

***World Shipping Council (WSC), European Community Shipowners' Associations (ECSA), and International Chamber of Shipping (ICS)
Background Paper on the Consortia Block Exemption Regulation***

The liner shipping industry, through the World Shipping Council (WSC), the European Community Shipowners' Associations (ECSA), and the International Chamber of Shipping (ICS), offers these preliminary observations as the Commission begins its consideration of extending the period of application of Commission Regulation (EC) No 906/2009 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions, and concerted practices between liner shipping companies (consortia) (the "Consortia Block Exemption Regulation" (BER)).

The industry supports a further five-year extension of the Consortia Block Exemption Regulation.

The trade associations named here and their members look forward to submitting formal comments to the Commission in the public consultation. In advance of the initiation of that consultation, the liner industry provides these initial, more limited observations with the hope that they will assist the Commission in its information-gathering and analysis. In particular, some parties have suggested that recent merger activity and changes to vessel sharing agreements represent fundamental changes to the structure of the industry that require changes to the existing regulatory regime. Although there has been substantial activity in these areas, that activity does not fundamentally change the structure of the industry or the competitive landscape. This initial paper provides both historical context and current, objective analysis of the liner shipping industry as it continues its evolution in response to changes in market conditions. That orderly evolution requires legal continuity and certainty, not regulatory change simply for the sake of change.

These initial comments address three points: (1) the operational reasons why vessel sharing arrangements are essential to the efficient provision of liner shipping services; (2) evolution of the liner shipping market, including historical trends and recent developments, and (3) the reasons why extension of the BER is good policy.

A. Vessel Sharing Arrangements Are a Longstanding and Integral Part of the Liner Shipping Industry

The primary requirement for a ship operator to enter liner shipping markets, or to maintain on-going regular service to existing markets, is the enormous capital investment required for ships and equipment. Liner shipping agreements that, in various forms, are used for the purpose of sharing vessel assets have existed for decades and are a fundamental tool used by carriers to effectively and efficiently deploy their ships and equipment once the capital investment is made.

Vessel sharing arrangements also promote competition and improve services for customers. They lower barriers to entry and expansion; they increase the number of port-pair combinations that any individual carrier could offer; they increase price competition for any given port pair; they enable the more efficient deployment of right-sized vessels; they enable carriers to use much larger and more efficient vessels in appropriate trades; they reduce unit costs; they enable a better calibration of capacity to market conditions; they improve responsiveness to changes in market requirements; they produce environmental benefits by reducing emissions per TEU; they broaden service networks for individual carriers, and therefore allow carriers to offer better and more choices for customers, with enhanced product quality and reliability.

The structure, duration and geographic scope of these agreements vary according to the needs of the carriers seeking to offer service to a particular market. They can be structured as simple space or “slot” charter arrangements between two carriers, where carrier A agrees to charter a certain amount of space on carrier B’s vessel (s), often on a limited number of services and/or between a limited number of port pairs, thereby offering carrier A the ability to compete in a market where it does not have sufficient customer volume to justify the expense of operating an independent service.

A more expanded version of a slot charter agreement might be a vessel sharing agreement, where two or more carriers each agree to provide a specified number of ships in order to operate a service (s) in order to serve a particular market (s). These types of agreements are particularly useful for carriers wanting to enter new markets or continue to serve markets with smaller cargo volume.

Under the current regulatory regime in every major trading nation around the world, new entrants or smaller carriers, for example, have the ability to partner with other carriers, some of which will have larger, broader networks, in order to expand the services that the new entrant or the smaller carrier can offer to a customer. Similarly, under the current regulatory regimes throughout the world, when a carrier offers a niche service, perhaps with some unique port calls, it is able to share some of its capacity with other carriers that might seek to offer service to those ports, thereby creating additional service and competition in that market. Without that ability, service to smaller ports, regions or countries would be at risk. Vessel sharing also facilitates more frequent and competitive services on “long, thin” trades, meaning those routes that involve long distances but relatively low cargo volumes.

In addition to allowing carriers to maintain more service to smaller trades and ports, vessel sharing arrangements support more efficient services on high-volume trades, especially those trades that accommodate larger vessels. Those larger vessels are more efficient – economically and environmentally – on a per-unit basis. However, because the unit of supply for containerized liner shipping is a group or “string” of multiple ships needed to maintain a fixed weekly sailing schedule (typically 10-12 ships in the Asia/North Europe trades), it is challenging for a single carrier to fill that much capacity by itself on each voyage. Vessel sharing in this context allows the use of the most efficient ships by spreading that capacity over enough carriers to make

sure that the ships are reasonably full, thus allowing the efficiencies to be realized. This is also permitted by the regulatory regimes of every major trading nation in the world.

For example, carriers operating in the large volume trades between Asia and Europe and Asia and the Americas are dependent upon the use of larger vessels in order to make those services economically viable, because the use of these ships lowers per-unit costs. However, it is not the deployment of the ship alone that can achieve an economy of scale or the related cost reduction; it is the deployment of the larger ship when it is reasonably full with paying cargo. In other words, a 14,000 TEU ship that is half full is less efficient than a 7,000 TEU ship that is full, but one full 14,000 TEU ship is more efficient than two 7,000 TEU ships. Fuller vessels are also more carbon-efficient, resulting in lower CO₂ emissions per TEU per kilometer transported.

Historically, the ability to share space has been critical to carriers' ability to provide frequent, reliable services to their customers at reasonable cost. The importance of vessel sharing will continue as global trade increases in volume and scope. This perspective of development of the industry to date, current trends, and the outlook for the future is examined in more detail in the next section.

Development of Vessel Sharing Agreements

As international trade volume has grown, so has the size of the ships deployed to transport those goods. For example, in 2005, the largest ship delivered was 9,200 TEU. Ten years later, in 2015, the largest ship delivered was more than double that size at 19, 224 TEU¹. Ships in excess of 21,000 TEU have recently been delivered. The use of ever-larger ships to accommodate ever-growing international trade is neither new nor unexpected. In fact, as early as 1966, global management consulting firm McKinsey & Company concluded in a report it completed for the British Transport Docks Board on the outlook for containerization that: "If container ships follow the tanker trend, ships of more than 10,000-container capacity could be available." That prediction did indeed come true about 40 years later.

Since ships of 6,000 TEU or larger were introduced in 1996, we have seen the expanded use of carrier cooperation agreements to cover multiple ships and services operated by multiple carriers, as summarized in the chart on the following page.

¹ A "TEU," or twenty-foot equivalent unit, is the standard measure used in container shipping for ship capacity and cargo demand. Most containers are 40 feet in length and equate to 2 TEU.

Development of Multitrade Agreements/Alliances

1996	Global Alliance	Grand Alliance	Hanjin/Tricon	
Main Partners	APL, Nedlloyd, MOL, OOCL, MISC	Hapag-Lloyd, NYK, NOL, P&OCL.	Cho Yang, DSR/Senator, Hanjin	
2000	New World Alliance (NWA)	Grand Alliance	United Alliance	
Main Partners	APL-NOL, MOL, HMM	Hapag-Lloyd, P&O, Nedlloyd, OOCL, MISC	Cho Yang, DSR/Senator, Hanjin	
2006	New World Alliance (NWA)	Grand Alliance	CKYH	
Main Partners	APL-NOL, MOL, HMM	Hapag-Lloyd, OOCL, MISC Berhad, NYK Line	Hanjin, Yang Ming, K Line, COSCO	
2010	New World Alliance (NWA)	Grand Alliance	CKYH	
Main Partners	APL-NOL, MOL, HMM	NYK, Hapag-Lloyd, OOCL	Hanjin, Yang Ming, K Line, COSCO	
2015	2M	G6	CKYHE	O3
Main Partners	Maersk, MSC	Hapag-Lloyd, MOL, NYK, APL-NOL, Hyundai, OOCL	Hanjin, Yang Ming, K Line, COSCO, Evergreen	CMA-CGM, China Shipping, UASC
2017	2M	THE	OCEAN	
Main Partners	Maersk, MSC (HMM slots)	Hapag-Lloyd, K Line, MOL, NYK ² , Yang Ming	China COSCO, Evergreen, CMA-CGM, OOCL	

² K-Line, MOL and NYK have integrated their container businesses into the newly established Ocean Network Express or ONE, which is scheduled to commence operations as a single ocean carrier on April 1, 2018.

These multitrade vessel sharing agreements are sometimes referred to as “global” agreements or alliances. It is important to note, however, that despite what the name suggests, today’s alliances that are referred to as “global” include specific trades and/or services within their scope. Carriers operating in these arrangements also simultaneously operate other services and enter into cooperation agreements with other carriers. In other words, although these alliances have significant presences in the major east-west trades, carriers both within and outside of those alliances also engage in wide range of other service offerings.

There are numerous examples of how carriers operating in one of the large alliances will enter into agreements with carriers outside the scope of that alliance in order to expand service coverage and increase efficiency in various markets. There are also examples of carriers that do not participate in any one of the three large alliances partnering together or with carriers who are party to one of those alliances. These agreements change regularly in order to adapt to market conditions; however, some examples of those announced or in place as of February 15, 2018 are:

- New vessel sharing agreement between Asia and the West Coast of Latin America that partners Hapag-Lloyd, HMM, MSC and ONE³
- Service connecting North Europe and the Mediterranean with India and Pakistan that partners CMA CGM, Hapag Lloyd and MSC⁴
- Service connecting North Europe and the Mediterranean with the Middle East, India and Pakistan that partners CMA CGM, Hamburg Süd, and Hapag Lloyd⁵
- Vessel sharing agreement between the US East Coast and the Iberian Peninsula, the Mediterranean and Africa that partners Turkon Line and Nile Dutch Africa Line⁶

This represents just a small sample of the numerous cooperation agreements of various types that exist among the hundreds of carriers operating worldwide. As another data point, we note that the U.S. Federal Maritime Commission maintains a public database of all carrier agreements required to be filed in the United States. These are only agreements that touch U.S. international trade, but the size of the database is indicative of the scope of vessel sharing activity generally. In the three categories that the FMC labels as vessel sharing agreements, space charters, and joint service agreements, there were 273 agreements listed as of February 14, 2018.⁷

³ <https://www.hapag-lloyd.com/en/news-insights/news/2018/02/new-asia-to-west-coast-of-latin-america-vessel-sharing-agreement.html>

⁴ <http://www.cma-cgm.com/products-services/line-services/flyer/EPIC1>

⁵ <http://www.cma-cgm.com/products-services/line-services/flyer/EPIC2>

⁶ U.S. FMC Agreement No. 012456 available at:

<https://www2.fmc.gov/FMC.Agreements.Web/Public/AgreementHistory/1942>

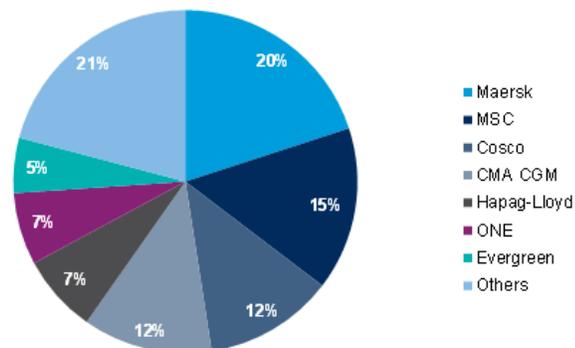
⁷ The FMC’s agreement database may be accessed at: <https://www2.fmc.gov/FMC.Agreements.Web/Public>

The changes in multitrade agreements that have taken place over time (as shown on the chart on page 4) occur for many reasons, and all are in reaction to changes in market conditions. Some might be the result of carriers ceasing to offer service, as was the case with Cho Yang, DSR/Senator and MISC Berhad, or a carrier going out of business entirely as recently happened with Hanjin. Many changes occurred as a result of the more than 75 mergers or acquisitions (M&A) that the industry has experienced in the last 40 years, which are summarized in detail by industry publication JOC.⁸

The ability to readily modify the carrier agreements, including cancelling them, adding new partners or entering into new agreements, is one of the key factors that has allowed the liner shipping industry to continue to provide regularly scheduled service (usually weekly), consistently and with limited interruption, for decades – and to plan to continuously offer that level of service for decades to come. Recent changes are simply an evolution of the same type of activity that has taken place regularly for the last 20 years. Although much attention in recent years has been paid to the larger alliances, it is critical to remember that vessel sharing agreements come in many varieties and sizes, and that most carriers employ these arrangements in some form in their businesses, even as they may also offer purely independent services.

B. The Industry Remains Competitive and Responsive to Cargo Demand

Given the recent merger and acquisition activity and the evolution of multitrade alliances, Drewry Shipping Consultants recently undertook an examination of whether the container shipping industry remains a competitive one. The title of the report reflects their conclusions: “Container market still competitive.”⁹ Drewry identified almost 400 different vessel operators providing regularly scheduled container service, and concluded that indeed the leading seven carrier groups (inclusive of all subsidiaries and assuming completion of all pending mergers) will control approximately 80% of the container fleet as defined as of October 1, 2017. Drewry then undertook a more thorough examination of the competitive environment on a trade-by-trade basis.

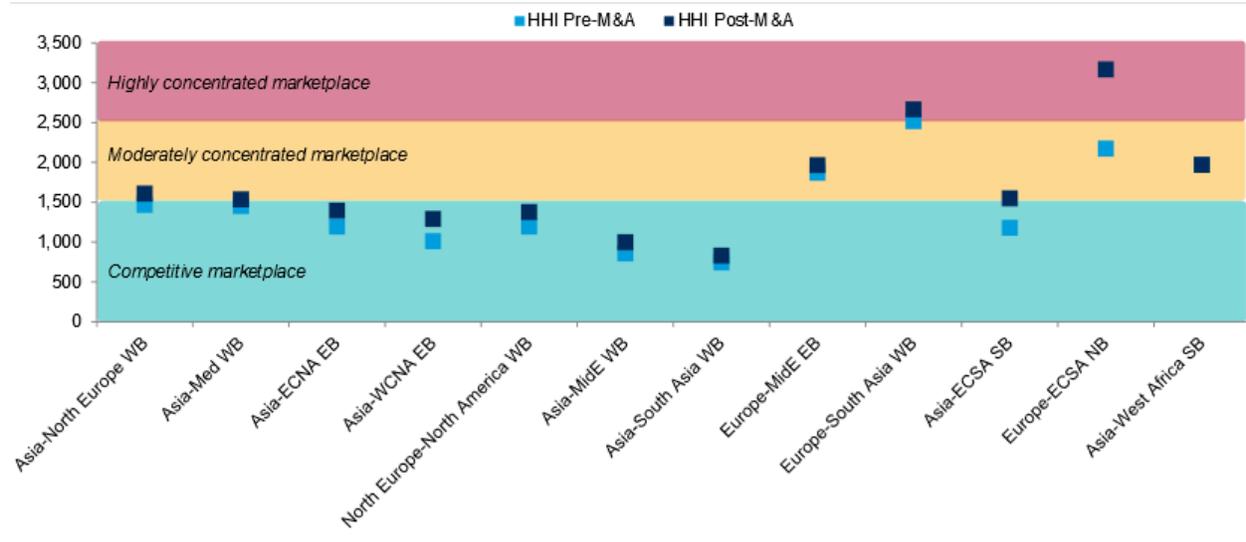


⁸ <https://www.joc.com/maritime-news/container-lines/container-carrier-mergers-acquisitions.html>

⁹ <https://www.drewry.co.uk/container-insight-weekly/weekly-feature-articles/container-market-still-competitive>

Source: Drewry Maritime Research

The approach utilized for that part of the review was the Herfindahl-Hirschman Index (HHI) methodology,¹⁰ applied to assess the competitive environment in 12 main trade routes globally. From this Drewry concluded that despite the fact that a significant portion of the global fleet capacity was controlled by a smaller number of operators than before, “the industry remains highly competitive by standard measures.”



Key: Less than 1,500 = competitive marketplace
 1,500-2,500 = moderately concentrated marketplace
 Greater than 2,500 = highly concentrated marketplace

Source: Drewry Maritime Research

Drewry’s recent study evaluates market concentration based on completion of all pending transactions, thus producing concentration levels in some cases that are greater than actual levels today.

A quite different metric for measuring market responsiveness in the liner shipping industry is the Liner Shipping Connectivity Index (LSCI), which was established by the United Nations Conference on Trade and Development (UNCTAD) in 2004 as a relative indicator of how well a country is connected by liner shipping networks to other countries around the world.¹¹

¹⁰ The Herfindahl-Hirschman Index (HHI) is calculated by squaring the market share (in this analysis the effective headhaul capacity is used as a proxy) of each company competing in the market, and then summing the resulting numbers, ranging from close to zero to 10,000, the latter being indicative of a monopoly. The higher the number the more concentrated a market is considered to be.

¹¹ <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=92>

The UNCTAD Review of Maritime Transport for 2017 notes that in general, increased connectivity for a country will increase the value of exports.

Since the LSCI computation is based on utilizing actual fleet deployment data, it can be a useful indicator of the trends in connectivity for a particular country. For example, an LSCI has been computed for 112 of the 134 UNCTAD member states. Of those, 96, or 86%, have seen an increase in liner connectivity as reflected by an increase in the LSCI from 2004 to 2017, with many values more than doubling. This indicates that overall, liner shipping connectivity has improved significantly since 2004.

For many of those countries, the LSCI fluctuated throughout the period, which is likely reflective of changes to carrier networks made from time to time to respond to changing market conditions. The ability of the liner shipping industry to respond to these fluctuations in demand is supported both by the competitiveness of the market (which rewards early entry and/or increased participation when demand increases) and also by the operational flexibility provided by vessel sharing arrangements.

C. The Consortia BER Remains an Appropriate Way to Provide Legal Certainty That Facilitates Efficiency in the Liner Shipping Industry

Some shipper trade associations have raised concerns about merger and acquisition activity in the liner industry, and some have sought to combine concerns about consolidation with calls for changes to the consortia BER. To date, we have seen no structural or quantitative analysis that would support a different regulatory approach either with respect to the Commission's well-established merger review process or with respect to the BER. Quite apart from the BER, the Commission has not hesitated to condition merger approvals on withdrawals from vessel sharing arrangements in appropriate cases, demonstrating that existing regulatory tools can effectively deliver market protections when needed.

Change causes anxiety, but the response to that anxiety should not be to make unwarranted revisions to regulatory structures and processes that have proven effective over time and that remain fit for purpose. The industry associations submitting this paper urge the Commission to treat the question of whether to extend, amend, or repeal the BER as what it is: a question of policy that asks which regulatory approach most likely results in a liner shipping market that is both competitive and efficient.

Vessel sharing arrangements – including large alliances, simple slot charters, and many variations in between – have been in existence for many years. Their operation is well understood by the Commission, by shippers, and by carriers. These arrangements increase efficiency, provide stable service, and reduce CO₂ and other air emissions by allowing carriers to

move containers using the most appropriate assets that burn the least amount of fuel per unit of cargo moved. The BER permits a broad variety of customized cooperative arrangements, permitting the carriers to build the best possible products for each trade and circumstance, whether simple slot charters or more complex operational agreements. This guarantees maximum efficiency, more competitors, and more market responsiveness. These are outcomes that should be supported as beneficial to all interested parties, including European businesses and consumers, as well as the EU's trading partners.

The consortia BER tells carriers what they can and cannot do with respect to vessel sharing activities in order to benefit from the legal certainty provided by its safe-harbour. This comfort covers both the operational vessel-sharing activities of the arrangement, as well other areas of their cooperation such as information sharing and the ancillary activities permitted by the BER. Outside the conditions in the BER, carriers must self-assess, but the BER still provides a useful baseline in those cases because it allows for speedier and more reliable self-assessments. In neither case does the BER represent special treatment under the law; it is an expression of the experience that the Commission has amassed through years of dealing with the liner shipping industry. It is of real practical utility to all involved that that amassed wisdom be memorialized so that the rules are clear for all.

If the BER were not renewed, this would have a chilling effect on efficiency-enhancing cooperation in the liner shipping industry. The loss of legal certainty would make the creation of such arrangements less straightforward, more risky, more complex and more legalistic. This would likely deter smaller carriers from entering into such arrangements, and deter all carriers from entering into such arrangements unless their size and scale justifies the costs of self-assessment.

If the BER were allowed to expire, there would also be knock-on effects in other jurisdictions which tend to follow the EU's lead on these subjects. Many other regulators look to the EU for guidance, and extensive policy discussions including in the context of OECD have taken place. Ending the BER would likely result in other regulators (who may not appreciate the distinction between BER and self-assessment) questioning the legality of operational agreements. If other legal regimes followed suit and ended explicit exemptions for vessel sharing, the industry could face enormous problems determining whether and how to mount these pro-competitive and pro-efficiency joint deployments.

Vessel sharing arrangements are essential to the efficient functioning of the liner shipping industry, and the consortia BER ensures that those efficiencies are accompanied by continued robust competition. For those reasons, the BER should be extended for another five years.

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