The European Shippers’ Council's submission to DG Competition of the European Commission

ON THE REVIEW OF COUNCIL REGULATION 4056/86

NON-CONFIDENTIAL VERSION
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European Shippers’ Council

The European Shippers’ Council (ESC) represents the interests of European industry as users of freight transport services. Its member organisations represent all branches of industry and commerce, who in turn represent thousands of companies who transport the majority of cargo shipped by road, rail, inland waterways and sea within Europe, as well as overseas.

The ESC operates from offices in Brussels and has amongst its priorities to promote efficient and commercially attractive freight transport services and to enhance the competitiveness of companies conducting business in Europe and in overseas transport markets.

In this capacity, the ESC represents the views of European business to a wide range of European Union institutions and international business and inter-governmental organisations, including UNICE (European industry and employers’ organisation), BIAC, the ICC and the OECD.
Summary

- A review of Regulation 4056/86 is long overdue.

- The liner shipping conferences must justify the retention and continued use and supposed benefits they bring to their customers.

- The practices allowed under Regulation 4056/86 (price fixing and capacity management) give rise to:
  - rate instability;
  - mistrust between customer and provider;
  - reduced incentives to improve efficiency and customer performance;
  - little differentiation between services leading to less choice;
  - a lack of transparency in costs;
  - a barrier to customer-provider partnerships that might otherwise lead to co-operative attempts to drive out costs of shipping but retain appropriate margins;
  - inhibit appropriate business strategies in response to changes in the market or customer requirements.

- There are some avenues that are worth exploring that might with some amendments satisfy shipping lines’ desire for authorised ‘co-operation councils’ without permission to discuss rate levels or surcharges:
  - The EU consortia regulation may form the basis for such a solution.
  - Strategic/global alliances: co-operative agreements between carriers on a global basis. These agreements should have an operational character and not confer undue market power to the parties involved through capacity agreements.

- ESC believes Discussion Agreements are little different from liner conferences and could encourage collaboration over rates and surcharges.

- Liner shipping companies should not be afraid of open competition: rather than restricting them, this can be liberating, enabling them to adapt to changing markets and more profitable and sustainable business models. This would result in a win-win situation for both carriers and shippers as a result of more stability in the market and greater service commitments.
1. Introduction

The European Shippers’ Council appreciates the opportunity to provide this submission in response to the Commission’s consultation document on the review of Council Regulation 4056/86. The Commission has very rightly identified a number of developments, of an economic, commercial and judicial nature, which justify the review of Council Regulation 4056/86. ESC supports the Commission’s conclusion that there is a need for further examination on the justification of the Regulation in the light of the current market conditions, the programme of modernisation of EC competition rules and a number of international developments. The ESC also agrees fully with the Commission’s preliminary conclusion that the justification for the most controversial aspect of the Regulation, i.e. the liner conference block exemption, appears to be “open to challenge.”

1.1 OECD recommendations

The ESC welcomes the fact that the Commission has followed the recommendation made by the OECD to its members to review anti-trust immunity for price fixing by liner shipping conferences. In its Final Report on Competition Policy in Liner Shipping published in April 2002, the OECD urged that the member countries: “when reviewing the application of competition policy on the liner shipping industry should seriously consider removing the anti-trust exemptions for price-fixing and rate discussions. Exemptions for other operational arrangements may be retained so long as these do not result in excessive market power.” The Commission has rightly used the publication of the Final Report on Competition Policy in Liner Shipping to initiate a public consultation with the aim of reviewing Regulation 4056/86 and in particular the block exemption part of the regulation. The Commission has made a particular reference to the Report’s conclusion questioning the existence of a causal relationship between anti-trust immunity and reliability of liner shipping services. This relationship was the very basis for the EC block exemption for liner shipping.

1.2 Market changes

The Commission has in its consultation paper described a number of the developments that have taken place in the way the shipping business is conducted. The conference system has gone through an enormous change over recent years...
through a combination of legal challenges and customer pressure for more tailored services. The conference system has started to disintegrate as a result of changes in US legislation and Commission decisions\(^1\) providing the possibility to have individual service contracts that provide scope for individual action in many trades. The Ocean Shipping Reform Act (OSRA) has led to improvements on the US trades by fostering a more competitive liner shipping industry through the use of confidential and individual service contracts.

Joint pricing is becoming less and less relevant as carriers and shippers conduct more of their business through confidential, individual service contracts or other forms of agreements. What large shippers see today is competition winning over the conference system. Global contracting by large and medium sized shippers is a dominant feature of liner shipping in today’s market. The conference system has therefore become almost irrelevant.\(^2\)

A lot of shippers in more recent years have had little to say over the effects of the conference system on their business. They have seen a degree of competition that drove rates, not some image of a shipping politburo determining them; they saw rates falling because some of the lines had mismanaged their business while others strived for market share.

However, the “irrelevance” argument also applies to the anti-trust exemption for price fixing. The OECD report led to the conclusion that the “antitrust exemption for conference price-fixing no longer served their stated purpose (if they ever did) and were no longer relevant (page 77 Competition report). So although shippers feel that the way they do business with shipping lines has changed - given that traditional rate fixing conferences are no longer able to enforce rate compliance as strictly as they once used to, they are nevertheless still confronted with carriers strongly trying to protect their anti-trust exemption in order to be able to discuss “the market” and

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\(^1\) The TACA decision also made it very clear that “it considered that the exemption for conference rate-fixing covered tariff arrangements only – as it could not be interpreted as encompassing the entirely different concept of contract carriage.”

\(^2\) This statement applies to shippers that have the regularity and size to enter into negotiations with individual carriers (independents or conference carriers). The conference does not even become involved any more in any of these actions. Larger shippers seek to make agreements or contracts with a selected few shipping lines serving a range of destinations. The following quote from Eduard Blank, Director Global Transportation Nestlé confirms this: “I consider liner conferences to be completely irrelevant. Whether or not a carrier is a conference member means nothing to us.” (Containerisation International June 2003)
exchange information. Shippers are nervous that keeping the present anti-trust immunity will keep alive the ability of conferences to revert to their former ways, should the market sing in their favor. Indeed, this is precisely what some shippers believe is beginning to happen today: ships are full and the conference lines are now able to collectively stick to conference agreed rate increases and surcharges. Shippers will always feel vulnerable to anti-competitive behavior while carriers are able to discuss together rates in one form or another.

The advent of individual and confidential contracting demonstrates that price fixing is not indispensable to the provision of liner shipping services. Many of the world’s major liner carriers have publicly stated their preference for individual and confidential contracting or similar one-to-one agreements as the most preferable form of doing business in the future. Now that contract carriage has become the norm, the arguments used by those who called for legislative protection against price discrimination have faded away.

Combined with the elimination of regulatory burdens by OSRA in the US and an evolving global market place re-shaping industry and business practices, the conference system struggles to maintain a control on the liner shipping industry. Conference discipline may have been weak in more recent times but this is not an accurate predictor of the future. The influence of the conference system depends on the characteristics of the market. As stated above, there are clear signs that conferences are trying to improve their control on price and dominance of the market.

In particular when markets are “tight” (demand outstrips supply) carrier seek to increase their rates and surplus beyond what might have been possible in a competitive market. The reality is that carriers will take advantage of favourable market situations by imposing rate hikes. This happened in 2000 which was a boom year for shipping lines and shippers see it happening again in 2003.

1.3 The need for an EU Review

Many of the issues raised by the Commission have been raised by the European Shippers’ Council over the last decade as being of considerable concern to its members. In this submission we will repeat those concerns.
The ESC has for a number of years underlined the fact that the group exemption for liner conferences is unusual in a number of respects and in need of reform. It is very generous in the sense that it is unlimited in time, there is no market share threshold and it allows horizontal price fixing and agreement on terms and conditions.

In 1986 prior to the adoption of Regulation 4056, ESC strongly argued that liner shipping conferences should be subject to the normal application of EU competition rules. The ESC maintained that like other industry sectors exemption from the normal provisions of EU competition policy should be subject to applications for individual exemption, provided it could be shown that benefits to customers were demonstrated and that effective competition was not eliminated in the relevant markets concerned.

The Commission has rightly invited the shipping industry to prove how the liner shipping block exemption regulation can be beneficial to the customers of liner shipping services.

ESC believes that, as is the case in all normal competition policy assessments, the onus of proof should rest with those industry parties seeking special exemptions from the normal application of competition policy. The ESC sees no reason why shippers as customers of services would need to prove the need for a removal of a very generous exemption. ESC believes that the burden should be on those who enjoy the privilege of a block exemption to justify their position. The Commission should therefore deal with the block exemption in the same way it has dealt with other industry sectors in reviewing its block exemption. Also, the views of shippers should be determinative as to the existence of the alleged customer benefits of price fixing claimed by the conference supporters.

In order to be able to respond to the questions posed by the Commission with supporting data the ESC undertook a survey among shipper members of the ESC maritime transport council covering the main liner shipping trades to and from Europe as well as a number of smaller niche markets. This group includes many of the largest buyers of shipping services but also some small and medium sized companies (shippers). The ESC anticipates providing the Commission with more data and details in the course of the review process.
In a competitive market and in trades where a few service providers can wield considerable influence on the decision of others operating in that trade, there will inevitably be some reluctance to reveal too much information that might be of value to a competitor or be used against the source by a shipping line or lines. ESC believes that the responses received provide a good sampling of shippers’ experiences with liner conferences and acknowledges those companies that have felt able to share their experiences and support these with commercial data passed on in strictest confidence. As such, the ESC is confident that the information contained in this submission can be considered representative of the general experience and attitude of European shippers vis-a-vis conferences and the block exemption enjoyed by conferences.

2. **Shippers opposed to block exemption for Liner Conferences**

The ESC strongly submits that for an industry to benefit from a unique immunity from anti-trust laws prohibiting price fixing it is essential that the benefits of price fixing are so overwhelmingly proven and that there are appropriate safeguards to prevent abuse. No such proof has been submitted nor claims of benefit substantiated. Indeed the claim made that the conference system provides for reliable and competitive services runs counter to the very essence of a liner conference, that is to restrict competition!

2.1. **Instability**

As pointed out by the Commission in it’s consultation paper, the legislator when approving the block exemption assumed that: 1) price fixing and supply regulation within conferences leads to stability of freight rates and 2) stability assures shippers of reliable maritime transport services. Liner shipping conferences and their ocean

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3 The Commission has so far not put this stabilizing role into question. At paragraph 351 of the TAA decision, the Commission stated that “A conference offers a general level of common prices which plays a stabilizing role and provides a frame of reference for shippers. Also, the Revised TACA claims to contribute to stability in the Transatlantic trade within the meaning of Regulation 4056/86 underlining that the stabilising effect assures shippers of efficient and reliable maritime transport services.”

Defence case T-395/94 – Paragraph 69 the Commission explains its understanding of the role of the conference tariff: “The notion that price fixing by a liner conference can promote stability in the liner transport market is not inconsistent with the recognition that the tariff set by the conference may not in fact be applied by all member lines at all times.”
carrier members have always argued that they provide freight rate stability for international shippers.

ESC believes that conferences have not provided rate stability. On the contrary, liner conferences contribute to rate volatility because of the way carriers attempt to artificially influence freight rates through General Rate Increases (GRI’s). Evidence for this lies in the public domain. Surveys regularly appear in leading trade press publications showing rate volatility. ESC’s own enquiries with member companies have confirmed these published findings. Instead of gentle market changes, up and down, shippers see huge variations in the form of saw tooth waves.

The results show that, regardless of the industry sector, rate volatility from the conferences is very high, particularly in the two major European trades, namely the North-Atlantic and the Far East. The results show that there can be many price fluctuations, some prices changing in excess of 100%. Direct experiences from shippers indicate that there has been considerable volatility in rate levels over recent years.

Indeed, the ESC believes that the liner conferences contribute to rate volatility because:

- During times of low demand the conference system provides little or no incentive to reduce costs and increase efficiency. In this situation the elimination of competitive pressures through a conference agreement reduces the competitive imperative on firms to minimise costs wherever possible, including by withdrawing capacity which is surplus to requirements and, for example, reallocating that capacity to routes exhibiting higher demand. This excessive

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4 Liner shipping conferences apply the so called General Rate Increase – or referred to as GRI. They are perceived by shippers as blanket price adjustments and completely unsuited in a modern, service contract era. They are also called ‘Rate Restorations’ implying an attempt to bring the benchmark rate back to the original paper conference tariff.

5 For example: regular column in Containerisation International (CI) “Freight Rates Indicators”, CI’s quarterly CI FreightFax and Freight Rate date web-pages on ci-online (www.ci-online.co.uk).

6 Quote from large shipper “Shipping is one of the commodities with the highest volatility we buy.”
stability in capacity on certain routes exacerbates the price decline that occurs following a reduction in demand; and

- During times of growing demand, the reduction in competition between cartel members enables them jointly to exercise market power to the greatest possible extent by increasing prices to a greater degree than would be observed in a deregulated, competitive, free market.

The Transatlantic and the transpacific trades illustrate this point. Shippers are today witnessing capacity reduction and rate hikes and are left with a “take it or leave it” attitude from the lines.7 (Annex 1, 2 and 3 provide examples of rate increases on the Transatlantic and capacity reductions by carriers in the trade in 2003). Evidence from shippers shows that many European companies have at the beginning of 2003 been confronted with price increases of 20 to 30 percent.

At certain times carriers may seek to reduce their costs by removing capacity. Many customers would expect well managed lines to take such action. However, they would expect lines to take such action as a means to reduce their costs and not as a way of ‘fixing’ the market to allow them to increase rates as a consequence of vastly reduced capacity.

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7 Alain Morin, Logistics Sea Liner Manager of Atofina in American Shipper June 2003: “People (referring to TACA carriers) have reduced capacity in an artificial manner, but we can clearly see that there is a growing cargo demand. Some 50 Atofina containers due to be shipped were recently left behind, because of capacity restrictions. Atofina, like many other westbound shippers, was affected by delays in shipping containers across the transatlantic. Morin alleged that the fact that capacity cuts were implemented just before TACA raised its westbound tariffs was part of a concerted plan by TACA carriers (see also Annex 1 for the full article).

Quote from large UK shipper: “To 'guarantee' space westbound we have to book at least a week in advance to avoid ‘rollovers’. We have even experienced problems on eastbound routes earlier this year, however much of this was attributed to the US forces commandeering equipment during the Iraq war. The lines do not look to the contract as a guarantee for rates through to the expiration date as, once the Minimum Quantity Commitment (MCQ) has been met, the carrier says it has fulfilled its obligation - they can return and request new rates even though the expiration date has not been reached. ‘On signing a contract with the shipping lines an MQC is agreed between the shipper and carrier. Historically we have always attempted to keep this a low number i.e. well below our forecasted volume. This avoids any liquidated damages for failure in shipping the agreed minimum quantity. This can be a four figure sum per FEU (forty foot equivalent). The stance that the carrier has taken this year is that once they have carried this quantity their commitment has been made and the rates are no longer valid. The carrier has forced on us a new contract, this has surprised us this year as it has always been assumed that the rates were valid for the period of the contract, any extra containers that were moved were a 'bonus' to the carrier.”
ESC maintains that price stability can best be reached through healthy competition. The introduction of individual and confidential service contracts has contributed to more stability in the market, in particular in the Transatlantic. As strongly argued by the ESC in its submission to the OECD: “in a competitive market reliable services would be provided and prices would adjust in response to supply and demand conditions, with such prices acting as signals for the entry and exit of capacity as in other competitive markets. As a general proposition, there is no benefit to consumers of stable high prices which substantially exceed the competitive level, or of any market structure in which the forces of competition have been muted to such an extent that individual operators do not have the appropriate incentives to maximise their efficiency and lower costs to the benefit of users.”

Despite the fact that shippers in general experience freight volatility, some of the larger companies with big volumes have made efforts to enter into normal business partnerships with their carriers through long-term contracts which has increased the stability in the business. Volvo Logistics has for example been in a position to negotiate freight rates covering a one to three-year contract period, including THCs, CAFs and BAFs, etc. This has proved successful in providing some guarantee for stability to the company for at least the duration of the contract period.

Companies which do not have the same buying power have more difficulty to negotiate lengthy contract periods and all-in freight rates and are consequently confronted with short contract periods on a port-to-port basis; surcharges are added later. Although many of the rate increases proposed by the conferences during the course of a year are not always sustained (unless the market allows – see above), shippers are frequently confronted with rate increases.

The falling rates in 2001 and 2002 may be caused by the carriers themselves who continued to purchase more vessels with even greater capacity to be introduced in trades where there could already have been excess capacity. In a situation of low demand carriers themselves were cutting rates in order to get higher market share.

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8 ESC submission to the OECD page 8.

9 Gunther Casjens, CEO of Hapag Lloyd Container Line (HLCL) has blamed part of the industry’s overcapacity problems on speculative or tax saving newbuild orders. (CI December 2002)
The 12% trade growth in 2002 on the Asia-Europe trade was not foreseen by the shipping lines, yet they were still able to absorb this growth without adding new services because of the overcapacity they had engineered in previous years. This however can hardly be described as a policy to create a stable market!

On many north-south trades price variations are linked to the offer and demand for maritime transport and linked to the economic situation at a certain period. An example which is quite illustrative is the situation on the Europe-South America trade where rates have shown to follow offer and demand over the last couple of years. The economic crisis in South America in 2002 led to a fall of freight rates of around 40%. Following annual rate decreases that averaged 19% per year between 1997 and 1999, shippers reported a 36% increase in rates to the region in 2000. The reasons for this increase are difficult to identify, but it does demonstrate the volatility of rates in many of the niche north-south markets. Rates again fell during 2001, between 10 and 15%.

As with other liner shipping routes, the key feature of this trade over the last few years has been the huge increase in shipping capacity in the trade, as the lines introduced larger and larger vessels.

2.2 Unreliability

Supporters of anti-trust immunity for price fixing believe that liner conferences are a necessary pre-requisite to the provision of reliable and uninterrupted ocean shipping services. According to them anti-trust immunity would avoid bankruptcy and allow shippers to benefit from stable services on scheduled routes and vessels leaving at scheduled times. The mere possibility of destructive competition would be enough reason to justify an artificial price fixing in order to ensure reliable and predictable supply. They fear unfettered competition would lead in the short term to the collapse of rates and the exit of competitors, which would adversely affect the diversity and reliability of services.

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10 In 2002/2003 the recession in Argentina, the devaluation of the Brazilian currency, and presidential elections in both countries have all contributed to a fall in southbound demand. The relative strengths of European currencies saw northbound cargo boom over the past year. Most ships are reportedly over-booked, with 95-100% utilisation. Northbound rates have been averaging around US$1,300/20ft and US$2,000/40ft. Southbound utilisation has only been between 40-50%.
The ESC concurs with the point made by the Commission that the real question is whether these services would have been provided anyway without the protection of Regulation 4056/86. Shippers maintain that conference price-fixing is not a necessary pre-requisite for the maintenance of reliable scheduled service.

The OECD report notes that there is no evidence that the conference system with exemption for price fixing leads to more reliable shipping services than would be the case in a fully competitive market.

It is ESC’s contention that the increased competition and service improvements have been made possible through OSRA, the legal cases in Europe and shipping lines looking to increase their individual market share, not from the functioning of the conference system. Shippers have told the ESC that Conference members in no way guarantee the level of service and have provided the ESC with a number of examples. The market and price are guided by over- or undercapacity.

Illustrating this, shippers again refer to difficulties in transporting their goods to the US in the last quarter 2002 because of a shortage of shipping capacity. As a result shippers experienced a decrease in service performance in particular in relation to reliability and punctuality. There have also been examples of services that have been annulled at the last moment. (Annex 9 provides an article with schedule reliability at ports in different regions)

In the Europe - Far East trade shippers note that service levels of conference lines is no different from independent lines, especially in relation to the geographical coverage and the changes of service experienced by shippers. Carriers will readily reduce service frequency if financial returns are not adequate. Service contracts are no guarantee of service performance.  

2.3  

Impacts on rest of the liner market

Article 7 of Regulation 4056/86 requires that actual or potential competition from outside the liner conference must not be eliminated.

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11 Response from shipper following an increasing number of last minute cancellations: “fiabilite! horaire! service! ponctualite! Peut-on avoir tous les droits dans un cartel et surtout aucune obligation!”
In the ESC submission to the OECD in April 2001 it was reported that the difference between conference and non-conference rates was in excess of 10% with the exception of the Far East Europe trade.

Further inquiries by the ESC revealed shippers have had different experiences regarding rates depending on the particular trade in which they ship and that it is difficult to establish any obvious trend with respect to pricing behaviour between members of the same conference and independents.

3. **Controlling the Price**

3.1 **GRIs/Rate restorations**

A liner conference by definition must have market dominance and control of prices charged to shippers. Competition erodes the ability of the conference to have such dominance and exhibit control. There are regular attempts by the conference secretariats to get agreement among their members for General Rate Increases (GRIs), but during times of abundant shipping capacity lines break ranks and offer discounts to shippers to capture greater market share and fill their ships. This happens on all the major trade lanes.\(^{12}\) In times of scarce capacity, however, the lines know they can control the price more readily and the conference GRI agreements are more generally applied and discounts much harder to negotiate even for the biggest volume.

As indicated earlier in this submission, carriers also take advantage when the market allows; for example shippers have reported to the ESC via their representative Councils that they were encouraged earlier this year by the member lines of the FEFC to sign very short term contracts of only three-month periods. Many of these shippers are now confronted with GRI’s westbound from Asia to Europe.\(^{13}\)

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\(^{12}\) Quote from large UK shipper October 2002: “The conference system is dead in the water – although lines may publicly be speaking as one, they are keen to undercut each other when negotiations start. Negotiations are taking so long because lines are always trying to undercut their competitors.”

\(^{13}\) FEFC has announced that the “starting rate” for negotiations covering six-month contracts in Northern Europe will be increased by $300/TEU, up to $1,1550/TEU. (Containerisation International July 2003)
Although the conference power and influence is fading as competition gains a firmer grip in the market, the tariff has simply become a paper tariff with lines applying freight rates according to offer and demand. Conferences do try to influence the rates through GRIs and the collective implementation of surcharges. Conference lines also try to regain control of the price through market dominance.

They are helped in this when freight forwarders, in particular small shippers and those who work with freight forwarders, feel the disbenefits of the conference system through their inability to negotiate freight rates. They can only discuss rates of inland haulage.\textsuperscript{14} The volumes bought by freight forwarders give these companies considerable buying power (similar to very large shippers) to negotiate the rates. The SMEs tend to utilise freight forwarders rather than arranging their own contracts with the lines because they may have “less than container load”, not regular service, or simply because they offer an enhanced service. Freight forwarders may not comment to their smaller customers about price competition and the huge discounts they may negotiate from carriers – discounts that may not always be passed on to their customers. Again, it has to be said that not all shippers know that the official paper tariff in many trades does not represent the market rate level in the trades. Some freight forwarders could benchmark their rates against the official conference tariff without informing their customers about the actual market rate levels.

In general it is argued by many industry commentators that freight forwarders therefore appreciate the tariff system because they can predict what costs will be passed on to the customer.

3.2 Surcharges

Conferences authorise members to engage in rate fixing including charges and surcharges. These additional charges are not included in the conference tariff and are normally introduced or amended at a relatively short notice.\textsuperscript{15} The total transport

\textsuperscript{14} Quote small shipper: “Impossibilité de négocier les taux. Quant aux pratiques, quel que soit le lieu ou vous questionnez, vous devez dévoiler qui est l'expéditeur et qui est le destinataire, donc les taux semblent être fixés de façon identique pour les deux parties ce qui ne nous laisse aucune marge de manœuvre dans la négociation.”  

\textsuperscript{15} Annex 4 provides an example of Temporary Port Additional of US $100/TEU at South African ports implemented by the Europe South Africa Conference. This surcharge was implemented with only a week notice to some shippers in Europe.
costs for a shipper include the non-negotiable surcharges and the Terminal Handling Charges. The total of these surcharges can account for more than 50% of the port-to-port ocean freight rate.

Many shippers criticise the use of surcharges by ocean carriers because of the way surcharges are imposed on them with very short notice periods and the lack of transparency in relation to the real costs incurred by the carriers. Shippers view surcharges as an unfair way for carriers to generate additional income. Ocean carriers continue to extract cost elements from their basic operations costs and roll them into surcharges without valid justification.

While it is arguable that individual confidential service contracts can provide some commercial stability over a minimum period, the same can not be said of General Rate Increase clauses. These allow surcharges to be passed on to the shipper, conflicting with the purpose of contracting for a specific rate. 16 Shippers generally want to know the full costs of shipment without the plethora of adds-ons which is the feature of shipping companies pricing policy at the moment. For this reason shippers do prefer ‘all-in’ rates.

The ESC has asked its members to provide information regarding the number and kind of surcharges imposed by carriers and to indicate how this has evolved in the last 5 years. All replied that number of surcharges have increased. On the question whether conference/discussion agreement carriers generally deviate from each other on the surcharges they impose all respondents indicated that they do not deviate. Conferences act as the price leaders and non-conference carriers merely shaddow actions, especially in relation to the surcharges. In our view these responses reconfirm the fact that as long as there is a conference system in place, non-conference carriers do not have to have their own specific pricing strategy, but can merely follow the pricing actions decided by the conferences.

16 Evidence from shippers suggests that rate increases have been successfully implemented by the lines in the first quarter of 2003. Several ESC members have also commented that lines have not honoured service contracts once minimum volume commitments had been reached and were forcing even long standing customers to either renegotiate their service contracts or alternatively to renegotiate the whole contract again, at a higher rate.
Some shippers indicated that they are not paying the surcharges; some address the assessment of surcharges in their contract negotiations with individual carriers. Many shippers are telling ESC that it is becoming harder to avoid the surcharges; carriers are starting to enforce the imposition of surcharges far more rigorously than they had done in the past and that all-in freight rates are harder to negotiate or obtain.

The position of shippers in relation to the Currency Adjustment Factor (CAF) and Bunker Adjustment Factor (BAF) can be summarized as follows:

- Shippers do not accept the ocean carriers’ claim that they operate in a unique environment and are a special case deserving special protection from market forces. Shippers face similar business risk when trading in global markets; they are unable to pass on additional costs incurred through the use of surcharges. A wide variety of instruments now exist which enable prudent companies in any trade or industry to hedge against short and medium term risks, particularly in the case of currency fluctuations.

- Bunker Adjustment Factors (BAFs) are being assessed as a collective surcharge by all members of a liner shipping conference whereas each carrier has its individual policy for fuel buying and consequently the prices vary accordingly. Moreover, it has never been demonstrated that the BAF increases reflect the true additional fuel costs. The article in American Shipper in Annex 4 provides a table comparing the BAF for shipments to and from US Atlantic and Gulf ports and the market prices measured by Platts for bunkers at the port of Rotterdam. The Platt’s index is the only index recognised at an international level and by international courts as the index for fuels.

- The cost of fuel as a percentage of total carrier costs is believed to be considerably lower than that of the airline industry. Whilst the ESC disagrees with the fundamentals of imposing non-negotiable surcharges on customers in any circumstance, airlines do participate in this practice. However, the EC

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17 Big shippers like Volvo Logistics are able to negotiate all-in rates including THC’s, CAFs and BAF’s etc. The company feels strongly about the need for all-in-rates, arguing that what goes up for carriers usually goes down.

18 In response to a question raised by ESC to shippers as to how the conference system impacts on the shippers’ supply chain, a shipper representative responded: “They PASS on, rather than seek to eradicate costs”
prevents collective action by the airlines when setting surcharges, so why are shipping lines given special treatment?

It can be concluded that conferences do still have an active role in the control of the freight rate through the implementation of surcharges. The absence of transparency in the imposition of surcharges have led shippers to call for their abolition. The method by which surcharges are calculated is complex and because of averaging of surcharges within a conference surcharges are unrelated to the actual costs experienced by individual shipowners. Surcharges are used as a means of obtaining additional revenues (see example annex

3.3 Terminal Handling Charges

Another element not covered by most freight rates is the charge for box handling in the loading or discharge port.

There has been an ongoing debate over the question as to whether the members of a liner conference benefit from exemption provided by Regulation 4056/86 when fixing Terminal Handling Charges (THC’s).¹⁹ In ESC’s view the fixing of rates for THC’s does not fall within the scope of the block exemption or should not do so.

The Court of First Instance clarified on this point. In the FETTCSA Judgement, though not dealing with THC per se, it has interpreted the related Commission decision, stating that THC has nothing to do with Regulation 4056/86, namely it is not part of the actual maritime transport activity.²⁰

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¹⁹ In the FETTSCA decision the Commission stated: “The handling of containers at port (possibly in combination with other services such as inspection and storage) at least in part constitutes stevedoring and other cargo-handling services within the port which are not maritime transport services as such. Therefore a restrictive agreement as to THC’s comes at least partly within the scope of application of Regulation 17 and not Regulation 4056/86.”

²⁰ Judgement of the Court of first Instance - Case T-213/00 (19 March 2003), clause 77. Lastly, contrary to the Commission’s claim with regard to THCs, it cannot be inferred from the statement at paragraph 128 of the contested decision that a restrictive agreement on such charges falls ‘at least partly within the scope of application of Regulation No 17 and not Regulation (EEC) No 4056/86’ that the decision confirms the partial application of Regulation No 4056/86 to those additionals. It is apparent from that passage that the phrase ‘in part’ does not refer to the application of Regulation No 4056/86, but to that of Regulation No 17. That is confirmed by the next sentence in the paragraph, which states that, to the extent that an agreement as to a THC has as its object or effect the fixing of rates and conditions for inland transport, ‘Regulation (EEC) No 1017/68 and not Regulation No 17 will be applicable’.
Carriers have claimed that THC’s bring benefits to shippers because they have the bargaining power to obtain lower prices from terminal operators than would be obtained by shippers acting on their own behalf. In practice, the conference accounts for the collective costs of its members and sets an aggregate rate level which is being published. As in any normal business charges are negotiable according to the volumes and carriers no doubt benefit from discounts – which are being kept highly confidential. But although terminal contracts are different for all individual carriers, and although carriers are beneficiaries of price reductions in terminals or depots, shippers pay the same rate level and often based on the published tariff of the terminal operator. Additionally, THC’s vary from port to port and per different type of equipment. What is more, the THC from the same port, for the same shipping line will vary according to the trade lane the ship is plying! This means that the THC’s can never only be a case of cost recovery. THC’s are widely perceived by shippers as a back-door revenue-increasing mechanism which has lost connection with the real costs.

Also in the case of THC’s shippers experience is that independents apply the same charges as conference carriers.

3.4 Capacity Management

Carriers argue that they need to manage capacity because of the nature of liner shipping.

Allowing carriers to reduce the amount of capacity available for cargo carried under individual contracts will result in a significant upward pressure on rates for individual service contracts as a result of the artificial limitation of supply.

\[21 \text{ The 15 members of the Far Eastern Freight Conference using the four different container terminals in Rotterdam all charge the same standard rate of EUR 137.50 per container.}\]

\[22 \text{ For shipments Ex Mediterranean ports, THC’s in US ports are invoiced 600 Usd/container by the conference USEC. For shipments ex North Europe, THC’s in US ports are invoiced Usd 500/container by TACA members for exactly the same service in the US (example provided by Jean-Louis Cambon, Head of Ocean Management Committee, Michelin during ESC Shipper Forum 12\textsuperscript{th} June 2003).}\]
The Commission has noted that the combination of price fixing and output limitation is probably the most potent form of anti-competitive behavior which can exist.\textsuperscript{23}

The Commission ruled in the TAA case that the freeze on the use of capacity was not a traditional liner conference practice and was not envisaged when the block exemption was granted.\textsuperscript{24} A reduction in capacity could benefit shippers if the costs of transport were reduced, i.e. if capacity was really withdrawn by the progressive withdrawal of certain vessels or operators.\textsuperscript{25} The Commission has also noted that there is no evidence that capacity management programmes help to ensure that in the long term the level of capacity is better adjusted to meet the level of demand and it is possible that they encourage the unnecessary and premature introduction of excess capacity.\textsuperscript{26}

The Commission stated in its Revised TACA decision that it will establish safeguards against such abuse. The Commission would monitor the situation through reports provided by the lines.

Some recent carrier practices have raised concern of shippers. In the Transatlantic and Transpacific trade lanes conference carriers are managing capacity to influence rate levels rather than reduce costs or improve efficiencies.\textsuperscript{27}

Carriers on the Transatlantic are managing the supply and demand artificially through the withdrawal of capacity on the trade, in other words, through vessel utilisation to fill ships in order to increase rates (see Annex 6). Carriers are trying to justify this situation by referring to the low rates paid by shippers in 2000 and 2001 and saying that they need these rate-hikes to raise the rates to “normal levels”. It is of major concern to shippers that the ability of carriers to ensure full vessel utilisation through capacity management is a means to increase rates. They are also

\textsuperscript{23} David Wood, presentation to EMLO 1999: ‘High tides, low tides: the scope of the Conference Group Exemption.’

\textsuperscript{24} idem

\textsuperscript{25} idem

\textsuperscript{26} idem

\textsuperscript{27} Aaron Young, junior vice president Yang Ming: “Most likely, no more tonnage will be deployed. But we believe this is a healthy situation because it could ensure the success of the rate restoration and possibly extend the peak season”, Containerisation International, June 2003.
worried that there is in the next couple of years no mechanism or appropriate safeguard to prevent abuse.

A similar situation exists on the Transpacific trade where, in a period of growing demand, carriers are trying to reinforce higher freight rates through the adoption of ‘voluntary guidelines’ for service contracts, discouraging differential pricing. The National Industrial Transportation League (NITL) has raised concern that that Transpacific Stabilisation Agreement (TSA) (a ‘discussion agreement’) may be acting to “impose identical and very substantial rate increases on certain market sectors in a co-ordinated manner. The US FMC has recently issued an order in which it expressed concern about the “degree of market power and long-term potential for abuse inherent in the ongoing authority of the carrier members of these related agreements, to discuss and agree on pricing, as well as matters relating to vessel capacity to be deployed in the agreement trades”

3.5 Regulation 4056/86: Making it legal

Shipping lines have openly proclaimed that they want a legal right to talk to each other in order to gather market intelligence and provide a forum in which carriers can without fear of prosecution discuss such matters as supply and demand, scheduling and ship deployment. Shipping line representatives have stated publicly that the

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28 In response to the development of individual service contracts, which created greater scope for price competition, many carriers on the US-Asia trade lanes have entered into discussion agreements which allow conference and non-conference carriers to discuss and share information about rates, service, costs and capacity. The members of these discussion agreements enter into voluntary guidelines to co-ordinate their activities.

29 The NITL is the largest broad-based shippers’ organisation in the United States.

30 The guidelines provided by both TSA and WTSA are the most recent guidelines for rates and changes applicable to the 2003 service contract season. They include guidelines relating to various rates and charges that were adopted prior to the current contract season, but which still apply on a voluntary basis to service contracts negotiated for 2003-2004. Most shippers will be paying the full $700/FEU eastbound rate increase proposed by discussion member lines from May 1, 2003 plus the peak season surcharge of $ 300/FEU between June 15 and October 31.

31 FMC, 30th May 2003 – order on competition, rates and service in the Transpacific inbound trades and the Indian subcontinent inbound trades to the US.

32 “Any conference now, in the east/west trade, which thinks it can micro-manage rates is living in another world. Conferences today are useful if they provide an umbrella under which people can hold discussions – at pretty senior level – about general issues. “ Christopher Rankin, American Shipper July 1998
Revised TACA has not been used (since its conception in 1999) for rate fixing - although this is one of the key pillars of its being. Instead they argue that it is to provide a forum where shipping supply and market demand can be discussed to achieve a balance, without the fear that anti-trust laws were being broken.

Shippers will always say that anything that specifically allows commercially sensitive issues such as price to be discussed amongst suppliers, whether or not is actually used for such a purpose, is anachronistic and makes shippers suspicious. If lines argue that they do not fix prices and that there is competition in the market, why do they then need the comfort of a discussion forum exempting them from anti-trust law?

4. Life without Regulation 4056/86

4.1 Would lines go out of business?

The members of the liner conferences seek to justify the block exemption largely on the basis that in the absence of conferences there would otherwise be "ruinous" price competition such that reliable services would not be available. This by itself would for them be a justification for the benefits it produces to shippers.

Shippers claim that in the long term the removal of block exemption will lead to more efficient matching of supply of vessel capacity to demand for it from transport users. Lines will need to become more finely tuned to the demand from customers; they will need to drive down costs through efficiency savings initiatives that can be aided with the cooperation of their customers through changing practices, for example. But margins need not deteriorate.

Experience in the logistics sector indeed shows the opposite is more likely as customers, armed with greater understanding of costs, accept higher margins in return for service quality. This argument is expanded upon in 4.2 below.

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33 Chris Bourne to Containerisation International 2002 Conference: “A perfect free market could cause damage as cost cutting is imperative to be competitive. He refers to decline in service standards as companies slash costs – shuts out/poor documentation and less choice.”
As pointed out by the OECD report, the removal of the anti-trust immunity may lead to greater market concentration.\textsuperscript{34} The trend towards ownership of the world’s liner shipping fleet being placed in an increasing smaller number of hands will be difficult to turn, the removal of the anti-trust immunity may quicken this. However, within the EU, competition law will be enforced through the EC merger regulation which already applies to the maritime transport sector as much as it applies to any other sector.

In an economic environment where market acquisition, take-overs and mergers are now more broadly seen by the industry as the means of obtaining economies of scale, enhanced market share, market rationalisation and restructuring, liner carrier operators need to respond to some fundamental questions including: why freight rates should not be established by free-market principles? Why a free market economy is not preferable to one in which rates are determined collectively? And what broader purpose is served by price fixing?

4.2 \textit{Market forces – Demand lead solutions not supply lead!}

As in other areas of business and trade activity, the action of market forces is the best and most efficient means of bringing the supply side into balance by the use of conventional economic and commercial mechanisms rather than artificial supplier-based constraints. These should of course be subject to the constraints of normal EC competition laws. The conference structure has simply been unable to meet shippers’ desire for price and service competition, as liner conferences were designed to limit, if not, to prevent competition and has not been able to maintain stability in shipping markets. As outlined by the ESC in its submission to the OECD, shippers are of the general opinion that a conference system with exemption for price fixing does not provide any incentive or reward to lines for developing their services or introducing other initiatives such a market penetration or technical advance. Instead the lowest common denominator prevails and effectively the least efficient line determines the level of the conference service.\textsuperscript{35}

\textsuperscript{34} OECD Report on Competition Policy in Liner Shipping – page 73 “Increasing concentration in the sector, in itself, would not necessarily have a detrimental impact as regulatory authorities treated liner shipping as any other globalised industry.”

\textsuperscript{35} ESC submission to OECD
In a competitive market reliable services would be provided and prices would adjust in response to supply and demand conditions, with such prices acting as signals for the entry and exit of capacity as in other competitive markets. As a general proposition, there is no benefit to consumers of stable high prices which substantially exceed the competitive level, or of any market structure in which the forces of competition have been muted to such an extent that individual operators do not have the appropriate incentives to maximise their efficiency and lower costs to the benefit of users.

Like in any other ‘normal’ industry, driven by threat of exit and entry, new entrants foster continuous improvement. In a market without anti-trust protection shipping lines would focus more on customer needs than being concerned with price volume fixing arrangements. The price fixing leads to a distortion of price functions resulting in inefficiencies which ultimately are paid for by increased prices to the consumer. 36

Like consortia and co-operation agreements, service contracts provide a stability of relation-ship which is greater between an individual shipper and individual line than a price fixing conference ever could be, since liner conference tariffs are said by the lines to be benchmarks only. 37

A report published by the World Bank on how policy influences prices in international trade has concluded that “maritime transport costs significantly impede international trade, and influence geographical pattern of production and income. Even though improvements in technology (notably containerization) have led to a significant decline in unit costs, there has not been a commensurate decline in maritime transport costs. The report challenges the notion that collusive carrier arrangements have lost their significance over the past decade: “In defense, maritime industry sources frequently point to the fact that liner operators hardly break even and, on this basis, argue that there is little scope for price reductions. But it is well known that protection and cartel-like behavior in the presence of fixed costs can lead to inefficient entry and reduced profitability. The benefits of competition typically

36 Shippers believe that the focus is too much on the rate level. “ the way the conference system is structured, carriers and shippers spend the majority of their time discussing rates and almost no time talking about how shippers can optimize their supply chain.” (Rey Ortiz – Du Pont in American Shippers March 1996)

37 For this reason ESC believed that the Commission should have precluded granting individual exemption to the Revised TACA since they do not satisfy the conditions under article 81 (3).
arise not only from increased allocative efficiency, i.e. pricing close to costs, but also from increased internal efficiency, i.e. reduction in the costs. And there may be scope particularly for increasing this latter type of efficiency in the maritime industry.38

4.3 Modern Business Practices

In general shippers requirements can be summarized as follows:

- Partnership that enable stability and shipping/logistics that match the business needs.
- Confidentiality of contract uninhibited by consideration of other providers not party to the contract
- Choice of service providers and services at competitive prices – and not simply with other shipping lines.

4.3.1 Partnerships

The rapid expansion of the global economy has intensified the international competition between competitors in manufacturing industries. This in turn has increased pressure on shippers to meet the higher service and product standards required by customers. Today, supply chain know-how and expertise in logistics is the source of considerable competitive edge for companies who are under pressure to improve their performance in the supply chain. It can be the difference between success and failure in the global market place for many shippers. Transport costs typically represent 5-10% of total costs of European exporters. For many sectors it can be as high as 30% e.g. for products such as chemicals or perishables. Shippers’ logistical costs and entire distribution systems are under constant pressure and scrutiny in the relentless pursuit of efficiency and competitiveness. Cost savings directly linked to lower unit costs and improved service standards are being sought and achieved.

A familiar complaint from carriers is that freight costs represent a very low percentage of the value of most containerised goods and that large rate increases have a minimal impact on the selling price. Carriers often present examples of

products for which the price of the ocean freight only represents a fraction of the value of the good implying that the ocean freight is in the end not so important for shippers and that it could well be increased (for example the ocean freight of a DVD player is said to represent only 0.3% of the value of the DVD). For shippers this unit-cost argument is completely irrelevant because these per-unit micro-rises still represent large percentage increases. Manufacturing companies need to make sure that their products are priced as competitively as possible, but also that they as a company are able to ensure that they remain profitable as well. The final price of the product is set at a level that reflects the whole supply chain cost: if the costs in any part of that supply chain increase they will have to reduce costs somewhere else in order to ensure that their products remain as attractive as possible to customers, and that their competitive advantage against other products is maximised.

Even if the ocean rates were a fraction of the costs of door-to-door delivery, matching logistics with supply chains has for many companies taken over as the main issue confronting business – that is why service has become so important.

Moreover, shippers have little sympathy for constant lamenting about low freight rates – for which the carriers themselves are responsible – and which has been made possible through a system which has offered carriers protection against their own weaknesses.39

Some shippers and their service providers who have developed partnerships are collaborating in such a way that they are able to find ways to reduce costs within the supply chain.

Big shippers spend large amounts of money on transport in absolute terms because of the volume of their shipments. There has been a large shift of manufacturing from Europe to the Far East, and more recently a shift towards the much lower cost base of China which is expected to continue unabated. In their constant efforts to control costs these companies will always scrutinise their total supply chain expenses and try to reduce and optimise it.

39 Drewry Shipping Consultants 1999 Container market outlook: “The globalisation of the world economy depends upon highly efficient and price competitive container shipping. Attempts to “turn the clock back” rate wise will be met by very powerful opposition.”
ESC has called upon its partners in the industry to listen carefully to the customer and to try to understand their needs in order to find solutions. Transport operators need to be more fully involved and integrated in the shippers’ supply chain process, including planning and long-term market projections. This calls for much closer relationships between all those involved in the logistics supply chain. The emphasis on improved communications and the successful development of intermodal transport services is of paramount importance in achieving these objectives. The role of benchmarking and development of service performance indicators is becoming more and more appreciated as the means of improving efficiency and reducing transport costs.

Many big shippers select their preferred carrier through tender processes on a global scale and conclude individual contracts with their selected carrier.

Other shippers aim for long-term partnership arrangements with carriers.40

As said above, individual service contracts are the preferred option for shippers. It offers the shipper the opportunity to more or less know the costs for transport for the duration of the contract and the bring the two parties into face-to-face negotiations over the whole range of service issues.

4.3.2 Confidentiality

The exchange of commercial information, particularly price information is one of the most serious restrictions to competition. In Europe, discussion agreements/stabilisation agreements are unlawful.

Shippers feel there is a need to protect the right of confidentiality in their contracts so that both shippers and carriers can be assured that privileged information resulting from their negotiations cannot provide another party with market signals or the basis of a “benchmark”. Much of the value of individual contracting would be lost if confidential terms were able to be utilised, since this would mean that one side

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40 Eduard Blank in Containerisation International June 2003: “Apart from the obvious standards relating to service levels, including the maintenance of sailing schedules and port coverage, the availability and condition of container equipment, and agreement on freight rates, an absolute is that lines must be prepared to commit themselves to long-term partnership arrangements with Nestlé.”
would enter into negotiations with prior and undue knowledge of their “competitors” negotiated rates and conditions.

To illustrate this, on the Transatlantic trade the ESC maintains that the Revised TACA carriers are keen to exchange information to maintain a degree of price discipline.

According to the Commission “it is appropriate that the tariff is set by reference to the prevailing prices on the market, including service contract prices. The concern is to ensure in such circumstances that there is a sufficient degree of aggregation to protect confidentiality of information relating to individual and multicarrier service contracts.” The ESC believes that this allows the R-TACA lines to set prices higher than they would otherwise. There is no possible alternative explanation for the agreement to exchange information than to have mechanism that restrict price competition on this market.

There is an important difference between US and EU shippers trading from their respective continents. ESC noted in its submission to the OECD when investigating the need for maritime regulatory reform that “the wider potential benefits available to US shippers through individual and confidential contracts are not widely available to EU shippers.” In no other trades in the world do European shippers and lines have “service contracts” with rigid terms and conditions. Freedom of contracts operates in all non-US trades with the result that contracts are often not committed to in writing and generally take the form of “gentlemen’s agreements.” These agreements are usually based on negotiated discounts from the published conference tariff; the conference tariff by default therefore becomes a benchmark from which all rate negotiations begin. “Another major draw back with these agreements is that there is no confidentiality as provided by OSRA and conference lines are free to exchange information on rates and shippers with each other, thereby reducing any competitive advantage provided by individual rate agreements in non-US related trades.”

While individual confidential contracting can, as said before in this submission, contribute to commercial stability over a minimum period, the Commission has

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41 Commission decision C (2202) 4349 final in Case COMP/37.396/D2 – Revised TACA – Recital 72.
rightly found in the TACA Decision of 18 September 1998 that service contracts are not part of a liner conference tariff. The Commission found that service contracts do not fall within the scope of the group exemption. Therefore, one has to question the legality of using the conference tariff in negotiations over confidential service contracts.

The European Commission has with its recent decision on the Revised TACA provided an individual exemption for agreement service contracts (ASCs) and multicarrier service contracts (MCSs) to the extent that they may be restrictive of competition, fall outside the scope of the liner conference block exemption, but qualify for individual exemption. The Commission accepts that 90% of the trade is served by confidential service contracts and that, therefore, the conference tariff only applies to 10% of the trade at most. ESC has expressed its concern that individual exemption has been granted to ASCs and MCSs on the basis that there were ACSs in MSCs in 2000 and that there was therefore a continuing demand from shippers for such contracts.

The result is that an exemption has been granted for service contract agreements that fall outside Regulation 4056 and shall apply a barely used conference tariff for individual service contracts that also fall outside of a conference ‘right’ to discuss. Not only this, but the R-TACA allows individual confidential service contracts, not covered by any block exemption, to be used to set the conference tariff!

4.3.3 Choice

Evidence from shippers shows that they will never give all traffic to one dominant line. Shippers will continue to utilise the wider variety of type and levels of both service and price which must continue to develop if shippers’ requirements are to be met.

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42 ESC submission to OECD
44 The fact that the users had no involvement whatsoever other than to express concern at the Commission’s proposal which was entirely unnecessary, meant that consumer benefit condition of article 81 (3) could not be satisfied.
The requirements of liner shipping users are fundamentally no different from those of customers in any other mode of freight transportation – road, rail or air. Indeed the concept of multimodal operations, with the sea leg increasingly treated as one part of the overall operation of moving goods from supplier to customers, means that any differences are negligible. Similarly, within Europe, shippers tend not to rely on one particular mode of transport.

4.3.4 Need for niche players

Since the advent of containerization container operators have sought to build larger and larger vessel to access economies of scale and reduce slot costs in order to get profit maximization. Some of the carriers in the industry have acknowledged the disadvantageous situation to the customer. Many of ESC’s members believe that they suffer from the reverse economies of the potential savings of bigger ships because of the increased inland costs and additional transshipment associated with ‘hub and spoke’ operations. It will cost a shipper more to move a container over land to its final destination. This is especially true in Europe where traffic is concentrated in a small number of ports, where they not only cause congestion and delays inside the ports but also on Europe’s already heavily congested roads. Moreover, feeder operations require punctuality and create opportunities for things to go wrong, in other words that the right cargo will not be supplied at the right time. This has been done to avoid port and road congestion and to improve the reliability of their service contracts.

A major EU shipper advocated at a CI Conference in 2001 that bigger ships entailed a general deterioration of services to shippers. He strongly felt that the volume driven containerisation strategy adopted by the “big players” had made the liner industry homogeneous.

45 Michael Beard President Australia-New Zealand Direct Line, CI conference 1998 “The problems of oversupply are due to the blundering supply side activities of ship operators supported by governments. This has sent the industry into a short sighted spiral with no equilibrium and has turned the ship operating business into an inherently unstable business.” “The case for antitrust protection exemption has little validity in today’s economic environment.”

46 Alain Morin, Logistics Sea Liner Manager, AtoFina: “There is no segmentation. Everyone gets the same service, on the same ships to the same hub terminals”. With carriers having the same rates, vessels, containers and port rotations and sailing schedules, it is only the service that set them apart from each other. Unfortunately there are few shipping industry representatives who recognise that as carriers compete less on operational service due to
4.4 **Alliances and the EU Consortia Block Exemption**

The European anti-trust law permits some form of co-operation among competitors and would permit such agreements in the liner industry where they genuinely contribute to efficiency.

An appropriate legal framework already exists in EU Competition law and would require little amendment to produce a legislative structure which would recognise and accommodate the need for competitiveness, the carriers’ quest for greater efficiencies through co-operative agreements and the shippers’ demand for total freedom of choice and commercial contracting.

This situation could be reached through:

- the complete elimination of the Regulation 4056/86.
- the application and enforcement of the Competition rules article 81 and 82.
- the application and enforcement of EU Consortia Regulation 870/95

In the late 1980’s the ESC asked the European Competition Directorate to examine the impact of liner consortia and vessel sharing agreements. The ESC maintained that liner-shipping consortia agreements were not liner conferences, and taken in conjunction with price fixing liner conference agreements, afforded the members of consortia agreements the possibility of eliminating effective competition by being in a position to control both price and supply in the market.

After an extensive investigation the European Commission agreed with the ESC. In 1996 the EU adopted the consortia block exemption Regulation. The Regulation specifically precluded members of a consortium and vessel sharing agreements from fixing maritime prices. The fixing of inland transport prices was also prohibited. In addition, the Commission set trade share parameters for consortia agreements in recognition of the potential of consortia and vessel sharing agreements to distort competition in liner shipping markets. In 2000 the Commission reviewed the consortia block exemption Regulation and made some minor changes, including the conversion of trade shares into normal market share thresholds. As a consequence, consolidation they are forced to compete on customers service, information technology, and documentation accuracy which all ultimately benefit the customer.”
the block exemption only applies to consortia with market shares below 35% (with the possibility of individual exemption up to 50%).

The ESC believes that liner-shipping consortia and vessel sharing agreements are the most suitable form of cooperation between liner shipping operators and has no objection to them under EC competition rules, provided such agreements comply with requirements such as those in the EU consortia block exemption regulation.

In this respect the ESC draws a clear distinction between price-fixing or rate setting liner conferences and liner shipping consortia agreements. The former category of restrictive price fixing agreements provide no benefit to shippers, and have largely been superseded by individual and confidential contracting (particularly in relation to US trades). Liner shipping consortia agreements may potentially provide benefits to both shippers and liner-shipping operators in terms of rationalisation of capacity and cost reduction.

The review process and possible reform would allow the liner shipping industry to focus more on consortia with the emphasis on cost reductions and increased profitability from efficiency and less on the elimination of competition through market management and collective price agreements.

This is recognised by the consortia block exemption regulation which the TACA Decision notes: “Demonstrates the Commission’s positive attitude to service arrangements – but does not accept that price-fixing is necessary to obtain their advantages” (see Article 9 of Commission Regulation 870/95 and TACA Decision footnote 135).

In its observations on the Revised TACA the ESC has drawn the Commission’s attention to the fact that the combination of the two kinds of restrictive agreements (conferences and consortia) between the parties is likely to restrict non-price competition between the TACA parties.

4.5 Guidelines on rate/price policy

In any future legal framework the use of voluntary guidelines would be of paramount concern to the ESC to ensure the presence of effective and workable competition. The use of ‘voluntary guidelines’ for contracts (for both individual and confidential
contracts and conference and multi-carrier contracts) would create the ability to exchange rates and other commercially sensitive information in aggregated form from individual and confidential contracts in order to set a market based conference tariff. As mentioned above, there is within the ESC no general recognition of the usefulness of creating a kind of benchmark for those negotiating rates.

Ocean carriers individual and confidential contracts would not be sufficient to safeguard competition. Under the Revised TACA decision lines are allowed to aggregate individual service contract rates to get statistical information on service contract rates e.g. automobile sector rates. Although the ESC has not appealed this decision this does however not mean that the ESC is in agreement with the Revised TACA decision. ESC continues to have concerns regarding the exchange of information comprised in confidential individual service contract rates (and other terms and conditions) when such disclosure of confidential information infringes OSRA and the shippers contractual rights.

Shippers expect that once the review has removed the block exemption for liner shipping conferences, in turn, this should automatically remove any justification for an exemption for conference or multi-carrier service contracts and, by definition, the justification for any exchange of information of individual service contracts such as price and conditions, for the purpose of fixing a liner conference tariff.

ESC believes that in an industry where the barriers to entry are relatively high\(^47\), and the natural trend is towards at best oligopoly and at worst monopoly, giving ocean carriers the freedom to discuss issues like service and rates with their competitors has the potential to seriously distort competition. Allowing suppliers to discuss what would, elsewhere in industry, be commercially highly sensitive information, can only present carriers with an opportunity to tempt them to distort the market in their favour.

It is believed by the ESC that voluntary guidelines such as those used on the Transpacific remain the single largest obstacle to effective competition. They have

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\(^{47}\) Although there are no regulatory barriers to enter liner shipping, there are other mainly economic barriers to entering the market. Entry to the industry involves high costs. There are not that many new carriers that have sufficient resources to enter trades served by existing carriers. New carriers often serve niche markets or are inferior to services offered by conference lines in terms of geographic scope and frequency of service.
been deliberately proposed by the shipowners to enable the carriers to unilaterally control the terms and conditions of all contracts (conference/multi carrier, individual and confidential). When the market is very tight there is nothing to prevent the shipowners uniformly applying the same contract terms and conditions in accordance with guidelines. The Guidelines cannot be voluntary if all conference carriers apply them and they are in practice non-negotiable.

Shippers would therefore not accept a future legal framework of the sort that are used on the Pacific trades that provide for discussion agreements which enables competitors to sit down and exchange information in a way that is unheard of in any other competitive industry. The Transpacific trade has demonstrated that “voluntary guidelines” have resulted in the imposition of standard service contract rate increases for US and Japanese shippers. The experience of Japanese shippers demonstrates that the apparent “voluntary” nature of the TSA guidelines in reality resulted in the general imposition of an enormous rate increase in all service contracts. As outlined very clearly by Ed Emmett, former President of the NITL, at the recent CI Conference: “Although there are significant legal differences between conferences and discussion agreements, both can be considered forms of collective action on the part of the liner industry. Collective action, particularly in the matter of rates, is counterproductive to the liner industry, because it creates a mindset of “us versus them” with “us” being the liner industry and “them” being the customers.”

5. **Comparisons with other industries**

Ocean carriers often claim that shipping lines are efficient and that freight rates have gone down over the last couple of decades. This may well be the case. It would be interesting to compare the evaluation of freight rates with other transportation industries, in particular bulk shipping and air transport, where collective price control agreements have been outlawed. The general trend in other industries, as also outlined by the OECD report, is that prices go down. Whilst this historic decrease in

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48 Speech made by Ed Emmett during the Containerisation International Conference April 2003 “Regulated transport industries resist deregulatory change. Even following a review, you would often see that such industries try to modify old business structures to fit the new reality.”
rates has characterised the liner sector for many years, it is not unique in having to contend with the global pressure for more efficient products and lower prices.\textsuperscript{49}

Even the shipping consultants Drewry have observed that “the argument that liner shipping services have been undervalued and undersold over a long period is correct, but the carrier industry still has a long way to go to match the falls in prices seen in the telecommunications sector, for instance. Moreover, few other industries have enjoyed the same anti-trust privileges as liner shipping, and have had to compete in a no less global market but without the freedom to consult and agree on prices. Whatever underselling of the industry has occurred has been done from a position of tremendous strength, and might well raise charges of extreme carelessness.”

The OECD Report on Competition Policy in Liner Shipping has rightly pointed out that “the transport sector is a sector where regulatory review has the potential to unleash efficiency gains, cost savings, service innovation and users and consumer welfare”.\textsuperscript{50} Many of these, in the past highly regulated industries have spent considerable efforts in protecting their special status. The OECD refers to the fact that transport industries have similar features: high capital investments; uneven demand; chronic and necessary overcapacity etc. These characteristics are not unique to liner shipping, neither is the provision of fixed schedule transport services such as, a deregulated air and the rail freight industry also provide.

Many shippers are accustomed to the deregulated motor carrier and air cargo industries and see no reason why liner shipping should not function in a similar manner. What makes liner shipping so different from other service industries so as to justify that all containers should be carried at the same or agreed at comparable rates? Or indeed, what makes the liner industry different from a large part of manufacturing industry which is encumbered with high fixed costs and suffer the problems of “lumpy” investment.

In a deregulated transport market, as the road haulage market nowadays is in Europe, and the rail transport sector is well on its way to becoming, prices for moving freight are not decided by collective tariff fixing bodies. For rail services price is decided in

\textsuperscript{49} As Panasonic’s UK Logistics Manager Neil Harries pointed to CI “the rates we are paying for freight services are now lower, but so are the prices of our televisions.”

\textsuperscript{50} page 10 OECD Competition Policy Report
a normal business agreement between the carrier and its customers, where volume commitment, traffic balance, service levels etc influence the rate.

As the ESC has noted in its submission to the OECD the air transport industry is a highly comparable industry with that of the liner shipping industry. The airline industry has high fixed costs, suffers trade imbalances and experiences seasonal fluctuations in demand. Like the liner shipping market the aviation industry provides scheduled air transport services (for passenger and freight services) and, in common with shipping, utilisation of capacity is the key to profitability.

However, unlike the liner-shipping industry airlines are not allowed to fix prices or to set air cargo rates. Air cargo prices are therefore determined by normal competitive market economy pricing conditions, with airlines competing head-on with each other, subject to supply and demand conditions in the relevant markets.

ESC has supported and welcomed the Commission’s attempts to promote competition and deregulate the European air transport industry over the last 15 years. We believe that the Commission’s activities in this area have made a valuable contribution to creating the free market based airline sector that we now have in Europe. This has seen volumes in both passengers and freight transport increase dramatically. The exemption for cargo interlining has already been removed by the Commission. And further de-regulation will follow as the EU takes on the mantle for negotiation air service agreements for all EU airlines with countries like the US, and challenges the restrictive ownership rules such countries as the US impose on airlines. All this will allow the aviation industry to change to new market conditions, forcing it up to make business decisions that will enable the industry to capitalise further on the increasing demand for its services. That the cargo sector is thriving, and enjoying both record levels of traffic and also of expected future growth is testament to the fact that airlines do not need tariff conferences to prosper.

6. Comparison with tramp shipping

Tramp shipping which refers to transport services performed irregularly is a fairly competitive market, mostly free from restrictions. The ESC believes that the bulk market operates efficiently and competitively in a free and competitive market to the satisfaction of shippers and carriers.
The ESC does not believe that there are any substantive arguments to support the case for pooling arrangements in the bulk shipping sector, or for the need to change the way in which competition policy is applied to the bulk sector. On the contrary, the ESC considers that the continued best prospects for the bulk sector rests with the continuation of the existing competition policy regime applicable to the sector. Unlike the liner shipping market, the bulk sector has a much more mature customer-supplier tradition where shippers and carriers do business in an open and confrontational manner. It is the ESC’s view that the liner shipping sector would have much to gain and learn by emulating the approach adopted by the bulk market.
7. **Conclusions**

- The ESC remains opposed to the liner conference block exemption, particularly the price fixing provisions and capacity management provisions. It is the firm belief of the ESC that liner-shipping conferences do not provide freight rate stability and do not contribute to efficient liner shipping services.

- The consensus of the shipper members represented by the ESC is that the benefits of a free market in liner shipping service would outweigh all possible drawbacks. As described above, without conferences, carriers would still be able to offer liner shipping services.

- Although the relevance of conferences has diminished because of the possibility to negotiate individual service contracts, conferences do still have an active role in the control of the freight rate through their possibility to manage supply and demand and the implementation of surcharges.

- Shippers claim that the justifications for the present day conference system have no relevance in today’s business environment which is dominated by the need for effective competition. Shippers believe that in today’s global economy in which ‘state of the art’ logistics and supply chain management services are more and more tailor made – there is no place for conferences. Traditional arguments in favour of liner conference fail to reflect business needs.

- International companies from other industries today operate in the international marketplace without the “privilege” that liner carriers enjoy today. The “old” arguments which have sustained antitrust exemption authority exemption authority simply do no hold up when compared to other international businesses which successfully do business across national boundaries, and under different statuary and regulatory regimes.

- The ESC continues to support the concept of freedom for carriers and their customers to conclude confidential service contracts in its firm belief that these are modern business arrangements for a modern industry. Shippers should always have the option of freely negotiating rates, surcharges and other terms of carriage on an individual and confidential basis with the carrier(s) of their choice.
without the interference of any regulatory body or other administrative bureaucracies such as a conference.

- Any co-operative arrangements among shipping lines must be of a technical nature in order to enhance efficiency and reflect global trading patterns. The ESC views consortia as the most acceptable and preferable form of co-operation between shipowners, provided consortia agreements meet the kind of provisions set out in the EC Consortia Regulation 870/96. The adoption of consortia as the appropriate regulatory instrument for co-operation between shipowners would influence the liner shipping industry to focus on consortia (with the emphasis on cost reduction and increased profitability from efficiency) and less on the elimination of competition (with the emphasis on price fixing and bureaucratic market management). In any future legal framework the use of voluntary guidelines would be of paramount concern to the ESC to ensure the presence of effective and workable competition.
ANNEX 1

Interview with Alain Morin in ‘American Shipper ‘ Magazine June 2003
ANNEX 2

Examples of TACA “ANNOUNCEMENTS TO THE TRADE - GRI’s”
Source: TACA website (www.tacaconf.com)

May 28th, 2003
Subject: Westbound Tariff Announcement

Mid February 2003, TACA advised the Trade that it would implement a two part general tariff rate increase programme during 2003. At that time, announcement of the full details relating to the second phase, for effectiveness October 1st 2003, was held over. Such details have now been finalised and as part of the continuing need for rate viability restoration, balanced against maintaining the level of service quality demanded by the Trade, the following Westbound TACA Tariff increases will be published to take effect from October 1st, 2003:
- $400 per 20ft container
- $500 per 40ft container
- $25 WM

It can be expected that Tariff rates at their increased October 1st, 2003 level will be held good through March 31st, 2004

March 31st, 2003
Subject: Eastbound Temperature Controlled Cargo Increase Eff. May 1st, 2003

Further to the March 13, 2003 announcement implementing Eastbound Tariff increases under a Conference Rate Restoration Program, effective April 15th 2003, TACA wishes to announce increases to temperature controlled containers effective May 1st, 2003, at the following levels: Traffic from and via Atlantic/Gulf Coast Ports
- $400 per 20ft temperature controlled container
- $500 per 40ft temperature controlled container

March 13th, 2003
Subject: Conference Rate Restoration (Eastbound), Effective April 15th, 2003

The TACA wishes to announce that it is necessary to implement Eastbound Tariff increases under a Conference Rate Restoration Program, effective April 15th 2003, at the following levels: Traffic from and via: Atlantic/Gulf Coast Ports Pacific Coast Ports $160 per 20ft
container $ 240 per 20ft dry van container $ 200 per 40/45ft container $ 300 per 40/45ft dry
van container $ 400 per 20ft temp. controlled container $ 500 per 40ft temp. controlled
container

**February 11th, 2003**

**Subject : TACA Tariff 2003 Business Plan**

The amount of cargo lifted by TACA Parties in the Westbound trade between North European
Ports and Scandinavian/Baltic Ports to US Ports during 2002 was in excess of 7 per cent bove
2001 performance, and after the Christmas / New Year holiday period, traffic volumes are
returning quicker than usual to normal levels. The expectation is that cargo flows and capacity
utilisation will continue to run at high levels throughout this year. However, the general level
of rates remains unsustainable and tariff rate increases are necessary to support the service
levels demanded by the trade. To this end, TACA wishes to give notice that it will be
publishing a Westbound two part general tariff rate increase programme during 2003, the first
phase effective April 1st and the second, effective 1st October. The first phase of this tariff
rate increase programme, from April 1st 2003, will be: $400 per 20ft container $500 per 40ft
container $25 WM Details relative to phase two, from October 1st 2003, will be announced
later.

**October 2002**

TACA members announced a further increase of $320/20ft and $400/40ft on October 1st
2002.

*This announcement to the trade is not listed in the archived press releases on the TACA
website. This announcement coincided with the major contract renegotiating period in the
interim. Also the announcement followed an earlier announcement of Cosco, K-Line, Yang
Ming and Hanjin withdrawing 130.000 TEU capacity by January 2003.*

**July 8th, 2002**

**Subject : General Rate Increase (GRI) - Eff. October 1st, 2002**

Overall volumes in the Westbound trade have continued to increase, with TACA carriers
experiencing close to a 10 percent increase in volume through the first 20 weeks this year
versus the same period in 2001. The current demand for Westbound space is unprecedented;
vessel utilisation is at a very high level and is expected to continue into the traditional heavy
shipping period in the second half of this year. Despite the increases in TACA tariff levels introduced in the second quarter, the general level of rates is still significantly below that required to maintain service levels demanded by the trade. To this end, TACA wishes to inform their customers of the introduction of a Westbound general tariff increase programme, effective 1st October, 2002. Whilst full details have yet to be finalised, and will be released early August, that tariff increase can be expected to be substantial in nature.

**11th February, 2002**

**Subject : General Rate Increase**

Following a review of current and projected Trans Atlantic trading conditions, TACA Parties have concluded that marginal increases in total available capacity, coupled with no dramatic swings in cargo flow, do not explain the significant general downward pressure on rates that has been experienced for some time. The resulting situation is not sustainable as the overall return on the substantial capital deployed, to provide regular and reliable service, is far from adequate. The TACA Parties further consider that in the prevailing economic climate there is scope for TACA tariff rate increases. To this end, TACA will publish the following general tariff rate increases upon implementation of which the general level of rates will still not reach the levels of early 2001: Westbound, effective 1st June 2002: $240 per 20ft container $300 per 40ft container $15 WM Eastbound, effective 15th March 2002: $120 per 20ft container $150 per 40ft container $8 WM
ANNEX 3

Capacity cuts implemented in early 2003 (source: trade press and information provided by shippers)

1. DSR left the trade: a reduction of 2700 teus/week.

2. Cosco, Hanjin, K-Line, Yang Ming alliance dropped a whole loop and bought 810 teus/week from the Grand Alliance - a reduction roundly 2200 teus/week

3. PONL reduces capacity in the Atlantic by roundly 800 teus.

4. Maersk/Sealand capacity reduction 1500 teus/week.

5. CMA CGM reduced weekly capacity from 550 TEU to 425 TEU following a change of slot partner.

Announcement in CI-on line 05/03/03

Maersk confirms Atlantic capacity cuts
Maersk Sealand is to cut its weekly Atlantic capacity by around 1,500TEU following a reorganisation of its TP-3/TA-3 pendulum service next month.

Currently the line operates 12 vessels of 4,437TEU each on the service but the company confirmed that three of these ships will be re-deployed and a reduced capacity Atlantic service formed. ‘Coverage will be the same but the capacity will be less,’ confirmed Peter Frederiksen, chief commercial officer and senior VP at MSL. Ships will now turn around in New York on the TP-3, he added.

European cargo bound for the US West Coast, and Asian cargo heading east will be carried on the TA-2 service which has direct calls at Houston with cargo transported via a mini-landbridge service between Houston and the West Coast.

The new TA-3 service has yet to be finalised but the changes are expected to be phased in during April said Frederiksen.
ANNEX 4

Example of conference notice to shippers (several days notice to shippers).

EUROPE SOUTHERN AFRICA CONFERENCE

www.esa-conference.com  Holland House, 1-4 Bury Street, London  EC3A 5AT

NOTICE TO SHIPPERS

SOUTH AFRICAN PORT ADDITIONAL

Due to past and continuing operational delays and the additional expense involved in maintaining service schedule in the present difficult circumstances at South African ports, ESAC Lines feel that they are unable to continue subsidising these considerable additional costs and have to announce that they are introducing a temporary Emergency Port Additional of US$100/TEU at South African ports. It is intended that the surcharge will remain in place until the average delay to vessels berthing in each South African Port, as measured over a two-month period, reduces below 16 hours.

The additional will be payable by the freight-payer and will not apply to international transhipment cargoes. It will be implemented from 15th May with effect from the following vessels:

<table>
<thead>
<tr>
<th>Southbound</th>
<th>Northbound</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Stuttgart v. 023</td>
<td>Winterberg v. 516</td>
</tr>
<tr>
<td>Helderberg v. 024</td>
<td>Safmarine Kei v. 517</td>
</tr>
<tr>
<td>Grey Fox v.2324</td>
<td>Golden Isle v.2325</td>
</tr>
</tbody>
</table>

The Conference Secretariat,
London 6th May 2003
ANNEX 5

Europe Middle East Rate Agreement (EMERA) “Warrisk Surcharge”

During the first Gulf War and after the terrorist attacks in the USA in September 2001, various conferences introduced war-risk surcharges of around $300,- per 20’ container. The level of charges has been disputed by shippers, because, until now shipping lines have not been able to give a transparent picture how the surcharge is calculated.

Shippers showed a certain amount of understanding for the introduction of a warrisk surcharge during the hostilities in Iraq on March 30th 2003. The main reason that shippers in general did not oppose this charge was, that the level of the amounts charged seemed to be much more realistic than previously experienced. The charges ranged between $20,- and $60,- per TEU with Kuwait as exception where the charge was $180,- per TEU. These amounts illustrate that the earlier warrisk charges were outrageous and could only lead to the suspicion that they were an additional source of income for either the insurance companies or the carriers or both!

Shippers continue to contest that it is the Europe Middle East Rate Agreement (EMERA) that decided the corporate level of the surcharge. On April 11th 2003, when the hostilities in Iraq had come to an end, EVO-Dutch Shippers’ Council asked EMERA why the warrisk surcharge had not yet been abolished. EMERA commented that, as long as underwriters did not adjust their premiums, there was not much carriers could do but to pass on the costs to shippers. Never have shipping lines attempted to show their customers what efforts they had been taken to make insurers withdraw the increased premiums. Almost 2 months after the end of the military actions in Iraq, the EMERA warrisk surcharge was still in place! Although the amounts have been reduced as per May 8th 2003 shippers are still paying for a risk that has not been existing for more than 8 weeks.

It is interesting to note that the airfreight industry, which was suffering just as much from the Iraq war as the maritime industry, did not hesitate to withdraw the warrisk surcharge the very moment the war was over.

Some shippers do negotiate individual terms with EMERA members, but in general the conference carriers follow one line and “hold each other’s hand”. Also independent carriers
automatically follow the conference. That is common practice as far as the application of surcharges is concerned.

The above is a typical example of how the conference structure damages the interests of shippers.
ANNEX 6

Campaign Israel Shippers’ Council on Terminal Handling Charges

The current campaign of the Israel Shippers’ Council (ISC) where the European Mediterranean Trade Agreement (EMTA) is trying to introduce terminal handling charges (THC) is a good example of the response from shippers on the collective implementation of THCs. The ISC lodged a complaint against EMTA member lines with the Israel anti-trust authority putting a stop to the announced collective THC surcharge. EMTA was due to introduce on 20th January 2003 a THC of US $40 per 20ft container and $60 per 40ft container on both import and export boxes. EMTA controls about 90% of the market between Israel and Northern Europe. Following the notice to trade from EMTA on the THC, a similar notice to trade was announced by the Israel Adriatic Conference, with effect of 1st February 2003.

EMTA’s lawyers based their response on the historical agreement between ESC and CENSA51 containing the famous 17 terminal cost elements dated 1989, which formed the THC, as it is known today. This agreement was annulled by ESC in 1991 due to the abuse of its implementation by the shipping lines.

Since one cost element was not deemed to be part of the maritime service EMTA’s collective THC was deemed not to be exempt under the Antitrust Law. In response to this judgement EMTA announced that with effect from 18th June 2003, a new THC would be levied, claiming to have amended it in accordance with their interpretation of the earlier legal decision.

51 Council of European and Japanese Shipowners’ Associations.