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CASE STUDY

MOVING TOWARDS THE BOGOR GOALS

THE MIDDLE WAY:

AN INCREMENTAL APPROACH TOWARD REFORMING
MARITIME TRANSPORT REGULATION

UNITED STATES

Introduction

In recognition of the need to develop within APEC a common approach to ocean shipping policy in order to reduce non-tariff barriers, the United States is pleased to offer this case study of the American experience with shipping deregulation. The study will briefly examine earlier shipping regulatory policies in the United States, and then turn to recent deregulation under the Ocean Shipping Reform Act of 1998, and the successes it has created. The Ocean Shipping Reform Act (better known as OSRA) comprised a set of deregulatory amendments to the Shipping Act of 1984. It introduced a number of regulatory reforms and encouraged commercial innovations that have dramatically changed the way liner shipping companies price their services in the U.S. trades. This case study reviews the regulatory and commercial results achieved since OSRA went into effect.

When looking at recent discussions of liner shipping regulatory policy and how it should be reformed, one can easily come away with the impression that there are only two general approaches: either support for the traditional conference system, or instead an insistence that liner shipping is no different than any other industry and should receive no special consideration. The success of OSRA has revealed that a middle path is available between these two extremes. Examining the OSRA experience can broaden what might otherwise be a too-narrow perspective on shipping regulatory policy and its reform.

Many national governments, when considering competition policy in general and the regulation of liner shipping in particular, are concerned that their individual economic situations may be best served by a pragmatic regulatory approach to liner shipping rather than one that is largely theory-driven and legalistic. For example, a "one size fits all" approach to liner regulation may not prove particularly attractive in a region where foreign trade -- and the ocean transportation system that allows it to thrive -- are viewed by national governments as a matter of long-term strategic importance. Nonetheless, liner shipping is often understood as a highly competitive business operating in a multinational market where participants are potentially subject to a host of differing national regulatory regimes. Therefore, liner shipping is viewed as a market best served by a well-understood and widely accepted regulatory framework. This perspective tends to place a high value on international comity, and on introducing major policy changes, when warranted, through a consensus process of dialogue, negotiation, and targeted reforms that address specific problems.

On the other hand, a regulatory approach that advocates subjecting international liner shipping to each individual trading nation's domestic competition rules under the oversight of each country's domestic antitrust authorities could have the effect of minimizing international comity. Such an effectively unilateral approach might be constrained only by the wish to avoid direct conflicts of law. While there may be, as yet, no significant real world example of such an approach, the recent proposal by the European Commission's Competition Directorate to eliminate Europe's bloc exemption

for liner shipping suggests that such a state of affairs may not be too far over the horizon.¹

Of course, these two different general approaches are simplified models introduced to highlight key distinctions. Reality is much more complex. For example, the “evolutionary” approach taken by the United States in OSRA has produced dramatic efficiency-generating benefits without entirely discarding past regulatory practices. Similarly, the European Commission’s determination that it will continue to provide a limited bloc exemption (special immunity from the competition laws) for consortia arrangements between or among competing liner operators, indicates there is still broad consensus that some aspects of liner shipping warrant special treatment.

U.S. Regulation of Liner Shipping

Space limitations preclude a full discussion of how liner conferences originally developed, what economic and other rationales supported their existence, how technological changes like containerization affected them, and what changes took place in their structures and effectiveness over the decades. Instead, this case study will focus exclusively on conference members’ rate authority and pricing practices. However, issues of rate and service stability, investment in new vessels and related landside equipment, the development of intermodal carriage, the existence of government controlled carriers, and other key topics remain central to an informed understanding of today’s regulatory regimes.

How central they are, and how complex they can be, is perhaps best illustrated by the fact that, as part of its review of liner conferences, the EC Competition Directorate commissioned two different economic studies covering exactly those topics -- one by a group of maritime experts at Erasmus University, the other by a U.S.-based consulting firm. The Erasmus University group concluded that conferences in their present form have little market power, may actually heighten competition among both their members and independent lines, and that the existence of conferences may promote freight rate stability. The U.S.-based consultants reached rather different results. They concluded that conferences can directly impact ocean shipping rates, mainly by publishing common surcharge tariffs, and that conferences can be a source of instability. It is apparent, then, that reasonable minds can differ, sometimes quite dramatically, on ocean shipping policy and the impact of the traditional conference system.

The Shipping Act, 1916

The first U.S. legislation addressing conferences was the Shipping Act, 1916. Under the 1916 Act, ocean common carriers (known better as liner operators), in return for submitting to the oversight of a specialized regulatory body, were exempt from the

¹ Commission for the European Communities, *Proposal for a Council Regulation repealing Regulation (EEC) No. 4056/86 laying down detailed rules for the application of Rules 85 and 86 to maritime transport, and Regulation (EEC) No. 1/2003, as regards extension of its scope to include tramp and cabotage services*, December 14, 2005.

otherwise applicable antitrust laws for their collaborative practices, including shipping conferences. Conferences collectively set prices for shipping services. It was thought that such collective price-setting was necessary to maintain adequate service, stable prices and to otherwise avoid competition that the industry could not support, also known as “destructive competition.”

Under the 1916 Act, all shipping rates were required to be set forth in tariffs, and these tariffs were filed with the federal regulatory agency having oversight of the industry. Members of liner conferences in the U.S. trades were permitted to agree on common rates and file them in a joint “conference tariff.” By operation of a legal principle known as the “filed rate doctrine,” the filed rates were the only rates that could be legally charged by conference members. Secret discounts and other forms of rebating were illegal. If a conference member became dissatisfied with the common rates the conference established, it could leave the conference and operate as an independent line, filing its own tariff rates at whatever level it believed to be appropriate.

Many changes in the shipping industry developed under the 1916 Act, including the rise of containerization, the increased importance of transportation intermediaries like freight forwarders, and an overall surge in the amount of cargo that was shipped worldwide. Starting in the late 1970s, advocates began to call for the development of a refined and less burdensome regulatory system for liner shipping in the United States. This call led eventually to the passage of the Shipping Act of 1984.

The Shipping Act of 1984

After nearly 70 years of regulation under the 1916 Act, the next significant set of reforms was made in the Shipping Act of 1984. The 1984 Act, which in retrospect can be seen as the first phase in an evolutionary process, introduced two important pricing reforms. First, it allowed conference members to charge rates other than the agreed-upon conference tariff rate, without having to withdraw from the conference, by filing their own individual “independent rate” within the conference tariff. This procedure was known as taking “independent action,” and it significantly loosened the bonds of a conference’s theoretical “binding rate authority.”

Second, the 1984 Act introduced “service contracts” as an alternative to tariff rates. Service contracts are negotiated arrangements for the provision of shipping services, and constitute a separate and more customized form of rate-setting than the traditional tariff system. By authorizing service contracts, the law allowed individual member lines -- or the conference as a whole -- to offer contracts with rates that differed from (that is, were lower than) the conference tariff rates. Both “service contracting” and “independent action” became very popular vehicles for negotiating rates below the existing conference tariff rates.

From the shipper’s perspective, these two new elements were significant improvements over traditional “tariff only” pricing, but residual problems remained. Three particular concerns were often noted. First, service contract rates were publicly

available – they were filed with and published by the Federal Maritime Commission. The difficulty this presented was that shippers who were not party to the original contract negotiations could use the publicly-filed contract rates as a benchmark for their own negotiations with ocean carriers. Too much transparency, it was believed, might discourage ocean carriers from offering lower rates to one shipper, because other shippers would then demand the same rate or an even lower one. Second, the non-discrimination requirement that liner operators offer the same service contract terms to all similarly situated shippers, known as “me-too” provisions, limited the extent to which service contracts could be customized. Third, some conferences regulated their members’ use of service contracts either by (a) collectively deciding to forego or strictly limit the use of service contracts, or (b) establishing conference contracting procedures that required collective discussion and approval by conference members of the contracts that each individual member had independently negotiated with its shipper clients. The strict limitations on even offering contracting in the first case, and the delay and bureaucracy involved in the second case, became sources of growing shipper dissatisfaction.

The 1984 Act reduced restrictions on how lines could price their services, creating options that -- while still somewhat constrained -- were nevertheless favorably received by shippers. However, after several years of experience with “independent action” and conference-regulated service contracting, shippers and carriers began serious discussions and negotiations that eventually convinced the U.S. Congress to take the next step in liner pricing reforms – passage of the Ocean Shipping Reform Act of 1998.

The Ocean Shipping Reform Act of 1998

OSRA went into effect on May 1, 1999. The statute, essentially a set of amendments to the Shipping Act of 1984, made further changes to the U.S. regulation of ocean transport and has had a dramatic effect on how liner operators do business with their shipper customers. First, OSRA eliminated the requirement that liner operators offer the same service contract terms to all similarly situated shippers. Special service terms, especially pricing aspects, of service contracts could be confidential. OSRA also shifted the requirement that all tariffs be filed with the Commission to a requirement that they be published in electronic format. This can be done by the carriers themselves on their own websites or can be outsourced to tariff publishers. The amount and type of information that had to be presented in a public tariff was also reduced.

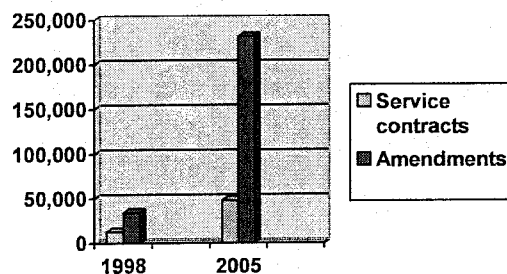
Importantly, OSRA significantly changed the permissible practices for conferences. OSRA reduced the notice requirement for independent action (carrier members setting rates different from the conference tariff) within a conference from 10 to 5 days. OSRA also enabled non-conference carrier agreements to jointly offer service contracts; there was no longer a limitation that this only be done through a tariff-setting conference. OSRA also forbade any agreement from prohibiting or restricting its members’ service contract negotiations, which had been a common conference practice pre-OSRA. Finally, OSRA prohibited any type of carrier agreement from placing mandatory requirements on its members to disclose service contract negotiations or their terms or otherwise affect the rights of members to negotiate individual service contracts.

It was these changes that encouraged the rise of the “discussion agreement” and the decline of the traditional liner conference. Although undefined by statute or regulation, a discussion agreement is commonly understood to be a rate agreement among ocean common carriers to discuss the prices they charge their shipper customers. Unlike a conference agreement, a discussion agreement does not have the authority to publish a common tariff or to police adherence to whatever voluntary service contract guidelines they might create. The purpose of such an agreement, then, is information sharing, rather than strict rate discipline.

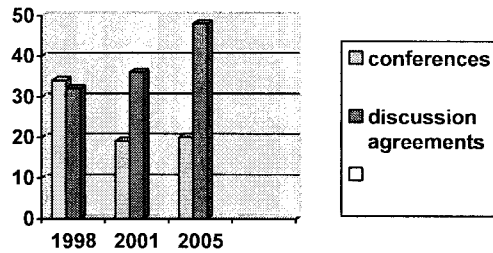
With respect to service contracting, OSRA significantly broadened the way the industry could structure business dealings. Under OSRA, shippers can enter into service contracts individually, through a shippers’ association, or as an unaffiliated group. Ocean common carriers can enter into service contracts individually or collectively through a conference or discussion agreement. Service contracts, once executed, must be filed with the Federal Maritime Commission before they can become effective, but the Commission does not approve or disapprove the terms of service contracts. The “essential terms” (duration, origin/destination, volume and commodities) of service contracts that have been filed with FMC must be separately published in tariff format. Most significantly, since OSRA, all rate features of these service contracts can remain confidential.

The Effects of OSRA

OSRA was the result of detailed negotiations among carriers, shippers, maritime labor, and public port authorities. A centerpiece of the new law is that publicly-available, conference-regulated service contracts gave way to the unrestricted negotiation of confidential rate-and-service packages. As a consequence, conference service contracting all but disappeared in favor of confidential contracts offered by individual lines, thus eliminating the problems of delay and bureaucracy previously associated with conference contracts. The following table shows the rise in the use of service contracts, and amendments to such contracts, from 1998 to 2005.



After OSRA went into effect, traditional carrier conferences with binding rate authority were soon replaced by voluntary discussion agreements that imposed no binding authority on members’ activities. The following chart illustrates the rise in discussion agreements, and the simultaneous decline in conferences, from 1998 to 2005.



In short, OSRA promoted a more market-driven and efficient liner shipping regime by, among other things, introducing changes in the way the industry priced its services. The reforms that were first introduced almost seven years ago, and the efficiencies that they produced, continue to benefit all sectors of the industry. In fact, OSRA's reforms in the area of service contracting were so successful that the Federal Maritime Commission was soon petitioned to extend confidential contracting rights to ocean transportation intermediaries.

This extension of contracting rights was the result of a further change enabled by OSRA. The statute gave the Federal Maritime Commission broadened authority to craft exemptions from regulatory provisions by agency rulemaking, rather than requiring such changes to come about through legislative enactment by the U.S. Congress. If the Commission concludes that any particular exemption will not result in a substantial reduction in competition or be detrimental to commerce, it may enact the change of its own authority. This was particularly relevant recently, when ocean transportation intermediaries (called non-vessel-operating common carriers (NVOCCs) in U.S. parlance) requested the right to offer service contracts in the same fashion as liner operators. (An NVOCC is a common carrier that does not operate the vessels on which cargo moves, and is a shipper in relation to a liner operator. Nonetheless, it stands as a common carrier vis-à-vis its shipper customers). Although OSRA had substantially deregulated many areas of ocean shipping, it had not permitted NVOCCs to offer service contracts – they were still required to sell shipping services exclusively through published tariffs, and the tariff rate was the only legal rate they could charge.

After soliciting broad industry comment on the various proposals presented, and finding that the ocean transportation intermediary community was able to agree on a common approach to contracting, the Commission established an exemption to the existing tariff publishing requirements. This new exemption permits NVOCCs to offer their customers NVOCC Service Arrangements (NSAs) – a contracting option virtually identical to the service contracts that liner operators use. While this option is at this point too new to evaluate, it is anticipated that NSAs will be as enthusiastically received by the industry as service contracts have been.

As this experience reveals, OSRA gave the Commission increased authority to, in effect, revise the Shipping Act of 1984 by allowing an exemption when it finds that the proposed exemption will not result in a substantial reduction in competition or be detrimental to commerce. Thus, OSRA not only introduced direct legislative reforms