競爭事務委員會
COMPETITION
COMMISSION

CASE BE/0004

APPLICATION FOR A BLOCK EXEMPTION ORDER UNDER SECTION 15 OF THE COMPETITION ORDINANCE IN RESPECT OF CERTAIN LINER SHIPPING AGREEMENTS

DECISION TO ISSUE A BLOCK EXEMPTION ORDER IN RESPECT OF VESSEL SHARING AGREEMENTS

STATEMENT OF REASONS

8 AUGUST 2017

TABLE OF CONTENTS

1 INTRODUCTION

1.1 On 17 December 2015, the Competition Commission ("**Commission**") received an application for a block exemption order ("**Application**") under section 15 of the Competition Ordinance (Cap. 619) ("**Ordinance**") from the Hong Kong Liner Shipping Association or HKLSA ("**Applicant**"). The Commission's case reference number is BE/0004.

1.2 The Applicant sought a block exemption order in relation to liner shipping agreements, including vessel sharing agreements ("**VSAs**") and voluntary discussion agreements ("**VDAs**"). A description of these agreements is provided in Part 2 below.

Framework for issue of a block exemption order

1.3 Under section 15(1) of the Ordinance, the Commission may issue a block exemption order in respect of a category of agreement where it is satisfied that that category of agreement is an 'excluded agreement'. Section 15(5) provides that an 'excluded agreement' for the purposes of section 15 is an agreement that is excluded from the application of the first conduct rule by or as a result of section 1 (*Agreements enhancing overall economic efficiency*) of Schedule 1 to the Ordinance ("**efficiency exclusion**").

1.4 Under section 17 of the Ordinance, an agreement that falls within the category of agreement specified in a block exemption order is exempt from the application of the first conduct rule, provided that parties to the agreement comply with the conditions and limitations (if any) in the block exemption order.

1.5 The Commission may issue a block exemption order in response to an application from an undertaking or association of undertakings, or on its own initiative. Further details on the Commission's processes regarding applications for a block exemption order are set out in the Commission's *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders* ("**Applications Guideline**").

1.6 As indicated in the Applications Guideline, there is no requirement that the Commission issue a block exemption order in order for undertakings to rely on the efficiency exclusion. Undertakings may self-assess the legality of their conduct having regard to the first conduct rule and the efficiency exclusion.[1]

[1] Applications Guideline, paragraph 11.4.

1.7 Where the Commission decides that a particular category of agreements does not meet the criteria for the issue of a block exemption order, this does not necessarily mean that the Commission has formed a view on whether it has reasonable cause to believe that a contravention of the first conduct rule has occurred in connection with that category of agreements.[2]

The Applicant

1.8 The Applicant was established in 1981 and represents shipping lines in Hong Kong in relation to liner shipping policy and other issues. Its members are said to account for approximately 90% of the containerised liner industry in Hong Kong.

1.9 The Applicant currently has 16 members, which are as follows:

(a) APL Co. Pte Ltd;
(b) Cheng Lie Navigation Co. Ltd.;
(c) CMA CGM (HK) Limited;
(d) COSCO Container Line Agencies Ltd.;
(e) Evergreen Star Hong Kong Ltd.;
(f) Hamburg Sud Hong Kong Ltd.;
(g) Hapag-Lloyd (China) Ltd.;
(h) Hyundai Merchant Marine (Hong Kong) Ltd.;
(i) "K" Line (Hong Kong) Ltd.;
(j) Maersk Hong Kong Ltd.;
(k) Mitsui O.S.K. Line (H.K.) Ltd.;
(l) N.Y.K. Line (H.K.) Ltd.;
(m) OOCL (H.K.) Ltd.;
(n) United Arab Shipping Agency Co. (HK) Ltd.;
(o) Wan Hai Lines (H.K.) Ltd.; and
(p) Yangming Marine Transport Corporation.

1.10 Certain shipping lines operating in Hong Kong are not members of the Applicant. As the Application is in respect of liner shipping agreements generally, any carriers which are not members of the Applicant but are party to such agreements are also covered by the Commission's decision in response to this Application.

[2] Applications Guideline, paragraph 13.7.

Handling of Application, publication of proposed block exemption order and other steps

1.11 In accordance with the Applications Guideline, the Commission engaged in an Initial Consultation with the Applicant prior to the Applicant's submission of the Application on 17 December 2015. The Commission published a notice of the Application on its website on 18 December 2015, together with the Applicant's summary of the Application.[3]

Preliminary consultation

1.12 On 19 January 2016, the Commission published a notice on its website in relation to a preliminary consultation on the Application ("**preliminary consultation**"), which called for interested parties to submit their views on the Application. In addition to issuing the notice, the Commission specifically invited over 50 parties which it considered likely to be affected by the Application to participate in the preliminary consultation. The preliminary consultation ended on 24 March 2016.

1.13 During the preliminary consultation, the Commission received written submissions from, and/or held meetings with, almost 30 interested parties, including customers; trade associations and chambers of commerce; container terminal operators; non-HKLSA shipping lines; and Government bodies.

1.14 In parallel with the preliminary consultation, the Commission consulted an industry expert to obtain and verify certain information in relation to the liner shipping industry. The Commission has published on its website a copy of a presentation on the liner shipping industry given by the industry expert to Commission members on 12 August 2016. The expert's advice to Commission members was limited to this presentation and the industry expert did not draft any particular written report in this matter.

[3] As confirmed in this notice, the Commission indicated to the Applicant that it would be unlikely to initiate enforcement action in respect of the agreements which formed the subject of the Application, while it was considering the Application. This indication was provided in line with the Commission's press release of 28 October 2015 outlining further arrangements for dealing with applications. The Commission was satisfied that the conditions for providing such an indication (as set out in the press release of 28 October 2015) were fulfilled in this case.

Publication of proposed block exemption order and section 16 consultation

1.15 Based on its preliminary views regarding the Application, the Commission proposed to issue a block exemption order for VSAs ("**Proposed Order**"). VDAs were not included in the scope of the Proposed Order.

1.16 In accordance with the procedure set out in section 16 of the Ordinance, on 14 September 2016, the Commission:

(a) published the text of the Proposed Order along with a Statement of Preliminary Views, which included the Commission's provisional assessment of the Application and its reasons for the Proposed Order; and

(b) sought representations from interested parties (including the Applicant) on the Proposed Order and/or the Commission's provisional position on the Application as detailed in the Statement of Preliminary Views ("**section 16 consultation**").[4] The Commission also invited parties to provide certain information identified in the Statement of Preliminary Views in relation to VSAs, which would assist the Commission in making a final decision on whether or not to issue a block exemption order for VSAs.

1.17 The section 16 consultation ended on 14 December 2016. The Commission received a total of 15 representations, which have been published on the Commission's website. The representations were submitted by both Hong Kong-based and international entities, including a number of associations representing shipowners; bodies representing shippers, container terminal operators and others in the maritime industry; a Legislative Council member; academics; and the Applicant itself.

Supplementary submission from Applicant

1.18 On 17 January 2017, the Applicant submitted a supplementary representation to the Commission, in which the Applicant requested the Commission to consider the possibility of a block exemption order for a 'revised VDA scope' ("**supplementary submission**"). Further details of the Applicant's proposal and the Commission's assessment of it are set out in Part 5 below.

[4] The Commission provided further details for parties wishing to make representations in the Commission's *Notice issued under section 16 of the Competition Ordinance of a proposed block exemption order for certain liner shipping agreements*.

1.19 A non-confidential version of the supplementary submission was provided to the Commission on 27 February 2017, which the Commission published on its website on 1 March 2017. The Commission sought comments from interested parties on the supplementary submission until 24 March 2017 ("**supplementary submission consultation**" and, together with the preliminary consultation and the section 16 consultation, "**Commission consultations**"). The Commission received a total of nine sets of comments, which have been published on the Commission's website.

Requests for information and other steps

1.20 In parallel to the Commission consultations, the Commission held several meetings with the Applicant and issued it with a number of formal requests for information aimed at clarifying, and seeking further information on, various issues in the Application and the supplementary submission. The Applicant separately provided several additional written submissions to the Commission on particular issues relevant to the Application.

1.21 Finally, the Commission also obtained general background information from its counterpart agencies in other jurisdictions in relation to how they deal with liner shipping agreements under their respective competition laws.

The Order and Statement of Reasons

1.22 Following the publication of the Statement of Preliminary Views, the Commission has considered all of the representations received during the section 16 consultation, the supplementary submission and the comments received during the supplementary submission consultation.

1.23 On the basis of the representations and comments received and the Commission's provisional position on the Application, the Commission has decided to issue a block exemption order for VSAs ("**Order**"). In accordance with section 34 of the Ordinance, the Order is published in the Commission's Register of Decisions and Block Exemption Orders, which is available on the Commission's website and at its offices during ordinary business hours. A Guidance Note containing an explanation of the provisions of the Order accompanies the Order. The Commission has decided not to issue a block exemption order for VDAs or the revised VDA scope.

1.24 This Statement of Reasons sets out:

(a) certain background information in relation to the Application (Part 2 below outlines relevant details concerning the liner shipping industry

and liner shipping agreements, while Part 3 provides an overview of exemptions for liner shipping agreements in other jurisdictions);

(b) the Commission's assessment of the Application and the submissions received during the preliminary consultation and section 16 consultation, along with the Commission's reasons for the Order (Part 4);

(c) the Commission's assessment of the supplementary submission and the comments received during the supplementary submission consultation (Part 5); and

(d) transitional arrangements in respect of VDAs, for which no block exemption order is proposed, and any VSAs which do not benefit from the Order (Part 6).

2 LINER SHIPPING SERVICES AND LINER SHIPPING AGREEMENTS

Liner shipping services

2.1 The carriage of international cargo by sea generally falls into two main categories: (i) liner shipping and (ii) tramp shipping.

2.2 Where shipping lines (also referred to as liner operators, ocean carriers or simply carriers) offer regular, scheduled services for the carriage of goods by ocean-going vessel, this is known as liner shipping. Such services are offered on fixed trade routes and based on fixed schedules. Any party wishing to transport goods by sea may obtain a space or slot on a particular service in return for payment. Importers and exporters may thus use liner shipping services for the carriage of goods, without having to charter an entire ship.

2.3 Liner shipping vessels carry cargoes such as manufactured and consumer goods and agricultural goods, mostly in standard-size containers. These metal containers are filled and sealed at origin, and remain intact as they are transported, before being loaded onto a vessel. The use of standard-size containers permits the same cargo to be transported not only by ship, but also loaded onto a truck or rail car before or after ocean transportation. Cargo may also be carried on liner shipping services in non-containerised form, which is also known as conventional or break-bulk shipping. Most goods may be transported either in containers (on dedicated container ships) or in non-containerised form (on conventional cargo ships). Customers choose between containerised and conventional shipping based on their specific needs, such as their timing requirements, size of shipment and need for onward transportation. Container ships today account for almost two thirds of the carrying capacity of the liner shipping fleet.[5]

2.4 In contrast, in the tramp shipping sector, vessels carry cargoes that are not suited for regular and fixed liner services. Tramp shipping is generally used for large volume and non-unitised shipments such as coal, oil, grain, metal ore and bulk chemicals. Tramp services are not offered on a fixed schedule and shippers are required to charter a full vessel to move their cargo.

2.5 The Application concerns only liner shipping services. Tramp shipping services are therefore not considered in this Statement of Reasons or included in the scope of the Order.

[5] Data from Equasis based on 2013 figures, as cited in the Organisation for Economic Cooperation and Development Note by the Secretariat, *Competition Issues in Liner Shipping*, June 2015, paragraph 16.

2.6 Finally, shipping lines are sometimes responsible for collection of liner cargo from, and/or delivery of cargo to, an inland point, such that they will arrange landside transport using truck, rail or barge transport. Such inland services are not treated as part of 'liner shipping services' for the purposes of this Statement of Reasons or the Order.

Arrangements between carriers and their customers

2.7 Customers of liner shipping services include exporters or sellers of cargo (for example, the manufacturers of finished and unfinished goods) and importers or buyers of cargo (for example, retailers). Exporters or sellers of cargo are generally referred to as shippers, while importers or buyers of cargo may be referred to as consignees. Larger parties may procure liner shipping services directly with shipping lines, while smaller parties may engage freight forwarders and logistics companies to do so. Freight forwarders and logistics companies will act as an intermediary and contract with carriers for a certain amount of space on vessels, which they then sell on to their own customers.

2.8 Shippers, consignees, freight forwarders and logistics companies may all be considered to be customers of liner shipping services.

Tariffs and service contracts

2.9 There are two basic types of arrangements between carriers and their customers: (i) tariffs and (ii) service contracts.

2.10 Customers wishing to transport cargo on an occasional basis may obtain the necessary space on a particular liner shipping service in return for payment in accordance with the carrier's tariff. Tariffs are made publicly available by carriers and comprise freight rates, surcharges and other terms of transportation. Tariffs are of general application to all customers purchasing services in this way.

2.11 Alternatively, customers may enter into a service contract with carriers for the transportation of cargo over a particular period of time. Such contracts are confidential and individually negotiated with carriers. Customers commit to provide a certain minimum quantity of cargo over a fixed period of time, while carriers commit to a defined level of service. The contract will also make provision for the freight rate and surcharges to be paid by the customer. The vast majority of carrier business is today conducted under service contracts.

Rates and surcharges

2.12 Customers are charged a basic freight rate for liner shipping services, which covers the carriage of cargo from the port of loading to the port of discharge and is usually charged on a per container basis. Freight rates vary from carrier to carrier, from route to route, and from leg to leg within each route.

2.13 In addition to freight rates, customers are also often required to pay charges, fees or surcharges which are said to relate to particular cost items. For the purposes of this Statement of Reasons, such charges, fees or surcharges are all referred to as surcharges. Common surcharges include:

(a) a fuel surcharge, commonly known as a Bunker Adjustment Factor ("**BAF**"), which varies with the cost of marine fuel;

(b) a Terminal Handling Charge ("**THC**"), aimed at covering various shore-side and equipment related costs; and

(c) a Currency Adjustment Factor ("**CAF**"), which varies according to the exchange rate between the tariff currency and the currency in which shipping lines collect revenue on a particular route.

2.14 There are a range of other surcharges which may be applied, including documentation fees and surcharges applied on a temporary basis (such as port congestion or peak season surcharges).

2.15 Freight rates in service contracts may be set by reference to the rate specified in the carrier's tariff applicable at the relevant time or a particular index, or fixed at a particular level. The rate may also be calculated by reference to a guideline issued through a VDA for a particular route. Carriers may publish their own surcharges (which may in some cases be calculated according to their own particular formula), or reference may be made to a VDA recommended guideline or formula to determine the amount of the surcharge. Rates and, to a lesser extent, surcharges may be subject to negotiation between parties, such that the relevant published amounts will not necessarily apply.

2.16 Carriers may publish General Rate Increases ("**GRIs**") in their tariff, which specify that their existing freight rates will increase by a particular amount.[6] Customers which have entered into a service contract with a carrier may be affected by such GRIs, where the contract has a GRI clause providing for an increase in the

[6] Certain carriers refer to such rate increases as General Rate Restorations or GRRs.

contract rate if the carrier publishes a GRI. Equally, however, it is common for customers with service contracts to seek rate reductions, for example by renegotiating their contracts, where prevailing market rates have fallen below the contract rate.

Trade routes, transshipment and liner shipping services in Hong Kong

2.17 Liner shipping services typically call at a number of ports on a particular route. Containers and other cargo may be loaded and unloaded from vessels as they stop at these ports.

2.18 From a geographic perspective, liner shipping services are generally divided into particular "trades", being the service between two ranges of ports at either end of the trade (such as the trade between ports in North America and ports in North Europe).

2.19 From the perspective of Hong Kong, the relevant trades are those from the Far East (which includes Hong Kong) and back. For these purposes, major trades include those between the Far East and North America, the Far East and Northern Europe, the Far East and the Mediterranean, and the Far East and Australia. In addition, certain trades may be characterised as "intra-regional", comprised of short sea shipping routes within a particular region. Certain intra-Asia trades are therefore also relevant trades from Hong Kong's perspective. Trades differ from each other in terms of the volumes shipped, the types of goods transported, the types of ships utilised, the ports called at and the length of voyage from origin to destination.

2.20 Liner shipping cargo passing through a particular port may generally be divided into direct cargo and transshipment cargo. Direct cargo comprises cargo which is for import at or export from that port (including the possibility of transportation by land to or from a location in the hinterland). Transshipment cargo comprises cargo where the port of origin and final destination is elsewhere (i.e. the port in question serves as an intermediary port). Such cargo is removed from a vessel and either returned to the same vessel or transferred to a different vessel in the transshipment port.

2.21 In the case of Hong Kong, cargo for which Hong Kong is the port of origin or destination is therefore considered as direct cargo.[7] Cargo which passes through Hong Kong but for which the ultimate port of origin or destination is elsewhere

[7] Direct cargo includes cargo which is subsequently or initially transported by road into or out of Mainland China.

(including other ports in South China) is considered transshipment cargo. Based on Census and Statistics Department data, approximately 31% of total container throughput for Port of Hong Kong in 2016 was made up of direct cargo, while transshipment cargo accounted for approximately 69%.[8]

2.22 Hong Kong is served by an extensive range of liner shipping services, both in terms of the frequency of services and geographic or network coverage (i.e. the number of destinations served). In 2016, the Port of Hong Kong provided around 330 container liner services per week connecting to about 470 destinations worldwide.[9] Liner shipping services account for the largest proportion of Hong Kong's ocean trade, with approximately 75% of all ocean trade in Hong Kong estimated to take place through container shipping.[10]

2.23 Hong Kong is therefore recognised as a significant global trading hub, with its port ranking fifth globally in terms of container throughput.[11] In this context, the liner shipping and related industries provide significant economic benefits for Hong Kong. In 2015, for example, the port of Hong Kong and the maritime industry contributed 1.3% to Hong Kong's GDP and employed 2.3% of Hong Kong's labour force.[12] These industries in turn provide an important contribution to the trading and logistics industries, which in 2015 accounted for 18.9% and 3.3% of Hong Kong's GDP respectively and 19.8% of Hong Kong's total employment.[13]

Liner shipping agreements

2.24 The Application submitted that a block exemption order should be issued in relation to liner shipping agreements between vessel-operating carriers, which in practice mainly cover VSAs and VDAs.

2.25 The Application did not seek a block exemption order in respect of rate-fixing agreements, also known as conferences. Conference agreements were the

[8] Hong Kong Shipping Statistics, Fourth Quarter 2016, Census and Statistics Department. Total container throughput refers to laden containers for ocean container transport and river container transport.

[9] Hong Kong Maritime and Port Board website, 'Port of Hong Kong', available at http://www.hkmpb.gov.hk/en/port/port.html.

[10] Based on data from Hong Kong Census and Statistics Department in respect of 2016.

[11] Based on data from Hong Kong Shipping Statistics, Fourth Quarter 2016, Census and Statistics Department, in respect of 2016.

[12] Based on data from the Hong Kong Census and Statistics Department.

[13] Based on data from the Hong Kong Census and Statistics Department.

traditional form of cooperation between carriers and involved the fixing of freight rates and other conditions of carriage on particular routes. The Applicant indicated that conference agreements are no longer representative of the liner shipping agreements which currently operate in the industry in Hong Kong, while other forms of liner shipping agreements were not addressed in the Application. The Commission's assessment therefore focused solely on VSAs and VDAs, and other forms of liner shipping agreement have not been considered.

2.26 The Application referred to […] and […], being a VSA and VDA respectively, as representative of the agreements entered into by carriers operating through Hong Kong. The Applicant also provided the Commission with copies of more than 20 other VSAs and VDAs covering Hong Kong to which the Applicant's members are party, and subsequently also provided copies of VSA alliance agreements which have been concluded recently.

Vessel sharing agreements

2.27 VSAs are agreements between carriers in which parties agree on operational arrangements relating to the provision of liner shipping services, including the coordination or joint operation of vessel services, and the exchange or charter of vessel space. VSAs are often compared to airline code-sharing or alliance agreements.

2.28 The nature and extent of the cooperation between VSA members may vary. Simple VSAs may provide for the transfer or reciprocal exchange of capacity between members of the VSA. This will involve a carrier obtaining a pre-determined number of container slots on another carrier's vessel in exchange for payment (in the case of a slot charter arrangement) or slots on its own vessels (a slot exchange arrangement). More integrated VSAs may also include the coordination of the parties' respective sailing schedules and port calls and/or the operation of a joint service. In such cases, each party provides vessels for operating the joint service and in exchange receives a number of container slots across all vessels in the service based on the total vessel capacity contributed.

2.29 VSAs may also include supporting arrangements relating for example to the establishment of a service centre to coordinate the operation of the agreement, the shared use of terminals and/or pooling of equipment such as containers. Parties to such agreements may also share information relating to aspects of their operations on a particular trade in order to implement the cooperation envisaged.

2.30 VSAs may be referred to by a number of different names, such as consortia, slot exchange agreements, slot charter agreements, joint service agreements or slot swap agreements. The term 'alliance' or 'strategic alliance' may also be used in respect of VSAs which cover multiple trades rather than one trade, so that liner operators manage several joint shipping services worldwide. On the key global trades, most VSAs take the form of alliances. For the purposes of this Statement of Reasons and the Order, all such agreements are considered to be VSAs.

Voluntary discussion agreements

2.31 VDAs are agreements between carriers in which parties discuss commercial issues relating to a particular trade or trades.

2.32 VDAs provide for members to discuss information concerning pricing offered to customers (including freight rates and surcharges applicable to the transportation of cargo and ancillary services). VDA members may, for example, notify each other in advance of their planned or proposed rates and changes to those rates. According to the Application, however, the terms of specific, individual service contracts (including as to price) are confidential and are not subject to monitoring by other VDA members.

2.33 Parties to VDAs may reach agreements on pricing recommendations to be issued collectively by the VDA members with respect to freight rates (including GRIs) and certain surcharges. Members of the VDA are not bound to follow such pricing recommendations.

2.34 VDAs also provide for the exchange of other commercial information in relation to a trade or trades, such as specific statistics or reports on members' costs, vessel capacity and deployment, and market shares. Finally, VDAs permit the discussion and exchange of information on general issues relevant to a trade, such as regulatory developments, economic trends, best practices and compliance issues.

3 OVERVIEW OF EXEMPTIONS FOR LINER SHIPPING AGREEMENTS IN OTHER JURISDICTIONS

Introduction

3.1 Liner shipping agreements have historically been subject to exemptions from competition law in a number of jurisdictions. The Applicant has referred to these exemptions in the Application and in its subsequent submissions. In addition, a number of parties which participated in the Commission consultations suggested that the approach of a particular jurisdiction or jurisdictions be adopted in the Commission's decision on the Application.

3.2 The Commission reiterates, as was previously mentioned in the Statement of Preliminary Views, that there are differences between the legal and economic context underlying exemptions regimes overseas and in Hong Kong, such that the approach taken in other jurisdictions cannot be imported 'wholesale' into Hong Kong. The Commission is tasked with reviewing the Application solely on the basis of the efficiency exclusion in the Ordinance, by reference to the specific economic efficiencies claimed to be generated by the liner shipping agreements covered by the Application and the impact of those agreements on customers.

3.3 The Commission recognises, however, that it may be informative to consider the approach taken by other jurisdictions as background to the Application. This Part therefore sets out a brief overview of exemptions for liner shipping agreements in a number of other jurisdictions.

Different approaches to exemptions for liner shipping agreements

3.4 The scope, form and basis of the relevant exemptions vary from jurisdiction to jurisdiction.

Scope of the relevant exemptions

3.5 As mentioned in paragraph 2.25 above, cooperation between shipping lines traditionally took the form of rate-fixing or conference agreements. The United Nations Conference on Trade and Development adopted the Convention on a Code of Conduct for Liner Conferences in 1974 (which entered into force in 1983), setting forth certain regulations for conference agreements.[14]

[14] In 1997, Hong Kong implemented the provisions of the Code through the Merchant Shipping (Liner Conferences) Ordinance (Cap. 482). Section 12 of this ordinance, enacted before Hong Kong had a general competition law, provides that certain restrictions of competition imposed by conferences

3.6 A number of jurisdictions continue to provide exemptions from competition law for conference or rate-fixing agreements under specific statutory provisions, including Australia, Japan, New Zealand, and South Korea.[15] In general, such exemptions implicitly or explicitly also cover agreements between carriers on operational and commercial matters (i.e. the matters covered by VSAs and VDAs respectively). In certain of these jurisdictions, there are proposals to reduce the scope of or abolish such exemptions, as outlined further in paragraph 3.15 below.

3.7 In recent years, other forms of cooperation between carriers have emerged and largely replaced conference agreements, namely VDAs and VSAs. VSAs and VDAs do not involve binding agreements on uniform or common rates.

3.8 Both VSAs and VDAs are permitted in the United States and Canada by virtue of specific shipping legislation, which grant exemptions from the relevant competition laws.[16] However, in the European Union, only 'consortia' agreements between carriers (equivalent to VSAs) benefit from a block exemption from the EU competition rules ("**EU Consortia BER**").[17] Similarly, in Israel, a block exemption limited to VSAs entered into force in January 2013,[18] while in India, VSAs have been exempted from the relevant competition rules by virtue of a series of government notifications.[19]

---

shall not be "unenforceable by virtue of any rule of law about unreasonable restraint of trade". The Commission does not interpret section 12 of the Merchant Shipping (Liner Conferences) Ordinance as providing an exclusion from the competition rules in the Competition Ordinance. In particular, the Commission does not take the view that section 12 affords a basis for the application of the exclusion provided for in section 2 of Schedule 1 to the Competition Ordinance (*Compliance with legal requirements*). Section 12 of the Merchant Shipping (Liner Conferences) Ordinance has no bearing on whether parties might be pursued with a view to the imposition of a financial penalty for contravention of section 6(1) of the Competition Ordinance.

[15] See Part X of the Competition and Consumer Act 2010 in Australia; the Maritime Transportation Act in Japan; the Commerce Act 1986 and the Shipping Act 1987 in New Zealand; and the Maritime Transport Act in South Korea.

[16] See the Shipping Act of 1984 (as amended by the Ocean Shipping Reform Act of 1998) in the United States; and the Shipping Conferences Exemption Act, 1987 in Canada. Conference agreements would be permitted under these statutory provisions provided that conference members are permitted to enter into confidential and individual service contracts with customers.

[17] Commission Regulation 906/2009 of 28 September 2009 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices between liner shipping companies (consortia).

[18] See OECD, *Annual Report on Competition Policy Developments in Israel*, 2012.

[19] See most recently the Ministry of Corporate Affairs Notification of 16 June 2017, which exempted VSAs from relevant Indian competition rules for a period of one year with effect from 20 June 2017.

3.9 In Singapore, a block exemption order for liner shipping agreements (covering both VSAs and VDAs) has been in force since 2006.[20] To fall within the scope of the block exemption order, such agreements may not require carriers to adhere to a particular tariff. In Malaysia, a block exemption order was issued in 2014 for a period of three years, and a subsequent block exemption order was recently issued for a further period of two years.[21] The block exemption orders issued in Malaysia have covered VSAs and VDAs, though in both cases only to the extent that such agreements do not involve any element of price-fixing, price recommendation or tariff imposition.

3.10 In mainland China, international liner shipping agreements are subject to specific sectoral legislation.[22] Liner conference agreements, operational and pricing agreements among liner shippers which involve Chinese ports are required to be filed with the Ministry of Transport within 15 days of execution. The Ministry of Transport may conduct investigations into any such agreements in the circumstances specified in the relevant regulations, including where the agreements may harm fair competition. Such investigations are conducted jointly with the National Development and Reform Commission and the State Administration for Industry and Commerce, whose responsibilities include the enforcement of mainland China's Anti-monopoly Law.

3.11 Finally, in certain jurisdictions such as Russia and South Africa, liner shipping agreements have never benefited from a specific exemption from competition law and are subject to the general competition regime.[23]

---

[20] See the Competition (Block Exemption for Liner Shipping Agreements) Order, issued in 2006 and extended by the Competition (Block Exemption for Liner Shipping Agreements) (Amendment) Order 2010 and the Competition (Block Exemption for Liner Shipping Agreements) (Amendment) Order 2015.

[21] See Competition (Block Exemption for Vessel Sharing Agreements and Voluntary Discussion Agreements in respect of Liner Shipping Services) Order 2014; and Malaysia Competition Commission, Press release, *MyCC Grants Conditional Block Exemption in Respect of Liner Shipping Agreements for Another Two Years*, 21 June 2017.

[22] See the State Council's Regulations of the People's Republic of China on International Maritime Transportation, which has been in force since 2002, and the implementing rules promulgated by the Ministry of Transport in 2003.

[23] See OECD, *Competition Issues in Liner Shipping*, Contribution from Russian Federation, June 2015; and OECD, Competition Issues in Liner Shipping, Contribution from South Africa, June 2015.

Form and basis of exemptions

3.12 In jurisdictions such as the EU, Malaysia and Singapore, exemptions are the result of a block exemption regime similar to that in Hong Kong. The relevant block exemptions have been issued on the basis that the agreements covered satisfy a specific efficiency exemption comparable to the efficiency exclusion in the Ordinance. In the case of Singapore, the relevant exemption does not contain an express requirement for efficiencies to be passed on to customers, though this issue may in practice be taken into account in applying the exemption. The block exemption order is issued by a government minister as designated under the Singapore Competition Act 2004 following a recommendation from the Competition Commission of Singapore ("**CCS**") (rather than by the CCS itself).

3.13 In other jurisdictions, the exemptions are the result of specific statutory provisions, and have not necessarily been granted on the basis that particular economic efficiency tests are met. Examples of this approach include Australia, Canada, Japan, New Zealand, South Korea and the United States.

3.14 Under both types of regime, the exemption may be accompanied by a requirement that the relevant agreements be filed with a designated authority in order to enjoy the benefit of the exemption. In some jurisdictions, that designated authority or another authority reserves the power to investigate the filed agreements in certain circumstances. Relevant exemptions may also be subject to market share limits and other conditions.

Reviews of exemptions for liner shipping agreements

3.15 The relevant exemption regimes have been subject to a number of reviews and reforms by competition authorities and other bodies in recent years. These include the following:

(a) In the United States, the Ocean Shipping Reform Act of 1998 made certain amendments to the system of exemption under the Shipping Act of 1984, including a requirement that conference members be permitted to enter into confidential and individual service contracts with shippers. A similar requirement was introduced to the Canadian regime in 2001 by way of amendments to the Shipping Conferences Exemption Act, 1987.

(b) In 2002, the Organisation for Economic Cooperation and Development ("**OECD**") released a report on competition policy in

liner shipping, in which it examined the traditional justifications for exemption for liner shipping agreements. It recommended the repeal of antitrust exemptions for rate-fixing and rate discussions while maintaining exemptions for operational arrangements to the extent that they did not permit excessive market power.[24]

(c) Shortly afterwards, the EU launched a review of its previous block exemption for conference agreements ("**EU Conference BER**").[25] This resulted in the repeal of the block exemption in 2006, subject to a transitional period of two years.[26] Similarly, in Israel, a longstanding statutory exemption providing immunity for international conference and other liner shipping agreements was repealed in 2010, while the block exemption for consortia was adopted in its place.[27] In India, a previous exemption for VDAs has not been included in the relevant government notifications since 2013, such that only VSAs benefit from an exemption today.[28]

(d) In New Zealand, a Commerce (Cartels and Other Matters) Amendment Bill was introduced to Parliament in 2015, which if enacted will repeal the competition regulation in the Shipping Act 1987 and the exemption in the Commerce Act 1986. Liner shipping agreements would then be subject to the general competition regime under the oversight of the New Zealand Commerce Commission.[29] An amendment recently tabled to the Bill proposed the introduction of a targeted block exception for international liner shipping, which largely covers the same VSA activities as those falling within the scope of the Order.[30]

---

[24] OECD, *Competition Policy in Liner Shipping Final Report*, 16 April 2002.

[25] See Council Regulation 4056/86 of 22 December 1986 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport.

[26] See Council Regulation 1419/2006 of 25 September 2006 repealing Council Regulation 4056/86.

[27] See OECD, *Annual Report on Competition Policy Developments in Israel*, 2010; and OECD, *Annual Report on Competition Policy Developments in Israel*, 2012.

[28] United Nations Economics and Social Commission for Asia and the Pacific, Policy Brief, *Shipping Block Exemption from Competition Law*, 2015.

[29] OECD, *Competition Issues in Liner Shipping*, Contribution from New Zealand, June 2015.

[30] Supplementary Order Paper No 343, released on 6 July 2017. The proposed block exception would provide exemption from the prohibitions against anti-competitive agreements and cartels in the Commerce Act 1986, subject to certain conditions.

(e) With respect to Australia, a 2015 review of its competition laws (known as the Harper Review) recommended that the statutory exemption be repealed, and instead a block exemption granted by the Australian Competition and Consumer Commission should be available for liner shipping agreements meeting a minimum standard of pro-competitive features.[31] The Australian Government response to the Harper Review indicated that it "remained open" to this recommendation.[32]

3.16 In some cases, it has been decided not to make substantive amendments to the existing regime following relevant reviews:

(a) In Singapore, for example, the block exemption order for liner shipping agreements which was originally granted in 2006 was reviewed by the CCS in 2010 and 2015. In both instances, the CCS recommended that the relevant Singapore government minister renew the block exemption order on the same terms as previously.

(b) The Japan Fair Trade Commission ("**JFTC**") conducted a review of the antitrust exemptions for international ocean shipping under Japanese law in 2016.[33] While the JFTC concluded that there was no case for maintaining the exemptions from a competition law perspective, the Japanese transport ministry decided to leave the exemptions in place for the time being.[34]

(c) The Malaysia Competition Commission recently held a public consultation on its existing block exemption order,[35] following which it decided to issue a further block exemption order for VSAs and VDAs for a period of two years. With respect to VDAs, the block exemption continues to be subject to the condition that there is no element of price fixing, price recommendation or tariff imposition.

---

[31] See "Recommendation 4 – Liner shipping" in *Competition Policy Review Final Report*, March 2015.

[32] *Australian Government Response to the Competition Policy Review*, 2015.

[33] JFTC, *Review of the System for Exemption from the Antimonopoly Act for International Ocean Shipping*, February 2016. The types of arrangements under review included conferences, discussion agreements, consortia and car-carrier agreements.

[34] Japanese Ministry of Land, Infrastructure, Transport and Tourism, Press release of 14 June 2016.

[35] Malaysia Competition Commission, Public Consultation, *Proposed Block Exemption for Vessel Sharing Agreements and Voluntary Discussion Agreements in Respect of Liner Shipping Services*, 11 May 2017.

Summary

3.17 In general, VSAs continue to benefit from exemptions from competition law in a number of jurisdictions. With respect to VDAs, the picture is more nuanced. Exemptions for conference agreements and/or VDAs remain in place in certain jurisdictions. However, a number of jurisdictions and organisations which have reviewed the rationale for exemptions for conference agreements and/or VDAs in recent years have concluded that they do not merit exemption, including the European Union, India, Israel and the OECD.

3.18 In Malaysia and Singapore, block exemption orders have been granted in respect of VDAs and VSAs, though in the case of Malaysia pricing-related conduct by parties to such agreements is not covered. In certain jurisdictions, such as Australia and New Zealand, there have been proposals that VDAs and/or VSAs become subject to the general competition regime. Other jurisdictions have never granted exemptions from competition law for liner shipping agreements.

4 COMMISSION ASSESSMENT OF APPLICATION

4.1 FRAMEWORK FOR ANALYSIS

4.1 In order to issue a block exemption order in respect of a particular category of agreement, the Commission must be satisfied that the category of agreement is excluded from the first conduct rule by or as a result of the efficiency exclusion in section 1 of Schedule 1 to the Ordinance.

4.2 The efficiency exclusion only applies where the following four cumulative criteria are met:

(a) the agreement contributes to improving production or distribution, or promoting technical or economic progress;

(b) consumers receive a fair share of the resulting benefit;

(c) the agreement does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the objectives stated at point (a); and

(d) the agreement does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question.

4.3 Further detail on each of the above conditions is provided in the Annex to the Commission's *Guideline on the First Conduct Rule* ("**FCR Guideline**").[36]

4.4 As noted in the FCR Guideline, the efficiency exclusion covers all objective economic efficiencies, including cost efficiencies and qualitative efficiencies.[37] Examples of efficiencies related to 'improving production or distribution' include lower costs from longer production or delivery runs, or from changes in methods of production or distribution, improvements in product quality, or increases in the range of products produced.[38] Efficiencies resulting from the promotion of 'technical progress' may include efficiency gains resulting from economies of scale and increased effectiveness in research and development.[39]

[36] FCR Guideline, Annex, paragraphs 2.6 to 2.21.

[37] FCR Guideline, Annex, paragraph 2.8.

[38] FCR Guideline, Annex, paragraph 2.11.

[39] FCR Guideline, Annex, paragraph 2.12.

4.5 The burden of proving that each of the cumulative conditions of the efficiency exclusion is satisfied rests with the undertaking(s) seeking the benefit of the exclusion.[40] This equally applies in the context of undertakings or associations of undertakings applying for a block exemption order. It is also not necessary for the Commission to come to a final conclusion on whether the conduct in question contravenes the first conduct rule before the application (or non-application) of the efficiency exclusion can be determined.

4.6 Against this framework, the Commission's conclusions on the application of the four conditions of the efficiency exclusion to VSAs and VDAs are set out in Parts 4.2 and 4.3 which follow.

4.2 VESSEL SHARING AGREEMENTS

Assessment of potential competitive harm

4.7 VSAs involve agreements between competitors in the liner shipping industry to cooperate on certain aspects of their operations. Some of this cooperation, particularly regarding the sharing of capacity and/or coordinating of the respective services of the parties, could potentially lead to competition concerns.

4.8 Such concerns include the following:

(a) VSAs could entail a reduction in service variety as between parties to a VSA, where services which would otherwise be provided by parties independently are provided jointly. In particular, the provision of a joint service by VSA members could have the result that customers have fewer choices in terms of port calls, choice of terminal, vessel speed and other service parameters on which shipping lines might compete.

(b) VSAs could potentially allow their members to restrict capacity in a market, and thus achieve higher rates, where the VSA members together have market power. In particular, where a VSA involves the provision of joint services, carriers may jointly decide on the allocation of capacity on a particular trade covered by the VSA. Carriers could potentially decide to allocate less capacity to their joint service in an effort to maintain higher rates, i.e., by reducing capacity the VSA members may no longer need to compete as vigorously to fill

[40] FCR Guideline, Annex, paragraph 2.4.

their vessels, leading to increased rates. This would particularly be the case where the carriers are not subject to sufficient competition from outside the VSA, such that there is not enough available capacity outside the VSA to be able to defeat a rate increase.[41]

(c) VSAs may involve the sharing of competitively sensitive information, in particular where used to plan the services to be offered under the VSA. Such information could relate, for example, to costs, capacity and vessel deployment (though not rates or surcharges). A carrier might have less incentive to compete and/or might be able to reach a coordinated outcome more easily where it has access to detailed and current information on the performance of individual competitors in the VSA in areas such as costs and capacity.[42] Of course, the particular carrier would not gain access to information on the performance of non-VSA members on the trade. Thus, the sharing of competitively sensitive information would be more likely to give rise to decreased incentives to compete and/or facilitate a coordinated outcome where non-VSA members do not exert sufficient competitive pressure on the VSA (i.e., the VSA members together exercise market power).

4.9 In summary, VSAs could potentially enable a softening of competition as between VSA members. Where VSA members are not subject to sufficient competition from outside the VSA, this could in turn lead to higher prices than would otherwise be the case on the trade in question.

4.10 The Commission therefore considers that VSAs are agreements between undertakings which could potentially harm competition in contravention of the first conduct rule in the Ordinance. Certain of the representations received in the section 16 consultation echoed the Commission's competition concerns. Such representations mentioned, for example, concerns around capacity management or restrictions and reductions in service differentiation by VSA members, in particular where large VSA alliances are concerned (though in some cases there was little substantiation of the arguments put forward in this respect).

[41] While the likelihood of this scenario arising might be at present reduced on some trades in light of the overcapacity which exists, the Commission's decision in respect of the Application must also take account of the possibility that market conditions may be more favourable in the future.

[42] See also paragraphs 5.26 to 5.28 below in relation to the Applicant's supplementary submission, which provide further explanation as to why the sharing of competitively sensitive information in these areas may decrease carriers' incentive to compete and/or facilitate coordinated behaviour.

4.11 However, in general VSAs are unlikely to result in significant harm to competition, unless the VSA activities allow members to enjoy some degree of market power. In particular, VSAs do not provide for joint marketing or pricing of services, which means that VSA members still compete with each other (as well as with non-VSA members) on price and other competitive parameters such as customer service. The VSAs examined by the Commission also do not involve the parties directly agreeing on prices or the allocation of markets or customers.

4.12 The extent of potential harm to competition is a relevant factor in determining whether a category of agreement satisfies the cumulative conditions of the efficiency exclusion. The more significant the harm or likely harm to competition, the greater the efficiencies generated by the agreements, and the more compelling the evidence that these efficiencies are passed on to consumers, must be.

4.13 Taking the above into account, the Commission's assessment of whether VSAs meet each of the four conditions of the efficiency exclusion is set out in paragraphs 4.20 to 4.91 below. As a preliminary matter, the Commission provides an explanation for the basis for the market share limit which is included in the Order.

Market share limit

4.14 The Commission included a market share limit in the Proposed Order, which meant that the Proposed Order would apply where the combined market shares of the parties to a VSA did not exceed a threshold of 40% (or 45% in certain circumstances).[43]

4.15 In the section 16 consultation which followed, the Applicant and another party submitted that a market share limit was not necessary and that the Commission had failed to explain sufficiently the basis for requiring a market share limit. It was also argued that should the Commission continue to maintain that a market share threshold is necessary, it should consider increasing the threshold in line with the approach taken in Singapore.[44] Certain of the other representations received in the section 16 consultation were in favour of a market share limit, and indeed suggested that the threshold of 40% might be too high.

[43] See paragraph (8) of the Proposed Order and the accompanying commentary in paragraphs 5.16 to 5.22 of the Statement of Preliminary Views.

[44] In Singapore, the relevant block exemption order applies a market share threshold of 50%. Liner shipping agreements (including VSAs) which exceed this threshold are required to be filed with the CCS, but do not lose the benefit of the block exemption.

4.16 As a general matter, it is only appropriate to offer the benefit of a block exemption order where there is sufficient certainty that the potential harm to competition which arises does not outweigh any efficiencies created by the agreements. The Commission considers that such certainty arises only in respect of VSAs which do not exceed the market share limit. This is particularly the case since, as will be outlined further below, it has not been possible to verify fully certain of the efficiency claims put forward by the Applicant in respect of VSAs.

4.17 The Commission has already explained above the ways in which VSAs could potentially harm competition, and noted that such harm would be more likely to arise where VSA members are not subject to sufficient competition from outside the VSA.

4.18 In the Order, the market share limit of 40% will ensure that each VSA is subject to competition from at least two other VSAs or independent parties in each relevant market in order to benefit from block exemption. At this level of concentration, the Commission considers there is sufficient certainty that no VSA will enable its members to exercise market power, and thus that the competitive harm outlined above is unlikely to arise. The Commission does not see a particular need to impose a lower market share limit for these purposes.

4.19 In addition, as a general proposition, the efficiencies which are said to arise from VSAs are likely to be passed on to a greater extent to consumers where the parties to the VSA are subject to effective competition. This would include for example the cost savings which are claimed to arise from the use of larger vessels through VSAs. Thus, where parties to the VSA do not exceed the market share limit, the Commission considers the relevant efficiencies are likely to be passed on to a greater extent to consumers.

Application of the efficiency exclusion

First condition: the agreement contributes to improving production or distribution or promoting technical or economic progress

4.20 According to the Applicant, VSAs result in:

(a) increased quality of service, through broader service coverage and higher service frequency;

(b) cost efficiencies;

(c) decreased costs of entry and expansion;

(d) increased efficiencies in the utilisation of port capacity; and

(e) environmental benefits.

4.21 The Commission accepts that operational cooperation through VSAs could potentially give rise to certain improvements in production or distribution and/or the promotion of technical or economic progress within the meaning of the first condition. The Commission's assessment in this respect is set out below.

Broader service coverage and higher service frequency

4.22 According to the Applicant, a VSA allows the individual shipping lines which are party to the VSA to offer their customers broader service coverage and higher service frequency than they would be able to offer if operating alone. In the case of a fully integrated VSA, for example, a shipping line may be able to offer services or slots on all vessels within the VSA and to all points served by the VSA members collectively.

4.23 As indicated in the FCR Guideline, improvements in product quality and increases in the ranges of products produced (which, in the context of services, would include broader service coverage and higher service frequency) may be considered to be examples of improvements in production or distribution for the purposes of the efficiency exclusion.[45]

4.24 The Commission has therefore considered whether VSAs could allow shipping lines to offer customers broader service coverage and higher service frequency than if the lines were operating alone. In addition, VSAs could potentially facilitate transshipment traffic, which relies on a high degree of connectivity. These issues are assessed in sub-sections (a) and (b) which follow.

(a) <u>Ability to offer customers broader service coverage and higher service frequency</u>

4.25 The Commission recognises that high levels of investment and the ability to guarantee a fixed schedule are required for an individual carrier to provide a scheduled service on a particular trade. For example, to offer a regular weekly service on a long-distance route, such as between Europe and Asia, takes in general eight or nine similarly sized ships.[46] Significant financial resources are required to

[45] FCR Guideline, Annex, paragraph 2.11.

[46] OECD, *Competition Issues in Liner Shipping*, Contribution from European Union, June 2015, paragraph 26.

operate a vessel, with the purchase price for larger vessels today typically in excess of US$100 million.[47] It is possible that carriers, particularly smaller ones, would be unable or unwilling individually to offer such a regular service on a number of routes.

4.26 As VSAs allow carriers to obtain access to slots on other carriers' services (through slot charter or slot exchange arrangements) and/or pool their vessels with those of other carriers to provide a joint service on a particular trade or trades, an individual carrier may be able to offer a wider range of services and frequencies to their customers than would otherwise be the case.

4.27 This efficiency claim, as put forward by the Applicant, focuses on how an individual carrier can expand the range of services offered to customers through a VSA. It is true that this could potentially give rise to certain benefits from the customer's perspective. For example, a customer could obtain access to the services of multiple carriers while avoiding the need to purchase such services separately from each carrier. This could conceivably save the customer the time and resources associated with negotiating multiple arrangements, and could lead to lower prices as the customer can contract the entirety of its volumes with a single carrier.

4.28 However, while an individual carrier might be able to expand the range of services offered to customers through a VSA, it would do so by offering the existing services of other carriers. It can therefore be queried whether the VSA in fact leads to any increase in the service coverage and higher frequencies in the market as a whole (which would generally be more relevant to determining whether an efficiency arises). That would be the case, for example, if there were certain routes where a joint service is provided through a VSA, but the individual VSA members would be unwilling or unable to operate the service on a standalone basis without the VSA.

4.29 The data provided by the Applicant in support of this efficiency claim focuses on the increase in service coverage which an individual carrier can offer its customers. The Commission notes the example provided by the Applicant in relation to the increase in services which […] was able to offer its customers on the Asia to North Europe trade after it joined […].

[47] […]

Table 4.1: Comparison of [...] Asia to North Europe services before and after it joined [...]

	[...] access to services before it joined [...]	[...] access to services after it joined [...]	Change (%)
Number of weekly services [(1)]	**2**	**6**	**+200%**
Asia port calls per week	**15**	**33**	**+120%**
European port calls per week	**9**	**24**	**+167%**

Source: Data provided by the Applicant from Drewry Maritime Research

Note: (1) Excludes slot charter services

4.30 Table 4.1 shows that the weekly Asia to North Europe services which [...] was able to offer increased threefold after it joined [...]. This resulted in an increase of its Asia port calls per week from 15 to 33, and an increase in its European port calls per week from 9 to 24.

4.31 In its representation in the section 16 consultation, the Applicant also provided data on the proportion of a carrier's cargo on particular trades or routes which are carried on the vessels of other VSA members.

Table 4.2: Proportion of cargo carried by VSA partners vs. own ships

Trade name	Average % of total cargo carried on a VSA partner's vessels (1 January 2016 to 30 June 2016)
Transpacific eastbound trade (Asia to US West Coast)	[...]%
Transpacific eastbound trade (Asia to US East Coast)	[...]%
Transpacific westbound trade (US West Coast to Asia)	[...]%
Transpacific westbound trade (US East Coast to Asia)	[...]%
Asia to Europe eastbound trade (Europe to Asia)	[...]%
Asia to Europe westbound trade (Asia to Europe)	[...]%

Source: Data provided by the Applicant based on individual data collected from [...] carriers

4.32 Table 4.2 shows that a significant proportion of the cargo of the carriers in question was carried on another VSA member's vessel on each of these trades, with an overall average of approximately [...]%.

4.33 The ability of VSAs to increase service coverage and frequencies in the market as a whole has been less well substantiated (which may in part be explained by the fact that VSAs have been in place on certain trades for a long time, limiting the number of 'counterfactual' scenarios which could be examined). In this respect, the Applicant has mentioned the potential adverse effects if a particular shipping line no longer participated in a VSA (such as a reduction in the frequency of vessel calls and number of destinations offered). It indicated that the same principles would work in the broad and apply across the whole industry when considering the position of multiple carriers (as opposed to the perspective of an individual carrier only). It sought to illustrate by way of hypothetical scenario, though did not provide particular data in this respect.

4.34 With respect in particular to the claim that VSAs lead to an increased number of service frequencies in the market as a whole, the Commission has not been able to verify whether this is in fact the case. In the Statement of Preliminary Views, the Commission noted that VSAs might lead to the consolidation of individual carriers' services on certain routes (for example, through the rationalisation of two less-than-full vessels into a single full vessel).[48] While this could result in certain cost

[48] Statement of Preliminary Views, paragraphs 4.31 to 4.32.

efficiencies, which are further examined in paragraph 4.45 to 4.48 below, it would also imply an adverse impact on service frequencies as a whole. Certain of the representations received in the section 16 consultation alluded to the effect of VSAs on frequencies, indicating for example that VSAs might reduce frequencies but also that additional frequencies might not in any event benefit customers. The Commission considers that, in the absence of further substantiation, there are at least some doubts as to whether VSAs would generally increase the number of service frequencies on a particular trade.

4.35 In summary, the Commission accepts that VSAs may enable individual carriers to offer their customers broader service coverage and higher service frequency than would be the case if they operated alone. In theory, it is possible that VSAs would also result in greater service coverage and a higher number of frequencies in the market as a whole, though the Commission has not been able to verify by reference to specific empirical evidence whether this is in fact the case. It is not, however, necessary to come to a final determination on the latter element of the claimed efficiency, since the market share limit which will apply in the Order gives the Commission adequate comfort that the potential harm to competition arising from VSAs will not outweigh any efficiencies which may result for the purposes of the first condition.

(b) Impact of VSAs on transshipment traffic

4.36 The Applicant and a number of parties which participated in the Commission consultations have referred to the importance of maintaining Hong Kong's status as a transshipment hub. The Port of Hong Kong relies to a significant extent on transshipment traffic, with transshipment container cargo accounting for the majority of total container transport in Hong Kong. It is argued that Hong Kong importers and exporters may benefit from this as they have access to a greater number of liner shipping services than would otherwise be the case. That is, without the presence of transshipment cargo, it might be expected that the frequency and coverage of services in Hong Kong would be reduced. The Applicant and other parties consider that consumers and the wider Hong Kong economy benefit from Hong Kong's status as a transshipment hub, as transshipment brings considerable economies of scale to the maritime industry (in turn leading to improved infrastructure and higher levels of employment in the maritime industry and related professional services sectors).

4.37 For present purposes, the Commission assesses whether VSAs could facilitate transshipment to the benefit of the direct users of liner shipping services, such as

importers and exporters. It does not consider it necessary to also assess the benefits to the wider Hong Kong economy which are said to arise from VSAs.

4.38 The Commission is of the view that, if it is indeed the case that VSAs may lead to broader service coverage and higher frequencies in the sense described above, it is conceivable that VSAs would also contribute towards maintaining levels of transshipment traffic in Hong Kong. The availability of a significant geographic network and a high number of frequencies are widely accepted as important factors in the attractiveness of a port as a transshipment hub.[49] Certain parties which participated in the preliminary consultation referred to the contribution of VSAs in ensuring the attractiveness of Hong Kong as a hub for transshipment in view of these factors. The Commission agrees that increased transshipment traffic would benefit Hong Kong importers and exporters by ensuring a greater volume of liner shipping services in Hong Kong than might otherwise be the case.

4.39 In addition, VSAs could potentially facilitate transshipment to the benefit of liner shipping customers in other ways. For example, the ease with which transshipment cargo may be loaded onto and unloaded from different carriers' vessels would seem likely to be increased where those carriers form part of a VSA. In its representation in the section 16 consultation, the Applicant mentioned that VSAs could enable the costs of moving cargo onto a connecting vessel to be shared among a greater volume of cargo, thus reducing unit costs. This might be the case, for example, where the cargo of multiple members of a VSA could be loaded onto a single barge headed for the same vessel.

4.40 The Commission has not received particular empirical evidence to the effect that VSAs facilitate transshipment, but accepts at least in principle that VSAs might facilitate transshipment traffic in the ways outlined above. In doing so, VSAs could be considered to contribute to "improving production or distribution" for the purposes of the efficiency exclusion.

Cost efficiencies arising from economies of scale

4.41 The Applicant has suggested that VSAs help to bring about economies of scale, which in turn lead to cost efficiencies. In particular, the Applicant submits that VSAs permit the operation of very large, modern vessels, which entail lower fuel

[49] See, for example, Hong Kong Maritime Industry Council report, *Study on the Strategic Development Plan for Hong Kong Port 2030*, Executive Summary prepared by BMT Asia Pacific, October 2014, section 3.3 ("Competitiveness for International Transshipment").

costs per TEU.[50] Such large ships would not be practicable or efficient if they could not be filled – which might be the case if carriers did not share space on such vessels through VSAs and instead operated such ships independently. This, it is submitted, has also allowed fewer, but larger, vessels to call at Hong Kong, while at the same time maintaining capacity levels. In essence, the level of services required by shippers can be provided, while reducing any potentially uneconomical duplication of services.

4.42 The Commission accepts that larger and more efficient vessels entail cost savings for carriers, as vessel operating costs per TEU carried will be lower. Cost savings resulting from economies of scale may be categorised as promoting 'technical progress' for the purposes of the efficiency exclusion.[51]

4.43 For example, according to data cited by the OECD, it is estimated that the cost of bunker fuel per TEU carried is 35% lower in the case of 'ultra large container ships' than a typical 13,100 TEU vessel.[52] The Applicant has also provided the following chart to demonstrate the impact of vessel size on a carrier's slot cost per TEU.[53]

Chart 4.1 Impact of vessel size on slot costs

[…]

4.44 In principle, the Commission accepts that VSAs may be expected to facilitate the use of larger and more efficient vessels, since they may help to ensure high utilisation rates. The fact that multiple carriers may obtain slots on a particular vessel may be expected to allow each vessel's capacity to be used to the greatest extent possible. This may in turn ensure that economies of scale are realised in practice. The Commission understands that the introduction of ultra large vessels on major trades may also give rise to a 'cascade effect' by increasing the size of vessels used on other, secondary trades (which are generally characterised by the use of smaller vessels than on the major trades). In particular, the vessels which have been replaced on the major trades may be put into operation on secondary trades, which

[50] 'TEU' refers to Twenty Equivalent Unit and is the standard size of a 20 foot long container.

[51] FCR Guideline, Annex, paragraph 2.12.

[52] OECD, Note by the Secretariat, *Competition Issues in Liner Shipping*, June 2015, paragraph 23, citing data from Drewry (2013).

[53] Ships costs are usually expressed in terms of unit slot cost (e.g. the cost of transport for 1 TEU per day).

may facilitate cost savings from the use of larger vessels than those previously in use on those secondary trades.

4.45 In addition, cost savings may also potentially be achieved by reducing the uneconomical duplication of activities through the use of a smaller number of vessels. For example, the rationalisation of two less-than-full vessels into a single full vessel on a certain route may be expected to lead to an avoidance of waste and a corresponding reduction in carriers' overall operational costs (although this does imply there may be a reduction in frequencies, as noted in paragraph 4.34 above). Operational costs for these purposes may include vessel costs, voyage and crewing costs, fuel costs, and port-related costs.

4.46 In the Statement of Preliminary Views, the Commission indicated that further empirical evidence demonstrating that VSAs have led to or lead to cost savings from the use of larger vessels and/or as a result of higher utilisation rates on particular vessels would assist the Commission in formulating a final view in relation to this efficiency claim.[54]

4.47 In its representation in the section 16 consultation, the Applicant provided a comparison of the estimated costs of two similarly sized carriers, one that participates in a major VSA alliance ([…]) and one that does not ([…]), based on data from Drewry Maritime Research. According to the Applicant, across the three trades where there are complete datasets, the VSA alliance carrier's slots are cheaper than the non-VSA alliance carrier's by:

(a) […]% on the Asia-East Coast North America trade;

(b) […]% on the Asia-Mediterranean trade; and

(c) […]% on the Asia-West Coast North America trade.

4.48 While there are necessarily some differences in the services operated by the two carriers on the trades, making a fully reliable comparison of costs impossible, the data from the Applicant does provide some support for the proposition that VSAs lead to lower per unit costs for individual carriers.

Decreases in the costs of entry and expansion

4.49 The Applicant has argued that VSAs may decrease the costs of entry and expansion required for carriers to commence services or expand services on a

[54] Statement of Preliminary Views, paragraph 4.32.

particular route, thus lowering barriers to entry and expansion in the market. By way of example, the Applicant indicates that if […] had not joined […], it would have had to spend around an additional US$[…] million a year to increase its number of weekly services on the Asia to North Europe route from two to six. By joining […], […] gained space on the alliance's six weekly services, without the need to absorb any additional costs (see further paragraphs 4.29 to 4.30 above).

4.50 From the perspective of facilitating entry or expansion, it can be noted that offering capacity on another carrier's vessel on a trade is not the same as entry or expansion involving the provision of an entirely new scheduled service. In addition, there appears to be some overlap between this claimed efficiency and the efficiency discussed above in respect of a broader service coverage and higher service frequency attributable to VSAs.

4.51 Nonetheless, the Commission sees some merit in the claimed efficiency. While the ability of a carrier to offer capacity on competitors' services through a VSA may not necessarily increase the overall capacity on a particular trade, the addition of another carrier operating on that trade or offering a particular scheduled service would in principle increase competition in respect of the trade or service in question. For a carrier wishing to expand its existing service offering, participation in a VSA might be a cost-efficient way to do so.

4.52 As mentioned, a large capital investment is required to purchase a sufficient number of ships to operate a service on a particular trade. VSAs would permit carriers to offer additional services without the same vessel commitment as operating independently, and thus potentially lower the costs of increasing their service offering. This feature of VSAs could be significant for smaller carriers in particular, which might, if operating on their own, be unlikely to provide certain of the services they can offer to customers as a result of their participation in a VSA.[55]

4.53 A limited number of parties which participated in the Commission's consultations argued that the claimed increase in competition on particular trades or scheduled services may not occur as VSAs have the effect of driving out smaller

[55] While the Commission recognises that smaller carriers may not have sufficient scale to be admitted to a large strategic alliance, a range of less integrated VSAs may be available for these carriers (including simple slot exchange or slot charter agreements). By providing access to slots on other carriers' vessels, such VSAs could conceivably enable smaller carriers to compete on specific trades they would not be able to serve without the VSA. In this sense, VSAs could reduce smaller carriers' costs of increasing their service offering. The number of carriers able to offer a service on a route or trade, and in turn the degree of competition on that route or trade, might thus be expected to increase.

carriers generally, mentioning examples of bankruptcies of non-alliance smaller carriers and acquisitions of smaller carriers by larger carriers after joining a VSA. However, the Commission considers that it has not been demonstrated that such occurrences are the result of VSAs (as opposed to a reflection of market forces). To the extent that smaller carriers remain independent entities, they may be able to benefit from the lower costs of increasing their service offering associated with VSAs. Examples of smaller carriers participating in VSAs (and which today remain independent) include Pacific International Lines (PIL), Sinokor Merchant Marine, and Wan Hai Lines.

4.54 In the Statement of Preliminary Views, the Commission indicated that it would benefit from further examples of carriers, particularly small ones, expanding their service offering by entering into VSAs and thus increasing competition on particular routes. In its representation in the section 16 consultation, the Applicant provided the following details of VSAs entered into by a smaller carrier, […], in the period from 2005 to 2017.[56]

Table 4.3: Expanded service offering available through entering VSAs, VSAs involving […] between 2005 and 2017

[…]

Source: Data provided by the Applicant

4.55 The data provided by the Applicant suggests that the carrier in question has been able to increase its service offering on the trades covered by the relevant VSAs with a relatively small amount of vessels, since it has access to significant additional capacity on the vessels of its VSA partners. While this may not in itself demonstrate that the relevant VSAs have led to entry or expansion involving the provision of an entirely new scheduled service on a trade, it does provide support for the contention that VSAs may enable a carrier to increase their existing service offering at a lower cost than by operating independently.

Conclusion on the first condition

4.56 The Commission has assessed the efficiency claims mentioned above, the submissions received in the Commission consultations, and the additional data provided by the Applicant in the section 16 consultation in respect of VSAs. While it

[56] The Applicant also provided an extract of sample text from a VSA Memorandum of Understanding between a small carrier and a large carrier, which is said to show that the smaller carrier could offer a sevenfold increase to its customers in the frequency of services offered on a particular route.

has not been possible to verify fully all of the efficiency claims discussed, the Commission has concluded on balance that VSAs which do not exceed the market share limit can be considered to satisfy the first condition of the efficiency exclusion. In reaching this conclusion, the Commission has noted that the potential competitive harm arising from VSAs would be unlikely to outweigh any efficiencies they produce under the first condition for those VSAs falling within the market share limit in the Order.

4.57 It is not proposed to discuss the other efficiency claims raised by the Applicant in respect of the first condition. However, the Commission considers it is conceivable that VSAs would improve the utilisation of port capacity and may result in environmental benefits, as submitted by the Applicant.

Second condition: consumers receive a fair share of the resulting benefit

4.58 The efficiency exclusion requires that consumers receive a fair share of the efficiencies claimed by the parties and generated by the agreement or category of agreements in question.[57]

4.59 In this respect, the notion of a 'fair share' means that the benefits accruing to consumers must at a minimum compensate them for the actual or likely harm to competition associated with the relevant restrictive agreement. While the parties need not demonstrate that consumers receive a share of every efficiency gain, the overall impact for consumers must at least be neutral and parties must demonstrate that this is the case.[58] For present purposes, consumers comprise users of liner shipping services such as shippers, consignees, freight forwarders, logistics companies and other customers.

Broader service coverage and higher service frequency

4.60 According to the Applicant, efficiencies in terms of broader service coverage and higher service frequency will be passed on to customers.

4.61 As elaborated above, the Commission accepts in principle that VSAs could enable an individual carrier to offer broader service coverage and higher service frequency to its customers (though it is not clear that such benefits would arise in respect of the market as a whole). If such efficiencies do arise, they could be expected in and of themselves to benefit customers (i.e. the broader service

[57] FCR Guideline, Annex, paragraph 2.13.

[58] FCR Guideline, Annex, paragraph 2.15.

coverage and higher service frequency which arise would by definition be 'passed on' to customers). A number of parties which participated in the preliminary consultation, including users of liner shipping services, agreed that VSAs increase service coverage.

4.62 A limited number of parties have, however, voiced concerns regarding the extent to which these efficiencies are in fact generated, and thus passed on to customers, in light of the levels of market concentration on, for example, trades which are characterised by a small number of large strategic alliances. One party submitted, for example, that while VSAs in theory do enable carriers to provide shippers with broader service coverage when compared to operating alone, shippers do not always enjoy the benefits of broader services as carriers in larger VSAs may have *de facto* control over supply in the market and refrain from deploying larger vessels at certain ports.

4.63 As a general matter, the Commission believes that the concerns about market concentration arising from changes in alliance membership which have been raised in the Commission consultations should be adequately addressed by the market share limit in the Order. The presence of the market share limit would also help to ensure that any efficiencies generated by VSAs are in fact passed on to consumers. Further explanation of the market share limit is provided in paragraphs 4.14 to 4.19 above.

Lower freight rates

4.64 The Applicant has argued that cost savings to carriers from better utilisation of vessel space are passed on to customers in the form of lower freight rates. In support of this, the Applicant has referred to a decline in average freight rates of 4% to 13% on various China routes since 2008, and submits it is extremely unlikely that this decline would have been possible without the cost efficiencies brought about by VSAs.[59]

4.65 The Commission notes the evidence in support of VSAs leading to cost savings generally (see further paragraphs 4.43 to 4.48 above). The Applicant has referred specifically to certain cost savings from the use of larger ships, such as in respect of fuel, which would generally be characterised as variable costs.

4.66 The Commission has not received particular empirical evidence demonstrating the pass on of these cost savings from VSAs to customers. As a

[59] These figures are based on data from the Shanghai Shipping Exchange.

matter of general economic principle, however, the more effective the competition to which they are subject, the more VSA members will be incentivised to pass on more of the variable cost savings they may enjoy as a result of VSAs to customers. The presence of effective competition will mean that carriers can be expected to attempt to win customers by passing on a more variable cost efficiencies in the form of lower prices.

4.67 As mentioned, the Order applies only to VSAs where parties do not exceed a particular market share limit, which should ensure that any VSAs covered by the block exemption would be subject to effective competition. Certain parties which participated in the section 16 consultation agreed that the Commission should include a market share limit in any block exemption for VSAs to help guarantee the increased pass through of any cost savings to customers.

Greater choice of carriers

4.68 The Applicant has argued that VSAs may decrease the costs for individual carriers of entering a new trade or expanding their existing service on a particular trade (especially where smaller carriers are concerned). VSAs could allow such carriers to offer new or additional services without incurring the more significant costs associated with providing a service on an individual basis.

4.69 The empirical evidence provided by the Applicant in this respect appears to relate mainly to carriers increasing their existing offering on a trade through joining a VSA (i.e., by being able to offer the additional frequencies of their VSA partners to customers). The Commission accepts that this could benefit customers by allowing them to choose from a greater choice of carriers for particular scheduled services. It is noted in this regard that carriers would continue to compete on price and market their services separately when operating pursuant to a VSA.

4.70 As to whether VSAs would facilitate the establishment of new scheduled services on a particular trade, the Commission accepts that the decreased costs associated with VSA arrangements could in principle assist in this respect, though the empirical evidence available to the Commission is less clear on this point. Customers could of course benefit if such new entry were to arise, since the level of competition on the trade as a whole would increase.

Conclusion on the second condition

4.71 The Commission has concluded that consumers of liner shipping services would be likely to receive a 'fair share' of at least some of the efficiencies generated

by VSAs, for those VSAs which do not exceed the market share limit in the Order. For such VSAs, the benefits accruing to customers are likely to compensate them for any actual or likely harm to competition which may occur.

Third condition: indispensability to the attainment of efficiencies

4.72 The third condition requires that the agreement does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the relevant efficiencies. As explained in the FCR Guideline, this means that the restrictions in question are "reasonably necessary to attain the efficiencies" and that there is no other "economically practicable and less restrictive means of achieving the efficiencies".[60]

4.73 The potential restrictions on competition arising from VSAs appear to be reasonably necessary to attain the efficiencies claimed under the first condition, as outlined above. Among the VSAs the Commission has examined, the various aspects of those agreements which may potentially be considered to restrict competition – such as the exchange of slots, pooling of resources, the joint operation of a service and the exchange of information on capacity and other operational matters – are, as a general matter, directly related to the operation of the VSAs. It might therefore be expected that, without such arrangements, the efficiencies claimed in respect of VSAs would not be achieved.

4.74 In any event, to ensure that the benefit of a block exemption order is limited to activities that are indispensable to the attainment of the relevant efficiencies, the Order permits certain specified activities related to VSAs but excludes from the scope of the exemption conduct such as price fixing, customer allocation and output limitation (other than capacity adjustments in response to fluctuations in supply and demand). Any other activities conducted within the context of a VSA are permitted to the extent that they are ancillary to the primary activities of the VSA as elaborated in the Order. Thus, while the exchange of information in relation to certain operational matters (for example, information on capacities) may be permitted as an ancillary activity under the Order, information exchange in relation to prices charged to customers would not. In addition, parties to VSAs must be permitted to withdraw from the VSA on providing a period of notice, which must be both reasonable and agreed by the VSA members. These conditions aim to ensure that only restrictions which are reasonably necessary for the attainment of the efficiencies resulting from the operation of VSAs fall within the scope of the Order.

[60] FCR Guideline, Annex, paragraphs 2.16 to 2.17.

4.75 There also does not appear to be an economically practicable and less restrictive means of achieving the efficiencies claimed. The Commission agrees with the Applicant's submission that a merger between carriers – which could be one alternative means of achieving the relevant efficiencies – would have a more restrictive effect on competition than VSAs.

4.76 As another alternative, it could be argued that the use of simple slot charter and slot exchange agreements alone would be a less restrictive means of achieving efficiencies than the use of all forms of VSAs (which would include more integrated arrangements such as alliances). Slot charter and slot exchange agreements could be said to have less potential to harm competition than more integrated VSAs, since the former do not involve the provision of joint services (see further paragraph 2.28 above).

4.77 However, it is possible that the provision of joint services through more integrated VSAs would achieve additional efficiencies compared to the use of slot exchange or charter agreements alone. For example, the operation of a joint service could give rise to cost savings and permit VSA members to offer additional frequencies or routes to their customers (which they might be unwilling or unable to provide on an individual basis). In contrast, where slot exchange or slot charter agreements are used, carriers continue to operate their services on an individual basis (while exchanging or purchasing space on each other's services). This would suggest that the use of all forms of VSAs should be permitted (subject to the conditions of the Order) in order to achieve the full range of VSA efficiencies claimed.

4.78 The Commission has not received particular evidence that more integrated forms of VSAs could achieve additional efficiencies compared to the use of simpler forms of VSA, but it accepts at least in principle that this could be the case based on the above reasoning.

4.79 In any event, taking into account the conditions which are included in the Order, the Commission believes that restrictions on competition resulting from the VSA activities permitted by the Order can be considered to be indispensable to the attainment of the efficiencies claimed in respect of with VSAs.

Fourth condition: no possibility of eliminating competition

4.80 The fourth condition of the efficiency exclusion requires that parties to the relevant agreement demonstrate that their agreement does not afford them the possibility of eliminating competition in respect of a substantial part of the goods or

services in question. As outlined in the FCR Guideline, the weaker the state of existing competition in the market, the smaller any further reduction in competition would need to be for competition to be eliminated. Similarly, the greater the harm to competition caused by an agreement, the greater the likelihood that the undertakings concerned are afforded the possibility of eliminating competition.[61]

4.81 The Commission notes, first, the degree of concentration on major trade routes and with respect to Hong Kong is relatively moderate. According to recent data provided by the Applicant, there were between […] and […] carriers with market shares of 5% or more operating on the three largest trades which include Hong Kong, and the highest market share of any carrier on these trades was below 35%.[62] With respect to the North-East Asia to Australia and intra-Asia trades, there were […] carriers with market shares of 5% or more operating on the trades, and the highest market share of any carrier on these trades was below […].[63]

4.82 In any event, as mentioned, the benefit of a block exemption order will be available only in respect of VSAs where the parties to the agreement do not exceed the market share limits in the Order.

4.83 Second, VSAs, as permitted under the Order, will not permit carriers to agree on the prices charged to their customers, to restrict output (except insofar as capacity adjustments in response to fluctuations in supply and demand are concerned), to allocate customers, or to engage in joint marketing or pooling of revenues. As such, parties to VSAs may still compete for customers on such key parameters as price (and the impact on price from capacity adjustments made through VSAs should be limited given the restrictions within the Order on such adjustments). A number of parties which participated in the Commission consultations, including users of liner shipping services, confirmed that there is indeed competition for customers both between members of a VSA and between carriers within a VSA and carriers outside the VSA.

4.84 The Commission has therefore reached the conclusion that VSAs within the scope of the Order would not afford parties to such agreements the possibility of eliminating competition in respect of liner shipping services.

---

[61] FCR Guideline, Annex, paragraphs 2.18 to 2.19.

[62] The trades in question are the following: Transpacific, Asia to North Europe, and Asia to Mediterranean. […]

[63] The relevant market share figures are based on data from, respectively, […] and […] and calculated based on cargo liftings per carrier in 2016.

Conclusion with respect to VSAs

4.85 Based on the above, the Commission has decided to issue a block exemption order in respect of VSAs (that is, the Order). In particular, the Commission has concluded that VSAs fulfil the four conditions of the efficiency exclusion, provided that they do not exceed the market share limit and meet other conditions set out in the Order.

4.86 In reaching this decision, the Commission has considered the representations concerning VSAs received during the section 16 consultation. The Commission notes that while certain parties raised concerns considering particular aspects of VSAs, which appeared mostly to stem from the increasing levels of consolidation among alliances on particular trades, no party objected outright to the issue of a block exemption order for VSAs. The Commission has taken similar concerns into account in its assessment of the potential competitive harm arising from VSAs, but considers that such concerns are likely to outweigh any efficiencies which might apply, for VSAs which do not exceed the market share limit.

4.87 Finally, a block exemption order for VSAs can be expected to provide greater legal certainty for parties covered by the order. Without a block exemption order, there may be a risk that such parties would refrain from participating in VSAs due to concerns about their legality. If this were the case, the efficiencies which may arise from the agreements would not be realised.

4.88 In addition, in the case of sector specific block exemptions, the Applications Guideline refers to a greater need for cooperation between undertakings in the relevant sector as compared with other sectors in the economy.[64] The particular features of the liner shipping industry outlined above, which have led to capacity sharing and the other forms of operational cooperation which occur in VSAs, may be noted in this regard.

Terms of the Order

4.89 The Order adopts the same provisions as the Proposed Order which formed the subject of the section 16 consultation, with some minor drafting adjustments. The Guidance Note published with the Order provides further explanation as to the provisions of the Order.

[64] Applications Guideline, paragraph 5.4.

4.90 The terms of the Proposed Order generally attracted only a limited amount of commentary in that context, with the exception of the market share limit which was proposed (see further paragraphs 4.14 to 4.19 above).

4.91 Certain parties also suggested that a block exemption order for VSAs should include an effective procedure to allow the Commission to monitor VSAs and/or a pre-notification mechanism whereby VSAs above a particular market share would be required to be notified to the Commission. The Commission notes that it would retain the right to exercise its investigative and enforcement powers where parties to a VSA engage in conduct which does not meet the terms of the Order and it has reasonable cause to suspect or reasonable cause to believe, as the case may be, a contravention of the Ordinance. More generally, it has the ability to review the terms of the Order at any time it considers appropriate in accordance with section 19(2) and 19(3) of the Ordinance. On this basis, the Commission does not consider the further monitoring mechanisms proposed to be necessary.

4.3 VOLUNTARY DISCUSSION AGREEMENTS

Assessment of potential competitive harm

4.92 VDAs consist of information sharing agreements between independent competitors in the liner shipping industry which cover particular trades. In this context, the issuing of recommended pricing guidelines and the exchange of information on pricing offered to customers through VDAs may give rise to significant competition concerns under the Ordinance.

4.93 VDAs also involve the exchange of other commercial information, as well as certain general and/or publicly available information. Since such information forms the focus of the revised VDA scope put forward in the Applicant's supplementary submission, the Commission's assessment in respect of this information is provided in Part 5 below. This Part 4.3 focuses on the efficiency claims put forward in respect of VDAs in the original Application, which related mostly to the pricing aspects of VDAs, as well as the claimed need for regulatory alignment regarding the treatment of VDAs under regional competition laws.

4.94 As indicated in the FCR Guideline, recommended fee scales or reference prices of an association of undertakings may be considered to have the object of harming competition, even where they are not binding.[65] In addition, where competitors share information on their future individual intentions or plans with

[65] FCR Guideline, paragraph 2.36.

respect to price in particular, as may be the case under VDAs, the Commission would likely consider this as having the object of harming competition.[66] The sharing of competitively sensitive pricing information between competitors and the agreement of recommending pricing guidelines may give rise to competition concerns for a number of reasons.

4.95 In particular, where carriers discuss and exchange rate information amongst themselves and formulate recommended rate guidelines, this is a form of coordination on prices which could as a matter of principle give rise to the possibility of higher rates compared to the situation where carriers make pricing decisions independently of each other. Conceptually, carriers would be more likely to introduce rate increases where they are aware in advance through discussions with their competitors that the latter will also introduce rate increases (and the level of such increases), since the risk of losing customers through a unilateral price increase would be avoided. The publication of a VDA rate guideline may also allow a number of carriers to announce a price increase at the same time, further increasing the likelihood of carriers proposing rate increases (even though the VDA guideline is not itself binding).

4.96 In this respect, the Commission is not suggesting that the pricing-related activities of VDAs necessarily lead to high prices in some absolute sense, but rather higher prices than would otherwise be the case absent such activities. Indeed, the Applicant's argument that VDAs 'mitigate against unsustainable prices', which is further addressed in paragraph 4.122 below, itself suggests that VDAs allow for the possibility of higher prices for customers than would otherwise be the case. As such, although certain parties which participated in the Commission consultations referred to data suggesting that freight rates have been in decline on trades which provide for VDAs, this would not allay the competition concerns identified by the Commission, given that such data does not show the position relative to trades without VDAs.

4.97 In addition, the Commission's decision in respect of the Application must take account of the possibility that market conditions may be more favourable in the future. Although it is possible, as the Applicant claims, that current market conditions mean that VDAs cannot successfully be used to achieve higher rates than on trades without VDAs (since carriers may be forced to accept lower rates in light of overcapacity in the market), this may not be the case if future market conditions are more favourable to carriers.

[66] FCR Guideline, paragraphs 6.39 and 6.40.

4.98 The Commission therefore considers that the elements of VDAs concerning recommended pricing guidelines, and the exchange of information on pricing charged to customers, amount to agreements and/or concerted practices between undertakings which could potentially harm competition in contravention of the first conduct rule in the Ordinance.

4.99 In the paragraphs which follow, it is considered whether VDAs meet each of the four conditions of the efficiency exclusion, based on the efficiency claims put forward in the original Application. Given that the pricing-related aspects of VDAs may give rise to significant competition concerns, the Commission considers that any efficiencies in this context must be particularly clear cut and that the evidence of consumer benefit would need to be compelling. In this respect, it is not for the Commission to substantiate the possible harm to competition which may arise from VDAs, but rather for the Applicant, as the party seeking the benefit of a block exemption order, to provide clear evidence of the efficiencies that are claimed to outweigh such possible harm.

Application of the efficiency exclusion

First condition: the agreement contributes to improving production or distribution or promoting technical or economic progress

4.100 According to the Application, the efficiencies brought about by VDAs are as follows:

(a) rate stability;

(b) service stability; and

(c) rate and surcharge transparency.

4.101 The Application also submits that it is necessary to permit VDAs in Hong Kong in order to ensure Hong Kong's regulatory regime remains aligned with those of China, the United States and other trading partners of Hong Kong. It is argued that, if Hong Kong's regulatory regime were to become misaligned or less hospitable to VDAs, it might become a less attractive hub for transshipment compared to other ports in the region. As such, VDAs are said by the Applicant to ensure the benefits of transshipment, in terms of connectivity and economies of scale, for Hong Kong's maritime industry.

4.102 In its representation in the section 16 consultation, the Applicant maintained that VDAs also give rise to the following 'broad' efficiencies: (a) the broad efficiency

to the Hong Kong economy of VDAs promoting a super-connector maritime shipping centre and Hong Kong role in the One Belt One Road initiative of the People's Republic of China; and (b) the broad efficiency to the Hong Kong economy of VDAs promoting transhipment services in Hong Kong. These efficiency arguments were also put forward in the Applicant's supplementary submission, and are included under the assessment of the supplementary submission in Part 5 below (see paragraphs 5.31 to 5.40).

Rate stability

4.103 According to the Application, VDAs encourage rate stability by allowing parties to a VDA to discuss prices and agree on voluntary rate recommendations. It is said that, by facilitating discussions on rates, VDAs lead to a consensus between carriers on rates which is in between the higher and lower ends of the scale, which helps to moderate volatility. The Application suggests that rate stability amounts to an efficiency under the first condition of the efficiency exclusion as it gives customers certainty regarding the level of shipping rates over a particular period, thus allowing them to plan their ocean transportation costs over that period. In addition, from the carriers' perspective, rate stability is said to reduce uncertainty associated with the viability of future investment, thus increasing the likelihood of investments in new capacity where demand exceeds supply. It is implied by the Applicant's argument that VDAs, by facilitating rate stability, contribute to "improving production or distribution" for the purposes of the efficiency exclusion.

4.104 In order to assess this claim, the Commission must examine (a) whether rate stability amounts to an efficiency for the purposes of the first condition in the present case; and (b) whether the evidence put forward by the Applicant demonstrates that VDAs in fact result in rate stability.

(a) <u>Whether rate stability amounts to an efficiency</u>

4.105 Based on the material provided by the Applicant, it seems unlikely that rate stability would amount to an efficiency for the purposes of the first condition in the present case.

4.106 It can be noted that price or rate stability which is the result of coordination between competitors could generally be expected to entail rates for customers which are higher than would otherwise be the case (as explained in paragraph 4.95 above). The Applicant's own suggestion that VDAs help mitigate against 'unsustainable rates' implies that VDAs in fact enable higher prices than would otherwise be the case (see further paragraph 4.122 below). In addition, customers

wishing to achieve rate stability may seek to enter into service contracts with the rates in such contracts fixed for the period of the contract (see further paragraph 4.145 below). Thus, customers have a means of achieving stable rates under the ordinary competitive process, without the need for carriers to discuss and agree recommendations on pricing through VDAs.

4.107 In order to conclude that the rate stability which is said to arise from VDAs amounts to an efficiency by facilitating customer planning of ocean transportation costs, it would need to be demonstrated that customers prefer and benefit from stable rates arising from VDAs to a greater extent than the harm they may suffer as a result of the possibility of higher rates (including, for example, by reference to the specific characteristics of the industry). Otherwise, any form of price coordination between competing undertakings (including cartel conduct) might be argued not to contravene the Ordinance on the basis that it gave rise to price stability from the perspective of the customer.

4.108 The Commission does not have any evidence that customers would receive sufficient or any benefit from the rate stability which is said to result from VDAs. Some customers who participated in the preliminary consultation agreed that they value rate stability generally as it enables them to better plan ocean transportation costs. However, such customers may have the option of entering into a fixed rate contract, as previously mentioned. In any event, a number of parties (including the Applicant) also acknowledged that rate stability was less of a concern for other customers. These customers may wish to build some rate volatility into their contracts with carriers because they believe, based on their predictions of future market conditions, that such volatility will in the long run benefit them by having to pay less overall for ocean transportation costs. These latter customers include freight forwarders, logistics companies and other intermediaries which, since they have their own customers, may wish to increase or decrease their rates to their customers in response to short term changes in the market.

4.109 With regard to the claimed efficiency for suppliers (namely that reduced pricing uncertainty facilitates investment), this suggests that, without VDAs, investment would be too low due to uncertainty. This would require convincing evidence that a market without VDAs would lead to underinvestment that would be to the detriment of customers. The Commission again does not have sufficient evidence that this is the case. In any event, carriers wishing to benefit from greater rate stability in order to reduce the uncertainty surrounding their investment decisions have the option of seeking to enter into fixed rate service contracts with their customers. Again, such contracts would provide a means for carriers to achieve

stable rates under the ordinary competitive process, without the need for pricing discussions and recommendations involving competing carriers as occur under VDAs.

(b) Whether VDAs in fact result in rate stability

4.110 Even if the Commission were satisfied that rate stability amounts to an efficiency under the first condition, it would still be necessary to demonstrate that VDAs in fact bring about this claimed efficiency in order to satisfy the first condition of the efficiency exclusion. As stated in the FCR Guideline, an undertaking relying on the efficiency exclusion must provide convincing evidence of the relevant efficiencies, which must be objective in nature, and convincing evidence of "a direct causal link between the efficiencies and the agreement".[67] In the Commission's view, the Applicant has not done so.

4.111 First, the evidence put forward by the Applicant does not clearly support a finding that VDAs give rise to greater rate stability. The Application relies on a comparison of rate volatility in EU trades (i) before and after the repeal of the EU Conference BER; and (ii) against the non-EU trades where VDAs are in operation. According to the Application, container freight rates have been more volatile since the repeal of the EU Conference BER (which also covered rate discussions) in October 2008.

4.112 The data provided by the Applicant and the feedback from a number of parties which participated in the Commission consultations provide some support for the position that there is a greater degree of volatility on Europe to Asia trades following the repeal of the EU Conference BER than on other trades. However, the question still arises as to whether there is a causal link between this greater volatility and the absence of rate discussions on EU trades.

4.113 In this respect, a number of alternative explanations for the comparatively higher level of rate volatility on EU trades may exist (both compared to the situation on EU trades before the repeal of the EU Conference BER and compared to non-EU trades).[68] As the Applicant itself recognises, the period after the repeal of the EU Conference BER coincided with the global financial crisis, which saw container volumes and subsequently freight rates plummet in 2009 and then rise sharply in 2010 as carriers idled ships in order to survive. In addition, a number of parties which participated in the preliminary consultation indicated that the problem of

[67] FCR Guideline, Annex, paragraph 2.7 (emphasis added).

[68] The Applicant has submitted that rate volatility on EU trades is not caused by Euro currency fluctuation. The Commission has not sought to contest this.

overcapacity resulting from the presence of ultra large ships combined with weak demand has been more pronounced on European than other trades, leading to greater volatility in rates. With respect to the Transpacific trade in particular, some parties also referred to the prevalence of long-term service contracts as a further reason why freight rates are less volatile than on the Asia to Europe trade.

4.114 The Applicant does not explain why the greater volatility on EU trades following the repeal of the EU Conference BER should be attributed (either in part or in whole) to the repeal itself, as opposed to the global financial crisis or the other factors mentioned. The 2012 study prepared by the US Federal Maritime Commission ("**FMC Study**") bears out the alternative explanations for the comparatively higher level of rate volatility on the Asia to Europe trade than on the Transpacific trade.[69] Without more, the arguments and evidence provided by the Applicant are not sufficient to establish a causal link between the repeal of the EU Conference BER and the alleged greater degree of rate volatility on EU trades, or by extension that VDAs directly cause rate stability and/or mitigate rate volatility. The Applicant has also not provided sufficient additional substantiation of its arguments to this effect in its subsequent submissions to the Commission.

4.115 Second, the Commission's own assessment and feedback received during the Commission consultations suggest that VDAs may not in fact have the claimed moderating effect on the rates sought by carriers, and may possibly undermine rate stability in certain respects.

4.116 VDAs provide carriers with a forum to discuss planned GRIs or other rate increases with their competitors, and may lead to the issuing of recommended guidelines by the VDA in respect of such rate increases (which in effect amount to coordinated announcements of recommended price increases). Conceptually, VDAs should therefore lessen the risk of losing customers and other uncertainties which would be inherent if carriers make rate increase decisions on an individual basis. In addition to the GRI mechanism, the Applicant has indicated that if the rates specified in VDA guidelines increase or decrease during the term of a particular service

[69] Federal Maritime Commission Bureau of Trade Analysis Staff Report, *Study of the 2008 Repeal of the Liner Conference Exemption from European Union Competition Law*, January 2012. As noted by the Applicant, the FMC Study indicates there appears to have been an increase in rate volatility in EU trades, and states that this result "suggests the possibility that the activities on discussions agreements in the Far East to US trade may have had a dampening effect on rate volatility" (emphasis added) (FMC Study, page *x*). However, the FMC Study also notes that other factors, such as the prevalence of annual contracts in the Far East to US trade and the difficulty in redeploying very large vessels from the Far East to North Europe trade, may also have contributed to the differences in rate volatility (FMC Study, page *x*).

contract, one of the parties may ask the other for an amendment to the contract to align with such changes (though such changes may be subject to negotiation and mutual agreement of the parties). Therefore it is possible that VDAs facilitate or incentivise carriers to ask for GRIs and other rate increases from their customers, which may tend to undermine rate stability. Indeed certain interested parties put forward the view that GRIs announced through VDAs create more rate volatility than might otherwise be the case.

4.117 The Applicant has also indicated that carriers rarely manage to obtain the full amount of a GRI announced through VDAs from customers, and may obtain a rate increase far below the VDA guideline. Far from moderating the rates which carriers seek from customers by avoiding excessively high or low rates (as claimed by the Applicant), this suggests that VDAs may in fact lead to carriers seeking rate increases significantly above what the market can accept. Indeed, in one example cited by the Applicant, a voluntary GRI of US$[…] per 40 foot container was announced on the Shanghai to Los Angeles trade in 2013, but in the end average rates in fact reduced by US$[…] per 40 foot container.[70] The Applicant has also stated that, in most cases, rates decrease to the levels which applied before the GRI, or even below that, within two to three weeks after the VDA-announced GRI.

4.118 This again can be taken to suggest that the system of GRI announcements through VDAs may in fact contribute to rate volatility or at least be ineffective as a means of moderating rate volatility. It is also not clear to the Commission why, as was subsequently suggested by the Applicant, regular GRIs through VDAs should still be considered as a means of reducing volatility even though individual recommended GRIs such as those referred to in paragraph 4.117 did not result in long term stability.

Service stability

4.119 The Applicant argues that VDAs result in more reliable and frequent services through improved access to trade information (such as third party reports and internal statistics based on data provided by VDA members). With greater visibility of demand, supply and cost trends, individual carriers are said to be able to make better decisions on vessel deployment and investment in tonnage and infrastructure. VDAs are also said to improve service stability by ensuring continued services for customers through 'mitigation of unsustainable rates'. According to the Applicant, unsustainable rates would mean that many carriers would be unable or unwilling to

[70] Based on data from the World Container Index and Drewry on announced vs actual increases in freight rate from Shanghai to Los Angeles from Mid-2011 to Mid-2014.

make necessary long-term investments or could even be forced into bankruptcy, to leave a trade or to consolidate. It is thus implied by the Applicant that VDAs, by facilitating the maintenance of a high level of services for customers, contribute to "improving production or distribution" under the efficiency exclusion.

4.120 While the maintenance (or improvement) of service levels could be considered to contribute to "improving production or distribution" for the purposes of the efficiency exclusion, the Applicant's arguments with respect to service stability are not sufficient to fulfil the first condition in this case.

4.121 First, with regard to the claim that improved access to information through VDAs facilitates vessel deployment and investment decisions, the better decisions which are said to result in reality seem to flow from the reduction of strategic and competitive uncertainty when carriers obtain detailed commercial information on their competitors (see further paragraphs 5.29 to 5.30 below). In addition, the comparison between EU and other routes which is relied on in the Application to show generally that service levels are better on routes where VDAs are permitted does not in itself establish that VDAs improve service levels, as further discussed in paragraphs 4.123 to 4.126 below.

4.122 Second, it must be queried whether the alleged 'mitigation against unsustainable rates' fulfills the first condition of the efficiency exclusion. This claim suggests that, absent VDAs, freight rates could fall below a level that would ensure an appropriate level of investment and/or that would allow carriers to remain in the market, thus negatively impacting service stability. However, the argument that VDAs mitigate against unsustainable prices necessarily suggests that they allow for the possibility of higher prices for customers than would otherwise be the case. To substantiate this efficiency claim, very convincing evidence would be required that customers benefit from the alleged higher investment levels and/or non-exit of carriers to a greater extent than the harm they may suffer as a result of higher prices. The Commission does not have any evidence that this is the case. In any event, to the extent that this argument suggests that higher prices can be used to subsidise inefficient firms, this would not amount to an economic efficiency.

4.123 Third, the Applicant has referred to a comparison between the conditions on EU trades before and after the repeal of the EU Conference BER, and between the conditions on EU and Transpacific trades, in order to demonstrate that VDAs result in service stability.

4.124 With respect to the argument that service schedule reliability is better on the Transpacific trade (where VDAs are permitted) than on the Asia to Europe trade, the

Applicant relies on the fact that in the period following the repeal average schedule reliability was slightly higher at […]% for the Transpacific trade compared to […]% for the Asia to Europe trade (which is the same as the overall industry average). There may be a number of possible reasons for this difference, such that the figures quoted are not in themselves sufficient evidence that greater schedule reliability is the result in whole or in part of the presence of VDAs. In any event, the minimal difference between the two figures, and the fact that the figure for the Asia to Europe trade is still in line with the industry average, can equally suggest that the absence of VDAs on a particular route has had limited or no impact in terms of schedule reliability.

4.125 The Applicant has also suggested in the Application and a subsequent submission that the repeal of the EU Conference BER has led to (i) a reduction in the number of competitors, (ii) greater industry concentration and (iii) a reduction in the number of weekly services on the Asia to Europe trade. In this regard, the data provided by the Applicant suggests that such trends were less pronounced (though still present) on the Asia to Europe trade prior to the repeal, and have been less pronounced (though again still present) on the Transpacific trade.[71] However, this is not sufficient to demonstrate that the absence of rate discussions on the Asia to Europe trade since 2008 is itself responsible in whole or in part for any of these differences (which are in any event relatively minor). Among other things, the Applicant has not attempted to take account of the effects of the global financial crisis, or differences in market dynamics between the Asia to Europe and Transpacific trades which were mentioned in the 2012 Study and the preliminary consultation (see further paragraphs 4.113 to 4.114 above), which could equally account for such differences.

4.126 On this basis, the comparison between the conditions on EU trades before and after the repeal of the EU Conference BER, and between conditions on the EU and Transpacific trades, is not in itself sufficient to establish that VDAs result in service stability.

Rate and surcharge transparency

4.127 The Applicant argues that rate guidelines issued through VDAs promote transparency by providing a starting point for rate negotiations between shippers

[71] For example, according to data provided by the Applicant from Drewry Maritime Research, the number of competitors on the Asia to Europe route dropped by […]% in the period from January 2005 to the repeal of the EU Conference BER, and by […]% in the period after the repeal to January 2015. The share controlled by the top 10 carriers (measured by capacity deployed per annum) has increased from […]% to […]%in the past 10 years on the Asia to Europe route, compared to from […]% to […]% on the Transpacific trade.

and carriers. It submits that it would be overly burdensome for a shipper to source alternative information on prevailing market rates by itself. VDAs also issue guidelines and permit the establishment of common formulas for calculating surcharges, which is said to promote transparency by allowing shippers to compare different carriers' surcharges more easily and to provide a transparent policy for such charges. The Applicant also maintains that the transparency resulting from the publication of recommended guidelines on the level of surcharges leads to moderation and a cost-based approach as regards the level of the surcharges.

4.128 It may be questioned whether the alleged transparency to which VDA guidelines and formula are said to give rise can be considered an efficiency for the purposes of the efficiency exclusion. If this were the case, any price recommendations by associations of undertakings might be argued not to contravene the Ordinance so long as they were issued publicly and therefore gave rise to increased price transparency from the perspective of the customer. It is not clear to the Commission that the particular characteristics of the liner shipping industry, which were referred to in the Applicant's representation in the section 16 consultation, justify the exchange of price information and creation of pricing guidelines by competing carriers in order to ensure transparency for customers.

4.129 Any transparency to which VDA guidelines might give rise from the customers' perspective would appear to be outweighed by the fact that the relevant guidelines facilitate the levying or introduction of rate increases and surcharges by carrier members on customers in the first place. This is the case even though an individual carrier may ultimately not obtain the level of the rate or surcharge specified in a VDA guideline from their customers (though information provided in the preliminary consultation suggests that customers often have little ability to negotiate on surcharges).

4.130 Indeed, evidence provided by the Applicant shows that VDA discussions in relation to particular events affecting the liner shipping industry have led to the coordinated introduction of specific *ad hoc* surcharges by VDA members (such as port congestion surcharges, war risk surcharges, low water surcharges and fumigation surcharges).[72] In addition to these *ad hoc* surcharges, a number of

[72] The Applicant has also mentioned VDA discussions in relation to the handling of particular problems and events arising in the liner shipping industry which did not result in the imposition of a surcharge. For example, following VDA discussions regarding piracy cases off the Horn of Africa, VDA members liaised with the International Maritime Organisation, and convoys under protection of naval ships were implemented in the Indian Ocean. Such exchanges of information would be unlikely to pose competition concerns and thus could be carried out between carriers regardless of whether VDAs meet the conditions of the efficiency exclusion.

common surcharges such as BAF, CAF and THCs mentioned in paragraph 2.13 above, can be subject to VDA guidelines (although there is some evidence to suggest that such surcharges are less likely to be the subject of VDA guidelines than previously). Although it may be the case, as the Applicant has sought to emphasise to the Commission in its representation in the section 16 consultation, that carriers will impose surcharges as a necessary way to recover their costs with or without VDAs, the collective action made possible through VDAs can clearly be expected to reduce the risk associated with the introduction or increase of particular surcharges on an individual basis, and thus facilitates carriers introducing or increasing the relevant surcharges.

4.131 With regard to the alleged moderating effect of recommended guidelines on surcharges which are issued, the Applicant has referred to increases in THCs observed in the EU following the repeal of the EU Conference BER.[73] Even if the repeal of the EU Conference BER was responsible for the increases in THCs (which is open to question), it would seem that VDAs increasingly do not issue guidelines or common formula for THCs in any event.[74]

4.132 Finally, even if the alleged transparency arising from VDA rate and surcharge guidelines could be accepted as an efficiency, there are doubts as to the extent to which such guidelines in fact result in transparency from the perspective of customers.

4.133 With respect to VDA guidelines on rates, the Applicant indicates that parties can and do deviate from the recommended VDA rates, which suggests that in practice the VDA guidelines will often not reflect actual market rates. Although the Applicant has suggested that negotiations between shipping lines and customers may refer to GRIs published through VDAs as a benchmark, certain users of liner shipping services which participated in the preliminary consultation indicated that, at least with respect to freight rates, VDA guidelines may not even be referred to as part of the relevant rate negotiations. Other sources of information, such as the publicly available data from the Shanghai Shipping Exchange, were considered to be a more commonly used and more useful reference point for customers in Hong Kong

[73] The Applicant refers to a report by Mr. Ben Hackett, on behalf of Raven Trading Limited, *Terminal handling charges during and after the liner conference era*, October 2009. The report was commissioned by the European Commission.

[74] The Commission notes that the Transpacific Stabilisation Agreement (a key VDA on the Transpacific trade) no longer provides guidelines or a common formula for THC for Asian origin countries, since lines have increasingly chosen to adjust their THCs on an individual basis.

wishing to obtain insight on current market rates for the purposes of negotiations with carriers.

4.134 With respect to VDA guidelines on surcharges, certain surcharges are set by individual carriers outside of VDAs (even on routes where VDAs enjoy exemptions from competition law). Carriers may also adopt their own formula for the calculation of common surcharges such as bunker fuel surcharges. Carriers will often make their list of surcharges publicly available (for example, on their website). It is thus not clear what additional transparency the publication of VDA guidelines on surcharges brings, in circumstances where carriers can and do set their own surcharges and make them publicly available.

Ensuring the benefits of transshipment for Hong Kong

4.135 The Applicant has argued that it is necessary to provide a block exemption for VDAs in order to ensure that the Hong Kong regulatory regime remains aligned with those of its trading partners, thus ensuring that the efficiencies associated with Hong Kong's status as a transshipment hub (connectivity and economies of scale) are maintained. A number of parties which submitted representations in the section 16 consultation put forward similar views.

4.136 The Commission does not accept that these arguments can be taken into account for the purposes of applying the efficiency exclusion.

4.137 The submissions suggests that, if Hong Kong's regulatory regime does not permit VDAs, Hong Kong would become a less attractive hub for transshipment compared to other ports in the region (and by implication that transshipment traffic might therefore leave Hong Kong). However, these arguments merely amount to an assertion that shipping lines find a consistent or particular approach to regulation to be a relevant consideration in assessing whether a given location might serve as a transshipment hub. They do not concern any particular efficiency created by VDAs as such. Insofar as the Applicant has subsequently suggested that it is the access to comprehensive market information enabled by VDAs which facilitates Hong Kong's status as a transshipment hub, it has not been sufficiently demonstrated that access to such information would have this effect, for the reasons outlined in paragraph 5.31 to 5.40 below.

4.138 In any event, the views submitted in the Commission consultations give rise to doubts as to the extent to which the issuing or non-issuing of a block exemption order for VDAs would impact on levels of transshipment activities in Hong Kong. According to several of the parties consulted, factors such as the frequency of

services and connectivity, cost, geographical location, port and terminal characteristics, customs procedures and cabotage restrictions, seem to play a much greater role in influencing the choice of transshipment hub locations.[75] Even among those in favour of a block exemption for VDAs, it has been noted that VDAs have little to do with transshipment *per se*. It is also not clear to the Commission on what basis the absence of a block exemption order for VDAs would be a factor which tips the balance in the decision of a shipping line as to which transshipment hub to use.

4.139 On the other hand, the Commission acknowledges that VSAs may have some impact in facilitating transshipment traffic (see further paragraphs 4.38 to 4.40 above). As already noted, the Commission has decided to issue a block exemption order for VSAs.

Conclusion on the first condition

4.140 Based on the efficiency claims put forward by the Applicant in its original Application, the Commission has concluded that it has not been shown that VDAs fulfil the first condition of the efficiency exclusion.

Second, third and fourth conditions

4.141 Since an agreement must fulfil each of the conditions of the efficiency exclusion in order to benefit from the exclusion, it is not necessary to consider whether the remaining conditions are met. For completeness, the Commission notes in the paragraphs which follow that it is also unlikely that the second and third conditions in particular would be satisfied.

4.142 With respect to the second condition, since the Commission's assessment suggests that VDAs would be unlikely to give rise to the claimed efficiencies in terms of rate stability, service stability or rate and surcharge transparency, it is not possible for any such efficiencies to be passed on to customers for the purposes of this condition.

4.143 More generally, VDAs permit discussions between carriers and the issuing of voluntary guidelines, which may facilitate the introduction of rate increases and surcharges as discussed above. It is difficult to see how VDAs can benefit customers in this respect. In addition, as mentioned in paragraph 4.97 above, while current market conditions may mean that VDA guidelines cannot successfully be used to achieve higher rates due to the presence of overcapacity, this may not be the case in

[75] Such factors are also listed in the Hong Kong Maritime Industry Council report, cited in footnote 49 above, in Executive Summary, section 3.3.

the future if market conditions are more favourable to carriers. The Applicant acknowledges that surcharges are a way for carriers to recover certain ongoing costs and/or costs incurred by ad hoc, interim or temporary events (as opposed to the carrier bearing such costs itself). By facilitating the passing on of such costs to customers through joint discussions and guidelines on surcharges, VDAs again cannot be said to benefit customers.

4.144 With respect to the third condition, even if it were assumed that the claimed efficiencies arise, there would likely be other "economically practicable and less restrictive means" of achieving them.[76] As such, the restrictions on competition to which VDAs give rise seem unlikely to be indispensable to the attainment of efficiencies.

4.145 For example, customers desiring a greater degree of rate stability may be able to enter into an individual service contract with a carrier for a particular period of time.[77] Customers may seek to have the rates in such contracts fixed for the period of the contract (as opposed to, for example, being linked to a particular index or the carrier's tariff). Depending on their bargaining power, some customers may also be able to refuse to agree to clauses permitting GRIs or other rate increases during the term of the contracts. Contracts of this nature may thus protect customers from the risk of rate volatility (whether up or down).

4.146 In this sense, individual service contracts with rates fixed for the duration of the contract represent an economically practicable, less restrictive – and more effective – way for parties to achieve rate stability. Even if, as maintained by the Applicant, fixed rate service contracts are not used by many customers in practice, this does not minimise the fact that there are clearly alternative means of achieving rate stability available which would be less restrictive of competition, and in any event this suggests that rate stability may not in fact be as important an efficiency for customers as claimed.

4.147 In addition, in so far as rate and surcharge transparency for shippers is concerned, it is doubtful to what extent the publication of VDA rate and surcharge guidelines can be considered 'indispensable' to the attainment of this efficiency. There is a wide variety of publicly available information on many issues of relevance to shippers. Based on the Applicant's submissions and the views received from

[76] FCR Guideline, Annex, paragraphs 2.16 to 2.17.

[77] The basic contracting cycle for most carriers operating in the Transpacific trade is from 1 May to 30 April. On this and all trades, however, contract cycles may also be monthly, quarterly, annual, or for some other defined period of time, depending on the negotiations between the relevant parties.

interested parties, it appears that carriers and shippers can and do refer to such information in their negotiations regarding liner shipping services.

4.148 It is also not clear that the information sharing aspects of VDAs are indispensable to the efficiencies in terms of service stability which are claimed to arise from the perspective of carriers, as further outlined in Part 5 below (see paragraphs 5.45 to 5.47).

4.149 Finally, with respect to the fourth condition, the FCR Guideline notes that "the more an agreement causes harm to competition, the greater the likelihood that the undertakings concerned are afforded the possibility of eliminating competition".[78] As noted in paragraph 4.94 above, pricing recommendations (even where non-binding) and the exchange of information between competitors on future individual intentions or plans with respect to price may be considered to have the object of harming competition. As such, certain aspects of VDAs may be considered to increase the likelihood that their members have the possibility to eliminate competition.

4.150 Whether this is in fact the case depends, among other things, on the state of competition in the market. In this respect, it is of relevance that the degree of concentration on key trades including Hong Kong is relatively moderate (see paragraph 4.81 above). However, since the Commission's assessment suggests that the preceding conditions in the efficiency exclusion would not be fulfilled, it is not necessary to make a final conclusion on this point (i.e., the efficiency exclusion would not apply to VDAs regardless of whether or not the fourth condition is met).

Conclusion with respect to VDAs

4.151 Based on its assessment of the Application and the subsequent submissions received, the Commission has concluded that the Applicant has not demonstrated that the VDA-related efficiencies claimed in the original Application meet the terms of the efficiency exclusion. As will be outlined in Part 5 which follows, the Commission also considers that the information sharing activities carried out under VDAs have not been shown to meet the terms of the efficiency exclusion. The Commission has therefore not included VDAs in the scope of the Order.

4.152 In reaching this conclusion, the Commission has taken account of the representations received in respect of VDAs during the section 16 consultation (including that from the Applicant).

[78] FCR Guideline, Annex, paragraph 2.19.

4.153 In addition to the Applicant, several parties argued in favour of the Commission granting a block exemption order for VDAs. The representations from these parties generally focused on the argument that permitting a block exemption order for VDAs would ensure that Hong Kong's regulatory regime would remain aligned with those in the Asia Pacific region, which would among other things ensure that Hong Kong remained attractive for transshipment traffic. For the reasons outlined above, the Commission does not consider that this argument is a sufficient basis for granting a block exemption order for VDAs under the efficiency exclusion, given that it does not relate to any particular efficiency associated with VDAs and there are in any event some doubts as to the extent to which the issuing or non-issuing of a block exemption order for VDAs would impact on levels of liner shipping activities in Hong Kong. The relevant representations also did not provide particular additional evidence or arguments in support of the efficiencies claimed by the Applicant with respect to rate stability, service stability and rate and surcharge transparency.

4.154 A smaller number of parties agreed with the assessment of VDAs set out in the Commission's Statement of Preliminary Views. Representations from those parties put forward the view that VDAs did not give rise to particular efficiencies and/or raised concerns regarding the pricing activities conducted through VDAs.

4.155 Finally, the Commission has formulated certain transitional arrangements in respect of VDAs, which are outlined in Part 6 below. These arrangements also cover any VSAs which do not benefit from the Order.

5 SUPPLEMENTARY SUBMISSION FROM THE APPLICANT

Introduction

5.1 In its supplementary submission, the Applicant requested that the Commission consider granting a block exemption order for VDAs under a revised scope ("**revised VDA scope**"), in the event that the Commission maintained the position in its Statement of Preliminary Views that VDAs in their current form did not meet the efficiency exclusion.

5.2 The block exemption order sought by the Applicant in respect of the revised VDA scope would:

(a) expressly carve out any Hong Kong-specific pricing (including rates and surcharges) discussions and voluntary agreements within VDAs; and

(b) permit the discussion and sharing of certain other types of information among VDA members relating to the shipping industry.

5.3 According to the supplementary submission, the revised VDA scope was formulated on the basis of the Applicant's understanding that the Commission's greatest concerns regarding VDAs related to discussions and voluntary agreements on pricing. The Applicant submitted that, even though these concerns would not arise under the revised VDA scope, a block exemption order was still necessary to ensure legal certainty in respect of the remaining information sharing conduct conducted through VDAs.

5.4 In the supplementary submission consultation referred to in paragraph 1.19 above, concerns were raised that the timing of the supplementary submission, being after the conclusion of the section 16 consultation, could give rise to procedural unfairness. The Commission considers that this issue did not arise in practice, since interested parties were provided with the opportunity to comment on the supplementary submission (i.e. through the supplementary submission consultation).

5.5 As a general matter, however, where applicants for a block exemption order are willing to accept different alternatives to the scope of the order sought, these should be outlined in the original application. This would avoid the procedural inefficiencies which have arisen in the present case. In particular, the Commission reached its preliminary views and consulted on an application for a block exemption order covering a particular scope, following which the Applicant provided the

supplementary submission, necessitating a fresh assessment and consultation regarding a possible block exemption order covering a different scope (the revised VDA scope).

Revised VDA scope

5.6 The Applicant proposes that the revised VDA scope would be implemented with respect to Hong Kong through the addition of a 'carve-out' provision to existing VDAs. A sample provision submitted by the Applicant indicates that all pricing-related activities covered by the VDA are suspended for trades to/from Hong Kong, and lists examples of the specific information which could continue to be discussed and exchanged. This section sets out further detail on the revised VDA scope proposed by the Applicant.

Carve-out for Hong Kong-specific pricing discussions and voluntary agreements

5.7 Under the revised VDA scope, VDA members would not engage in Hong Kong-specific pricing discussions and voluntary agreements (covering both rates and surcharges). According to the supplementary submission, this carve-out would apply only to the rates of cargo where the origin or destination port is Hong Kong, on the basis that cargo rates are determined by reference to origin and destination ports alone.

5.8 Accordingly, the "Hong Kong-specific" carve-out would not cover discussions or voluntary agreements concerning for example:

(a) the rates for cargo which is merely transhipped through Hong Kong (since the origin and destination ports are elsewhere); or

(b) the rates for cargo which belongs to a Hong Kong-based customer, where the customer has decided to ship the cargo through a neighbouring port in mainland China (since Hong Kong is not the origin port).

5.9 By granting a block exemption order for the revised VDA scope, the Commission would in effect be finding that any non-Hong Kong specific pricing discussions and voluntary agreements are excluded from the application of the first conduct rule. Such conduct could otherwise fall within the scope of the first conduct rule, if it prevented, restricted or distorted competition in Hong Kong.[79] This might

[79] According to section 8 of the Ordinance, the first conduct rule applies to an agreement that has the object or effect of preventing, restricting or distorting competition in Hong Kong, even if the

be the case in the scenario in paragraph 5.8(b) above for example, to the extent that the provision of liner shipping services from the neighbouring port in mainland China is a substitute or a potential substitute for the provision of liner shipping services from Hong Kong.

5.10 The "Hong Kong" specific carve-out may therefore not be sufficient to address the Commission's concerns about pricing related discussions and voluntary agreements (as outlined further in Part 4.3 above). However, it will be necessary to come to a definitive conclusion on this point only if the Commission proposes to grant a block exemption order for the revised VDA scope.

Information sharing activities under the revised VDA scope

5.11 The Applicant has highlighted eight different categories of information which could continue to be discussed and exchanged under the revised VDA scope, and identified the form in which the information would be shared. Table 5.1 provides a summary in this respect.

agreement is made or given effect to outside Hong Kong or any party to the agreement is outside Hong Kong.

Table 5.1 – Summary of information to be shared under revised VDA scope

	Category of information	Past, present and/or future data?	Individual and/or aggregated data?	Ability to reach voluntary agreements?
(a)	Supply and demand trends	Past, present and future	Individual and aggregated	No
(b)	Costs (general and Hong Kong specific)	Past, present and future	Individual and aggregated	No
(c)	Vessel utilisation and capacity levels	Past, present and future	Individual and aggregated	No
(d)	General industry issues	Past, present and future	Individual and aggregated	Yes
(e)	General economic issues/trends	Past, present and future	Individual and aggregated	No
(f)	Regulatory developments & compliance issues	Past, present and future	Individual and aggregated	Yes
(g)	Industry outreach & best practices, including service contract rules, terms, conditions	Past, present and future	Individual and aggregated	Yes
(h)	Rate indices	Past	Aggregated	No

5.12 As indicated in Table 5.1, in all but one of the categories, the information would include past, present and future data, as well as both individual data (i.e. data relating to a specific carrier) and aggregated data. The Applicant has confirmed that the individual data would in most cases be shared in such a way that the identity of the specific carrier to whom the data relates is disclosed (i.e., in non-anonymised form). In a more limited number of categories, the parties to the VDA would have authority to reach voluntary agreements in respect of the information exchanged (though in no case would such agreements relate to the setting of rates or charges).[80]

5.13 For the purpose of this Statement of Reasons, the Commission refers to the exchange, discussion and ability to reach voluntary agreements in respect of the

[80] By way of example, the Applicant has referred to voluntary agreements involving the establishment of an agreed approach to dealing with issues such as piracy, vessel emissions, standards for shipments of hazardous materials and container weighing.

categories of information covered by the revised VDA scope as "**revised VDA scope information sharing**". Further detail on each of these categories of information is provided in the paragraphs which follow.

(a) Supply and demand trends

5.14 VDA members may discuss and exchange information on specific cargo flows and exchange statistics on which port ranges and trade lanes have declining or increasing cargo throughput, both current and forecast. Information on supply and demand trends includes the following:

(a) summaries of individual carriers' existing fleets, including service and vessel information;

(b) data on trade growth and cargo flows in respect of each carrier;

(c) the market shares of carriers on particular trades;

(d) the expected deployments of individual carriers on particular trades;

(e) individual carrier forecasts of expected demand on particular trades; and

(f) information on specific carriers' seasonal deployments, and the voided or blank sailings which they may operate on a temporary basis (see further the description of voided or blank sailings in paragraph 5.63 below).

5.15 According to the Applicant, the discussion and exchange of these types of information lead to better individual carrier operational and commercial decisions that reflect true market trends.

(b) Costs (general and Hong Kong specific)

5.16 The costs which may be discussed within VDAs include those related to fuel, documentation, customs costs, crew wages, equipment, cargo handling, and maintenance and repair. In relation to fuel costs, VDAs may collate and publish average bunker costs and actual bunker prices, which may be used as a reference point by carriers' customers. VDAs may also prepare cost studies on behalf of members on the impact of various cost issues or 'break even' studies providing a 'bottom line' revenue figure for a given trade lane based on average vessel operating costs among VDA members.

(c) Vessel utilisation and capacity levels

5.17 Information on vessel utilisation and capacity levels relates, for example, to the number of carriers' allocated slots on a trade that have been filled (such as by reference to the weight or space utilised), or other aspects of capacity on the trade. According to the Applicant, such information is used by carriers to obtain an indication as to current supply and demand, and supply and demand trends more generally, on the trade. This information is also said to be helpful for making routine operational decisions such as in relation to slot arrangements, and strategic investments decisions.

(d) General industry issues

5.18 Various industry issues, and how specific carriers are dealing with those issues, may be discussed in VDAs. The Applicant has referred in this respect to issues around port congestion, equipment repositioning, piracy and container weighing.

(e) General economic issues/trends

5.19 VDAs may provide members with information on various economic indicators relevant to the markets which they serve, such as macro-economic trends, manufacturing and retail inventory levels, fuel prices, consumer confidence and exchange rates.

(f) Regulatory developments and compliance issues

5.20 VDA meetings may include discussion of the legal and regulatory positions and developments in relevant jurisdictions. The Applicant has referred in this respect to competition law developments, shipping regulatory developments and requirements, customs and documentation issues, anti-boycott regulations, import/export trade restrictions and export control, and economic sanctions issues.

(g) Industry outreach and best practices (general and Hong Kong specific), including service contract rules, terms and conditions

5.21 VDA members may discuss general industry best practices and potential model service contract terms and conditions, and potentially engage in outreach to carriers' customers including shipper organisations. As examples of the service contract rules, terms and conditions which may be discussed, the Applicant has referred to non-rate factors such as liability, insurance, *force majeure* provisions, contract terms, and other standard contract boilerplate issues. The specific

commercial terms and conditions which an individual carrier has with its shipper customers are not discussed.

(h) Rate and revenue indices

5.22 VDAs may collect historic rate and revenue information from members and distribute summaries in aggregated format. The information is kept confidential by the VDA and not distributed among members before or after aggregation. The typical time period or "delay" between the date of the data and its distribution to members varies but is currently around four to six weeks. The indices are used to show general trends in rates and revenues on particular trades, and do not present data in actual dollar amounts. Some indices, such as the TSA Revenue Index, are made publicly available and may be consulted by customers and others.

Assessment of potential competitive harm

5.23 The Commission notes that some of the information covered by the revised VDA scope is general in nature, and its exchange may not amount to a contravention of the Ordinance. As a general matter, the exchange of publicly available information is unlikely to involve a contravention, while the exchange of historical, aggregated and anonymised data is less likely to harm competition.[81] Certain of the revised VDA scope information sharing can thus continue without risk of contravening the Ordinance, regardless of whether the revised VDA scope meets the conditions of the efficiency exclusion.

5.24 However, certain of the categories of information which would be shared between carriers under the revised VDA scope would constitute competitively sensitive information. As indicated in the FCR Guideline, where competitors exchange competitively sensitive information, concerns may arise under the Ordinance.[82] Other than pricing information, competitively sensitive information may include (but is not limited to) information relating to production costs, quantities, sales, capacity, and investments.[83]

5.25 Under the revised VDA scope, each carrier would have access to accurate, confidential, individual and recent data in a number of these areas, shared at very

[81] FCR Guideline, paragraphs 6.47 and 6.48. The exchange of historical, aggregated and anonymised data is in particular less likely to result in harm to competition where information relating to an individual undertaking is unlikely to be easily discerned from the data.

[82] FCR Guideline, paragraph 6.39.

[83] FCR Guideline, paragraph 6.39.

regular intervals (often on a monthly basis). This data would effectively show the respective performances of a carrier's competitors across a particular trade.

5.26 The exchange of such information could give rise to competition concerns, for example, by:

(a) *Decreasing carriers' incentives to compete*. In particular, comprehensive information on individual competitors' costs, vessel deployments and/or capacity utilisation can reduce strategic uncertainty in the market, and thus cause a firm to behave less competitively. For example, with knowledge of its competitors' intended vessel deployments, a carrier could seek to allocate its own vessels to services where it is less likely to be subject to intense competition. In addition, if a firm knows that its competitor is capacity constrained, it will know with greater certainty that it be able to win customers without pricing aggressively. This is also the case with regard to a carrier's knowledge of its competitors' costs. Indeed, the Applicant itself has noted in the supplementary submission that the sharing of information on bunker costs may have a direct impact on a carrier's determination of its pricing. The frequency of the information sharing would enable the carrier to quickly temper their competitive response in light of their competitors' performance.

(b) *Facilitating coordinated behaviour*. With detailed information on matters such as market shares, capacity and trade growth, carriers could more easily detect deviations by a competitor from a particular coordinated outcome. In respect of individualised market share data for example, there appears to be little reason for carriers to share such data other than to enable them to assess the performance of their competitors and thus temper their competitive response.

5.27 Thus, the revised VDA scope information sharing activities could potentially amount to agreements and/or concerted practices between undertakings which harm competition in contravention of the first conduct rule in the Ordinance. In the sections which follow, the Commission assesses whether the revised VDA scope information sharing would meet the four conditions of the efficiency exclusion and thus be excluded from the application of the first conduct rule.

5.28 Since the Commission has concluded that it will not issue a block exemption order for the revised VDA scope, for the Applicant's benefit, it also provides guidance below on which of the specific information sharing activities would or would not be

likely to give rise to competition concerns under the Ordinance (see paragraphs 5.53 to 5.61 below).

Application of the efficiency exclusion

First condition: the agreement contributes to improving production or distribution or promoting technical or economic progress

5.29 The Applicant has referred generally to certain benefits which it considers to arise from the revised VDA scope information sharing. In essence, it is claimed that carriers gain the ability to make more informed investment and commercial decisions through access to the competitor information shared under VDAs. The Commission considers, however, that the claimed benefits are in fact aspects of the reduction of strategic and competitive uncertainty in the market. The lessening of competition between carriers in this sense cannot be considered to amount to an efficiency for the purposes of the first condition.

5.30 In particular:

(a) In relation to the individual carrier information which may be exchanged in relation to supply and demand trends (category (a) above) and vessel utilisation and capacity levels (category (c)), the Applicant has maintained that the discussion and exchange of this information leads to better individual carrier deployment, operational and commercial decisions that reflect true market trends. In essence, the argument appears to be that transparency among VDA members as to each member's vessel deployments and/or capacity levels on particular trades enables carriers to better decide where their own vessels or capacity should be deployed, thus allowing them to offer better services and compete more effectively. However, the improved decision-making which is said to arise from the exchange of this information in reality involves carriers being able to better temper their competitive response as a result of increased information on the vessel deployment and/or capacity levels of their competitors (and reduced strategic and competitive uncertainty). Such a lessening of competition between carriers could in turn enable each carrier to charge higher prices, to the detriment of consumers.

(b) With respect to costs information exchanged under category (b), the Applicant notes in relation to fuel costs in particular, that these are a key input in determining pricing. By this argument, the Commission

understands the Applicant is suggesting that the exchange of carriers' fuel costs data through VDAs would enable carriers to make better informed decisions on their pricing. However, put differently, this suggests that the sharing of detailed costs information, in particular in relation to fuel costs, gives carriers considerable insight into the pricing of individual competitors. The Commission has already outlined above its concerns in relation to the sharing of pricing information through VDAs.

5.31 In addition, the Applicant has specifically identified the following two efficiencies related to the revised VDA scope information sharing,[84] namely (i) the broad efficiency to the Hong Kong economy of VDAs promoting transshipment services in Hong Kong; and (ii) the broad efficiency to the Hong Kong economy of VDAs promoting a super-connector maritime shipping centre and Hong Kong's role in the One Belt One Road trade initiative of the People's Republic of China.[85]

5.32 In this respect, it is claimed that:

(a) the relevant information sharing activities provide carriers with broader, more accurate market knowledge, which will enable them to make better decisions in relation to the nature and extent of services which they offer to Hong Kong;

(b) in order for carriers and other relevant stakeholders to choose and commit to Hong Kong as a maritime centre, they need to be confident that there is a sufficient and credible flow of market information across the shipping industry to allow their respective businesses to succeed; and

(c) if carriers did not have sufficient market information about Hong Kong, they might decide to reduce the vessels calling at Hong Kong, leading to fewer competitors and less competition in Hong Kong.

5.33 By promoting Hong Kong as a transshipment hub and an international maritime centre, the Applicant maintains that the relevant information sharing activities will increase the volume of vessels routed through Port of Hong Kong and

[84] These two efficiency claims were also raised by the Applicant in its representation in the section 16 consultation.

[85] The One Belt One Road initiative, among other aspects, envisages the use of a network of maritime routes connecting regions through Chinese sea ports.

consequently result in economies of scale and reduced costs per TEU. This is said to lower the costs and thus the retail prices for all consumer products that are transported to Hong Kong in this way. The Applicant considers that these benefits are evidence of "improving production or distribution" or "promoting technical or economic progress" for the purposes of the first condition of the efficiency exclusion.

5.34 In its representation in the section 16 consultation, the Applicant put forward certain arguments as to why the Commission should be willing to accept the inclusion of so-called 'broad' efficiency claims under the first condition. The Commission considers, however, that the Applicant has not demonstrated that these efficiency claims fulfil the first condition. Regardless of whether such broad efficiencies should be accepted as falling within the scope of the efficiency exclusion, it is still necessary to show the causal link between the information sharing activities and the alleged broad efficiencies, which the Applicant has not done.

5.35 First, it appears that the information to be shared under the revised VDA scope would not in most cases involve Hong Kong-specific information, but would rather relate to a particular trade as a whole.[86] There are therefore doubts as to whether the information shared under the revised VDA scope could in fact ensure the flow of information and better investment decisions with respect to Hong Kong, as suggested by the Applicant in its "broad" efficiency claims. The Applicant subsequently suggested that while the information currently being exchanged under VDAs is often not Hong Kong-specific, the exclusion of Hong Kong-specific rate discussions under the revised VDA scope might lead to an increased need to discuss Hong Kong-specific non-rate information. In the absence of more concrete evidence, however, the Commission considers there is at least a significant potential for disconnect between the information shared under the revised VDA scope and the Hong Kong-specific efficiencies to which it is said to give rise.

5.36 Second, the two broad efficiency claims rely on a chain of assumptions which has not been adequately substantiated. The Applicant has not sufficiently demonstrated by way of empirical evidence or other substantiation that VDAs in fact result in (i) increased volumes of vessels in Hong Kong; (ii) reduced costs per TEU; and/or (iii) lower transport costs or prices for retail goods.

[86] This is suggested, for example, by the examples of statistics and reports circulated by VDAs which the Applicant provided in Confidential Annex 3 to the supplementary submission. One possible exception to this, which is mentioned by the Applicant, is the exchange of costs information in relation to Hong Kong-specific events or developments, such as following the Hong Kong terminal dock strike in 2013.

5.37 With respect to the claim that VDAs lead to increased volumes of vessels in Hong Kong, the Applicant has referred to the responses to a survey which it conducted of […]. This survey indicated that […].

5.38 The Commission notes, however, these views do not demonstrate with any certainty that VDAs in themselves mean that more vessels call at Hong Kong than they would without VDAs. Legal uncertainty about the permissibility of VDAs in Hong Kong is not the same issue as having insufficient market information about Hong Kong. In any event, the objectivity of the survey results may be questioned given the clear interest of the respondents in securing a particular outcome.[87] It is also at least arguable that the reverse of the Applicant's claim could be true, i.e., the exchange of information through VDAs could in fact lead to fewer vessels calling at Hong Kong. This might be the case if the information exchanged suggested that the relevant commercial and competitive conditions in Hong Kong were not attractive to carriers. Additionally or alternatively, the exchange of information through VDAs might enable carriers to coordinate capacity restrictions more easily on trades involving Hong Kong, which could also lead to fewer vessels calling at Hong Kong.

5.39 As the claim that VDAs lead to reduced costs per TEU, the Applicant has referred to evidence (including an OECD study) which suggests generally that the more vessel capacity and the higher the vessel utilisation of the liner shipping services at a particular port, the greater the economies of scale and associated cost savings for that port will be. To demonstrate that VDAs lead to lower transport costs and/or prices for retail goods, it has provided data on the increased costs associated with redirecting cargo from Hong Kong to neighbouring ports in mainland China, which is said to be likely in the event that there is legal uncertainty over the status of VDAs in Hong Kong.

5.40 However, the arguments that VDAs leads to reduced costs per TEU, and/or lower transport costs or prices for retail goods in Hong Kong, are predicated on the assumption that VDAs leads to an increase in the number of vessels calling at Hong Kong. Since the Applicant has failed to demonstrate that this is in fact the case, or even that it might be expected to be the case, the latter arguments must also fail. In

[87] The Applicant has also referred to a survey conducted by the European Commission in 2010 into the effects of the repeal of the EU Conference BER, in which respondent carriers referred to reduced service relative to the US transpacific trade as a consequence of the repeal (see FMC Study, cited in footnote 69 above, Appendix 1). It is not clear, however, that the reduction in service referred to related specifically to a decrease in the number of vessels (as opposed to, for example, schedule reliability) or that a decrease in the number of vessels in fact occurred (noting that the responses from the carriers constituted only their subjective views on the effects of the repeal of the EU Conference BER).

any event, as previously mentioned, the argument that the legal uncertainty as to the status of VDAs in Hong Kong would lead to increased costs associated with redirecting cargo from Hong Kong to neighbouring ports in mainland China does not demonstrate any cost efficiencies associated with the information sharing activities of VDAs themselves.

Second, third and fourth conditions

5.41 Although the Commission has concluded that the Applicant has not demonstrated that the information sharing under the revised VDA scope meets the first condition, for completeness, it notes that it is in any event unlikely that such information sharing would satisfy the second and third conditions in particular.

5.42 With respect to the second condition, the Applicant has maintained that "end or "final" consumers in Hong Kong" will receive a fair share of the relevant VDA efficiencies through reductions in transportation costs and lower prices for retail goods, as well as the promotion of Hong Kong abroad and increased employment. In this respect, the Applicant has submitted that the Commission should adopt a broad definition of "consumer" for the purposes of the application of the second condition, which would encompass not only the direct users of liner shipping services, but also "ordinary everyday consumers".

5.43 The Commission requested the Applicant to provide evidence that the claimed efficiencies would be passed on to the actual users of liner shipping services, such as shippers and freight forwarders. The Applicant has indicated that the claimed benefits to final consumers would not arise if direct users and other parties did not receive and pass on a fair share of the alleged VDA efficiencies.

5.44 However, the Applicant's claims in relation to the pass-through of VDA efficiencies to both direct users of liner shipping services and final consumers are not supported by any particular evidence. The claims in this respect are again based principally on the assertion that VDAs lead to higher volumes of vessels calling at Hong Kong (which has not been sufficiently demonstrated).

5.45 With respect to the third condition, it seems unlikely that the restrictions on competition arising from the wide-ranging information sharing under the revised VDA scope would be indispensable towards achieving the claimed efficiencies. In the Commission consultations, certain parties noted that there is a wide variety of publicly available information on many issues of relevance to both carriers and shippers. While the Applicant has agreed that publicly available information may be consulted by carriers, it has also noted that such information may not be as easily

analysed by smaller carriers and that the information exchanged through VDAs is generally more relevant and current. Even assuming that this is the case, however, it would still appear that the information sharing in its current form cannot be considered "indispensable".

5.46 It is not clear, for example, why it is necessary to share much of the relevant data on an individual basis, in a format which identifies the specific carrier to which the data relates. In this respect, the Applicant has maintained that sharing of such information provides a more granular view of relevant market trends than aggregated data alone. It seems likely, however, that aggregated and anonymised data would provide sufficient information on market trends (which are by definition to be assessed in a generalised fashion). On the other hand, the sharing of individual data would provide VDA members with a greater insight on the market position and commercial operations of specific competitors, which gives rises to heightened competition concerns compared to sharing aggregated market data.

5.47 More generally, it can be queried whether VDAs would meet the standard for indispensability on the basis, as suggested by the Applicant, that they are the only platform for this kind of information exchange in the liner shipping industry. There is no reason why the potentially beneficial forms of information sharing under VDAs, such as in relation to regulatory developments or general economic issues, could not be carried out in Hong Kong through forums other than VDAs. The Applicant itself, as an active trade association in the liner shipping industry in Hong Kong, gathers information from its members, conducts surveys, and represents the industry before relevant public bodies. Examples of other existing platforms for the discussion of issues of general concern were provided in the supplementary submission consultation. By extension, the potentially beneficial forms of information sharing could likely continue in Hong Kong even in the absence of a block exemption order for the revised VDA scope.

5.48 With respect to the fourth condition, the Commission considers that its assessment with respect to VDAs in general (as set out in paragraph 4.149 above) is also likely to apply in respect of the revised VDA scope. A final determination on this condition is not necessary since it has not been demonstrated that the other conditions are met.

Conclusion with respect to revised VDA scope information sharing and further guidance

5.49 For the reasons outlined above, the Commission considers that it has not been demonstrated that the revised VDA scope information sharing falls within the

efficiency exclusion and accordingly has decided not to issue a block exemption order for the revised VDA scope.

5.50 In reaching this conclusion, the Commission has taken account of the comments received during the supplementary submission consultation. A number of parties voiced their support for the Applicant's proposal in respect of the revised VDA scope, indicating that it represented a pragmatic compromise and referring to the benefits of Hong Kong aligning its treatment of VDA activities under competition law with that of neighbouring jurisdictions.[88] Nonetheless, the arguments put forward in favour of the proposal have not sufficiently allayed the Commission's competition concerns as outlined above, nor provided adequate support for the efficiencies claimed by the Applicant.

5.51 Other parties noted their opposition to the Applicant's proposal, in some cases setting out more detailed arguments to substantiate their position. The relevant comments referred for example to the detailed and individual nature of the information to be shared, and the fact that sharing of costs and capacity-related data between carrier competitors could lessen price competition and/or enable collusion. The concerns raised by these parties on these issues are generally in line with the Commission's own concerns (as further outlined in paragraphs 5.24 to 5.26 above).

5.52 While the Commission is not issuing a block exemption order for the revised VDA scope, in the interests of providing the Applicant with further guidance, it provides below its views on which aspects of the revised VDA scope information sharing would be unlikely to amount to a contravention of the Ordinance and which may give rise to competition concerns under the Ordinance.

Revised VDA scope information sharing unlikely to amount to a contravention

5.53 The Commission considers that the exchange, discussion and/or reaching of voluntary agreements in respect of the following categories of information would be unlikely to amount to a contravention of the first conduct rule:

(a) general industry issues (category (d) above);

(b) general economic issues/trends (category (e) above);

(c) regulatory developments and compliance issues (category (f) above); and

[88] The Commission's assessment of this argument is provided in Part 4.3 above.

(d) industry outreach and best practices (general and Hong Kong-specific), including service contract rules, terms, conditions (category (g) above).

5.54 The Commission notes that these categories of information do not appear to involve competitively sensitive information or specific data which would be confidential to an individual carrier. To the extent that publicly available information or data is concerned, the centralisation of such information or data could be beneficial for carriers. There may also be advantages in carriers being able to discuss how to tackle various issues of concern to the industry as a whole.

5.55 With respect to category (h) above, information sharing in relation to, and the formulation of, aggregated and historic rate and revenue indices are generally unlikely to amount to a contravention of the Ordinance, provided that they do not allow carriers to identify the individual positions or strategies of their competitors in the market. In this respect, the Applicant has indicated that rate and revenue indices do not involve any disclosure of information specific to any individual carrier since carriers do not discuss or share individual data before it is aggregated. Rate and revenue indices may generally be useful as an indicative benchmark for carriers and, where made publicly available, customers of liner shipping services.

5.56 The Commission's position in respect of categories (d) to (h) is based on the information provided in the Applicant's submissions regarding the relevant categories of information. To the extent that the exchange of information under these categories would include information going beyond that disclosed by the Applicant, the Commission's position cannot be assumed to apply.

Revised VDA scope information sharing which could give rise to competition concerns

5.57 The Commission considers that the exchange and discussion of the following categories of information could give rise to competition concerns under the first conduct rule:

(a) supply and demand trends, including summaries of individual carriers' existing fleets, market shares and expected deployments on individual trades (category (a) above);

(b) costs information (general and Hong Kong specific) (category (b) above); and

(c) vessel utilisation and capacity levels (category (c) above).

5.58 As noted in paragraph 5.24 above, information relating to production costs, quantities, sales, capacity, and/or investments would amount to competitively sensitive information under the FCR Guideline. The exchange of such information, particularly on an individualised basis, could enable a carrier to gain detailed and accurate information on the respective performances of its competitors across a particular trade. This could in turn lessen competition between carriers on the trade. With knowledge that its competitor is capacity constrained or has high costs, or does not plan to deploy vessels on a particular service, for example, a carrier may not compete as vigorously in order to win customers. With detailed information on matters such as market shares, capacity and trade growth, carriers could also more easily achieve a particular coordinated outcome, as they would have an enhanced ability to detect deviations from that outcome.

5.59 One way in which to reduce such concerns would be to aggregate and anonymise the data which is being shared. For example, some exchanges of costs information under category (b) might enable a carrier to compare its performance to its competitors (i.e., by benchmarking) and thus improve its efficiency, which could in fact enhance competition. Such information could be anonymised and aggregated to realise these benefits.

5.60 The degree of aggregation in terms of both scope and time frame would be important in this respect. The broader the scope of the information and the longer the time frame over which it is aggregated, the less likely competition concerns are to arise. It also should be borne in mind that for markets where there are only a limited number of carriers operating, even the sharing of aggregated information may give rise to concerns, to the extent that the information in respect of individual carriers can be discerned or inferred.

5.61 For the avoidance of doubt, the concerns outlined by the Commission in respect of categories (a) to (c) are provided for the Applicant's guidance and do not necessarily mean that the Commission has formed a view on whether it has reasonable cause to believe that the relevant information sharing activities would amount to a contravention of the first conduct rule.

Capacity efficiency programmes

5.62 For completeness, the Commission notes that, in addition to the revised VDA scope information sharing, the Applicant requested that the revised VDA scope also include the ability to apply capacity efficiency programmes (which may also be known as capacity management programmes) in relation to voided or blank sailings.

This request was made in the Applicant's response to a request for information from the Commission.

5.63 Voided or blank sailings refer to the practice by carriers of cancelling the scheduled call of a vessel at a particular port or ports in response to demand and/or capacity fluctuations, such that cargo booked on the voided or blank sailing needs to be transferred onto another sailing.[89]

5.64 Capacity efficiency programmes involve voluntary agreements which may be reached in the context of a VDA, whereby carriers agree to coordinate voided or blank sailings on a particular trade on a temporary basis. In particular, carriers take turns with each other to blank sailings, and may ship cargo which was due to be carried on their blank sailing on another VDA member's vessel instead. In this way, it is said that the customer does not need to wait until the next scheduled sailing of the carrier which has cancelled the sailing or to find another operator.

5.65 Only a limited number of VDAs provide for the authority to apply capacity efficiency programmes.[90] According to the Applicant, capacity efficiency programmes are designed to mitigate though not eliminate overcapacity. The Applicant refers in this regard to chronic overcapacity conditions of up to 60% on certain trades, at which level a carrier is said to be inevitably making a loss if it goes ahead with a sailing, and the difficulties in re-allocating excess vessels on a short term basis.

5.66 Since the Commission has concluded that it will not issue a block exemption order for the revised VDA scope, it does not propose to set out a detailed separate assessment of capacity efficiency programmes.

5.67 As a general matter, however, the Commission notes that capacity efficiency programmes could give rise to competition concerns as they involve carriers taking coordinated action to restrict capacity, i.e. by implementing a programme of cancelled sailings. Conceptually, such coordinated action would seem to increase the possibility of voided or blank sailings compared to a situation where carriers decide to implement voided or blank sailings independently and would risk losing customers if their competitors did not also do so. Coordinated action in relation to

[89] Voided or blank sailings may also be used in circumstances other than in response to demand or capacity fluctuations, for example, due to weather delays, strikes, or non-availability of berth at the relevant port.

[90] [...]

the restrictions of capacity entailed by capacity efficiency programmes could thus potentially result in higher prices than might otherwise apply.

5.68 Of course, carriers would also be able to take joint action to restrict capacity as members of a VSA, as further outlined in paragraph 4.8 above. However, while the Commission has decided to issue a block exemption order for VSAs, the Order will only apply in respect of VSAs which do not exceed the market share limit, thus limiting the potential harm to competition which could arise from VSA members coordinating capacity restrictions. By contrast, capacity efficiency programmes are applied in the context of VDAs, and could thus restrict capacity across all of the carriers operating on a particular trade (albeit potentially only on a temporary basis). Coordinated action to restrict capacity could thus be considerably more likely to result in price increases in the case of capacity efficiency programmes, where there would potentially be no capacity available outside the VDA to defeat a price increase on the trade, than the VSAs permitted under the Order.

5.69 In light of the potential risks arising where a coordinated approach to voided or blank sailings is taken across an entire trade, it may be queried whether the efficiency benefits to which capacity efficiency programmes are said to give rise would be sufficient to outweigh the potential competitive harm. It is also noted that only a limited number of VDAs permit capacity efficiency programmes, suggesting that carriers can adequately deal with capacity issues on other trades without resorting to coordinated action under a VDA.

6 TRANSITIONAL ARRANGEMENTS

6.1 While the Commission is not issuing a block exemption order in respect of VDAs (and potentially certain VSAs will not benefit from the Order), it recognises that these liner shipping agreements have been in force for a number of years in Hong Kong, pre-dating the full commencement of the Ordinance on 14 December 2015.

6.2 On this basis, the Commission set forth proposed transitional arrangements for such liner shipping agreements in its Statement of Preliminary Views. A limited number of parties commented on the proposed transitional arrangements in the section 16 consultation, and for the most part parties considered the arrangements to be sufficient.

6.3 The Commission has decided to adopt the transitional arrangements proposed in the Statement of Preliminary Views and accordingly will:

(a) allow undertakings which are party to a VDA or a VSA which does not benefit from the Order a 'grace period' following the Commission's decision on the Application within which to make any changes they may consider necessary to their commercial arrangements; and

(b) refrain from taking any enforcement action against existing VDAs or VSAs which do not benefit from the Order with respect to the period from 14 December 2015 to the end of the grace period.

6.4 The grace period will end six months from the date of this Statement of Reasons (i.e., on 8 February 2018).

6.5 For the purposes of these transitional arrangements, enforcement action would comprise the issuing of a warning notice or an infringement notice under Part 4 of the Ordinance or the initiation of any proceedings before the Competition Tribunal under Part 6 of the Ordinance. For the avoidance of doubt, the Commission's decision to implement transitional arrangements does not necessarily mean that it has formed a view on whether it has reasonable cause to believe that a contravention of the first conduct rule has occurred in respect of liner shipping agreements which do not fall within the scope of the Order.

6.6 Finally, the non-initiation of enforcement action is subject to the condition that the Commission does not discover the existence of anti-competitive conduct relating to the conduct covered by the Application but which has not been fully disclosed in the Application.