Statement of

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Mr. Chairman and members of the Subcommittee, thank you for the invitation to testify today. My name is John Butler. I am President and CEO of the World Shipping Council[1] (WSC or the Council).

WSC members comprise an industry that has invested over $400 billion in the vessels, equipment, and marine terminals that are in worldwide operation today. Approximately 1,200 ocean-going liner vessels, mostly containerships, make more than 28,000 calls at ports in the United States during a given year – almost 80 vessel calls a day. This industry provides American importers and exporters with door-to-door delivery service for almost any commodity to and from roughly 190 countries. In 2015,

[1] The World Shipping Council (WSC) is a non-profit trade association whose goal is to provide a coordinated voice for the liner shipping industry in its work with policymakers, the public, and other industry groups with an interest in international transportation. Liner shipping is the sector of the maritime shipping industry that offers regular service based on fixed schedules and itineraries. WSC members carry over 90% of the United States' international containerized ocean commerce, and include the full spectrum of carriers from large global lines to niche carriers, offering container, roll-on/roll-off, and car carrier services as well as a broad array of logistics services. A complete list of WSC members and more information about the Council can be found at www.worldshipping.org.

approximately 32 million TEUs[2] of containerized cargo were imported into or exported from the United States.

The containerized shipping sector provides the foundation for over one-third of the economic activity attributed to the U.S. port sector. That port sector was most recently valued by Martin Associates at $4.6 trillion, or about 26% of the nation's $17.4 trillion Gross Domestic Product in 2014. In addition, container shipping supports more than a half-million United States jobs, including shipping line employees and agents, longshore workers, truckers, warehouse and distribution center workers, freight forwarders and customs brokers, ocean carriers' agents, and railroads carrying containerized cargo to and from the ports. [3]

In short, the container shipping industry is one of the most important facilitators of the nation's growth and on-going economic activity. The efficient connection of liner vessels to adequate ports, roads and rail infrastructure completes an intermodal system that generally operates with such efficiency and reliability that in most parts of the country the average consumer is unaware of its workings.

My testimony will address a specific point that has been raised by Members of the subcommittee and by other witnesses: joint procurement by carriers utilizing ocean carrier agreements. Before I address that particular issue, I briefly provide some background on the economic and operational status of the liner shipping industry, as well as the regulatory structure under which the industry operates in the United States. This is an industry that is in the process of restructuring to address a very challenging set of economic circumstances. At the same time, the industry continues to make the investments necessary to keep America's foreign commerce moving.

A. Economics and Regulation of the International Liner Shipping Market

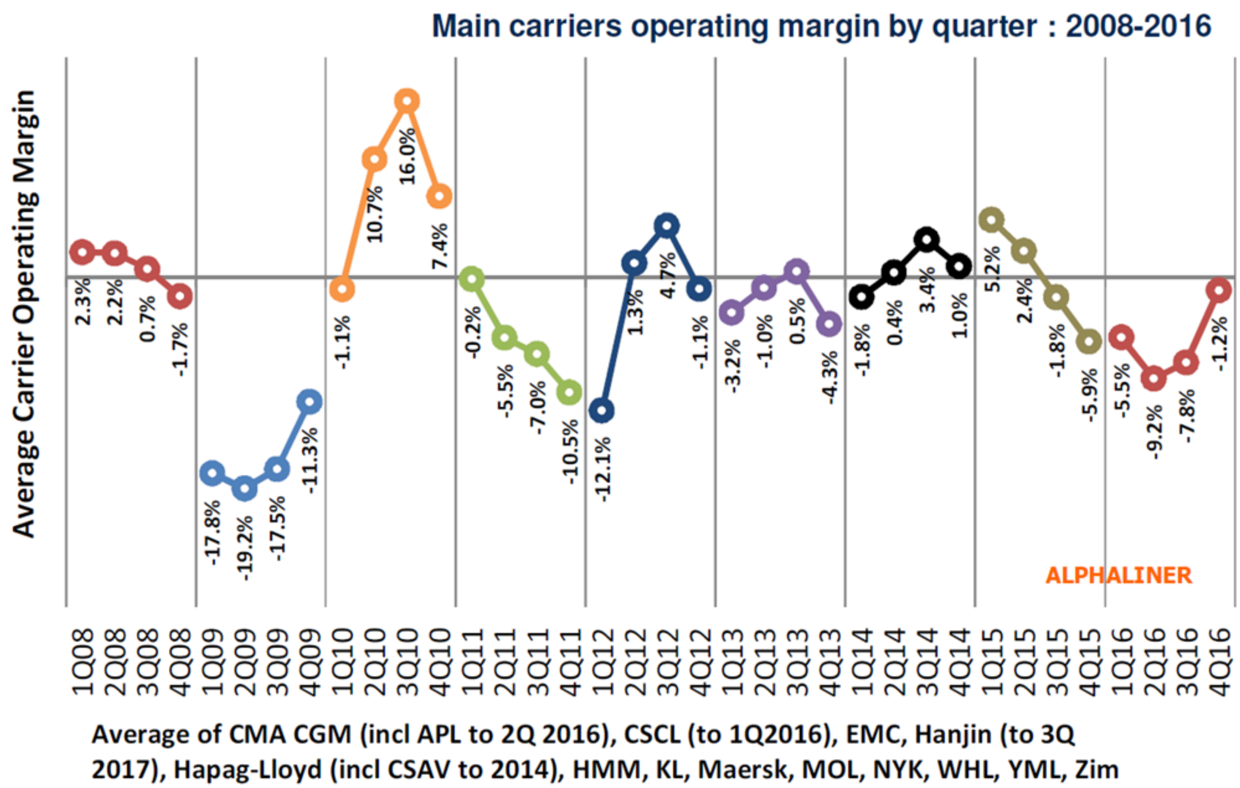
1. The Economic Situation in the Liner Shipping Industry

It is no secret that the shipping industry in general, and the liner shipping sector in particular, is experiencing rapid and substantial changes. Sustained weakness in global trade growth, consistently intense competition, a mismatch between the supply of vessel capacity and the demand to move cargo, the need to move to more energy-efficient vessels, and historically low freight rates have pushed the

[2] A TEU is a twenty-foot equivalent unit. Most containers are 40 feet in length and equal 2 TEUs.
[3] "The 2014 National Economic Impact of the U.S. Coastal Port System," Martin Associates, March 2015, supplemented by "The National Economic Impacts of Containerized Cargo Moving via the U.S. Maritime Transportation System, 2007," Martin Associates, April 2008 and World Shipping Council estimate.

industry to a point at which it has had to make fundamental changes in order to continue to provide the high quality ocean transportation services that drive the global economy, and the economy of the United States.

Coming out of the global recession that began in 2008, the liner shipping industry has yet to recover to a point where economic performance is sustainable for the long haul. Because of the supply and demand imbalance noted above, and because of the often non-compensatory rates that have resulted from that imbalance, the industry has had negative returns for the majority of the past six years. The graph below published last month by respected industry analyst Alphaliner illustrates the situation.



Source: Alphaliner Weekly Newsletter, Volume 2017, Issue 15, April 11, 2017.

In addition to unsustainable operating margins, the industry is facing increasing regulatory costs. For the liner sector alone, U.S. and international requirements to install ballast water treatment systems will cost $5-10 billion over the next five to seven years. A global cap on the sulphur content of marine fuel beginning in 2020 will add another $15 billion dollars in *annual* operating expenses for the liner shipping industry. To put these numbers in perspective, the liner shipping industry in 2016 lost an estimated $7 billion dollars worldwide. That means that the new regulatory costs that will come into play over the next several years will impose financial stress on the industry that is several times greater than the already substantial economic pressures that exist today. These regulations will result in environmental benefits, but those improvements will be expensive.

2. The Industry's Response to Economic Challenges

The combination of historically low ocean freight rates, unfavorable supply and demand conditions, and new environmental regulations has caused carriers to seek efficiencies wherever they can be found. That need for efficiency has resulted in technological innovation in terms of highly fuel efficient new vessels that produce fewer emissions per container transported. Newer, bigger ships are inherently more efficient than the older ships that they have replaced – in some cases over thirty percent more efficient – but larger ships are only more efficient if they are fully loaded. A 14,000 TEU ship burns less fuel on a per-unit basis than a 7,000 TEU ship, but it still burns more fuel overall. Thus, a 14,000 TEU ship that is half full is less efficient than a 7,000 TEU that is full. A high utilization rate is critical to realizing the designed efficiency of these larger vessels.

A related response of the industry to challenging economic conditions has been the use of vessel sharing agreements ("VSAs"). VSAs are arrangements under which two or more carriers cooperate to operate one or more vessel services, typically using assets contributed by each of the parties, even as they continue to compete for customers based on price and other aspects of service. The larger, multi-trade VSAs are commonly referred to as "alliances." The use of alliances is necessary to capture the efficiency benefits of larger ships because carriers often do not have enough cargo to fill ships of this size on their own. Vessel sharing allows carriers to utilize these expensive, large assets more efficiently than they could by themselves.

The operational case for sharing vessel assets through alliances is a simple one. As the industry has developed, many liner shipping companies provide service on multiple trade lanes around the world. Large carriers operate in multiple trade lanes for several reasons. First, carriers naturally seek to grow their businesses by providing services to emerging trading markets. Second, international shipper customers often demand ocean transportation on multiple routes. Third, participating in multiple trades provides market diversification for carriers, who can re-deploy assets from markets with low demand to markets with relatively higher demand as commercial conditions dictate.

Vessel sharing substantially reduces the cost of entry into new markets. If every liner operator needed to provide vessel capacity by itself on every trade in which it participated, there would either be a gross oversupply of capacity, thus making the services economically unsustainable, or there would be a shortage of investment and fewer service providers. In short, in the absence of alliances, there would be fewer services and fewer competitors.

Carriers of all sizes can improve efficiency from vessel sharing agreements, as is demonstrated by the range in the sizes of carriers participating in the three major alliances as of April 1 of this year.

Those carriers range from a global capacity of 3.3 million TEUs at the high end to a global capacity of 375,000 TEU at the low end – a ten-fold difference in size from the top to the bottom of the range. A larger carrier in a trade can order and deploy larger, more efficient ships with confidence that it can share the vessel assets in order to achieve efficient capacity utilization. Smaller carriers that may not be able to afford larger, more efficient assets may obtain the economic efficiencies of larger vessels through vessel sharing arrangements. New entrants will have an easier time starting a new service by sharing vessels rather than having to finance a stand-alone service.[4]

Carrier alliances benefit shippers (importers and exporters) as well as carriers. The fact that alliances allow the maintenance of more competitors on more routes through the efficient use of vessel capacity and shared services has consistently been recognized as beneficial by shipper customers and by regulators around the world.

Although more efficient ships and vessel sharing arrangements have reduced costs significantly, sustained financial pressures on shipping lines and their profitability have also led to structural changes within the industry. A number of carrier mergers were completed last year and more are going through the process this year: CMA CGM acquired APL; Hapag-Lloyd acquired CSAV and UASC; Hamburg Süd acquired CCNI; COSCO and China Shipping have merged into a single carrier; and Maersk is now pursuing acquisition of Hamburg Sud. The three Japanese lines – K Line, MOL and NYK – have also announced their intent to combine their container operations.

This consolidation has had the knock-on effect of causing several operational alliances within the industry to re-structure. For example, we have seen the formation of the "Ocean Alliance" (which includes CMA CGM, China COSCO Shipping, Evergreen, and OOCL) and a new group called "THE Alliance" (which includes Hapag-Lloyd, NYK, K-Line, MOL, and Yang Ming). These new groups formed in addition to the already existing "2M" alliance between Maersk and MSC. The two new alliances have just begun service as of April 1, but industry analysts calculate that the alliances will bring more capacity, not less, into most of the trades that they serve.

3. <u>The Regulatory Structure Under the Shipping Act of 1984, as Amended</u>

Under the Shipping Act of 1984, as amended by the Ocean Shipping Reform Act of 1998, agreements among ocean common carriers must be filed with the Federal Maritime Commission, and there is a waiting period before the agreement can go into effect. The Commission uses that time to review the agreement and supporting data submitted by carriers and available to it from other sources, to analyze the possible effects of the agreement on competition in the trades involved, and to request

[4] While there are no regulatory barriers to entry in liner shipping, vessel sharing arrangements reduce the risk that ships' capital and operating costs become barriers to entry.

additional information when necessary. The Commission often asks questions about particular language in agreements and seeks changes to that language. In addition to having significant ability to obtain changes to agreement language, the Commission also has authority to seek a judicial injunction if the Commission decides that an agreement would have a negative effect on competition. An injunction may be sought either before or after an agreement goes into effect. Agreements with the potential to affect competition are also subject to extensive periodic reporting requirements that allow the Commission to monitor any market impacts from those agreements.

Agreements that are filed with the FMC and that become effective are granted antitrust immunity, but only with respect to those activities that are set forth in the agreement. In addition to being subject to the antitrust laws, non-immunized carrier activities may lead to penalties imposed by the FMC under the Shipping Act. For example, if a group of carriers took action under an agreement that was required to be filed with the Commission, but they did not file that agreement, the FMC could impose penalties under the Shipping Act. If that same activity violated the antitrust laws, then the Department of Justice could also take action. Thus, activity under an unfiled carrier agreement may be subject to enforcement by both the FMC and the DOJ. In addition, even carrier activities that are immune from the antitrust laws are subject to regulation under the Shipping Act under the so-called "prohibited acts" set forth in the Shipping Act. *See* 46 U.S.C. §§ 41104 and 41105.

One might reasonably ask why carriers generally support the Shipping Act approach to regulation of the liner industry. The simple answer is that the Shipping Act regime provides regulatory certainty to a very capital intensive industry. Once an agreement is filed and becomes effective under the Act, the parties to that agreement know that they may proceed with activities within the scope of the agreement without legal exposure under the antitrust laws.[5] That certainty provides two important functions that are important for both carriers and their shipper customers.

First, it allows parties to an agreement to focus on the operational issues that generate the greatest efficiencies and service improvements from their cooperative operations.

Second, the certainty provided by the Shipping Act provides a predictable regulatory structure within which to restructure or terminate alliances and form new alliances. This means, for example, that if the members of an alliance determine that their existing cooperation is not providing the efficiencies and service improvements that they expected, they can add or delete carriers, leave the alliance, or start a new alliance with new partners. The fact that the substantive rules and the Commission's review processes are well established and consistent prevents inefficient carrier collaborations from becoming locked in place on the basis that changing them would cause too much

[5] This regulatory system is consistent with the rest of the world. Virtually every country authorizes the operation of alliances.

regulatory uncertainty. Because the legal regime is reasonably predictable and timely, arrangements can be changed relatively quickly, which encourages competition both within alliances and among alliances. That this regulatory predictability has supported a market that is responsive to changing economic conditions is most recently evidenced by the substantial restructuring of the major alliances over the past six months.

In addition to providing carriers with certainty, the public agreement filing system under the Shipping Act provides shippers, service providers, regulators, and the public with a level of transparency that does not apply in most industries. All agreement filings and amendments are publicly noticed in the *Federal Register* by the Federal Maritime Commission, and the Commission accepts public comments on those agreements. All agreements and amendments are maintained in a public database accessible without cost or registration through the Commission's website.

B. Ocean Carrier Agreements and Joint Procurement Provisions

Most recently, some entities providing services to vessels in U.S. ports have urged the Commission to fully employ its oversight authority to ensure that any joint procurement activity by carriers under ocean carrier agreements does not unfairly disadvantage vendors providing services to ocean carriers operating under those agreements.

In order to simplify operations and improve efficiencies, carrier agreements have, in some cases, included authority for joint procurement of some services that vessels require from vendors in the ports where the vessels call. That is not the case with the three major alliance agreements, however.

Having heard concerns from some service providers about joint procurement under carrier agreements, the Commission advised the major alliance members (2M Alliance, THE Alliance and OCEAN Alliance) that joint procurement would be subject to particular scrutiny. The alliance members responded by making it clear through the relevant agreement language that various types of joint procurement are either not authorized or are significantly limited under those agreements. The relevant language for each of the three major alliances is set forth below as it applies to joint negotiation for tug services and marine terminal services in the United States. (The full language of these agreements is available on the Federal Maritime Commission's website.)

The 2M agreement[6] reads:

[6] FMC Agreement No. 012293, the Maersk/MSC Vessel Sharing Agreement.

"5.4(b) The Parties shall negotiate independently with and enter into separate individual contracts with marine terminal operators, stevedores, tug operators, other providers or suppliers of other vessel-related goods and services and/or inland carriers in the United States; provided, however, that the Parties are authorized to discuss, exchange information, and/or coordinate negotiations with marine terminal operators relating to operational matters such as: port schedules and berthing windows, availability of port facilities, equipment and services, adequacy of throughput and productivity, and procedures for the interchange of operational data in a legally compliant matter." (emphasis added)

The relevant wording of the agreement for THE Alliance[7] also limits joint contracting for certain services within the United States:

"5.2 In furtherance of the authorities set forth in Article 5.1, the Parties are authorized to engage in the following activities, to the extent permitted by the applicable law of the relevant jurisdictions within the scope of this Agreement, and subject to any applicable filing requirements:

(l) Discuss and agree upon the joint contracting with tug operators or other providers or suppliers of other vessel-related goods and services, provided they are procured outside the United States; …."

"5.10 (a) The Parties may discuss and agree upon the terminal(s) to be called by the vessels operated hereunder as well as the stevedore(s) that will service such vessels, and/or the volume of cargo to be handled by such terminals or stevedores. The Parties shall negotiate independently with and enter into separate individual contracts with marine terminal operators (including operating port authorities) and stevedores (except where the marine terminal operator or stevedore is agreeable to a joint contract with the Parties, in which case a joint contract would be authorized); provided, however, that whether contracting on a joint or individual basis, the Parties are authorized to discuss, exchange information, and/or coordinate negotiations with marine terminal operators or stevedores relating to operational matters such as port schedules and berthing windows; availability of port facilities, equipment and services; contract duration; adequacy of throughput; and the procedures of the interchange of operational data in a legally compliant matter." (all emphasis added)

The OCEAN Alliance Agreement[8] states:

"5.9(b) The Parties shall negotiate independently with and enter into separate individual

[7] FMC Agreement No. 012439, THE Alliance, among Hapag Lloyd, K Line, MOL, NYK, and Yang Ming.

[8] FMC Agreement No. 012439, OCEAN Alliance among COSCO Shipping, CMA CGM, Evergreen and OOCL.

contracts with marine terminal operators (except where the marine terminal operator is agreeable to a joint contract with the parties, in which case a joint contract with such marine terminal operator would be authorized), stevedores, tug operators, other providers or suppliers of other vessel-related goods and services; provided, however, that the Parties are authorized to discuss, exchange information, and/or coordinate negotiations with marine terminal operators relating to operational matters such as port schedules and berthing windows; availability of port facilities, equipment and services; adequacy of throughput; and the procedures of the interchange of operational data in a legally compliant manner." (emphasis added)

We quote these provisions in full because they define what carriers within these alliances can and cannot do in the United States with respect to joint negotiations with service providers, specifically tugs and marine terminal operators. In short, the Commission and some commercial parties raised concerns about such activities, and the agreement language now in each case states that these services will be procured individually.

Although the Commission through its alliance agreement reviews and its regulations has, as a practical matter, substantially restricted the scope of joint purchasing by carrier agreements, there are instances in which that authority has been allowed to remain in agreements. Subject to proper oversight, that is an appropriate policy. Joint procurement can result in lower carrier costs and smoother port operations, which can result in lower costs and better services for U.S. importers, exporters, and consumers.

The Department of Justice and the Federal Trade Commission, in their Antitrust Guidelines for Collaborations Among Competitors (April 2000), have made it clear that whether a particular joint purchasing activity raises antitrust concerns depends upon the characteristics of the market in which the activity takes place:

> "Competitor collaborations may involve agreements jointly to purchase necessary inputs. Many such agreements do not raise antitrust concerns and indeed may be procompetitive. Purchasing collaborations, for example, may enable participants to centralize ordering, to combine warehousing or distribution functions more efficiently, or to achieve other efficiencies. However, such agreements can create or increase market power (which, in the case of buyers, is called 'monopsony power') or facilitate its exercise by increasing the ability or incentive to drive the price of the purchased product, and thereby depress output, below what would likely prevail in the absence of the relevant agreement." *Guidelines* at § 3.31(b).

Similarly, the Supreme Court has held that joint purchasing arrangements "are not a form of concerted activity characteristically likely to result in predominantly anticompetitive effects." *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co*., 472 U.S. 284, 295 (1985). In other words, the "rule of reason" standard applies to these arrangements, and they must be analyzed based on the facts of the given situation. This is the approach that the Commission has followed, and that approach is consistent with antitrust law.

C. Conclusion

The liner shipping industry is undergoing significant restructuring in order to find an economic and operational equilibrium that allows its participants to reach financial stability so that they may continue to provide regularly scheduled ocean transportation services that are on-time, efficient, and responsive to customer needs. Alliance agreements are one tool that helps carriers address some of today's challenges, so that carriers can continue to serve U.S. commerce, which is dependent upon an efficient international maritime transportation system.

The regulatory structure that is in place to manage these agreements is clear, well understood by all affected parties, and provides enough flexibility for businesses to adjust to changing market conditions. The agency charged with enforcing the regulations, the Federal Maritime Commission, provides active oversight that combines specialized industry expertise with familiar competition law principles. Commercially and structurally, many changes are taking place in the liner shipping industry. The scope and pace of those changes quite naturally make people nervous – carriers as much as their customers and service providers. But liner shipping has always been a cyclical industry. With the stable, predictable and transparent regulatory regime that is in place and a continued focus on operational efficiency, the industry will meet the current challenges. A period of major challenges in the industry is not the time to make significant changes to the regulatory scheme under which liner shipping operates. The regulatory regime that the United States has in place is both flexible and powerful, and the Federal Maritime Commission has the tools to maintain fair and competitive liner shipping markets in support of America's international commerce.

The World Shipping Council welcomes the Subcommittee's interest in this industry that is critical for the nation's economic success, and I thank you for the opportunity to testify today. We would be pleased to provide the Subcommittee with whatever further information may be of use as it continues its oversight of shipping regulation.

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