Commitment decision in the ship classification case: Paving the way for more competition

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1. Introduction

On 14 October 2009, the Commission adopted a decision under Article 9(1) of Regulation (EC) 1/2003 (2) that renders legally binding commitments offered by the International Association of Classification Societies (IACS) to address Commission concerns that IACS may have infringed Article 81 EC Treaty (now Article 101 TFEU) and Article 53 EEA Agreement, prohibiting anticompetitive business practices (3).

The Commission’s concerns related to the ship classification market and in particular the issue that IACS might have prevented classification societies (CSs) that are not members of IACS from: (i) joining IACS; (ii) participating in IACS’ technical working groups (which develop IACS technical resolutions laying down requirements and interpretations to be incorporated into the classification rules and procedures of individual CSs); and (iii) having access to technical background documents which relate to IACS technical resolutions and which are necessary to properly understand and apply these resolutions. Such behaviour would have hindered the entry and development of CSs that were not members of IACS in the ship classification market and may thus have restricted competition.

In order to accommodate the identified concerns, IACS offered a comprehensive set of commitments including (i) the establishment of objective and transparent qualitative criteria for membership of IACS, and guidance for their non-discriminatory application, (ii) the possibility for non-IACS CSs to participate in IACS’ working groups and (iii) full access to IACS technical resolutions and related background documents.

The decision of 14 October 2009 is the first competition decision in the ship classification sector. The implementation of the commitments will bring about significant change in this sector and will pave the way for more competition in this market, which should generate lower prices, more innovation and customer choice, as well as improved quality of service.

2. The ship classification market

The commitment decision concerns the market for classification services for merchant ships. In this respect, classification services of CSs consist of two closely related sub-segments (4):

(a) Classification work. This is the traditional domain of CSs. It encompasses (i) the production of technical standards (commonly known as ‘rules and procedures’ (5)) for ship construction, equipment, maintenance and inspection; (ii) the verification of plans and the supervision of ship construction against these rules and procedures; and (iii) the inspection and certification of ships against these rules once in service (thus issuing the so-called ‘class certificates’).

(b) Statutory work. Flag states can delegate to CSs, separately, for each ship flying their flag, the task of (i) carrying out the surveys of ships provided for in the International Maritime Organisation (IMO) maritime safety conventions in order to verify compliance with the technical requirements contained in the IMO maritime safety conventions (statutory requirements); and (ii) issuing the international certificates on their behalf which attest the ships’ compliance with these requirements.

The worldwide ship classification market is estimated to have an annual turnover of about 3.5 billion euros and it is obviously of great importance as an

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors
(3) See press release 1P/09/1513, 14.10.2009. A full non-confidential version of the decision can be found at: http://ec.europa.eu/competition/antitrust/cases/index/hy_nr_78.html#i39_416.
(4) In practice, both classification work and statutory work are interrelated as (a) classification rules must respect and incorporate statutory requirements and (b) the inspection practice in both work areas is closely interlinked.
input service for the shipping sector. More than 90% of the world’s cargo-carrying tonnage is covered by the classification rules and procedures set by the current ten members and one associate of IACS, which are the largest classification societies in the world. In addition, IACS has had consultative status with the IMO since 1969, and has had a permanent representative within IMO since 1976.

3. The problem: foreclosure of CSs not members of IACS

The ship classification case was based on the results of a surprise inspection at five providers of ship classification services and at the association of these providers in January 2008 (6). The investigation was subsequently pursued between 2008 and 2009 with further requests for information being sent to relevant stakeholders in the ship classification market (competing non-IACS CSs, the shipping industry such as ship-builders and ship-owners as users of ship classification services, and regulators), as well as to the parties themselves.

In the course of its investigation, the Commission came to the preliminary view that the ten members of IACS had a strong position on the ship classification market. The Commission based its preliminary assessment amongst other things on the high combined market shares of the ten members of IACS (7), and on the view that CSs which are not members of IACS may face significant competitive disadvantages preventing them from competing effectively with IACS members, in particular:

(a) Many flag states do not allow CSs that are not IACS members to perform statutory work on their behalf.

(b) Many ports do not permit entry of ships that are not classified by an IACS member.

(c) Some international associations of ship-owners and ship-builders require as a condition of membership that their members have their ships classified by IACS members.

(d) Under the so-called Institute Classification Clause, ships classified by an IACS member (or associate member) benefit from the standard insurance and marine rates for the cargo they carry whereas ships classed by non-IACS CSs cannot benefit from this clause and would therefore have to negotiate the insurance and marine rates for their cargo.

(e) Many Protection and Indemnity Clubs are hesitant to insure ships not classified by an IACS member and they either do not normally accept such ships or require special conditions of entry.

(f) IACS is the only actor from the ship classification industry having consultative status at the IMO and thus a permanent representative within IMO. Non-IACS CSs cannot take part in the formulation of proposals for IMO measures or in their defence; therefore their views and interests cannot as easily be taken into account.

(g) Non-IACS CSs are barred from IACS’ technical work, while IACS members alone decide within IACS upon adoption of IACS’ rules and procedures, which are, in practice, de facto industry standards.

(h) Non-IACS CSs are barred from the full knowledge and use of IACS technical standards (i.e. IACS resolutions). In particular, IACS prevents non-IACS CSs from having access to the technical background information relating to these standards (8).

In its preliminary assessment, the Commission took the preliminary view that there may have been a restriction of competition on the relevant market in ship classification services due to IACS’ decisions (i) on the criteria and procedures governing membership of IACS and the suspension or withdrawal of membership, and on the way that these criteria and procedures were applied, and (ii) on the preparation and accessibility to non-IACS CSs of IACS resolutions and technical background information relating to these resolutions. Given the Commission’s preliminary view that the ten members of IACS have a strong position on the market and that classification societies which are not members of IACS may face significant competitive disadvantages, the Commission’s preliminary assessment was that these decisions therefore raised concerns as to their compatibility with Article 81(1) EC Treaty (now Article 101(1) TFEU) and Article 53(1) EEA Agreement. Moreover, the Commission’s preliminary view was that these decisions did not appear to fulfil the cumulative requirements for exemption under Article 81(3) EC Treaty (now Article 101(3) TFEU) and Article 53(3) EEA Agreement.

In particular, the preliminary assessment expressed the concern that, contrary to Article 81 EC Treaty (now Article 101 TFEU) and Article 53 EEA Agreement as interpreted by the case law of the European


(8) During the Commission’s investigation, IACS improved the accessibility of its technical information, which was then published on its website. The Commission however considered it appropriate to ensure that this issue was also addressed in formal commitments.
Court of Justice (\(^7\)) and the Commission’s Horizontal Guidelines (\(^8\)), IACS may have failed to:

(a) enact requirements that are objective and sufficiently determinate so as to enable them to be applied uniformly and in a non-discriminatory manner concerning admission to, as well as suspension and withdrawal of, membership of IACS;

(b) apply these requirements in an appropriate, reasonable and non-discriminatory way (including the establishment of sufficient safeguards to ensure such kind of application through an independent appeal/review mechanism);

(c) provide an adequate system for including non-IACS CSs in the process of developing IACS technical standards (i.e. IACS resolutions), including the establishment of independent complaint/grievance and appeal/review mechanisms ensuring access to IACS’ technical working groups;

(d) provide for proper dissemination to non-IACS CSs of technical background information (in particular technical background documents) with regard to the application of IACS resolutions (including the establishment of an independent appeal/review mechanism ensuring access to this technical background information).

4. **The remedies offered by the commitments and their proportionality**

In order to address the Commission’s competition concerns, IACS offered a comprehensive set of commitments structured around the following core elements:

With regard to membership of IACS, IACS offered to set up objective and transparent membership criteria and to apply them in a uniform and non-discriminatory manner. In order to achieve this goal, the commitments provide for detailed rules, including clear deadlines, for the different steps of the membership application, suspension and withdrawal procedure.

With regard to IACS’ technical working groups, which develop IACS technical resolutions, IACS committed itself to ensuring that non-IACS CSs will nonetheless be able to participate in these groups.

With regard to IACS’ technical documents, IACS committed itself to ensuring that all current and future IACS resolutions and their related technical background documents will be put into the public domain at the same time and in the same way as they are made available to IACS members.

In addition, IACS committed to setting up an Independent Appeal Board to settle possible disputes over access to or suspension or withdrawal of membership of IACS, participation in IACS’ technical working groups and access to IACS resolutions and to their technical background documents.

In response to the market test notice published on 10 June 2009 (\(^9\)) pursuant to Article 27(4) Reg. 1/2003, the Commission received a significant number of responses from interested third parties representing different kinds of market participants. Most respondents welcomed the commitments as necessary for improving the competitive situation on the ship classification market and for further promoting the efficiency and quality of IACS’ technical work and standards.

In its assessment of the proportionality of the commitments, the Commission pointed out in its decision that with regard to the proposed criteria for membership of IACS, the commitments strike an appropriate balance between on the one hand maintaining demanding criteria for membership of IACS, while on the other hand removing unnecessary barriers to membership of IACS. The new criteria would ensure that only technically competent CSs are eligible to become members of IACS, thus preventing the efficiency and quality of IACS’ work being unduly impaired by too lenient requirements for participation in IACS. At the same time, the new criteria would not hinder CSs that are technically competent and willing to do so from joining IACS. Similarly, the new IACS system for participation of non-IACS CSs in the IACS technical standard-setting process would on the one hand ensure appropriate possibilities for non-IACS CSs to participate in the development of IACS technical resolutions, while guaranteeing the proper functioning of IACS’ technical working groups. In addition, by granting access to technical background documents to non-IACS CSs, the commitments would also ensure full access to the results of IACS’ technical standard-setting process.

Finally, the previous market test had also confirmed that the commitments were necessary and proportionate to remedy the above-mentioned competition concerns.

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\(^8\) Commission Notice: Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, OJ C 3, 6.1.2001, p. 2 (‘Horizontal Guidelines’), section 6 (paragraphs 159-175) on agreements on standards.

5. The future: paving the way for more competition

Competition law enforcement had been absent from the ship classification sector so far. While the Commission's commitment decision of 14 October 2009, like any other decision under Article 9(1) Reg. 1/2003, does not conclude whether there has been or still is an infringement, it nevertheless provides important clarifications about what EU competition law means for essential current features of the ship classification market. These clarifications can serve as precedents and at the same time enhance the possibilities for effective competition in the sector. Moreover, the Commission took particular care that the effectiveness of the commitments is ensured by the fact that they operate in full transparency, that there are clear deadlines for their implementation and that there is no practical scope for deviation from the understanding the Commission had of them when it made them binding upon IACS (12).

5.1 The principles of the CFI’s EBU judgment

First, the Commission’s decision in the ship classification case is a confirmation of the principles laid down by the CFI in the so-called EBU judgment with regard to membership of commercial associations. While associations without market power may have wide discretion about the way they design and apply their membership rules, this is different in the special circumstances that can be derived from the EBU judgment. According to this judgment, where an association has strong market power and where non-membership of that association gives rise to appreciable competitive disadvantages, while membership is not open to all applicants, the restrictions in the membership rules can be held indispensable within the meaning of Article 81(3) EC Treaty (now Article 101(3) TFEU) and Article 53(3) EEA Agreement if: (i) the membership rules and practices of that association are objective and sufficiently determine so as to enable them to be applied uniformly and in a non-discriminatory manner vis-à-vis all applicants for membership (13) and (ii) these membership rules are in fact applied in an appropriate, reasonable and non-discriminatory way (14). This consideration applies not only for rules governing admission to membership of an association of undertakings and the way they are applied but also for the rules and practices concerning suspension and withdrawal of membership of that association.

The Commission’s concerns in the ship classification case were that these principles may not have been respected. By making the commitments binding on IACS, the Commission’s decision ensures that these principles are implemented in an effective way. In full detail and in concrete text formulations, the commitments lay down the necessary changes IACS has to make to its Charter and to its internal procedures. Moreover, the commitments establish guidance that IACS will follow when assessing membership questions. Finally they set up an Independent Appeal Board to ensure that the appropriate, reasonable and non-discriminatory way of applying the membership criteria is subject to an impartial appeal and review mechanism. All these changes have to be published on IACS’ website.

5.2 The Commission’s Horizontal Guidelines

Second, the Commission's decision of 14 October 2009 is also an example of how, with regard to a standard-setting process, the guidance laid down in the Commission's Horizontal Guidelines (15) can be reasonably interpreted and implemented in the specific context of the ship classification sector.

In its technical working groups, IACS develops technical resolutions which lay down minimum requirements, and interpretations of public law requirements, to be incorporated into the classification rules and procedures of the individual CSs that are members of IACS. In practice, these minimum

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(13) Idem, paragraphs 100–102.

requirements and interpretations are de facto industry standards which all CSs need to know well, and be capable of applying properly, in order to operate and compete effectively on the market. Moreover, these de facto industry standards represent a platform on the basis of which innovation competition for the development of more demanding rules and procedures, quality competition and ultimately price competition can take place.

Pursuant to the Horizontal Guidelines, access to the results of a standard-setting process, that is the standards themselves, must be possible for third parties on fair, reasonable and non-discriminatory (“FRAND”) terms. This has been fully ensured by including in the commitments made binding on IACS the availability not only of IACS technical resolutions but also of the related background documents, which are necessary to properly understand and apply these resolutions.

The Horizontal Guidelines also state that participation in standard setting should be open to all, unless the parties demonstrate important inefficiencies in such participation. This is a question of proportionality and accordingly, in the ship classification case, the interest of non-IACS members in participation had to be balanced with the public interest that only highly competent CSs decide on the actual setting of a standard. Indeed, participation in IACS’ standard-setting process as such had to be seen from the standpoint that IACS standards, by establishing minimum requirements and interpretations to be incorporated in rules and procedures of CSs, play an important role in ensuring maritime safety and the prevention of marine pollution. Furthermore, it is clear from previous cases that ‘participation’ in standard setting within the meaning of the Horizontal Guidelines does not necessarily mean co-decision in the actual setting of the standard.

Therefore, the Commission accepted in the commitments a system which distinguishes between the right of any non-IACS CSs to actively participate in IACS’ technical working groups which prepare new standards and the right to finally decide about the adoption of a new standard. This latter right was reserved to CSs that are members of IACS and therefore have passed the demanding competence test of IACS’ objective technical membership conditions and are periodically checked as to their continuous compliance with these conditions. At the same time, the new design of IACS’ membership criteria as laid down by the commitments ensures that anticompetitive foreclosure under the disguise of technical competence requirements cannot occur.

In this system, all non-IACS CSs have the benefit of discussing, influencing and learning about the details, reasons and context of forthcoming new IACS standards through active participation in IACS’ working groups. This also enables them to anticipate new developments and, if necessary, to grow into higher technical competence and altogether to acquire a more solid basis for engaging in effective competition with the current members of IACS.

Moreover, those non-IACS CSs that wish to join IACS and pass the newly designed objective and non-discriminatory admission test will as new IACS members have the power to co-decide the adoption of new standards in the IACS Council.

5.3 Conclusion

In conclusion, the ship classification decision opens up the ship classification market to the benefit of both CSs that are not members of IACS and customers of ship classification services and enhances the possibilities for effective competition and in particular for lower prices, more innovation, more customer choice and improved quality of ship classification services.