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**AMERICAN BAR ASSOCIATION**

**Section of Antitrust Law**

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March 17, 2006

**Via Express Mail and E-mail**

Antitrust Modernization Commission  
Attention: Public Comments  
1120 G Street, N.W.  
Suite 810  
Washington, DC 20005

**Re: Comments regarding the Shipping Act of 1984, as amended by the Ocean  
Shipping  
Reform Act of 1998**

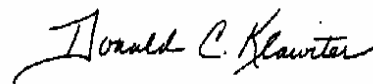
Ladies and Gentlemen:

On behalf of the Section of Antitrust Law of the American Bar Association, I am pleased to submit the enclosed comments to the Antitrust Modernization Commission in response to its request for comments regarding the Shipping Act of 1984, as amended by the Ocean Shipping Reform Act of 1998.

Please note that these views are being presented only on behalf of the Section of Antitrust Law and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

If you have any questions after reviewing this report, we would be happy to provide further comments.

Sincerely,



Donald C. Klawiter  
Chair, Section of Antitrust Law

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October 24, 2006

**Via Express Mail and E-mail**

Antitrust Modernization Commission

Attention: Public Comments

1120 G Street, N.W.

Suite 810

Washington, DC 20005

**Re: Amended comments regarding the Shipping Act of 1984,  
as amended by the Ocean Shipping Reform Act of 1998**

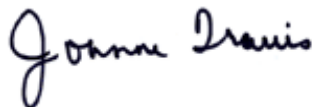
Ladies and Gentlemen:

Please accept the enclosed amended comments as a replacement for the comments submitted by the Section of Antitrust Law on March 17, 2006 regarding the Shipping Act of 1984, as amended by the Ocean Shipping Reform Act of 1998. The only amendment was the deletion of the last sentence in footnote 48 on page 16, which read:

“For what it is worth, such agreements would also likely qualify for treatment under the National Cooperative Research and Production Act, 15 U.S.C. §4301-05, permitting them to avoid even the possibility of treble damages liability upon the filing of a preliminary notice with the enforcement agencies. *See* 15 U.S.C. §4305; 13 HOVENKAMP, *supra*, at ¶2100h.”

If you have any questions, please let me know. Thank you.

Sincerely,



Joanne Travis

Director, Section of Antitrust Law

## **ABA Antitrust Section Amended Comments on the Shipping Act Antitrust Exemption**

The Section of Antitrust Law of the American Bar Association (“Section”) welcomes the opportunity to present its views to the Antitrust Modernization Commission on the Shipping Act of 1984 (“Shipping Act”), as amended by the Ocean Shipping Reform Act of 1998 (“OSRA”).<sup>1</sup> The views expressed here are those of the Section and have been approved by the Section’s Council. They have not been approved by the House of Delegates or the Board of Governors of the ABA and should not be construed as representing the policy of the ABA.<sup>2</sup>

### **Summary**

In keeping with its longstanding opposition to exemptions from antitrust law, the Section explains in the following that this decades-old exemption has caused significant economic harm without justification, despite the industry’s many arguments to the contrary. Moreover, despite partial deregulatory steps taken in 1984 and 1998, which have introduced genuine competition for essentially the first time in the industry’s history, the law continues broadly to exempt harmful anticompetitive collusion by ocean carriers. The impropriety of the exemption is shown both by the industry’s healthy performance during the past twenty years of deregulatory experience, which contrasts with the industry’s prediction of its own doom were deregulation to occur, and by evidence of continuing harmful conduct under the remaining exemption, which itself is justified only by the same arguments used to justify the exemption ever since its inception.

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<sup>1</sup> Shipping Act of 1984, Pub. L. 98-237 (1984), 98 Stat. 67 (1984), codified at 46 U.S.C. App. §§1701-19, as amended by the Ocean Shipping Reform Act of 1998, Pub. L. 105-258, 112 Stat. 1902 (1998). This policy applies to “common carriers” that “provide transportation by water . . . between the United States and a foreign country.” 46 U.S.C. App. §1702(6).

<sup>2</sup> The Section of Antitrust Law thanks Professor Chris Sagers, Cleveland State University, for assistance in preparing these comments.

## Analysis

The United States and other maritime countries have long permitted ocean liner shipping companies to fix their rates and other terms of service through horizontal cartels. The Shipping Act exempts such “conferences,” as they are known, from antitrust law,<sup>3</sup> but makes them subject to oversight by an agency known as the Federal Maritime Commission (“FMC”). As it has done with other transportation exemptions, most of which have been substantially repealed, Congress significantly limited the U.S. shipping exemption in the 1984 and 1998 legislation, and the industry for nearly the first time in its history has begun moving toward genuine competition.

The Antitrust Section, which has opposed antitrust exemptions generally and supported prior efforts to repeal the shipping exemption fully,<sup>4</sup> endorses completion of the industry’s transition to full competition, and therefore urges total repeal of all remaining antitrust exemption for ocean shipping. Because economic theory disfavors government-sponsored industry self-regulation, and because the United States continues its “longstanding congressional commitment to . . . free markets and open competition,”<sup>5</sup> exemptions from the antitrust laws ought to be known as privileges rather

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<sup>3</sup> A “conference” is any collection of carriers who by formal agreement decide to adhere to terms of service, including the fixing of rates. *See* AMOS HERMAN, SHIPPING CONFERENCES 15 (1983).; THOMAS J. SCHOENBAUM, ADMIRALTY AND MARITIME LAW 489 (3d ed. 2001); GERALD H. ULLMAN, U.S. REGULATION OF OCEAN TRANSPORTATION UNDER THE SHIPPING ACT OF 1984, at 4 (1995). The Shipping Act adopts a similar definition for the “conferences” to which it applies. *See* 46 U.S.C. App. §1702(7) (“‘conference’ means an association of ocean common carriers permitted, pursuant to an approved or effective agreement, to engage in concerted activity and utilize a common tariff . . .”).

<sup>4</sup> The Section supported repeal of the ocean shipping exemption in Report of the Section of Antitrust Law on the Free Market Antitrust Immunity Reform Act of 1999. For the Section’s views on other exemptions, see Reports of the Antitrust Section on the Quality Health-Care Coalition Act of 1999, Antitrust Health Care Advancement Act of 1997, the Television Improvement Act of 1997, the Major League Baseball Antitrust Reform Act of 1997, the Curt Flood Act of 1997, and the Major League Baseball Antitrust Reform Act of 1995 (all available at [www.abanet.org/antitrust](http://www.abanet.org/antitrust)).

<sup>5</sup> *Community Communications Co. v. Boulder*, 455 U.S. 40, 56 (1982).

than rights, and they ought to require ongoing proof of their legitimacy.<sup>6</sup> Courts have always construed exemptions narrowly in this country<sup>7</sup> and elsewhere,<sup>8</sup> and not only to respect the congressional desire “to strike as broadly as [possible] in §1 of the Sherman Act.”<sup>9</sup> Courts consider the exemption’s origins and bona fides, along with a range of economic opinion on exemptions.<sup>10</sup> Therefore, while Congress remains free to exempt behavior from the reach of the antitrust laws, the Section believes the onus of an exemption’s ongoing justification ought to be on those favoring its preservation.

These comments do not focus on the policy documents underlying the exemption, including

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<sup>6</sup> In other countries such a burden of proof is imposed as a matter of law. *See* Treaty Establishing the European Economic Community, Art. 85(3) 298 U.N.T.S. 11 (Mar. 25, 1957) (laying out four quite restrictive conditions any exemption must meet, on a continuing basis, in order to derogate from the basic principle of free competition); EUROPEAN COMMISSION, WHITE PAPER ON THE REVIEW OF REGULATION 4056/86, APPLYING THE EC COMPETITION RULES TO MARITIME TRANSPORT ¶14 (Comm. Prog. 2003/COMP/18, Oct. 13, 2004) (noting that an exemption’s “justification” must remain “valid in light of . . . present market circumstances. If not, there would no longer be a legal justification for the . . . exemption, which consequently would have to be either abolished or revised.”).

<sup>7</sup> Recognition of statutory limits on free competition is “strongly disfavored,” *U.S. v. Philadelphia Nat’l Bank*, 374 U.S. 321, 350-51 & nn. 28-29 (1963), a view announced by the Supreme Court as early as 1897, *see U.S. v. Trans-Missouri Freight Ass’n*, 166 U.S. 290, 314-15 (1897) (refusing to recognize Sherman Act exemption for all conduct of railroads, despite the fact that Interstate Commerce Act regulated some aspects of their business), and repeatedly reaffirmed ever since, *see Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 126 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 231 (1979); *U. S. v. McKesson & Robbins, Inc.*, 351 U.S. 305, 316 (1956); *U.S. v. Masonite Corp.*, 316 U.S. 265, 278-79 (1942). This rule applies with equal force to the ocean shipping exemption. *See FMC v. Seatrain Lines, Inc.*, 411 U.S. 726, 733 (1973).

<sup>8</sup> The courts of the European Union hold that competition law exemptions, including the EU’s shipping exemption regulation, “derogate from” the competition rules set out in the Treaty of Rome, and therefore must be construed narrowly. *See* Joined Cases T-191/98 and T-212/98 to T-214/98 *TACA* ¶568 (Court of First Instance 2003) (refusing to construe broadly the shipping exemption in EC Regulation 4056/86).

<sup>9</sup> *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 787 (1975). As the Court has said, “[l]anguage more comprehensive” than that used in Sherman Act §1 “is difficult to conceive.” *U.S. v. Southeastern Underwriters Assn.*, 322 U.S. 533, 553 (1944).

<sup>10</sup> Judge Easterbrook had this to say: “[An antitrust exemption is] special interest legislation, a single-industry exception to a law designed for the protection of the public. When special interests claim that they have obtained favors from Congress, a court should ask to see the bill of sale. . . . [Because] special interest legislation enshrines results rather than principles . . . courts read exceptions to the antitrust laws narrowly, with beady eyes and green eyeshades.” *Chicago Professional Sports v. National Basketball Association*, 961 F.2d. 667, 671-72 (7<sup>th</sup> Cir. 1992).

the enormous volume of industry-generated written advocacy. Thirty years of this policy debate has produced far more writings than can be systematically addressed.<sup>11</sup> Rather, the comments focus on the empirical evidence. Despite a body of theoretical support for the exemption predating OSRA,<sup>12</sup> the empirical evidence concerning the deregulatory experience suggests that the industry does not need horizontal collusion to perform and that its performance indeed has been better in its deregulated state. Moreover, the collusive conduct still permitted under the exemption continues to harm shippers and consumers, and no evidence exists of any pro-competitive upside other than the policy arguments used for years to defend the system before deregulation. This view is supported both by a body of work predating OSRA<sup>13</sup> and by a body of post-OSRA research, notably including

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<sup>11</sup> For a variety of reasons, the industry analysis has not proven persuasive. For example, carrier groups recently have urged the importance of a 2003 study performed by five economists associated with Erasmus University in the Netherlands, allegedly at the request of the European Commission., which found results arguably consistent with various “destructive competition” problems. Those groups do not add, however, that the empirical results actually appeared in an appendix to the contracted-for report, which appendix was *not* commissioned by the EC, but rather was added unilaterally by members of the team who have professional interests in proving such results. See, e.g., World Shipping Council, *European Commission Review of International Liner Shipping Competition and Regulation: EC-funded independent, economic study finds that liner conferences are not “price setting cartels”, and that they reduce freight rate volatility* (Nov. 26, 2003) (available at [www.worldshipping.org/final\\_report\\_erasmus.pdf](http://www.worldshipping.org/final_report_erasmus.pdf)).

In any event, interested readers can normally find recent advocacy documents produced by the various lobbying organizations via internet. See, e.g., [www.nitl.org](http://www.nitl.org) (National Industrial Transportation League, a leading shipper representative); [www.worldshipping.org](http://www.worldshipping.org) (World Shipping Council, a carrier representative that has actively opposed all shipping deregulation); [www.elaa.net](http://www.elaa.net) (European Liner Affairs Association, a carrier representative actively involved in the European Commission’s pending review of its own ocean shipping exemption).

<sup>12</sup> See Stephen C. Pirrong, *An Application of Core Theory to the Analysis of Ocean Shipping Markets*, 35 J. L. & ECON. 89 (1992); William Sjostrom, *Antitrust Immunity for Shipping Conferences: An Empty Core Approach*, ANTITRUST BULL., Summer 1993, at 419; see also William Sjostrom, *Liner Shipping: Modeling Competition and Collusion*, in HANDBOOK OF MARITIME ECONOMICS AND BUSINESS 307 (Costas T. Grammenos ed. 2002) [hereinafter “Sjostrom, *Modeling Competition*”]. The pre-OSRA empirical evidence, though much debated, was largely indeterminate. Compare N.R. Fox, *An Empirical Analysis of Ocean Liner Shipping*, 19 INT’L J. TRANSP. ECON. 205 (1992) (finding a correlation between market shares and freight rates), with PAUL S. CLYDE & JAMES D. REITZES, FEDERAL TRADE COMMISSION, THE EFFECTIVENESS OF COLLUSION UNDER ANTITRUST IMMUNITY 2 (1995) (finding no statistically significant correlation).

<sup>13</sup> See COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, COMMITTEE ON MERCHANT MARINE AND FISHERIES OF THE U.S. HOUSE OF REPRESENTATIVES: CHANGES IN FEDERAL MARITIME REGULATION CAN INCREASE EFFICIENCY AND REDUCE COSTS IN THE OCEAN LINER SHIPPING INDUSTRY (1982) [hereinafter “GAO REPORT”]; George Deltas et al., *American Shipping Cartels in the Pre-World War I Era*, 19 RES. IN ECON. HIST. 1 (1999); J. W. Devanney III et al., *Conference Ratemaking and the West Coast of South America*, 9 J.

studies by government and non-governmental organizations critical of the conference system in light of deregulatory experience.<sup>14</sup> Finally, perhaps as important as the empirical evidence, these comments conclude by trying to put the industry and its antitrust exemption into historical perspective.

## I. AN OVERVIEW OF OCEAN LINER SHIPPING AND U.S. OCEAN SHIPPING POLICY

Ocean shipping remains among the world's vital industries,<sup>15</sup> and it is of great significance to the U.S. economy.<sup>16</sup> However, the industry is now fairly concentrated world-wide, and none of its major participants are U.S. owned. All but two of the world's top twenty lines are based in Western Europe or Southeast Asia, and neither of the two exceptions is American.<sup>17</sup>

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TRANSP. ECON. & POL'Y 154 (1975); Trevor D. Heaven, *The Structure of Liner Conference Rates*, 21 J. INDUS. ECON. 257 (1973).

<sup>14</sup> See FEDERAL MARITIME COMMISSION, THE IMPACT OF THE OCEAN SHIPPING REFORM ACT OF 1998 (2001) [hereinafter "FMC, OSRA REPORT"]; ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, DIRECTORATE OF SCIENCE, TECHNOLOGY AND INDUSTRY, COMPETITION POLICY IN LINER SHIPPING: FINAL REPORT (2002) [hereinafter "OECD, FINAL REPORT"]; Carsten Fink et al., *World Bank Developmental Research Group, Trade in International Maritime Services: How Much Does Policy Matter?*, World Bank Rep. No. WPS 2522 (Jan. 31, 2001) (report by World Bank economists). Another interesting government report is a very thorough Federal Trade Commission empirical study prepared by two staff economists in 1995. While they found no statistically significant correlation between conference market share and freight rates, they did find that freight rates were significantly lower where conference members were free to negotiate individual contracts directly with shippers. See CLYDE & REITZES, *supra* note 12, at 2.

<sup>15</sup> Maritime transport remains by far the main mode of international transport of goods, see OECD, FINAL REPORT, *supra* note 14, at 10; HERMAN, *supra* note 3, at 3 (noting that as of 1983 over 80% of world trade by volume was carried by ship), and is the chief means by which U.S. goods are shipped in foreign commerce. Ninety-five percent of U.S. foreign commerce is transported in ocean-going vessels, roughly half of which is carried on vessels covered by the Shipping Act and which enjoy that Act's antitrust exemption. See Constantine G. Papavizas & Lawrence I. Kiern, *1997-98 U.S. Maritime Legislative Developments*, 30 J. MAR. L. & COM. 487, 488 (1999) (citing 144 CONG. REC. S11301 (Oct. 1, 1998) (statement of Sen. Hutchison)).

<sup>16</sup> The U.S. ships nearly \$2.4 trillion in ocean-going exports annually and three of the world's busiest ports are in the United States. See [www.PIERS.com](http://www.PIERS.com) (calculating value of U.S. exports); CONTAINERISATION INT'L ONLINE, *Container Traffic* (available at [www.ci-online.co.uk](http://www.ci-online.co.uk)) (listing traffic at top port cities for 2004; top U.S. ports are Los Angeles, Long Beach, and New York/New Jersey).

<sup>17</sup> See CONTAINERISATION INT'L, Nov. 2003 (listing top twenty liner services by name and nationality). The two exceptions are the Israeli Zim and the UK-Canadian CP Ships, a subsidiary of Canadian Pacific. See *id.* Even American President Lines is a Singapore outfit.

“Liner shipping” as such – regularly scheduled transport along pre-specified routes, often described as “common carriage” shipping – became possible only with the development of seaworthy steamships in the mid-nineteenth century, an event that also quickly caused the demise of the centuries old sailing ship industry. Virtually as long as there has been liner shipping there have been conferences to govern it, a coincidence said by the conference system’s defenders to reflect liner shipping’s inherent need for centralized capacity rationalization. Though they remain legal under U.S. law, conferences have dwindled in number both because of deregulation and consolidation.<sup>18</sup>

Probably the most significant events in the industry’s history, since the rise of liner service, have been (1) the so-called “containerization” and “intermodalism” movements, and (2) the industry’s still incipient deregulation. Both events are thought to have encouraged significant restructuring in the past few decades. First, beginning in the 1950s and 1960s, transportation companies began devising means for the easy transfer of freight among the various traditional “modes” of transportation – among truck, rail and ship. These efforts culminated in a revolution known as “containerization,” which employs large, standardized metal containers that can be carried either on special semi-truck trailers, flatbed rail cars, or specialized ocean vessels called “containerships,” and can be transferred easily amongst these “modes.”<sup>19</sup> In turn, containerization

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<sup>18</sup> For more detailed background on the industry and its history, see OECD, FINAL REPORT, *supra* note 14, at 19; Chris Sagers, *The Demise of Regulation in Ocean Shipping: A Study of Evolution of Competition Policy and the Predictive Power of Microeconomics* (forthcoming 2006). The effects of deregulation and consolidation are discussed *infra* at notes 26-30 and accompanying text.

<sup>19</sup> Container carriage is thus to be distinguished from traditional “break-bulk” carriage, which was shipment of cargoes that literally had to be broken down from the truck or rail transport that brought it to port, and then repacked in cargo ships. See ADVISORY COMMISSION ON CONFERENCES IN OCEAN SHIPPING, REPORT 17 & nn.1-3 (1992) [hereinafter “ADVISORY COMMISSION REPORT”]. Containerization is thought to have produced significant efficiencies. See *id.*; OECD, FINAL REPORT, *supra* note 14, at 14; see also ADVISORY COMMISSION REPORT, *supra*, at 9 (noting that by 1960 labor costs in port accounted for 80% of the total cost of a typical voyage, and that following containerization the average



has led to a broader conceptual and organizational evolution in transportation commonly thought of as “intermodalism” – the merging of different transportation modes into a seamless whole, with the entwined consequences of greater efficiency and ever larger global transport firms (sometimes called “logistics” or “supply chain management” firms).<sup>20</sup>

Second, at least as significant is the industry’s ongoing deregulation. For almost as long as shipping conferences have existed, they have been exempt from competition law in the United States and elsewhere, and in most of the world have gone completely unregulated.<sup>21</sup> That, however, is beginning rapidly to change. OSRA, which took effect in May of 1999, remains the most significant step in U.S. policy so far. Though it retained antitrust immunity for carrier agreements, for the first time OSRA made it possible for ocean carriers to negotiate independent “service contracts” with shippers, the terms of which may remain confidential, and which conferences may not deter, by action against any carrier or any shipper.<sup>22</sup> In other words, as a practical matter, U.S. shipping is now

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handling time per voyage fell from 157 hours to 31 hours). Break-bulk shipping also created large exposure to damage and pilfering. *See id.* at 17.

<sup>20</sup> *See* ADVISORY COMMISSION REPORT, *supra* note 19, at 9; Richard W. Palmer & Frank P. DeGiulio, *Terminal Operations and Multimodal Carriage: History and Prognosis*, 64 TUL. L. REV. 281 (1989). Thus, the popular understanding of the organization of transportation services – as comprised of distinct “modes” – is at odds with its reality, and this result is in part to be blamed on conceptualization of transport “modes” in traditional regulatory schemes. For two extremely thoughtful and comprehensive historical analyses of this phenomenon, see Arthur Donovan, *Intermodal Transportation in Historical Perspective*, 27 TRANSP. L. J. 317 (2000), and Palmer & DeGiulio, *supra*.

<sup>21</sup> *See* S. Rep. 105-61, 105th Cong., 1st Sess., 2 (1997) (“All . . . maritime nations allow shipping conferences to exist with immunity from application of the antitrust or competition law.”); H.R. Rep. 98-53(I), 98th Cong., 1st Sess., 9 (1984) (“Generally, ocean shipping is unregulated in the rest of the world. For the most part, the U.S. is alone in having a regulatory commission like the FMC”); GAO REPORT, *supra* note 13, at iv (“Most countries do not impose restrictions on the practices or organization structure of shipping conferences.”). Liner shipping in U.S. foreign commerce – the shipping to which the U.S. antitrust exemption applies – has never been subject to any international regulation specific to shipping itself.

<sup>22</sup> A “service contract” is a contract between one or more shippers and one or more carriers or a conference, in which the shipper commits to a certain volume of cargo over a fixed period of time and the carrier commits to a certain rate and level of service. *See* 46 U.S.C. App. §1702(19); 46 C.F.R. §530.3(q); SCHOENBAUM, *supra* note 3, at 404. Prior to OSRA the Shipping Act had permitted service contracts, but severely restricted their effectiveness. The Act: (1) permitted conferences to regulate or prohibit service contracting, (2) required that service contracts be filed with the

like other free markets, except that carriers remain broadly exempt from the antitrust laws.<sup>23</sup> Further deregulation has been proposed,<sup>24</sup> and deregulatory efforts are afoot in other countries as well.<sup>25</sup>

In the short time since OSRA's enactment, service contracting has largely replaced the

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Commission and made their terms available to the public, and (3) required that all "similarly situated" shippers be entitled to the same essential terms for a period of 30 days. *See generally* ADVISORY COMMISSION REPORT, *supra* note 19, at 130-32. Generally, prior to OSRA the conferences prohibited independent service contracting entirely. *See* FMC, OSRA REPORT, *supra* note 14, at 18; ADVISORY COMMISSION REPORT, *supra* note 19, at 133 ("At present, no conference in the U.S. foreign trades permits its member lines to engage independently in service contract activity.").

OSRA now prohibits retaliation for independent service contracting. *See* 46 U.S.C. App. §1704(c)-(d) (prohibiting conferences and inter-conference agreements from barring or restricting individual service contracting); *id.* at §1709(b)(3) (prohibiting retaliation against any shipper "because the shipper has patronized another carrier, or has filed a complaint, or for any other reason.")

<sup>23</sup> The Shipping Act, as amended, continues to exempt traditional conference agreements (which may produce collectively fixed prices, made public as "tariffs," *see* 46 U.S.C. App. §1707) and a range of other collusive or information sharing agreements. *See* 46 U.S.C. App. §1706(a)(1) (exempting the broad range of agreements described in 46 U.S.C. App. §1703(a)). The only limits on such agreements are contained in the Shipping Act itself, *see* 46 U.S.C. App. §1704(b), and those limits in effect only require that conferences be "open" and that they permit independent action by their members. Thus, in short, current U.S. law permits liner carriers within the coverage of the Act to fix their rates and essentially any other terms of service or operations, so long as such agreements are first filed with the FMC. *See* 46 U.S.C. App. §1703(a) (defining "agreements" within the scope of the Act and therefore exempt from antitrust upon filing with the FMC); *See* 46 U.S.C. App. §1704(a) (setting forth filing requirements). Agreements among carriers and the operators of marine terminals are also exempt, meaning that one or more carriers may conspire with a port operator (often a state or local government entity, though not always) to fix prices or engage in "exclusive [or] preferential" treatment. *See* 46 U.S.C. §1703(b).

<sup>24</sup> An effort has been made several times since 1999 to do away with the U.S. antitrust exemption almost entirely. The Free Market Antitrust Immunity Reform Act ("FAIR Act"), first introduced as H.R. 3138, 106th Cong., 1st Sess., in October of 1999 and re-introduced as H.R. 1253, 107th Cong., 1st Sess., in March of 2001, would phase out the U.S. antitrust exemption as to all ocean shipping agreements except those among marine terminal operators, *see* H.R. 1253, 107th Cong., 1st Sess., §2; H.R. 3138, 106th Cong., 1st Sess., §2. The bill was introduced in the 106th Congress by then-Chairman Hyde and in the 107th by Chairman Sensenbrenner. The Antitrust Division under both Presidents Clinton and George W. Bush supported the bill. *See* Statement of Charles James, Assistant Attorney General, U.S. Dept. of Justice, Antitrust Division, Before the House Committee on the Judiciary on H.R. 1253, The Free Market Antitrust Immunity Reform Act of 2001 (June 5, 2002); Statement of John Nannes, Deputy Assistant Attorney General, U.S. Dept. of Justice, Antitrust Division, Before the House Committee on the Judiciary on H.R. 3138, The Free Market Antitrust Immunity Reform Act of 1999) (March 22, 2000).

<sup>25</sup> Canada has modified its exemption to introduce greater competition, *see* TRANSPORT CANADA, TRANSPORTATION IN CANADA 2000, at 2-3 (available at [www.tc.gc.ca/pol/en/Report/anre2000/tc0011ee.htm](http://www.tc.gc.ca/pol/en/Report/anre2000/tc0011ee.htm)), while Australian and EU inquiries are still pending. *See* AUSTRALIAN PRODUCTIVITY COMMISSION, DRAFT REPORT: REVIEW OF PART X OF THE TRADE PRACTICES ACT OF 1974: INTERNATIONAL LINER CARGO SHIPPING (2004); EC WHITE PAPER, *supra* note 11.

conference system,<sup>26</sup> and the effectiveness of the “voluntary guidelines” still permitted to guide service contracting is dependent on market conditions.<sup>27</sup> Moreover, evolving trends in non-conference capacity rationalization indicate further reorganization to come. Non-price operational agreements now constitute the majority of inter-carrier agreements on file with the FMC<sup>28</sup> and, along with the continuing concentration of the industry,<sup>29</sup> they suggest that a better characterization of its future will be as a handful of interlocking, partnered blocs of capacity than a group of competitors.<sup>30</sup>

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<sup>26</sup> The FMC now receives filing of nearly 50,000 new service contracts annually. *See* FEDERAL MARITIME COMMISSION, 41ST ANNUAL REPORT FOR FISCAL YEAR 2002, at 132 (2003) (48,154 new service contracts filed in fiscal 2002); FEDERAL MARITIME COMMISSION, 40TH ANNUAL REPORT FOR FISCAL YEAR 2001, at 124 (2002) (47,629 new service contracts filed in fiscal 2001); FEDERAL MARITIME COMMISSION, 39TH ANNUAL REPORT FOR FISCAL YEAR 2000, at 112 (2001) (35,190 new service contracts filed in fiscal year 2000). Under prior regulation that number had been as low as 400 and tended to run between 2,000 and 4,000. *See* ADVISORY COMMISSION REPORT, *supra* note 19, at 33 & table VIII-1. The Commission estimates that as much as eighty percent of cargo carried by conference members is now carried under independent service contracts. *See* FMC, OSRA REPORT, *supra* note 14, at 20; *see also* OECD, FINAL REPORT, *supra* note 14, at 22 (noting that since OSRA there has been “a rapid and massive switch (200% increase)” to service contracts, and that “[v]ery little traffic (*e.g.*, less than 10% of the USA-Europe traffic) now takes place directly under conference terms.”).

<sup>27</sup> Where demand is slack or competition is strong, the guidelines have comparatively little influence. *See* FMC, OSRA REPORT, *supra* note 14, at 13-17. The competitive environment of ocean shipping varies significantly from place to place. *See id.* at 14-15.

<sup>28</sup> *See* FMC, OSRA REPORT, *supra* note 14, at 26. Such agreements differ from “conference” agreements in that they create no central management authority and need not involve any fixing of rates or terms. Rather, they emulate familiar joint venture arrangements and involve the sharing of vessels and capacity.

<sup>29</sup> Since 1995 seven principal mergers and more than thirty acquisitions have taken place. *See* FMC, OSRA REPORT, *supra* note 14, at 17. Thus, as of 2001 the top twenty liner operators accounted for 81% of the world fleet, *see id.*, at 17, and 72% of world container capacity, and the five largest operators accounted for 34% of capacity. Though this trend began even before the 1984 Act, *See* H.R. Rep. 98-53(II), 98th Cong., 1st Sess., 4 (1984), it appears to have accelerated since OSRA.

Industry representatives deny that their markets are “concentrated” because many individual trade lanes remain competitive and the worldwide concentration ratios remain comparatively low. However that may be, overall ownership of shipping assets has become concentrated and it has happened comparatively rapidly. Moreover, indications are that it should continue, in light of the scale economies thought to be associated with containerization and intermodalism and the perceived need for capacity rationalization that can no longer conveniently be achieved via horizontal price fixing cartels.

<sup>30</sup> As the FMC wrote in a recent report, “[n]o longer can the structure of liner shipping be viewed as fifty or so major carriers operating autonomously. It is more appropriate to view the industry as blocs of operational partnerships, with crisscross ties via space charters between many different members of different partnership blocs.” FMC, OSRA REPORT, *supra* note 14, at 25.

These changes have resulted from the industry's loss of legally sanctioned, horizontal price and output restraints and because of concentration driven by perceived scale economies.

## II. DESIRABILITY OF THE EXEMPTION: THEORY AND EMPIRICAL EVIDENCE

Arguments in support of the antitrust exemption take a variety of forms, but their gravamen is that special cost and capacity problems of liner shipping make it impossible for the industry to arrive at efficient levels of supply, and that unbridled competition will lead to “destructive competition,” instability of prices, and undesirable oligopoly.

It is widely agreed that liner shipping of general cargo is beset by unusually high fixed costs,<sup>31</sup> and that a liner carrier's initial capital investment is very large.<sup>32</sup> Moreover, liner shipping entails a large complement of “avoidable fixed” costs or “non-cargo” costs – that is, costs that do not vary with the quantity of cargo carried, but that are not incurred until a voyage is embarked upon.<sup>33</sup> A related problem is overcapacity. No one doubts the industry has faced overcapacity

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<sup>31</sup> It is estimated that in liner shipping of general cargo from 65 to 90% of all costs are fixed. This problem arises both from the cost of contemporary container vessels and from the committed nature of *scheduled* transport services, which renders many operating costs invariant in the short run. See J.E. Davies, *An Analysis of Cost and Supply Conditions in the Liner Shipping Industry*, 31 J. INDUS. ECON. 417, 417 (1983). As Davies notes, liner shipping, especially since the advent of containerization, demands a greater capital stake than other shipping sectors, because containerized cargo vessels are by far the most expensive to build. See *id.* Moreover, once a schedule has been agreed upon, cost items such as fuel, crew wages, subsistence, maintenance and repair—which might be regarded as variable in other industries – become fixed and cannot be avoided within the short run planning horizon. See *id.* at 418. The only costs typical in general cargo ocean shipping which are truly variable are (1) commissions paid to agents who secure cargo, and (2) actual handling costs. See *id.*

<sup>32</sup> This is so not only because the individual ships are expensive, but because the maintenance of scheduled service at typically demanded frequencies requires not one ship, but a fleet of them, plus all the appurtenant equipment and shore-based capital infrastructure they require (containers, cranes, etc.). See Davies, *supra* note 31, at 418-19. Davies calculated that the minimum capital outlay to establish a new entry in the U.S.-Far East trade, where a minimum fleet size was estimated to be five vessels, would be on the order of \$374 million in 1978 dollars, even ignoring completely the costs of maintaining the shore-based administrative support such a fleet would require.

<sup>33</sup> Most of these costs are outside the control of ship owners, and some of them are the subject of regulatory price controls. In the U.S. this would include notably wage rates of U.S. officers and crew, the employment of which is mandatory on U.S.-flag vessels. Carriers therefore face significant limitations in their ability to cut operational costs even when they do so under pressure of price competition. These include most obviously the substantial administrative and marketing organization a liner fleet requires, which, given the committed nature of scheduled transport services,

problems,<sup>34</sup> and they may follow as a consequence of high fixed costs.<sup>35</sup> Cost problems have become only more acute with the advent of containerization and the increased scale economies it engenders. As a separate cause of overcapacity, the industry faces periodic cycles of slack and/or asymmetrical demand, which are driven by inevitable shifts in currency fluctuations and international trade imbalances, and thus faces particular problems of forecasting needed capacity.<sup>36</sup>

So do these economic problems legitimate capacity rationalization by horizontal price and output restraints? That is, do they justify the industry's ongoing exemption?

A. *Capacity Rationalization and Unstable Price*

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is largely fixed in the short run, *see* Davies, *supra* note 31, at 418-19, as well as operational costs that are committed as soon as sailings are scheduled, including fuel, insurance, crew wages and costs, and maintenance, *see* HERMAN, *supra* note 3, at 29-30.

<sup>34</sup> *See* S. Rep. 105-61, 105th Cong., 1st Sess., 1-2 (1997) (noting the industry's "chronic carrier conditions of overcapacity."); H.R. Rep. 98-53(II), 98th Cong., 1st Sess., 5 (1984) ("Almost all studies agree that the industry is suffering from overcapacity.").

<sup>35</sup> Large fixed costs naturally entail significant returns to scale, and as a result a larger ship is normally more efficient. However, the fact that liner service by definition requires ships to sail regardless how much unused capacity they may contain creates a perpetual risk of underutilization. Moreover, ships are durable and long-lived assets, and so even as more modern vessels enter the market, older vessels may be resold at distress prices and remain in service. *See* ADVISORY COMMISSION REPORT, *supra* note 19, at 68. Moreover, while overcapacity may be manageable in some industries, it is a particular problem in liner shipping. Because a carrier's costs are predominantly fixed, the marginal cost of exploiting unused capacity within each particular ship is very low (indeed, a particular carrier's cost functions are peculiar – namely, average cost constantly decreases over the entire capacity of a particular ship, but capacity beyond full utilization of a given ship causes a sharp spike in average cost as the costs of an additional sailing are incurred, but then decrease constantly across the full capacity of the added ship), and therefore overcapacity can and does result in rate war. *See id.*

<sup>36</sup> Because demand is derivative of demand for the goods to be shipped, it varies according to currency fluctuations and changing trade imbalances generally. *See* HERMAN, *supra* note 3, at 30-31. Demand for shipping also varies in some trade lanes as a consequence of seasonal variations in outputs of particular national commodities, particularly agricultural commodities, *see* Davies, *supra* note 31, at 432 (noting that demand for outbound shipping from New Zealand varies considerably by season owing to that country's large meat exports), and because of institutional factors such as import quotas, export subsidies, cargo preference rules, and so on, *see* Clinton H. Whitehurst, Jr., *The Merchant Marine Act of 1936: An Operational Subsidy in Retrospect*, 1 J. L. & ECON. 223 (1958). During such trade imbalances a carrier cannot ensure the same degree of capacity utilization in both directions of a voyage, and therefore will suffer less efficient operation in one direction. *See* FMC, 2002 ANNUAL REPORT, *supra* note 26, at 23-24. In fact, U.S. carriers have faced slack demand for outbound services for several years, and the imbalance has grown each year since 1995. *See* FMC, OSRA REPORT, *supra* note 14, at 12-13.

While no one doubts the industry has suffered overcapacity, there are competing explanations why. It may be, as the industry argues, due to organic features of liner shipping. However, at least some of whatever overcapacity exists is attributable not to endogenous market phenomena but to subsidization of shipyards and preferential treatment of national-flag carriers by many countries.<sup>37</sup> Second, there is reason to believe that the carriers themselves have deliberately contributed to capacity problems through the inefficient service competition typical of regulated or price-stabilized industries.<sup>38</sup>

Carriers have also argued that without collective rate setting “destructive” competition will lead to unstable prices. First, while some shipper customers have also expressed such a fear,<sup>39</sup> it is not obvious that price volatility must be avoided. Fluctuating prices are characteristic of many industries that are subject to the antitrust laws,<sup>40</sup> and in liner shipping they might simply reflect sensitivity to changing supply and demand. Moreover, there is evidence that the conference system

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<sup>37</sup> ADVISORY COMMISSION REPORT, *supra* note 19, at 58; OECD, FINAL REPORT, *supra* note 14, at 71 (“[T]here are many underlying reasons for . . . overcapacity, including state support for shipbuilding leading to exceptionally low . . . costs for newbuildings.”).

<sup>38</sup> If in fact conferences were able to maintain supra-competitive prices under the conference system, *see infra* Part II.D (discussing evidence suggesting that they were), and were able to contain internal cheating and lower price entry, *see infra* Part II.F (discussing evidence suggesting that they were), then conference members have little basis on which to compete with one another except through improved service which, as a practical matter, means either more ships or more frequent sailings. *See* GAO REPORT, *supra* note 13, at ii-iii. Devanney et al. found empirical support that open conferences – which, unlike closed conferences, have difficulty controlling capacity – lead to inefficient service competition. *See* Devanney et al., *supra* note 13, at 162 & n.8. Increased capacity, other things being equal, necessarily means higher costs due to lower capacity utilization. *See id.* Conference members, however, can still recoup the attendant loss if they are able to charge artificially inflated rates.

<sup>39</sup> *See* ADVISORY COMMISSION REPORT, *supra* note 19, at 69; GAO REPORT, *supra* note 13, at v.

<sup>40</sup> *See* ADVISORY COMMISSION REPORT, *supra* note 19, at 69.

actually promoted rate instability, especially in trades where there was less competition.<sup>41</sup>

## B. *The Theory of the Empty Core*

The exemption's academic proponents have urged a theoretical re-tooling of this basic problem of "destructive competition" or capacity rationalization, known as the "theory of the empty core." In principle the argument is simple, and if there are industries in which empty cores can exist the liner shipping industry should be a good candidate. The argument is that special cost or technological problems in some markets make it impossible for competition to produce a stable long-run equilibrium price.<sup>42</sup> A market has a "core" if there is a set of transactions between buyers and sellers such that there are no other transactions which could make some of the buyers or sellers better off. A basic implication of microeconomics is that such a "core" will survive in a competitive market where all firms are making zero economic profits. In a market where the core is empty, no coalition of firms will be able to persist at zero profit; some firm will always eventually earn a surplus and thereby attract entry, but because the core is empty the new entry will result in all firms suffering losses. Likewise, because the core is empty, when firms exit due to economic losses, the

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<sup>41</sup> See OECD, FINAL REPORT, *supra* note 14, at 44-45 (noting that, according to shipper responses to an OECD survey, annual rate changes averaged 5-10% in most trades, with 30% changes not uncommon and some changes as high as 200%). This deliberate instability was inherent in the traditional common tariff system itself, under which rates could be and frequently were unilaterally changed by the conferences, a process known as the "general rate increase" or GRI. Under service contracting, which has largely replaced the tariff system, rates are typically fixed for specified periods. Long-term contracts are a well known means by which to protect against price instability and are used in a variety of industries. See ADVISORY COMMISSION REPORT, *supra* note 19, at 70.

<sup>42</sup> Specifically, empty cores are said to be possible in markets which have some or all of the following characteristics: (1) uncertain demand, (2) scale economies in production, (3) avoidable supply costs, (4) products that cannot be stored cheaply, (5) fixed firm capacities, and (6) firm capacities that are large relative to demand. See John S. Wiley, *Antitrust and Core Theory*, 54 U. CHI. L. REV. 556, 565 (1987). Ocean liner shipping arguably suffers all of these, depending on just how seriously capacity is "fixed." Carriers and advocates of the antitrust exemption long asserted that capacity was tightly fixed, because any change in capacity seemed to require purchase or sale of an entire ship. Deregulatory experience, however, has shown that carriers can manage their capacity easily, efficiently and with suppleness through non-price operational agreements. Indeed, as will be explained, this turns out to be a major reason to doubt that empty cores characterize ocean shipping markets.

remaining firms will again be able to earn greater than zero profit.<sup>43</sup>

Liner shipping markets could once have been thought to contain empty cores. Because the entry of even one new ship expands capacity not just incrementally but by the entire capacity of that new ship, existing firms earning a surplus will attract new entry that may automatically lead to overcapacity,<sup>44</sup> and therefore to likely economic losses and a potential rate war. But as soon as a firm removes its bloc of non-incremental capacity, remaining firms may again be able to earn excess profit, again attracting entry and perhaps overcapacity.<sup>45</sup> Certain scholars have argued as much, and there is also some empirical evidence in support of an empty core in liner shipping markets, though

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<sup>43</sup> Empty core theory was first derived in the abstract by economist Lester Telser of the University of Chicago and later applied (sometimes by Telser's own doctoral students) to a variety of practical situations, including liner shipping. The explanation above is taken from the rendition in the OECD report. See OECD, FINAL REPORT *supra* note 14, at 61-62.

For more formal theoretical explanations, including several attempted applications to liner shipping, see LESTER G. TELSER, ECONOMIC THEORY AND THE CORE (1978); Varouj A. Aivazian & Jeffrey L. Callen, *The Coase Theorem and the Empty Core*, 24 J. L. & ECON. 175 (1981); George Bittlingmayer, *Did Antitrust Policy Cause the Great Merger Wave?*, 28 J. L. & ECON. 77 (1985); George Bittlingmayer, *Decreasing Average Cost and Competition: A New Look at the Addyston Pipe Case*, 25 J. L. & ECON. 201 (1982); Pirrong, *supra* note 12; Abigail McWilliams, *Rethinking Horizontal Market Restrictions: In Defense of Cooperation in Empty Core Markets*, 30 Q. REV. ECON. & BUS. 3 (1990); William Sjostrom, *Antitrust Immunity for Shipping Conferences: An Empty Core Approach*, ANTITRUST BULL., Summer 1993, at 419; Lester G. Telser, *Competition and the Core*, 104 J. POL. ECON. 85 (1996); Lester G. Telser, *The Usefulness of Core Theory in Economics*, 8 J. ECON. PERSP. 151 (1994); Wiley, *supra* note 42.

<sup>44</sup> Thus, William Sjostrom believes that empty cores can stem from the lack of a price on the industry supply curve for every possible quantity, which could occur because supply curves are "lumpy" or non-continuous. Where this is so, there are "gaps" on the supply curve into which the only possible equilibrium price might fall, thus making the core empty. Such a situation would arguably characterize liner markets if capacity can be added only in non-incremental blocs. See William Sjostrom, *Collusion in Ocean Shipping: A Test of Monopoly and Empty Core Models*, 97 J. POL. ECON. 1160, 1166 (1989) [hereinafter "Sjostrom, *Collusion*"].

<sup>45</sup> Suppose that a particular trade is such that when two ships service the route, the market price is above average cost, while when three ships service the route the market price is below average cost. Suppose also that three different carriers want to serve this route. Since demand is such that only two carriers can survive in the market, one firm will always be left out. If the incumbent firms are making profit, the firm that is left out could seek to negotiate a deal with the customers of the other carriers, disrupting the original arrangement. See OECD, FINAL REPORT, *supra* note 14, at 61-62.



the evidence that exists is limited and has been criticized on methodological grounds.<sup>46</sup>

Empty core theory is problematic for several reasons, and deregulatory experience in the shipping industry suggests that, if they exist anywhere, empty cores do not exist in shipping markets. As a theoretical matter, the model requires certain problematic assumptions. First, it assumes that wherever pricing above average cost poses short term gains an outside firm will enter, even though in an industry like liner shipping each new entry might result in long-run overcapacity requiring exit and potentially spurring rate war, entailing costs that could drastically outweigh short-run gains. What is important to a potential entrant is not the existing market price but the market price post-entry, and if a firm can foresee that its entry would force price below average cost it will not enter. Next it assumes that additional capacity can be added only in non-incremental blocs by autonomous and self-contained “firms,” which can cooperate by no means except naked, multilateral restrictions on price or output. As applied to liner shipping the argument assumes that carriers can seek entry in markets with surplus profits only by making irrevocable short term commitments of the full capacity of their own ships, which is at odds with experience. Almost immediately after OSRA the industry greatly increased its use of vessel sharing, space sharing, and other non-price operational agreements that allowed carriers to rationalize capacity without naked price or output constraints.<sup>47</sup>

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<sup>46</sup> In particular, William Sjostrom found some empirical evidence of conference behavior arguably consistent with attempts to rationalize performance under empty core conditions. He relied, however, on a highly simplified model of liner markets, used admittedly problematic data, *see* Sjostrom, *Collusion*, *supra* note 44, at 1162-70, and found no more than that “[t]he results [of econometric analysis], although certainly not definitive, offer further evidence for the proposition that market arrangements that appear to be cartels may be attempts to solve the problem of the empty core.” *Id.* at 1177. Likewise, Stephen Pirrong argued energetically for the empty core hypothesis, but on little more than his econometric estimation of the cost function of one liner operator and the asserted longevity and universality of the conference system. *See* Pirrong, *supra* note 12, at 107, 116-29; *see generally* OECD, FINAL REPORT, *supra* note 14, at 62 (providing criticism).

<sup>47</sup> *See* OECD, FINAL REPORT, *supra* note 14, at 49 (“[A] growing proportion of the top 20 operators’ fleets is made up of time-chartered vessels, indicating a trend away from self-ownership to relatively more flexible asset management arrangements.”); *id.* at 57 (“Slot chartering allows carriers to respond flexibly to demand without necessarily purchasing a new vessel.”).

Thus, empty core theory ignores an industry solution that was made clear by the pressure of competition, which does not violate the antitrust laws even without the exemption.<sup>48</sup>

In any event, even if liner shipping markets have empty cores, private capacity regulation of the kind urged by the industry and its supporters – regulation by self-interested market participants themselves – would be a poor means to address the problem, because of the dramatic risk of abusive conduct lacking any procompetitive upside.<sup>49</sup>

### C. *Susceptibility to Oligopoly Conditions*

The industry also argues that unrestrained competition will lead to concentration in the industry. The argument implies that oligopoly would be negative because it would facilitate supracompetitive price and consolidate control over access to ocean transport. The prediction of concentration has strong theoretical support<sup>50</sup> and post-OSRA practical experience bears it out.

But the relevant policy question is not whether competition would lead to oligopoly, but whether applying the antitrust laws would be worse than conference price-fixing. As a matter of

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<sup>48</sup> The typical non-price operational agreement among carriers would not violate antitrust, at least so long as it contains no direct constraints on price or output. *See* 13 HERBERT HOVENKAMP, ANTITRUST LAW ¶2100g (1999); U.S. Dept. of Justice and Federal Trade Commission, Antitrust Guidelines for Collaborations Among Competitors §3.3 (2000).

<sup>49</sup> As Professor Wiley put it, “[c]ore quota managers will find their powers for good tempt them to evil. They must be either saintly or regulated. . . . Legalizing core quotas would render useless the easy ways of outlawing cartels, because no simple, surefire test distinguishes laudable core management from injurious cartel conduct.” Wiley, *supra* note 42, at 575-76. A better solution, in other words, would be long-term contracting directly between shippers and carriers, subject to antitrust control. Even Professor Telser thought that long-term contracting can be a solution to excess capacity where costs are lumpy or demand is uncertain. *See* Wiley, *supra* note 42, at 565 (citing Lester Telser, *Cooperation, Competition, and Efficiency*, 28 J. L. & ECON. 271, 274-76, 277-78, 284-85 (1985)).

<sup>50</sup> Liner shipping is characterized by factors traditionally thought to facilitate oligopoly. Its customers are numerous, unaffiliated, and their identities change frequently. George Stigler has shown that oligopoly should be more stable where cheating is more difficult to detect, and that detection should be more difficult under these circumstances. *See* George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44, 47 (1964). Likewise, liner markets may contain some entry barriers. *See infra* notes 71-73 and accompanying text. Finally, containerization and intermodalism are thought to have led to large scale economies, which also should encourage ongoing consolidation.

theory, capacity rationalization by oligopolists, constrained by a competitive fringe, is preferable. A conference has an incentive to price off its least efficient member, and empirical evidence shows conferences have done so.<sup>51</sup> An oligopolist, by contrast, is motivated to minimize costs by competition from other oligopolists and from fringe competitors. Therefore, competition should result in net pro-competitive consolidation, whereas conference price-fixing leads to subsidization of inefficient carriers.

D. *Does the Conference System Result in Supracompetitive Price?*

If shipping conferences are harmful it would be chiefly because they charge inefficiently high rates. Carriers, however, point out that rates actually fell for a period of roughly twenty years (a decline that appears to have ended with recent increases in global trade volume<sup>52</sup>), and cite this as evidence that they have no power over rates. Evaluating this claim is more difficult than it may seem because carrier cost data are hard to secure<sup>53</sup> and because much of the evidence of price behavior is contradictory and hard to interpret.<sup>54</sup> However, the evidence that exists is either inconclusive or tends to suggest that conferences had some ability to inflate price.<sup>55</sup> Moreover, the fact that price has

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<sup>51</sup> See OECD, FINAL REPORT, *supra* note 14, at 59.

<sup>52</sup> See FEDERAL MARITIME COMMISSION, 43RD ANNUAL REPORT FOR FISCAL YEAR 2004, at 5 (2005) [hereinafter "FMC, FY 2004 REPORT"].

<sup>53</sup> See OECD, FINAL REPORT, *supra* note 14, at 31; Pirrong, *supra* note 12, at 107.

<sup>54</sup> The data are contradictory because with some frequency prices have behaved differently in seemingly similarly situated trades and they are difficult to interpret because of the size and complexity of the industry and the range of factors other than carrier market power that could conceivably affect rates. See OECD, FINAL REPORT, *supra* note 14, at 40.

<sup>55</sup> The evidence is in conflict as to whether there was ever a correlation between conference market share and freight rates. Compare CLYDE & REITZES, *supra* note 12 (finding no correlation between market share and rates), with Fox, *supra* note 12 (finding such a correlation). However, a 1995 econometric study by Federal Trade Commission staff economists found that freight rates went down significantly where carriers were permitted directly to negotiate independent service contracts. See CLYDE & REITZES, *supra* note 12, at 2.

fallen over a given period is as theoretically consistent with market power as it is with lack of market power, since even monopoly maximizing rates are sensitive to changes in demand over time.<sup>56</sup> Indeed, for what it is worth, the practical evidence is more consistent with market power, because, though rates were in decline for some time, the decline began only at about the time of the first U.S. deregulatory reforms in 1984, and have declined from a peak during the 1970s.<sup>57</sup> This decline, then, coincides with a steady decrease in the influence of the conferences themselves,<sup>58</sup> and if anything is more consistent with the idea that conferences exerted market power.

E. *Will Competition Lead to Inadequate Returns, Investment Uncertainty, and Lower Service Quality?*

Carriers have argued that open competition would lead to desperate overcapacity and pricing below cost, and in support they frequently argue that their industry already performs poorly economically. However, even if liner shipping overall has performed comparatively poorly as among industries generally, the evidence that exists suggests that it performs about as well as other transportation sectors. Moreover, the best-performing liner carriers perform quite well by comparison to railroads and other transport industries, and most of the top 20 carriers have been in business for over 20 years – that is, throughout the entire period of price competition under deregulation.<sup>59</sup> The evidence of the past few years has been that leading carriers are beginning to do

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<sup>56</sup> As the OECD Report pointed out, even the U.S. telephone industry experienced steeply falling prices for long distance service throughout the entire period up to the break-up of AT&T in 1980, before which AT&T was an unchallenged monopolist. *See* OECD, FINAL REPORT, *supra* note 14, at 42.

<sup>57</sup> *See* OECD, FINAL REPORT, *supra* note 14, at 40.

<sup>58</sup> That the influence of the conferences has declined appears now fairly well documented. The FMC has found that since OSRA the ability of conferences and discussion agreements to increase rates by way of voluntary pricing guidelines and non-binding common tariffs is dependent on demand. *See* FMC, OSRA REPORT, *supra* note 14, at 14.

<sup>59</sup> *See* OECD, FINAL REPORT, *supra* note 14, at 45-46.

very well.<sup>60</sup> Thus, while it may be that many carriers have struggled since price competition began, that may reflect no more than the healthy market function of forcing exit of higher cost firms.<sup>61</sup>

In any case, it appears that the carriers may have contributed to whatever underperformance they have experienced by engaging in service competition through investment in overcapacity. As already discussed, the conference system at least sometimes may have encouraged inefficient service competition, which would be financed through profit. There is empirical evidence to the contrary, finding no link between conference control and overcapacity,<sup>62</sup> but the evidence that exists is based only on study of closed conferences.<sup>63</sup>

Carriers also argue that the lack of adequate return they anticipate under competition and the capacity instability it will cause will result in a loss of service quality. A generalized decrease in shipping rates persisted from the enactment of the Shipping Act in 1984, with its initial liberalization of individual service contracting, until recently, but there is no evidence of an impact on service.<sup>64</sup>

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<sup>60</sup> International trade volume has expanded in the past few years, and in terms of value reached record highs in federal fiscal year 2004. While carriers face fuel cost-related strains, rates are rising. Chief evidence of the industry's flourishing under these conditions is that carriers have expanded not just to meet the current excess demand; new ship orders currently planned will expand world capacity by *fifty percent*. See FMC, FY 2004 REPORT, *supra* note 52, at 5.

<sup>61</sup> Indeed, the early deregulatory steps appearing in the Shipping Act in 1984 were taken in part because a 1982 report of the General Accounting Office found the industry to be doing much better than it claimed. See GAO REPORT, *supra* note 13, at 11-17; H.R. Rep. 98-53(II), 98th Cong., 1st Sess., 4 (1984) (House Committee Report accompanying 1984 Act, noting reliance on GAO findings).

Likewise, carriers argue that without horizontal capacity rationalization they will face unacceptable investment risk. But ocean carriers face investment risk similar to actors in other capital-intensive industries, which perform well under antitrust law.

<sup>62</sup> See, e.g., B.M. DEAKIN & T. SEWARD, SHIPPING CONFERENCES: A STUDY OF THEIR ORIGINS, DEVELOPMENT AND ECONOMIC PRACTICES 23 (1973).

<sup>63</sup> Closed conferences should be better able to rationalize capacity. While closed conferences are still theoretically permitted in some trades, they have long been illegal in U.S. shipping and in practice even where they are permitted they rarely exercise membership restrictions and operate essentially as open conferences. See OECD, FINAL REPORT, *supra* note 14, at 53.

<sup>64</sup> See OECD, FINAL REPORT, *supra* note 14, at 22, *citing* FEDERAL MARITIME COMMISSION, SECTION 18 REPORT ON THE SHIPPING ACT OF 1984 (1989).

F. *Why Wouldn't Harmful Conference Activity Invite Cheating and New Entry?*

A final problem remains: If conferences are inefficient, and their price-fixing is not merely a procompetitive effort to control otherwise unmanageable capacity, then conference abuses should invite cheating and new entry and render them comparatively harmless.<sup>65</sup> Moreover, carriers note that individual ships by their nature are moveable capital<sup>66</sup> and predatory retaliation against new entrants is believed by some to be slow.<sup>67</sup> Carriers and some academics argue that liner conferences have historically been long-lived and stable, a result that should not obtain if the conferences have ever abused their position.<sup>68</sup>

These claims are quite problematic theoretically and are at odds with experience. First, unlike cartels operating under normal competition and subject to antitrust law, liner conferences throughout their history had the benefit of a powerful, government-sanctioned cartel enforcer – the FMC and its predecessors. Prior to OSRA both conference tariff rates and deviations from them were required to be on file with the FMC and available to public review,<sup>69</sup> and between 1961 and

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<sup>65</sup> A basic prediction of economic theory is that in the absence of entry barriers any abuse by a cartel of its position should create the possibility of surplus for other competitors, and therefore should invite both disciplinary competition and opportunistic cheating by its own members. See FREDERIC M. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 171 (2d ed. 1980) (noting “the tendency for informal price-fixing and output-restricting agreements to break down.”).

<sup>66</sup> Ships, obviously enough, are “moveable,” and it is therefore often suggested that particular trade routes are highly contestable. See HERMAN, *supra* note 3, at 5; Sjöström, *Modeling Competition*, *supra* note 12, at 2

<sup>67</sup> See John Davies, *Impediments to Contestability in Liner Markets*, 25 *LOGISTICS & TRANSP. REV.* 325.

<sup>68</sup> See, e.g., Pirrong, *supra* note 12, at 116; Sjöström, *Modeling Competition*, *supra* note 12, at 2. Professor Sjöström has gone so far as to say that the conference system is *popular* with shipping consumers, and that this helps explain their durability. The evidence he cites, however, comes mainly from small shippers, *see id.* at 2 & nn.7-8, who would be less able to negotiate favorable rates with carriers even in competitive environments, and in any event, query why their opinion is either (1) reliable, or (2) relevant to larger policy questions. In any case, there seems to be substantial evidence to the contrary. See, e.g., John S. McGee, *Ocean Freight Rate Conferences and the American Merchant Marine*, 27 *U. CHI. L. REV.* 191, 238-39 (1960).

<sup>69</sup> Even under the 1984 Act, direct negotiation between shippers and conference members was limited by FMC rule. See Paul S. Edelman, *The Ocean Shipping Reform Act of 1998*, 9 *CURRENTS* 65, 65 (2000).

1999 they were enforced by the FMC as a matter of law.<sup>70</sup> Conference members had no legal right of independent action prior to OSRA, and even where such action was permitted by a particular conference, shipping law prior to OSRA required that the rate and terms of any individual service contract be filed with the Commission and available to public review. Thus, cheating by conference members was not only difficult and easily disciplined by conferences, it was in fact illegal. In short, until OSRA the liner conferences had the one thing that most cartels lack, the lack of which is thought to make most cartels unstable – a highly effective regime of cartel enforcement.

Second, prior to OSRA the conferences had a variety of devices at their disposal to discipline their markets and protect collectively set rates, and even where some restrictive devices are prohibited, as under U.S. law, conferences historically retained a variety of disciplinary tools.<sup>71</sup> For example, U.S. policy has historically permitted the use of one particular form of entry deterrence that is thought to have some substantive effect even in the absence of other entry barriers – the so-called “dual rate” or “loyalty” contract.<sup>72</sup>

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<sup>70</sup> Enforcement of tariff terms, including prosecution of secret rebates and other undercutting activities, was added by the 1961 Shipping Act amendments. Such enforcement grew to become a dominant feature of the FMC’s activities – perhaps because the agency was incentivized by the large penalties available in tariff enforcement – and by 1992 they constituted two-thirds of the agency’s enforcement activities. *See* ADVISORY COMMISSION REPORT, *supra* note 19, at 107-10. Tariff enforcement was effectively ended by OSRA, with the adoption of freely available service contracting. *Cf.* 46 U.S.C. App. §1709(b)(2)(A) (prohibiting the charging of rates by a common carrier not contained in a filed tariff *or* service contract).

<sup>71</sup> For example, conferences employed revenue pools to suppress internal cheating and “loyalty contracts” or service competition to deal with price-cutting independents. *See* GAO REPORT, *supra* note 13, at 4-5. They also sometimes resorted to more drastic and/or illegal measures, such as boycotts of shippers who used non-conference carriers and the so-called “fighting ship,” a vessel subsidized by conference members that would meet or undercut the lower rates changed by any independent until it either left the trade or joined the conference.

<sup>72</sup> Under a dual rate contract the shipper agrees to purchase exclusively from the conference, and in return receives a discount. If it then purchases from a different carrier, it must pay damages. Even one of the conference system’s defenders has argued that such arrangements can deter entry, so long as entrants are capacity constrained. *See* William Sjoström, *Monopoly Exclusion of Lower Cost Entry*, 22 J. TRANSPORT ECON. & POL’Y 339, 341-42 (1988). *See also* Jong-Say Yong, *Excluding Capacity-Constrained Entrants Through Exclusive Dealing: Theory and Application to Ocean Shipping*, 44 J. INDUSTRIAL ECON. 115 (1996) (applying game theoretic model to reach similar result).

Finally, despite superficial appearances there remains steady debate concerning the contestability of liner markets, and in fact there is reason to believe that substantial portions of world shipping capacity are not suitable to competition in the general cargo trades that make up most Shipping Act-covered commerce.<sup>73</sup>

In any case, the frequent suggestion that liner conferences are long-lived and stable is misleading in two respects. First, while it is true that throughout its history and up until OSRA the industry was dominated by conferences, the conferences themselves typically lasted only a few years, and individual conference membership fluctuated along with carriers' business strategies.<sup>74</sup> Second, OSRA's first steps towards deregulation and the introduction of price competition through confidential, individual service contracting have hastened the virtual demise of the century-old conference system in just a few years.

### III. SHOULD OSRA'S ANTITRUST EXEMPTION BE RETAINED?

The question remains whether the antitrust exemption that continues under OSRA causes any negative consequences calling for further deregulation. In fact, though OSRA made genuine price competition possible for the first time, problematic behaviors persist and arguments for any pro-

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<sup>73</sup> Bulk cargo ships and some others cannot be switched into general cargo competition at low cost. This is so because virtually all general cargo shipping is now by container ship and modification of other ships for container carriage would likely be prohibitively expensive. Containerships are much more expensive than ships fitted for other carriage – a containership can cost on the order of three and a half times that of a similar sized bulk carrier. *See* Davies, *supra* note 31, at 417; *see also* HERMAN, *supra* note 3, at 6. Also, there is at least some specialization of ships to particular routes even in general cargo trades, *see* Sjostrom, *Modeling Competition*, *supra* note 12, at 6, and at least some other non-trivial sunk costs may inhere in serving individual routes in general cargo trades. *See* CLYDE & REITZES, *supra* note 12, at 22 (hypothesizing that “there may be sunk costs involved in serving a given route (i.e., costs of warehouses, cargo-handling equipment, and other terminal facilities).”). Thus, except for high value and very low value goods, most cargo transported by containerized ship cannot be cost-effectively shipped by alternative means. *See* OECD, FINAL REPORT, *supra* note 14, at 20, *citing* MARY R. BROOKS, SEA CHANGE IN LINER SHIPPING: REGULATION AND MANAGERIAL DECISION-MAKING IN A GLOBAL INDUSTRY (2000).

<sup>74</sup> *See* OECD FINAL REPORT, *supra* note 14, at 62, *citing* N. Shashikumar, *Competition and Models of Market Structure in Liner Shipping*, 15 TRANSPORT REV. 3 (1996).



competitive upside, which come almost exclusively from the industry, are really the same as those made in defense of the conference system itself. We reject the occasional suggestion that no evidence of competitive harm post-OSRA exists.

First, the “discussion agreements” and “voluntary guidelines” for service contracting still tolerated by OSRA routinely involve a large amount of information sharing that would likely violate U.S. antitrust were it not for the exemption. Despite the introduction of competition, this conduct appears to have facilitated significant collusion. Though the voluntary guidelines have proven vulnerable to independent service contracting, particularly in times of overcapacity, they facilitate generalized rate increases in times of high demand and capacity utilization,<sup>75</sup> and carriers may benefit more from rate increases in times of high demand than shippers do from rate troughs in times of low demand.<sup>76</sup> Indeed, were GRIs ineffective in the face of independent contracting, one expects the conferences would not go to the effort and expense of doing them, and yet they do so.<sup>77</sup> More significantly, the guidelines and discussion agreements facilitate price-fixing of the many ancillary “surcharges” that carriers pass on to shippers, even in independent service contracts, notwithstanding that freight rates themselves remain negotiable. These charges often constitute significant portions of overall transport cost, and also result in major (and sometimes unseen) shifting of risk to

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<sup>75</sup> See FMC, OSRA REPORT, *supra* note 14, at 13-14, 28-29. Moreover, evidence that carriers can price discriminate as between high and low value cargo, owing to the general inelasticity of freight rates for high value freight, suggests they should be able to constrain prices through voluntary guidelines as to high value goods even in times of slack demand. See Ingrid Bryan, *Regression Analysis of Ocean Liner Freight Rates on Some Canadian Export Routes*, 8 J. TRANSP. ECON. & POL’Y 161 (1974) (finding evidence of discrimination); Fox, *supra* note 12 (same).

<sup>76</sup> See OECD, FINAL REPORT, *supra* note 14, at 67.

<sup>77</sup> See FMC, FY 2004 REPORT, *supra* note 52, at 6-7 (noting GRIs in a variety of U.S. trade lanes in federal fiscal year 2004).

shippers.<sup>78</sup>

Second, while OSRA has introduced price competition, independently negotiated rates are probably available only to shippers large enough to exert influence in negotiation with individual carriers. Whereas published tariff rates now largely serve as benchmark prices below which large shippers enjoy deep discounts through service contracts, small shippers typically have no choice but to accept the benchmark rate.<sup>79</sup> Thus, as to them, the conferences remain effective price fixers.

Furthermore, the operational agreements now prevalent amongst carriers come within OSRA's antitrust exemption, and while they appear to promise procompetitive benefits, there is no obvious reason they should not be subject to antitrust. Procompetitive aspects of inter-carrier operational agreements would not be subject to per se analysis,<sup>80</sup> and even if exposure to rule of reason scrutiny would burden inter-carrier negotiations to some extent there is no obvious reason such agreements should be treated differently than any other efficiency enhancing cooperative behavior. Moreover, while they appear likely to result in productive efficiencies, collaborations amongst carriers can easily shield conduct harmful to competition.<sup>81</sup>

#### IV. CONCLUSIONS: A BRIEF HISTORICAL RETROSPECTIVE

Ultimately, however, having said all that, the best summary of the industry's current state and

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<sup>78</sup> See OECD, FINAL REPORT, *supra* note 14, at 43-44. These apparently collusively fixed surcharges include a variety of costs that presumably should vary as among carriers, such as equipment repositioning charges and paper work filing. Carriers have also managed to pass on a number of major variable charges to shippers (such as currency and fuel price fluctuations), so that shippers are then faced with rates that vary highly from the published tariff. Finally, the lack of transparency involved in the assessment of these charges and the fact that they are presented to shippers as non-negotiable "direct costs" suggest that surcharges are simply a continued price-fixing effort. *See id.*

<sup>79</sup> See OECD, FINAL REPORT, *supra* note 14, at 66.

<sup>80</sup> See *supra* note 48.

<sup>81</sup> See 13 HOVENKAMP, *supra* note 48, at ¶2100b ("While many joint activities are clearly anticompetitive and many others are clearly competitive, in the middle are a significant number whose effects are ambiguous, at least upon an initial look."); OECD, FINAL REPORT, *supra* note 14, at 27 (noting problems with operational agreements on file).

the state of deregulatory debate may be to see them in historical perspective. The most illuminating insights of all may come from consideration of the time during which the exemption was first adopted, and of just how alien the political and economic thought of that time now seem.

The shipping exemption is the oldest of America's surviving antitrust exemptions. Several other industries still enjoy minor, miscellaneous exemptions, but almost none remain that broadly exempt an entire industry in the manner of the Shipping Act. The exemption arose in 1916, at a time when transport sectors were widely thought to suffer such intractable problems of cost and overcapacity that they could not be competitive.<sup>82</sup> The turn of the twentieth century was also a time of severe economic depression throughout the economies of the North Atlantic,<sup>83</sup> and a time when industry commonly perceived its only hope for dealing with its problems to lie in horizontal price and output restraints.<sup>84</sup> Accordingly, during this same period many industrial sectors formed pools

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<sup>82</sup> Arguments from high fixed costs were well developed by 1916, and were given sophisticated theoretical treatment in the academic literature. See RICHARD T. ELY, *OUTLINES OF ECONOMICS* 199 (1916) (discussing ruinous competition in railroads); Eliot Jones, *Is Competition in Industry Ruinous?*, 34 Q. J. ECON. 473 (1920); see generally NAOMIR LAMOREAUX, *THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904*, at 50 & n.3 (1985) (citing academic literature from as early as 1918). They were demonstrably the theoretical basis of the federal government's adoption of the original 1916 Shipping Act. The House committee that initially recommended the bill said: "Practically all steamship representatives who testified before the Committee, as well as a majority of the leading American exporting and importing firms . . . contended that shipping agreements . . . are a natural evolution and are necessary if shippers are at all times to enjoy ample tonnage and efficient, frequent, and regular service at reasonable rates." See *Report of the Committee on the Merchant Marine and Fisheries on Steamship Agreements and Affiliations in the American Foreign and Domestic Trade*, H.R. Doc. No. 805, 63d Cong., 2d Sess., at 295 (1914); cf. *Washington Notes*, 24 J. POL. ECON. 1012, 1013 (1916) (noting passage of 1916 Shipping Act and noting the "wide difference of expert opinion" as to whether "transportation by water is necessarily controlled by considerations very different from those that prevail in connection with railway transportation").

<sup>83</sup> See generally Tony Freyer, *The Sherman Antitrust Act, Comparative Business Structure, and the Rule of Reason: American and Great Britain, 1880-1920*, 74 IOWA L. REV. 991, 994 (1989); James Livingston, *The Social Analysis of Economic History and Theory: Conjectures on Late Nineteenth Century American Development*, 92 AM. HIST. REV. 69, 72-73 (1987); Jeffrey G. Williamson, *Watersheds and Turning Points: Conjectures on the Long-Term Impacts of Civil War Financing*, 34 J. ECON. HIST. 636 (1974); Jeffrey G. Williamson, *Late Nineteenth-Century American Retardation: A Neoclassical Analysis*, 33 J. ECON. HIST. 581 (1973).

<sup>84</sup> These trends led to an attempt during the Commerce Secretariat of Herbert Hoover virtually to hand over industry regulation entirely to trade associations, and ultimately to the abortive National Industrial Recovery Act. See generally ELLIS W. HAWLEY, *THE NEW DEAL AND THE PROBLEM OF MONOPOLY* (1966); ROBERT F. HIMMELBERG, *THE ORIGINS OF THE NATIONAL RECOVERY ADMINISTRATION: BUSINESS, GOVERNMENT, AND THE TRADE ASSOCIATION ISSUE*,

or cartels similar to the shipping conferences,<sup>85</sup> and most American transport industries were sweepingly exempted from antitrust.<sup>86</sup>

In light of deregulatory experience, however, it appears the economic problems of the time were simply misunderstood. Given the healthy performance of deregulated sectors, those problems seem better characterized as merely a painful readjustment, which affected American industry generally, associated with large technological advances, increasing scale economies, and general economic downturn. In many sectors that readjustment, which might otherwise have worked itself toward more stable long-run equilibrium, was cut short by legislative intervention at the behest of suffering industry. In other words, the current ocean shipping regulatory regime may best be understood as virtually the last, vestigial remnant of a very large mistake of economic theory. As a consequence of that mistake, price-constrained regulated industries over many decades undertook substantial capital and psychological commitments to inefficient modes of operation. Accordingly, repeal of antitrust exemptions in all regulated industries has been slow, difficult, and contested at every turn.

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1921-1933 (1993); Ellis W. Hawley, *Herbert Hoover, the Commerce Secretariat, and the Vision of an "Associative State,"* 1921-28, 61 J. AM. HIST. 116 (1974). The National Industrial Recovery Act, a response to the Great Depression and a cornerstone of the so-called "First" New Deal, delegated very broad self-regulatory power to industry. It was held unconstitutional not long after its adoption. See *A.L.A. Schechter Poultry Corp. v. U.S.*, 295 U.S. 495 (1935).

<sup>85</sup> See ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 122-44 (1977); HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836-1937*, at 145-48 (1991); Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1199-1200 (1986); cf. H. R. Tosdal, *Open Price Associations*, 7 AM. ECON. REV. 331 (1917) (reviewing the rapid World War I-era rise of the "open price association" form of horizontal cartel, devised by antitrust lawyer Arthur Jerome Eddy)

<sup>86</sup> See Paul Stephen Dempsey, *Transportation: A Legal History*, 30 TRANS. L. J. 235, 281-89 (2003).