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Changes in Block Exemption Applied to Maritime Transport and its Implication

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Ⅰ. Introduction

Liner shipping market has long been protected from capitalistic economy and its competition by block exemption. The market is well known to be

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highly inelastic, and in the case of liner shipping sector, it is often considered impossible to make profit while calling at ports on fixed schedule, unless there are enough cargoes to load with enough ships to run the routes to provide frequent services to shippers. Also, with its unique characteristics of operating punctually regardless of fully loaded or not, competition between shipping companies could only lead to deficit operation. In order to prevent excessive competition which would lead to bankruptcy, companies have formed cartels, and this has been the rule over the last centuries. Since the very first cartel, UK/Calcutta Conference in 1875, being protected to price-fix under the law over a long period of time, now the market is facing a new era. In the US, deregulation in transportation sector began from 80's, and continuing through OSRA 1998, conferences were dissolving. In EU, Regulation 4056/86 contained block exemption for liner conferences with no review clause included, but in October 2008, EU has announced removal or the Regulation 4056/86 leaving conferences no longer permitted to fix the price. With this removal, now the US and EU are on the same approach to liner regulation by permitting to share general information and market conditions, but prohibiting collective rate setting capability. Therefore, the aim of this paper is to review maritime transport policy (regarding liner conference) and to study changes in the liner market. It will discuss on the background of liner shipping market and its conferences, then review Regulation 4056/86 with OSRA1998. Lastly, it will discuss the removal of 4056/86 and its current status.

Ⅱ. Background

Sea borne trade is run by different types of vessels according to various types of cargoes its carrying, for example, dry bulk, tanker, and container. Also, it is operated differently according to its contract, such as tramp shipping and liner shipping industry. Liner shipping service can be defined as "a fixed itinerary, inclusion in a regular service, and the obligation to accept

cargo from all comers and to sail, whether filled or not, on the date fixed by a published schedule are what distinguish the liner from the tramp."[1] In other words, it is a regular scheduled service, emphasizing on its regularity and frequency. Liner service has developed since the second half of the 19th century, after steam engines became common, which allowed vessels to sail itself without being affected by wind, thereby able to be scheduled. However, unlike tramp industry, which can react relatively fast to its imbalanced supply and demand by putting into lay ups, liner industry cannot respond by reducing number of vessels or changing the size of vessel according to cargo volume and maintain its characteristics as a liner service provider at the same time. Whether cargo fully onboard or not, it has to make its journey to next destination as scheduled, and this condition led to high fixed cost. The failure to co-ordinate such services often led to bunching of arrivals in ports, and competition for cargo among rival firms proved destructive; to increase profit, companies needed to collect more cargo, but unable to charge shippers higher freight to maintain the customers. Also as technology develops, there were more vessels coming into the market, causing not enough cargo to load, and eventually leading to provide service at lower price as possible resulting in deficit. Hence, liner shipping companies were facing bankruptcy, but only large companies that are financially well established were able to stand against the financial burden and manage the imbalances in traffic flow.

Due to such imbalances in traffic flow, the market struggles at its unstable equilibrium. This is also related to inelastic market; freight rate variation (in short term). Shipping market could be divided into 4 segments - new building market, freight market, sales and purchase market, and demolition market.[2] The tariff is affected by those 4 segments' movement, which even more complicates the freight fluctuation. A solution to such problems as these

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1) Stopford, M. *Maritime Economics.* p.343 - quoted from *A Short History of the World's Shipping Industry.* Fayle, 1997. p.253

2) *Ibid.* p.77

possibly called handicapped features[3] , and most importantly to continue their service making profit, companies formed a group working together, a self-regulation.[4] The agreement is among scheduled carriers on a particular trade route to restrict competition among themselves by setting mutually agreed freight rates and conditions of service. Thus conferences could regulate of sailings and improve quality of ships, and thereby the UK/Calcutta Conference was formed in 1875, known as the first conference.

The government also interferes in this market as the industry has great impact to national economy and security. With the various functions, countries have been more on supportive side of its forming of cartels, so that its shipping market accelerates for bigger share of international market. Ever since the formation of the conference, it seemed that the market has been protected under various laws, and allowed even confidential agreements for such as price fixing.

Ⅲ. Changes in block exemption

1. Council Regulation (ECC) 4056/86 and liner shipping market

1.1 Council Regulation (ECC) 4056/86

Originally, European regulation began as Treaty of Rome, in 1957, which Art.85[5] and Art.86[6] contained the rules on competition. These rules were renumbered by the Treaty of Amsterdam, in 1999, to Art.81 and 82. It is perhaps natural to contain such legal restrictions to prevent any type of price

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3) Seasonality(cargo volume), cargo imbalances(trade lane), and indivisibilities

4) *Ibid.* p.343-349

5) This prohibits all agreements and practices that could affect trade and its competition in the market.

6) This prohibits any abuse by undertaking of dominant position within the market

fixing that would affect fair competition and economy structure. However, this was not to come into practice for maritime transport sector. The competition rules took into force to the Treaty in 1962, Regulation 121/62, but transport field was still excluded by Regulation 1017/62; it still was not noticeable sector by then. In 1974, European Court of Justice (ECJ) held that Art.81 and 82 applied to sea and air transport, but it took another period of time to put into practices, until European Commission (EC) published a Memorandum on Maritime Transport, and later on "1986 maritime package" adopted by the Council of Ministers, which could be the basis of the European maritime common policy; the four regulations are 4055/86- Freedom to provide services, 4056/86- Competition regime, 4057/86- Unfair pricing practices, and 4058/86- Coordinated action. From the package, Council Regulation 4056/86 deals with Art.81 and 82 of the Treaty; the Art.3[7] of the regulation contains block exemption for liner conferences. The Art.3 specifies its objectives for example, coordination of time-tables and the allocation of cargo or revenue. "This block exemption is often called the most generous exemption ever given as it covers traditional hard-core restrictions and furthermore does not contain a review clause and remains in force for an unlimited period of time. "[8] Considering these assumptions that the shipping markets could be led to destructive competition and that without cooperation the market won't be able

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7) Reg.4056/86 Art.3 - Agreements, decisions and concerted practices of all or part of the members of one or more liner conferences are hereby exempted from the prohibition in Article85(1) of the Treaty, subject to the condition imposed by Article4 of this Regulation, when they have as their objective the fixing of rates and conditions of carriage, and, as the case may be, one or more of the following objectives:
(a) the coordination of shipping timetables, sailing dates or dates of calls;
(b) the determination of the frequency of sailings or calls;
(c) the coordination or allocation of sailings or calls among members of the conference;
(d) the regulation of the carrying capacity offered by each member;
(e) the allocation of cargo or revenue among members.

8) Marco, B., Claudio, F. and Enrico, M. *The liner shipping industry and EU competition rules.* Transport Policy. vol.14, 2007. p.4

to provide service as it is supposedly but become bankrupt, carriers were able to form the conferences to provide reliable scheduled services.

1.2 Changes to traditional conference market

However, since the enforcement of the Regulation, shipping market conditions and other surroundings have been changed over decades, with high technology support. With the ever increasing overseas trade there are more customers with more cargoes, and mostly shipping market is now heading for competition. Thereby conferences have been attempting for openness, to provide competitive services. Even so, EU has been standing on its traditional conference market, and the regulation has not been changed or reviewed as there was absence of its revision clause, but kept strictly applied. Below mentioned cases show strict application of the Regulation 4056/86, and this eventually led to some conflicts later on. Well known cases would be Trans Atlantic Agreement (TAA), Far Eastern Freight Conference (FEFC), in 1994, and Trans Atlantic Conference Agreement (TACA), which replaced TAA in 1998, dealing with exemption for rate-fixing[9] . Its decisions by the Court of First Instance (CFI) were; 1) TAA case prohibited two-tier pricing which applying different rates to former conference members and others, including discussion agreements, that all members of a conference should be offered the same rate, 2) FEFC case held that 4056/86 doesn't cover inland tariff, only limited to port to port sea transport, 3) and TACA case decided that joint service contracts are not covered by 4056/86[10] . The latest could be The

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9) The Commission objected to the collective fixing of tariffs for the inland leg of multimodal transport operations, relying on Art.1 (2). - Consultation paper on the review of Council Regulation (ECC) No 4056/86 laying down detailed rules for the application of Articles 81 and 82 of the Treaty to maritime transport. http://europa.eu.int/comm/competition/antitrust/legislation/maritime/en.pdf

10) This is due to conferences' possible two big abuses; 1)fixing freight forwarders' commissions including some restrictions over service contracts, and 2)placing its dominant power over others.

Revised TACA which was declared in Nov.2003, that cargo-handling services in ports would fall within FEFC decision. However, these strict applications of the regulation could cause conflicts, especially after the United States reforming the Act in late 90's to adopt the trends, and considering the fact that shipping market is originally an international market; EU shipping market could not stand alone with its traditional conferences and its supporting regulations. In this context, EU perhaps had no other choices then to accept the changes brought into the market and OSRA 1998 and its impacts cannot be ignored.

2. The US Shipping Act of 1984 to OSRA 1998

2.1 The US Shipping Act of 1984

"The US Shipping Act of 1984, which repealed the 1916 Act, was enacted by the Congress and signed into law by the President on 20 March 1984.[11] " The United States has been working on deregulation in transport sector from 1970's, and the 1984 Act was logical extension of the process. "The three key goals of the Act were to encourage the development of an economically viable US flag liner fleet, provide for an efficient and economic transportation system in the US, and to establish a non-discriminatory regulatory process that would minimise the amount of governmental interference in the marketplace.[12] " The occurred changes were, accordingly, on antitrust immunity, service contracts, and independent action. The agreements under antitrust immunity were allowed to go into effect 45 days after filing[13] , which used to be approved by Federal Maritime Commission (FMC) before going into effect.[14] Until the

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11) Gardner, B., Marlow, P. and Nair, R. *The economic regulation of liner shipping: the impact of US and EU regulation in US trades.* In: Grammenos, C. TH. (ed), The Handbook of Maritime Economics and Business. 2002. p.331

12) Lewis, I and Vellenga, D. B. *The Ocean Shipping Reform Act of 1998.* Transportation Journal. 2000. p.28

13) Sec.6 (c) Unless rejected by the Commission …shall become effective (1) on the 45th day after filing, or on the 30th day after notice of the filing is published in the Federal Register, whichever day is later

1984 Act was enforced, antitrust immunity was allowed only to ones that had been filed with FMC, but after the Act, it was extended to practices that have a reasonable basis under Sec.7 (a). Furthermore, it was no longer provided to sue for antitrust damages as it is prohibited by the Act[15] . Secondly, under Sec.8, it was permitted to provide service contracts, offering special tariff to certain shipper, and this could be joint agreements, agreeing not to undercut the price. However, with anti-competitive action allowed, it was also provided pro-competitive duties. Carriers had to file them with FMC, and terms were to be available to public. Hence all shippers with similar conditions were able to request the terms on their contract as well. This is known as the "me-too" provision. Lastly, through Sec.4, independent action became mandatory, and carriers were allowed to charge different prices. This was mainly to counterbalance the antitrust immunity. In addition, other provisions such as Sec.4 (a) (1) and Sec.10 (c) (4) states of intermodal rates, that conference authority to set intermodal rates but not able to negotiate with inland carriers within the US territory. This was to prevent small - in terms of cargo volume carried at once - inland carriers being overruled by sea carrier conferences, which can carry big number of containers at once. Moreover, it states to prohibit the dual rate[16], and to be open conference to any carriers[17]. Above all these provisions, under Sec.18, FMC was placed on duty to collect and analyse the data of five-year period within the industry, and report, known to be Sec.18 report.

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14) According to the Sec.6 (g), FMC at anytime may seek an injunction to any agreements that is considered to be causing a reduction in competition, but burden of proof was now on FMC, not on the parties to the agreements.

15) Sec.7 (c) (2) No person may recover damages under section 4 of the Clayton Act (15U.S.C. 15), or obtain injunctive relief under section 16 of that Act (15U.S.C. 26), for conduct prohibited by this Act.

16) Sec.10 (b) (9) "… give any undue or unreasonable preference or advantage… prejudice or disadvantage…" - providing different rate to a certain shipper according to its loyalty to a certain carrier or conference

17) Sec.5 (b) (2)

2.2 OSRA 1998

In 1994, National Industrial Transportation League, known as NIT League, proposed a reform to the Act 1984. The bill requesting reform the Act was passed to the House of Representatives, but opposed to Senate in 1996, disagreeing on abolition of the FMC, which was one of the proposals given. Later on, this came into force on 1 May 1999; the US Ocean Shipping Reform Act of 1998 (OSRA), amending the Act 1984. One of the major changes was that individual service contract and its confidentiality was permitted[18]. Related to this, 10 days to give notice of independent action was reduced to 5 days, under Sec.5 (b) (8). The reform was to protect U.S. firms from foreign companies taking advantages by accessing to important contract terms, such as cost. Therefore previous "me-too" provision was deleted. This has affected the decline of conferences. Shipping conferences were set up mainly to stabilize rate among the members, but as the industry became globalized and needed intermodality to deliver cargoes, firms required something more than just rate stability. Trade routes based conferences became an old obstacles, since the industry environment has been changed its base to global and thereby shipping companies were tending to be more preferable to alliances than conferences. Other changes were the replacement of filing tariff system to posting on internet[19], and freight forwarders and non-vessel operating common carrier (NVOCC) were placed under ocean intermediaries.

3. Conflicts among different regulations

One of the major differences between US regulations and EU regulations was that discussion agreements were available in US but not allowed in EU. Hence in the transatlantic lane, where carriers had to comply with both

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18) Sec.8 (c) - individual service contract stated in (1), and confidentiality stated in (2)
19) Sec.8 (a) (1)

regulations of the US and the EU, the conferences, namely TACA (formerly TAA), became necessary in order to share information and setup the rate. In 1999, TACA submitted an application to amend provisions to comply with OSRA, and consequently the members were allowed to enter into non-conference service contracts. Moreover, while the US allowed to discuss information with outsiders of conference, EU did not allow this, hence conferences were prohibited to share information on the contents of the contract regarding non-conference service contracts. However they were able to form a model conference service and discuss of individual contract negotiations.[20] This gave dramatically decrease in both market share and the number of conference membership. The market share dropped from roughly 80% to 50%, and the number of membership was 7 carriers, which used to be around 17 carriers in 1992. It was almost 600 conference service contracts in 1998, but the next year 80% of the cargoes were moved under individual service contracts. Out of 1,000 service contracts of TACA, only 30 contracts were by the conference, and the rest were by individual. It was even reduced to 3 conference service contracts in 2000[21]. Although existence of the conference rate, as shown above, massive increase of individual contract affected freight rate as well. Due to imbalances of the trade, higher growth cargoes heading to the US and steady or fallen growth heading to the EU, accordingly freight rates has increased towards to the US and steady or fallen towards to the EU. This could be seen as the beginning of the changes, as well as the decline of liner conferences, although the EU was maintaining the regulation on liner conference strictly.

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20) Gardner, B., Marlow, P. and Nair, R. The economic regulation of liner shipping: the impact of US and EU regulation in US trades. In: Grammenos, C. TH. (ed), The Handbook of Maritime Economics and Business. 2002. pp.340-341

21) Numbers from - Federal Maritime Commission. The impact of the Ocean Shipping Reform Act of 1998. 2001. p.17

Ⅳ. The Removal of ECC 4056/86

While both the US and the EU provide ocean carriers with some form of immunity or exemption from respective antitrust/competition laws, each entity's approach leads to different and significant economic consequences. The United States have been moving towards more open and competitive while EU have been standing on strictly traditional conference based market. The establishment of OSRA 1998 brought different regulations to the market, especially in Trans Atlantic lane which could cause conflict. After all these changes made to the shipping markets, EU has been also began to review the market, and on Oct. 2008, Regulation 4056/86 has been removed from maritime transport sector, and forming cartels or any sort of price fixing is no longer permitted to ships that are operating in and out of Europe.[22] And with this removal, now the scope of the regulatory regimes can be seen unilateral with the regime of the US.

Although unexampled changes are made to the market, carriers and related parties are not in panic as one could have concerned, as this removal has been discussed since 2003. After reviewing the market status through various organizations, the White Paper was issued in Oct. 2004 and the removal was passed on Sept. 2006; Regulation 1419/2006 was entered into force which repealed the Regulation 4056/86 and the shipping industry became subjected to Art.81 and Art.82.[23] Furthermore, in order to prevent confusion or disordered state, guideline has been issued so that relevant parties have enough time to settle. In the beginning of this process, the European Liner Affairs Association (ELAA) and carriers were against the removal, but later on they

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22) Numbers from – Federal Maritime Commission. The impact of the Ocean Shipping Reform Act of 1998. 2001. p.17

23) Stamatiou, C. and Neocleous, P. "The new era of EC Competition law in the shipping industry", International Company and Commercial Law Review. vol.20, iss.1, 2009. p.1

claim for alternative plans, insisting that the block exemption should be replaced with an information exchange system.[24] As ELAA advises alternative measure, the removal of the regulation became clearer, and the issue was whether information exchange system would be selected as an alternative or not. Carriers also admit price fixing through conferences is no longer necessary to maintain the market[25]. They suggested that the replacement of conference to information exchange system will eventually lead to more competitive market by providing more information to shippers and sharing core data among carriers.[26] On the other hand shippers were supporting the removal and they opposed on information exchange system as well. They were seeking more competition in the market which could possibly provide cheaper and clear tariff than the tariff under the conference system by eliminating the block exemption.[27] Although the two parties showed little differences in their views, both were advising that entering into more competition would lead to providing benefits to both parties.

If the Regulation was to be replaced with information exchange system, then the market would show much similar structure to the US shipping market under OSRA 1998. It would not have too much of effects to but falling under similar structure reducing conflicts in transatlantic lane. However, it has been decided to remove it without any other system to assist, and therefore it would be an opening to a new era of shipping market, although

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24) European Liner Affairs Association Review of Regulation 4056/86: Comment on EC Commission Draft Guidelines on the Application of Article 81 of the EC Treaty to Maritime Transport – [http://ec.europa.eu/comm/competition/antitrust/legislation/maritime/index.html]

25) IP/06/1249 – Brussels, 25th Sept.2006 [http://ec.europa.eu/comm/competition/antitrust/legislation/maritime/index.html]

26) Nitsche and Hinten-Reed 2004, Competitive Impacts of Information Exchange. p.10-22

27) Response to the ELAA Proposal for a new regulatory framework for the liner shipping industry – Article 81 EC Assessment, 10th Mar. 2005 – [http://ec.europa.eu/comm/competition/antitrust/legislation/maritime/index.html]

the scope of the regimes being more unilateral than before, as it had not been under such a condition before. Liner industry is now facing diverse and various strategic options and would be difficult to predict the market, but this removal will have certain affect to other relevant Regulations to be revised, as well as ones in other countries.

Existing conferences are no longer permitted from October 2008; typically vessels operating in and out EU cannot fix the price. Thus there are some concerns regarding mega-sized shipping companies. For example Maersk Line, CMA CGM, MSC are well known large companies that take large portion of the European market, and they will be positioned advantageous than other non-Europe based companies in many ways such as obtaining information. Therefore small European shipping companies as well as non-Europe based shipping companies are expected some difficulties in European market. However as the removal of 4056/86 does not interfere forming of consortia and alliances[28], there are chances of carriers to form alliances to compete with mega-sized European companies.

1. The impact of the removal

Although the scope of the regime for both continents is now more unilateral than before the removal, they still not have met the agreement. The reform of the system in the US was done within the range of admitting the existence of conference, on the other hand the EU now has announced to abolish conference system. Hence both continents were seeking for more competition but one side allowing conference while the other doesn't. This does affect the US regime in some ways as it did to the EU regime causing the removal. The US created Antitrust Modernization Commission[29] to review antitrust laws,

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28) MEMO/06/344 - Brussels, 25th Sept.2006
[http://ec.europa.eu/comm/competition/antitrust/legislation/maritime/index.html]

29) Antitrust Modernization Commission created pursuant to the Antitrust Modernization Commission Act of 2002 and dismissed on May 2007 after the amendment of the Act.

and according to their report with the EU's recent elimination of its antitrust exemption for ocean carriers left "the United States as the only major country that still immunizes fixing shipping rates"[30]. They also have pointed out the efficient operation of ocean transport with competition, emphasizing on its quality of the service it matters not the price fixing to survive in the market; which has certain possibilities to abolish the conference system in the US as well.

The changes in the EU regime not only affect the US regime, but also shipping companies too. MOL has resigned from its conference as of Nov.2008. MOL did not prefer operating two different sets of rules – one for Europe lane and another for non-Europe lane. Carriers are still facing to operate under different sets of rules, and it is considered as only a matter of time for other carriers to follow MOL.[31] Shipping companies will face more difficulties running in two different regimes with the intense competition, hence to select unified one. Perhaps it would be wise move to resign from the conference and seek for alliances to maintain the market share they had in and out of Europe, considering the fact that OSRA 1998 already rendered conferences virtually obsolete, although admitting its existence.

Moreover, the impacts would not leave out the Asian market, considering its borne characteristics of international market. Many Asian countries also are reviewing their antitrust law and under this tendency, dismissal of conference system would be only a matter of time. In the case of Korea, it would be required to be prepared for the possible changes in regime; Korean regulatory has not yet considered of antitrust law in ocean shipping industry, but it needs to review and clearly state regarding the exemption. Once conference system is removed, it does contain risks of market becoming quite unstable, especially due to freight rate changes. Hence, Korean regulatory should seek ways to

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30) Antitrust Modernization Commission. Antitrust Modernization Commission Report and Recommendation. 2007. p.335

31) Johnson, E. "Chain reaction?" American Shipper January 2009 pp.32-35

minimize the risks but to encourage competition on the other hand – policies that could support reduction of operation cost would be more appropriate than to set freight rate at certain level.[32)]

V. Conclusion

Regulations have changed over period of time as the market environment changed, and are still changing. As discussed above, liner services were, in order to provide proper service and maintain themselves from running bankruptcy, forming conferences. They were once advised to protect liner industry and to develop them, but now they are put into free and open competition with little interference of the government. The EU has moved forward to competitive market by removing 4056/86 from liner industry. The repeal of the immunity for price fixing will alter significantly the rule on cooperation in the industry since it is a unilateral move by the EU. OSRA 1998 has already broken up conferences by allowing individual service contracts, thus the impact from removal of 4056/86 may not bring issues into the market as much as it did with OSRA 1998. However the EU does not even allow information exchange system among the carriers which would lead the market to far more competition. The advantages exist for both carriers as well as shippers and their operation is augmented by the ability of carriers to coordinate their container ships and facilities through consortia on specific routes without being in conflict with the anti-trust laws. Over the century, port-to-port base trade has changed into door-to-door logistics. Accordingly, companies are not just getting bigger in terms of its size but also extending its

32) Kil. KS and Ko, BW. "An evaluation of EU's abolition of liners' block exemption to competition rule and its implication for Korea liner market – using the difference-difference estimation concept", Journal of Shipping and Logistics. vol.65. p.249

business to inland transport. There are rapid changes in shipping market getting much more complicated, and with removal of 4056/86 allowing the market to be more competitive, opening up the industry with far more diverse strategic options. Although there are some different views, the market will become more difficult to forecast – for example, the global economic recession in 2008 which could have jeopardized the new era of liner industry with abolishing conference system in EU in the same year, – hence further study is necessary to gain deeper understandings to changing regulatory regimes.

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- MEMO/07/355 Brussels, Sep 2007, Antitrust: Draft Guidelines for maritime transport – frequently asked questions

ABSTRACT

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This study reviews maritime transport policy regarding liner conference and the changes in the liner market over the decades. Liner shipping industry has long been protected from competition by block exemption. To prevent excessive competition in punctual operation and its inelastic market structure, liner shipping companies formed conferences that are protected to fix the prices under the law. In the US, deregulation in transport sector began from 80's and continuing with OSRA 1998, conferences were dissolving. On the other hand, the EU with close conference system, Regulation 4056/86 contained block exemption remained in force for unlimited time without review clause. However, in Oct 2008, the EU has announced its removal, and conferences were no longer permitted to fix the price nor exchange information. Although OSRA 1998 has already broken up conferences by allowing individual service contracts, but the repeal of the immunity for price fixing will alter significantly the rule on cooperation in the industry since it is a unilateral move by the EU, especially in transatlantic lane. There are rapid changes in shipping market getting much more complicated, and with removal of 4056/86 allowing the market to be more competitive, opening up the industry with far more diverse strategic options. Hence this paper reviews on liner shipping industry and its changes of policies over the years from protected market to open competition market of today.

Key Words : Liner Conference, Anti-trust law, Price fix, OSRA 1998, Reg.4056/86