Ms. Lowri Evans  
Director  
DG Competition / Services  
European Commission  
70, Rue Joseph II  
1049 Brussels

Dear Ms. Evans,

**Review of Regulation 4056/86: Proposal for a new Regulatory Structure**

The European Liner Affairs Association (ELAA) and its membership\(^1\) submits to the Commission’s services this Proposal which constitutes a framework for a new regulatory structure for liner shipping services operating to and from the EU, to replace Regulation 4056/86.

*Without Prejudice – No Need for Reform*

The ELAA submits this Proposal *without prejudice to its position* (as articulated during the Commission’s review process) that DG Competition (DG Comp) has not received any convincing evidence whatsoever that Regulation 4056/86 fails to satisfy the conditions of Article 81(3) EC and should be abolished. Further, DG Comp has not itself yet made a convincing case for the abolition of Regulation 4056/86 either in the Discussion Paper published on 16 June 2004 or at any other stage during the review of Regulation 4056/86. The ELAA has explained during the review process\(^2\) that the conference system (granted an Article 81(3) EC exemption by the Council in Regulation 4056/86) was considered to be a

\(^1\) A full listing of the ELAA’s membership is contained in **Annex I**; in effect the ELAA represents the world’s entire liner shipping industry

\(^2\) See ELAA Comments on Responses Submitted by Third Parties, 15 October 2003, at 2.21; ELAA Issues Paper of 3 December 2003, at 1.8; and ELAA Post Hearing Submission of 20 February 2004, at 2.2.
low cost way of achieving pricing based on long run marginal or average costs, in a high fixed cost industry where the opposite would lead to destructive competition and, consequently, unreliable services. The system was intended to provide greater stability in a market prone to serious instability. Recent years have seen a series of cases brought by the Commission’s services which, combined with judgements of the European Courts, have resulted in a significant narrowing of the scope of application of the system authorised by the Council in Regulation 4056/86. The current regime, resulting from the compromise set out in the Carrier Agreement of 1998 and in the Revised TACA\(^3\) (which was granted an exemption under Article 81(3) EC) has been seen to be workable and the current legal position is relatively clear.

Although the ELAA maintains the views summarized above, it has always sought to participate in the Commission’s ongoing review process in a constructive manner and engage in worthwhile discussion with the Commission and its services. Therefore, it has decided to submit this Proposal (without prejudice to its position summarized above) which represents a significant change in the position adopted by the industry and which recommends the implementation of an alternative regulatory structure to Regulation 4056/86.

**Preserving the Essential Welfare Benefit of the Current Regime – Stability of Supply**

The essential welfare benefit generated by the current regime is the stability of supply. The Commissions’ review has confirmed that liner shipping provides regular, reliable, high quality scheduled services, with ample competition, no switching costs and no barriers to entry. Stability of supply was and remains a valid objective for regulation in this industry.\(^4\) However, the ELAA has argued – and is referred to the detail in the ELAA’s submissions\(^5\) – that the liner shipping industry is characterised by a unique blend of economic characteristics which necessitate regulatory intervention, the form of which may differ from that operated in other network industries. The combination of high fixed costs, inelastic and asymmetric demand, inelastic and lumpy supply, high risk and no or little regulatory barriers make the market inherently and chronically unstable. This chronic instability – market failure – manifests itself through high fixed costs for the provision of regular scheduled international services, rate fluctuations and fluctuating demand which the industry cannot control. The ELAA and its members consider that the special characteristics of the liner shipping industry warrant continued sector-specific treatment to ensure the stability of supply. Such stability of


\(^4\) ELAA refers to previous ELAA submission(s), in particular ELAA Issues Paper of 3 December 2003, at 7.8; and ELAA Technical Paper: Precedents drawn from case law regarding the concept of stability, 3 December 2003 and the Erasmus Report, at pages 76 and 82.

\(^5\) See e.g. ELAA Issues Paper for the Oral Hearing, 3 December 2003, at paras 7.15 and 8.9; and ELAA Post Hearing Submission, 20 February 2004, annex 2.
supply is not achievable without effective capacity planning, in the short-term as well as in the long-term.

In formulating the Proposal, the ELAA and its members have engaged in a self-assessment exercise covering all aspects of the industry’s practices, in line with the Commission’s new approach to the application of Article 81 EC, to determine the core elements of the current regime that must be preserved to maintain stability of supply. This included detailed and meticulous data gathering and consultation across the full ELAA membership. The ELAA has reviewed the results of the consultation to establish whether current and desired practices would fall within the application of Article 81 EC and, if so, could fulfil the four conditions of exemption in Article 81(3) EC, as further developed in the Commission Guidelines on the application of Article 81(3) EC. The Proposal contained in this document is the result of this analysis.

The ELAA submits that the Proposal contains those elements indispensable to a new regulatory structure for liner services that will result in significant benefits to the industry and consumers alike.

**Summary of the Proposal**

The ELAA proposes that a new legal instrument be adopted, which applies to the provision of liner shipping services - defined as “the transport of goods on a regular basis on a particular route or routes between ports and in accordance with timetables and sailing dates advertised in advance and available, even on an occasional basis, to any transport user against payment, and ancillary activities” (wording based on Article 2(2) Regulation 823/2000, the Consortia Block Exemption).

The new legal instrument would exempt the following elements of an information exchange system:

- Exchange and discussion between lines of aggregated capacity utilization and market size data by trade and on a region/zone to region/zone basis (historic data with a month’s delay);
- Exchange, discussion and evaluation of commodity developments by trade (based on data aggregated with a month’s delay);
- Discussion and evaluation of aggregate supply and demand data by trade/commodity. Forecasts of demand by trade and commodity would be published;

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• Lines will obtain their own market share by trade, by region, and by port (data aggregated with a month’s delay);

• Price index differentiated by type of equipment (e.g. reefer, dry) and/or trade (data aggregated with a quarterly delay). This information would be made publicly available;

• Surcharges and ancillary charges based on publicly available and transparent formulae; the details of which would be discussed with shippers.

The ELAA emphasises that in contrast to Regulation 4056/86, the Proposal makes no reference to either “price fixing” or the “regulation” or “limitation” of supply or capacity.

The envisaged system of information exchange would be based upon one or more industry body(ies) or agreements and committees per trade.

Functioning of the Liner Shipping Industry – Absence of Market Power and Collusion

Before turning to a detailed description of the various elements of the Proposal, we summarize some key characteristics of the liner shipping industry to ensure that the Proposal is considered in a realistic and appropriate context.

There is no recent evidence of market power being exerted by the conferences, in part due to the market changes implemented after the 1998 Carrier Agreement and to the inherent characteristics of the market outlined above. The ELAA encloses a study commissioned from Charles River Associates (CRA) concerning the Europe – Far East trade (the largest trade to/from Europe), and, in particular the operation of the Far East Freight Conference ("the Market Study"). The ELAA submits that this study, contained in Annex 2 to this Proposal\(^7\), indicates that movements in rates can be explained by market fundamentals and that any differential between the rates obtained by conference and non-conference members is unlikely to be due to the exercise of market power. Using the conclusions contained in the Market Study and applying them to the Proposal, the ELAA wishes to make the following points:

• Previous collusive arrangements were related to tariff setting, but this is an out of date view of the industry since the changes effective in 1999, and industry practice is very different today;

\(^7\) The analysis undertaken, and the data on which this analysis is based, contains sensitive business information from the members of the ELAA. The data gathering exercise, as well as the processing and analysis thereof, have been conducted by Charles River Associates at the request of external counsel, and have not been shared with the ELAA beyond the non-confidential results of the study.
- No rate or tariff setting, agreement, or discussion of rates is envisaged in the Proposal, as a result of which there will be no transparency of rates given the extensive use of individual service contracts and/or rate agreements, where negotiations are bilateral and confidential;

- Absent explicit tariff setting, there is no viable mechanism for collusion in the liner shipping industry;

- Market structure is not conducive to collusion. Concentration is low, even at port-to-port level, so collusion is highly unlikely: lines are unable to reach terms of coordination given the complex and unstable economic environment in which they operate; demand conditions are unstable; demand patterns are volatile; lines engage in confidential service contracting or rate agreements; low barriers to entry and low switching costs; market shares are asymmetric and vertical integration is asymmetric;

- Inability to monitor deviation. There is no credible threat of timely and sufficient retaliation given the shipbuilding cycle of 3 years; confidential service contracts and independent rate agreements result in limited or no market transparency; and there is only a limited ability to interpret market behaviour as divergent from any terms of coordination;

- Inability to deter. There is no credible threat of future retaliation if deviation is detected, either on capacity or price. Capacity retaliation can materialise only after three years, and lack of market transparency renders price retaliation impossible – a strategy of “fighting ships” is only viable for an individual line if it is in the context of a wider organisation i.e. a properly functioning conference;

- On explicit collusion, it should be noted that after the terms of the 1999 settlement were implemented by the industry, the market has been characterized by individual service contracting and rate agreements, in essence confidential bilateral contracts whatever their form; little or no cargo is carried on the conference tariff and there is no hint of explicit collusion between lines. Today’s market has hundreds of thousands of different pricing points and has been shown to be competitive. There is no evidence of market power by lines. In fact, there is much evidence that shippers use low switching costs to shift demand between the lines at any time;

- On tacit collusion, it should be noted that this is even harder to sustain in practice. Tacit collusion cannot be assumed and to forgo the benefits of information exchange on the basis of a wholly theoretical proposition with no support is not justified, especially in a market which has characteristics that clearly make tacit collusion and coordinated interaction difficult, if not impossible (see above). The ELAA submits
that in the specific case of liner shipping, the benefits of information exchange far outweigh any risk of collusion.

The ELAA suggests that the conclusions of the Market Study, based on detailed empirical data directly obtained from conference and non-conference members, echo the (unrebutted) theoretical work of the independent Erasmus economists selected by the Commission to provide advice on specific issues relating to the application of the liner conference block exemption.  

**Detailed Description of the Proposal**

Taking into account the functioning of the liner shipping industry, as well as the need to preserve the essential welfare benefits of the current regime, the ELAA wishes to describe in more detail those elements it considers to be indispensable to a new regulatory structure for liner services.

**Industry Body(ies) or Agreements and Committees per Trade**

The envisaged system of information exchange – see below – would be based upon one or more industry body(ies) or agreements and committees per trade:

- The industry body(ies) or agreements would organize the input of data from the individual lines, which would then be aggregated such that no individual line could detect other lines’ data;

- There would be no discussion of individual lines data within the committee meetings;

- The industry body(ies) or agreements and their committees would be subject to clear competition compliance rules, the contents of which will be discussed with the Commission. The ELAA is willing to discuss the modalities of the independent industry body(ies) or agreements, including the implementation of appropriate firewalls and compliance policies, its voting structure and finances.

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8 In particular, see the Erasmus Report, at page 82.
A System for the Exchange of Information

The new legal instrument would exempt an information exchange system, as summarized in the following diagram:

In terms of information input, the proposed information exchange system envisages each carrier providing the industry body(ies) with data based on its bills of lading, vessel loadings, and vessel capacities. The information would be provided on a port-port and trade basis. The data would be summarized by the industry body(ies) with "macro data", which would include trade and port statistics obtained from various sources and outside consultant reports. The industry body(ies) would then process the data input and the output would be provided to either (depending on the information) a trade committee comprising the trade managers of those lines providing information to the industry body(ies) which could then

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9 Under the existing regime of Regulation 4056/86, more information can be exchanged. However, the application of the existing regime is not necessarily consistent and the quality of the interpretation and analysis of the information exchanged varies widely. The envisaged system will authorize the exchange of less information, but would enable it to be carried out in a more coherent manner enabling more accurate interpretation and analysis.
interpret the figures produced, and/or directly to individual carriers. No carrier or employee of any carrier would have any access to data provided to the industry body(ies) (which would itself be subject to strict compliance rules and bound by, e.g., a confidentiality agreement with the lines that provide it with their confidential data).

The various aspects of the “output side” of the envisaged system of information exchange are discussed in the following.

Capacity Forecasting

The first element of the envisaged system of information exchange relates to the exchange and discussion between lines of aggregated capacity utilization and market size data by trade and on a region/zone to region/zone basis (historic data with a month’s delay). The information output would be provided to the trade committee and to member carriers on a monthly basis. Each member would also receive its own volume and capacity utilisation data. The trade committee would: (a) interpret the capacity utilisation and market size data provided, and (b) discuss information that comes out of the envisaged system (i.e. trade patterns and trends in demand, given historic patterns) to better understand market developments. The output would be a report, the contents of which would need to be agreed with DG Comp. It is envisaged that the report would be more robust, accurate and useful in comparison to what is available today and would be used by each individual line as a guide to market conditions, and also be shared with customers. There would be no coordination or consultation between the lines on matters that are to be decided at individual company level (i.e. capacity, investment, deployment, etc.) and/or at consortia level.

The level of detail on the output side would be by trade and on a region/zone to region/zone basis. The ELAA notes that under Regulation 4056/86, input is already provided by port, while output is provided per trade or zone (e.g. Hong Kong to South China, country to country). Detail going beyond trade is needed under the Proposal to ensure more accurate forecasting of future capacity, taking into account factors relating to important regional differences in infrastructure (e.g. facilities, feeder operations, access to ports, etc.). The ELAA stresses that capacity, deployment and investment will be determined by each carrier individually with no discussion among participants to the trade committee, or otherwise. Each carrier, in taking its own individual decisions, could take into account the better information and forecasting of general market trends by the trade committee, which – the ELAA expects – would in turn make any individual decision taken by a carrier more efficient and accurate in matching future supply with expected demand.

The ELAA considers that a one month period is sufficient to ensure that the data is historic as well as necessary and indispensable for a useful discussion of demand and supply in the liner shipping industry. The starting point to assess whether the output information is historic is to determine the duration of a sailing in a particular trade. Depending on the trade, one round
trip takes 56 to 63 days or longer (i.e. significantly longer than one month). Once a ship sails, its capacity is lost ("perishability of supply"). To change schedule on a trade (i.e. to use the information exchange for the purpose of capacity decisions), the decision itself would be taken over 2 to 4 weeks, while the time to inform customers could take another 4 weeks, after which at least another 4 to 6 weeks would be needed for implementation. Therefore, the information is needed as quickly as possible to ensure that decisions are effective, and one month old data is seen as necessary and indispensable to achieve this. The ELAA notes that under the existing regime, one week is the period of reference.

The exchange of information concerning aggregated capacity utilization and market size data would allow carriers to make better investment decisions (i.e. how many vessels to deploy in each trade, their capacity, etc.). More accurate figures on vessel capacity would improve individual lines’ understanding of how future supply and demand for liner services would evolve and ensure stability of supply (allowing carriers to better meet growing demand for liner services).

Commodity Developments

The second element of the envisaged information exchange system relates to the exchange, discussion and evaluation of commodity developments by trade (based on data aggregated with a month’s delay). Carrier members would provide data (to the industry body(ies)) on volumes of specific commodities carried on the trade.

The ELAA notes that different commodities require different types of equipment. The envisaged information exchange system is vital for taking effective investment decisions, as: (a) different types of containers are needed for different types of goods (e.g. onions in open top/open side containers; coffee in ventilated containers; 45 foot containers for toys; half height containers for ingots); and (b) different specifications are required for vessels (e.g. reefers for food impact on vessel design and the number of plugs; dangerous goods / IMO reduces loading capacity; weight differs per type of goods). The essential content of this kind of information (derived from the bill of lading) is already exchanged today in trades to/from the US – this information is publicly available through Journal of Commerce/PIERS Consistent with the exchange of information concerning capacity utilization and market size data (see above), the ELAA submits that a one month period is sufficient to ensure that the data is historic.

The exchange of information concerning commodity developments allows lines to better assess commodity/trading patterns. This contributes to carriers making better investment decisions and, in turn, ensures the stability of supply.
Published Forecasts of Demand

The previous two elements of the envisaged system of information exchange would result in the discussion and evaluation of aggregate supply and demand data by trade/commodity; forecasts of demand by trade and commodity would be published and made available to shippers. Concerning capacity forecasting and the transparency vis-à-vis the demand side (i.e. information provided to customers), the ELAA notes that currently the information is generally available to conference members only, whereas the proposed system would make the information available to customers as well.

Market Shares

As the third element of the envisaged system of information exchange, lines will obtain their own market shares by trade, by region, and by port (data aggregated with a month delay). The market shares data output will not be the subject of any discussion between the lines.

Consistent with the exchange of information concerning capacity utilization, market size data, and commodity developments (see above), the ELAA submits that a one month period is sufficient to ensure that the data is historic.

The exchange of information concerning market shares will enable each individual line to track its own performance, follow the market and improve its own decision making and, in turn, ensure stability of supply. The ELAA notes that market shares are already publicly available on US trades and have not impacted competition.

Price Index

As its fourth element, the envisaged system of information exchange also includes a price index differentiated by type of equipment (e.g. reefer, dry) and/or trade (data aggregated with a quarterly delay). The price index will be based on actual spot and contract prices (without indication of shipper identity) and will reflect how equipment (reefer or dry) prices have developed on the market (trade leg based). The price index would not disclose individual line data (aggregated data only, derived from the average rate per TEU on a trade). In terms of scope, the ELAA notes that the price index would relate only to ocean transport.

The output data would be historic (3 months old) and therefore would not be capable of reflecting projected future prices. The ELAA considers that the price index would provide no means of facilitating collusion (see also above), as:

- No line knows the individual rates of the other lines, i.e. there is very low transparency of rates applied;
Each line has thousands of pricing points on a trade. Even on a port-to-port pair there would be considerable variation in individual pricing;

Concentration in liner shipping trades and port pairs is very low.

The price index would allow lines, in combination with capacity utilisation data, to make better investment decisions. Lines will only invest if they have a reasonable belief and expectation that such investments would be profitable. Rates and capacity utilization are not necessarily positively correlated at all times. The price index will provide a more informed view on the past, and will thus help a line better comprehend whether or not to invest and, in turn, provide more reliable liner services.

The price index will be transparent: it is to be provided to the trade committee, the lines, as well as shippers.

**Surcharges and Ancillary Charges**

Finally, the establishment of publicly available and transparent formulae for surcharges and ancillary charges are included in the Proposal.

The envisaged common formulae would be based on a pass-through principle and are indispensable and necessary because individual contracting (by lines or shippers) would result in uncertainty and involve greater transaction costs.

The establishment of common formulae are considered to be in the interest of consumers as they would provide a stable and consistent framework of application. The review of Regulation 4056/86 has apparently indicated that surcharges and ancillary charges are a controversial issue for shippers regarding their relationship with cost. The ELAA proposes to discuss with customers its proposal regarding the establishment of publicly available and transparent formulae for surcharges and ancillary charges.

**Other matters**

The ELAA considers that its Proposal provides indispensable benefits for the industry, carriers and shippers alike. To this end, the ELAA proposes that the new industry body(ies)/agreements may in addition also address areas of common liner industry interest that may be of relevance from time to time, such as for instance safety and security, environmental issues or similar.
Self-Assessment under Article 81 EC

The system of information exchange contained in the ELAA’s Proposal has been designed to mitigate the risk of the industry miscalculating capacity requirements with the result that there would be insufficient capacity to meet growing and often variable demand. The Proposal has been structured to create legal certainty for the industry and provide the greatest possible benefits for the industry and its customers, on terms compatible with Article 81 EC.

Article 81(1) EC prohibits agreements and concerted practices which have as their object or effect the prevention, restriction or distortion of competition. However, agreements and concerted practices which fulfill the four cumulative criteria of Article 81(3) EC may benefit from an exception to the application of Article 81(1) EC. Applied to information exchange, it is generally considered that the exchange of historical aggregated data is non-restrictive and falls outside Article 81(1) EC. The Commission has also recognized the need for discussions on future demand and non-binding recommendations on how best to adjust supply in markets subject to extreme cyclical price variations.

As part of the ELAA’s self-assessment exercise under Article 81 EC, the ELAA commissioned a second study from CRA to review the exchange of information (“the Information Exchange Study”). This study is contained in Annex 3, and contains an assessment of the benefits and costs of information exchange and, in particular, the legal and economic criteria that should be applied in assessing whether an information exchange is likely to result in collusive or coordinated behaviour. For the reasons explained above, the ELAA submits that the economic circumstances of the industry are not conducive to such behaviour.

The ELAA has consistently argued that the liner shipping industry has a unique blend of characteristics that requires a sector-specific legal instrument to enable the industry to operate efficiently and provide the stability of supply that it seeks and European trade requires. The Proposal identifies the essential components of a new regulatory structure that would be significantly less restrictive of competition than the current regime, yet will result in the requisite stability and hence consumer welfare benefits. To the extent that some elements of the Proposal may fall within the scope of Article 81(1) EC, the ELAA is of the

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opinion that they fulfill all four requirements of Article 81(3) EC and qualify for the grant of a block exemption:

- The information exchange improves distribution and technical progress, and the price index and the common formulae for establishing surcharges and ancillary charges create economic efficiencies;

- The Proposal’s benefits will be passed on to the consumers in the form of cheaper and more reliable shipping services to meet ever-growing demand;

- All elements of the Proposal are indispensable for the attainment of these benefits. Information provided by independent sources has proven too unreliable to form a basis for sound investment decisions, and other alternatives as identified during the review process do not generate equivalent efficiencies;

- The proposed system does not, if at all, restrict competition to any significant degree as demonstrated by the economic evidence as submitted by the ELAA, which shows that the liner shipping industry, absent rate fixing, is not prone to collusion (see also above). There is no risk of competition being eliminated in any relevant market as a result of the proposed system.

For carriers, market forecasting mitigates the risk of miscalculation of capacity requirements, i.e. how many vessels to deploy in each trade, without facilitating collusion amongst themselves:

- Combined with capacity utilization data, market forecasting provides a more efficient and reliable means of assessing whether capacity should be added to a trade, and, if so, by how much (to satisfy growing demand and so ensure stability of supply). The importance to European and world trade of getting this calculation right cannot be overstated;

- Forecasting of market changes over a specific time period reduces uncertainty about how the market is likely to develop. This can be done without fixing prices, sharing markets, or any other variable on which to collude. The Proposal ensures that no carrier will have information on what its competitors’ rates are, and an individual carrier will not be able to distinguish strategic competitive choices from reductions in overall demand for liner shipping services.

The ELAA therefore submits that the Proposal provides for more accurate capacity planning through a system that is significantly less restrictive of competition than the currently exempted conference system (for example, by abolishing the requirement of conferences to set a common tariff and eliminating the exemption given to conference lines to reach
agreements on price and capacity etc). Through the creation of a more effective method of predicting future capacity and demand, the proposed system would provide significant benefits for the industry; these would be passed on to the users of liner shipping services and the ultimate consumer, all of whom would be assured of more efficient (hence cheaper) and more reliable liner shipping services.

Conclusions – Compatibility of the Proposal with Article 81 EC

Overall, the ELAA draws the following conclusions from the self-assessment of the present Proposal:

- Given the nature of competition in the liner shipping industry, the exchange of information on future demand, which in turn improves the carriers’ decision making on capacity, will lead to benefits to both carriers and shippers alike;

- In general, the regulatory approach and policy conclusion relating to the exchange of information as adopted in the past needs to be updated. Information exchange can produce clear consumer welfare benefits and there should be no presumption that when information is exchanged, this would be undertaken for the purpose of tacit or explicit collusion;

- In particular, current economic thinking indicates that it is unlikely that the exchange of aggregate data provides a necessary or sufficient basis for collusion;

- Given the potentially large benefits to consumers from the exchange of information in the liner shipping industry, it would be necessary to properly identify the existence of a robust mechanism for collusion before disallowing it;

- Such mechanism is absent in the liner shipping industry, however, which is also demonstrated by the empirical study concerning the functioning of the Europe – Far East trade as referred to before.

The ELAA considers that the proposed system will be a significant and indispensable improvement on the existing reliance on market consultants to provide forecasts which are often based on incomplete data. Currently, there are major forecasting errors that can result in too little capacity being made available to the market, which, in turn, could lead to a potentially disastrous breakdown in supply resulting in cargo not moving. The combination of general price index and industry knowledge should appreciably improve the ability of individual lines to plan for capacity additions.

In sum, this Proposal is a radical departure from what many perceive to be the industry’s practices. In the following months, the ELAA will continue the self-assessment exercise
under Article 81 EC it has engaged in, to substantiate further the underlying analysis of the Proposal.

The ELAA is confident that the Proposal can result in a regulatory structure for liner services operating to and from the EU that will be acceptable to the Commission, the carriers, and the shippers (and ultimately to the Parliament and Council).

Yours sincerely,

[Signature]

Ken Bloch Soerensen
Executive Director
European Liner Affairs Association
List of Annexes:

- Annex 1: List of ELAA members;
- Annex 2: Market Power Study;