this exception of the prohibition of Article 81 §1 has to be interpreted strictly. The practical meaning of this provision is very limited, as relating only to purely technical agreements, not involving any commercial co-operation and which therefore are not caught by the prohibition of Article 81 §1.

The consultation has put forward no convincing reason why this provision should be maintained. It cannot be said that the provision would have a guidance function, since the provision, and notably the list of examples it provides for, has shown to lead to confusion in practice since undertakings that rely on it tend to interpret it too broadly. There seems also to be no reason to maintain the provision for reasons of legal certainty since the case practice of the Commission and the case law of the Court has made it sufficiently clear that purely technical agreements are not caught by the prohibition of Article 81 §1. In appropriate cases, there would be alternative ways for the Commission to provide its views on purely technical provisions falling outside the scope of Article 81 §1, e.g. by deciding in an individual case on the inapplicability of Article 81, where the Community interest so requires.

Finally, it should be noted that the Council earlier this year decided to repeal a similar provision on technical agreements in the air transport sector for the same reasons.

[Conflict of laws]

The last substantive item to be considered concerns the conflict of laws provision of Article 9 of the Maritime Regulation. This provision provides for a procedure, which should be followed in case the application of the Maritime Regulation would amount to a conflict with the law of a third country. In that case the Commission should consult relevant authorities in third countries and should ask the Council to authorize it to open negotiations if needed. A conflict of laws would arise if one jurisdiction requires something that another jurisdiction prohibits. Such a conflict has not arisen under the application of the Maritime Regulation so far and it is highly unlikely to arise in the future, even if the block exemption for liner conferences were to be repealed in its entirety.

Also with respect to this item, the consultation process has not brought forward any convincing reason why the conflict of laws provision should be maintained. It would therefore appear appropriate to propose repealing the provision. It should also be noted that other international transport sectors, such as international air transport do not have a similar provision.

[Tramp vessel and cabotage services]

Finally, the review also concerns an important procedural item. As said, the specific procedural rules for the application of Articles 81 and 82 EC Treaty to maritime transport

have been repealed and they are replaced by the general implementation rules of Regulation 1/2003. However, as before, these implementation rules do not apply to international tramp vessel services (non-scheduled maritime services) nor to maritime transport between ports of the same Member State (cabotage traffic). To avoid any misunderstanding, it should be recalled that the substantive competition rules (Articles 81 and 82 EC) are applicable also to these services.

Regulation 1/2003 gives the Commission the practical tools needed for efficient fact-finding [e.g. the power to enforce legal deadlines for replies to requests for information, the right to impose fines for incorrect information or the possibility to carry out on the spot investigations] and ensures effective enforcement of the competition rules [e.g. by giving the Commission the direct power to bring infringements to an end or make commitments legally binding]. Moreover, Regulation 1/2003 codifies and safeguards certain rights of defence [e.g. the right to a hearing, the right of access to file].

Excluding maritime cabotage and tramp vessel services from the normal procedural framework has consequences also for the powers of the national authorities and national courts. The network system of Regulation 1/2003, providing for rules on information exchange and efficient case-allocation between the Commission and the national competition authorities, does not apply to maritime cabotage and tramp vessel services.

The role of the national courts in these sectors is similarly restricted since national courts may, in the absence of an applicable implementing regulation, only rule on Article 81 EC when the Commission or a national competition authority has held that a given practice infringes Article 81 EC.

Tramp vessel services and cabotage are the only services, which are currently excluded from the scope of Regulation 1/2003. A similar exception for aviation between the Community and third countries has been removed by the Council in February this year. No credible consideration has been put forward in the responses to the consultation to justify why these maritime services need to benefit from different enforcement rules than those which the Council has decided should apply to all other sectors. It would therefore appear appropriate to propose repealing the current exclusion.

[Next steps]

The next step in the review process is the preparation of a Commission White Paper, with concrete proposals, which is in principle foreseen for the autumn, in due time before the new Commission enters office.

All interested parties, governments and industry will be given another opportunity to submit their views before any concrete proposal for legislation would be submitted formally to the Council.

In the meantime, the Commission is ready to examine any further data, arguments or submissions from the industry or other interested parties. In particular, the Commission would expect that shipping lines start exploring alternative business models which they would consider necessary to maintain stable and reliable services in a world without the current anti-trust exemption for liner conference price-fixing, market sharing and capacity regulation. The Commission will have to carefully examine whether any alternative business model is acceptable under EU competition law and if confirmed, what specific regulation or other legal instrument may be necessary and/or appropriate for that purpose.

It goes without saying that the Commission will undertake this process in close contact with the EU's main trading partners, and in particular with the United States.

Conclusion

Chairman,

It is stating the obvious if I say that the Maritime Regulation deviates notably from the orthodoxy of European competition law. The explanation is historical. The Regulation codified generalised practices of liner conferences since 1875. It is time to review the situation and look forward. No convincing arguments have been advanced to maintain the *status quo*. Resistance to substantial change is completely in line of expectation. But we should not be afraid to be the first to propose such change if we have strong arguments.

I thank you for your attention.