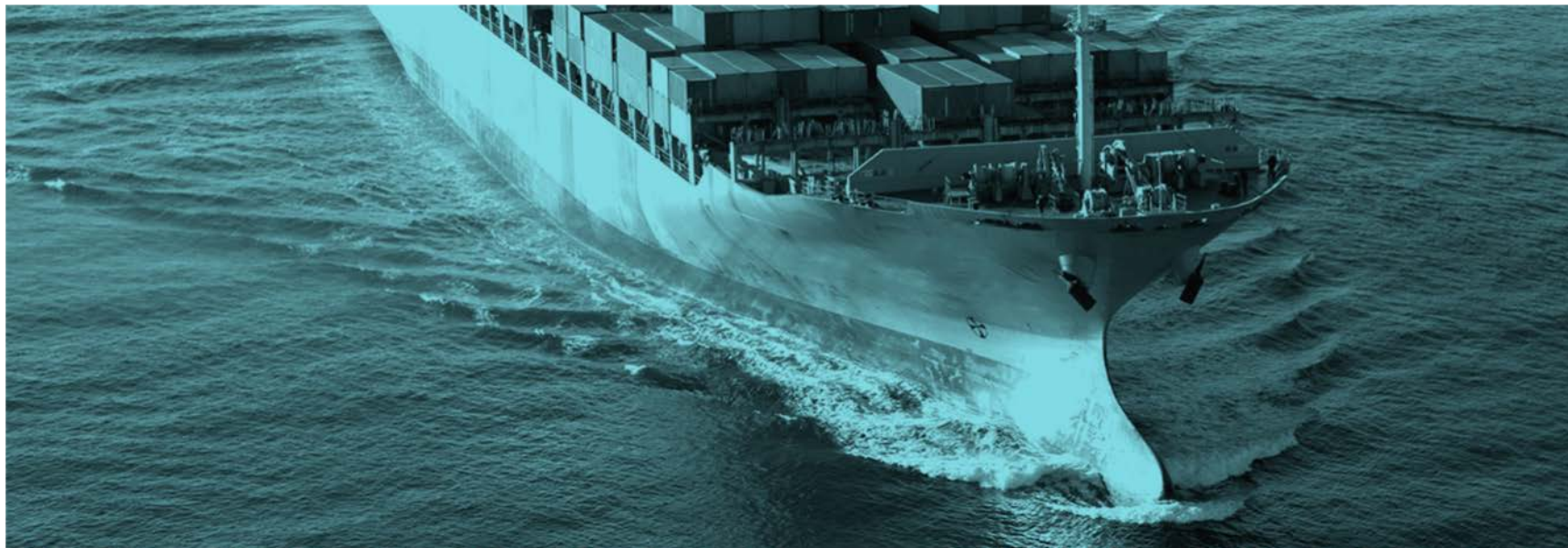


## THE FUTURE OF ALLIANCES

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# THE FUTURE OF ALLIANCES

*"Those who do not learn history are doomed to repeat it"*  
George Santayana (1863-1952)

# CONTENTS

1. The drive to consolidation
2. The current competitive line-up
3. Competition issues
  - Price competition
  - Capacity
  - Vertical impact
  - Contestability of trades
4. Conclusions

# 1. The drive to consolidation

Concentration of the liner sector has accelerated:

- > 2015 OECD survey of maritime sector: an average of **15.7** carriers offer regular liner services compared to **22** in 2004.
- > Since 2015, Hanjin, Hamburg Süd, UASC, and NOL/APL have disappeared or been acquired. And soon (by April 2018) NYK, MOL, and K-Line will have merged their container businesses.
- > In 2016, there were **4** global alliances with **16** member Lines.
- > By 2017 there will be **3** global alliances and only **12** Lines (**10** after the 3 Japanese lines merge).

# Drivers towards consolidation: Mergers

- > Unlike in the aviation sector, in shipping there are no nationality-based restrictions (e.g. the majority EU ownership/control required of aviation “Community carriers” in Regulation 1008/2008 does not apply).
- > Mergers between liner companies are therefore an option which can achieve economies of scale and scope, reducing costs.

# Liner sector mergers 1997-2017

**1997** P&O and Nedlloyd merger.

**1999** Maersk had acquired Safmarine, CMB-T, Sealand, and in 2005 acquired P&O/Nedlloyd; now has 15% of global capacity.

**2015-**

**2016** "Consolidation season":

- Hapag-Lloyd bought CSAV's liner business;
- Cosco consolidated CSCL into one container line, forming new China Cosco Shipping;
- CMA-CGM bought APL/NOL;
- Hapag-Lloyd announced merger with UASC; and
- NYK, MOL, and K Line announced the merger of their container businesses.
- November 2016: announcement of intended sale of Hamburg Süd to Maersk.

# Capacity is being increasingly concentrated

Capacity is being increasingly concentrated in fewer and fewer carriers:

**2000**      The 5 top carriers had **34%** of total world capacity.

**2014**      The 5 top carriers had **43%** of total world capacity.

From 2000-2014 the 10 largest carriers' share of global capacity grew from **50.8%** to **60.4%**.

## 2. The current competitive line-up

Four Alliances have now contracted into three Alliances in Asia-Europe-Transatlantic trades:

### **2M:**

- > Maersk (buying Hamburg Süd) and MSC
- > Strategic 3-year agreement with HMM: combination of slot exchanges and slot purchases, Maersk and MSC taking over charters and vessel operations currently chartered to HMM.

### **Ocean Alliance:**

- > CMA-CGM (having bought APL/NOL)
- > Cosco China Shipping (amalgamating Cosco and CSCL)
- > OOCL
- > Evergreen.

### **Transport High Efficiency (“THE”) Alliance:**

- > Hapag-Lloyd (having merged with UASC)
- > NYK, MOL and K Line (soon to merge into 1 Line)
- > Yang Ming.



# How balanced are the three new global Alliances?

## The POSITIVE view

- > The three Alliances are competitively balanced in terms of capacity and market share as well as services.
- > Current and future fleets also well-balanced.
- > Intense price competition is maintained both within the Alliances and between the Alliances.
- > Pro-competitive structure is reflected by the absence of concerns voiced against the three new Alliances by regulators in USA, EU, and China in 2015-16.

# How balanced are the three new global Alliances?

## The **NEGATIVE** view

- > Dangers exist in this over-concentrated sector
- > Global Shippers' Forum November 2016 paper lists four concerns:
  - > How much consumer choice really exists with only three alliances?
  - > How compatible are just-in-time logistics chains with mega-carriers: ULCs create spikes in cargo, create massive capacity challenges for hub port to process huge cargo flows. Any disruption (e.g. late arrival because of weather etc.) creates massive problems, congestion, etc.
  - > Markets are no longer contestable by independent carriers outside Alliances: the three are so big that any independent carrier is driven to niche markets, so there is insufficient outside competitive pressure.
  - > GSF call to change regulatory regime, requiring notification/reporting and opposing renewal of the Consortia BER after April 2020.

# Some statistics and facts (not alt-facts...)

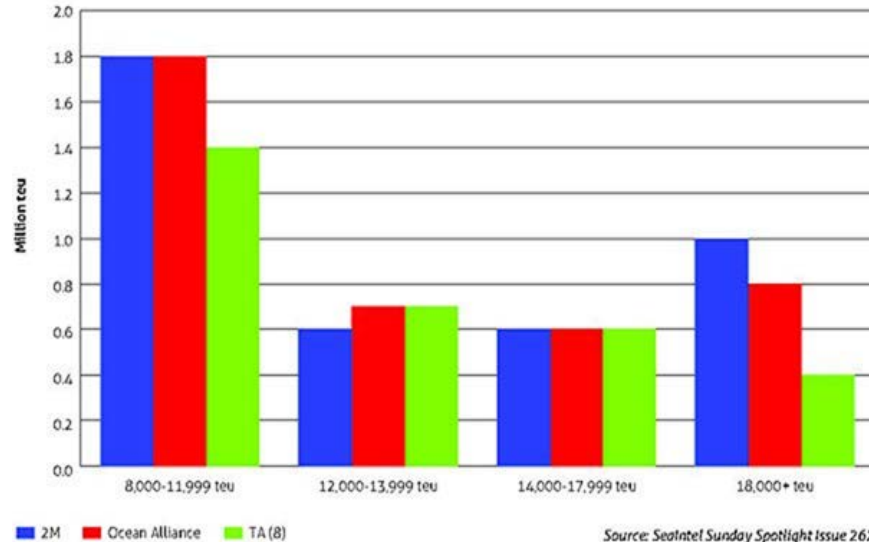
# Capacity on EU trades of the three global Alliances

(Source: Alphaliner)

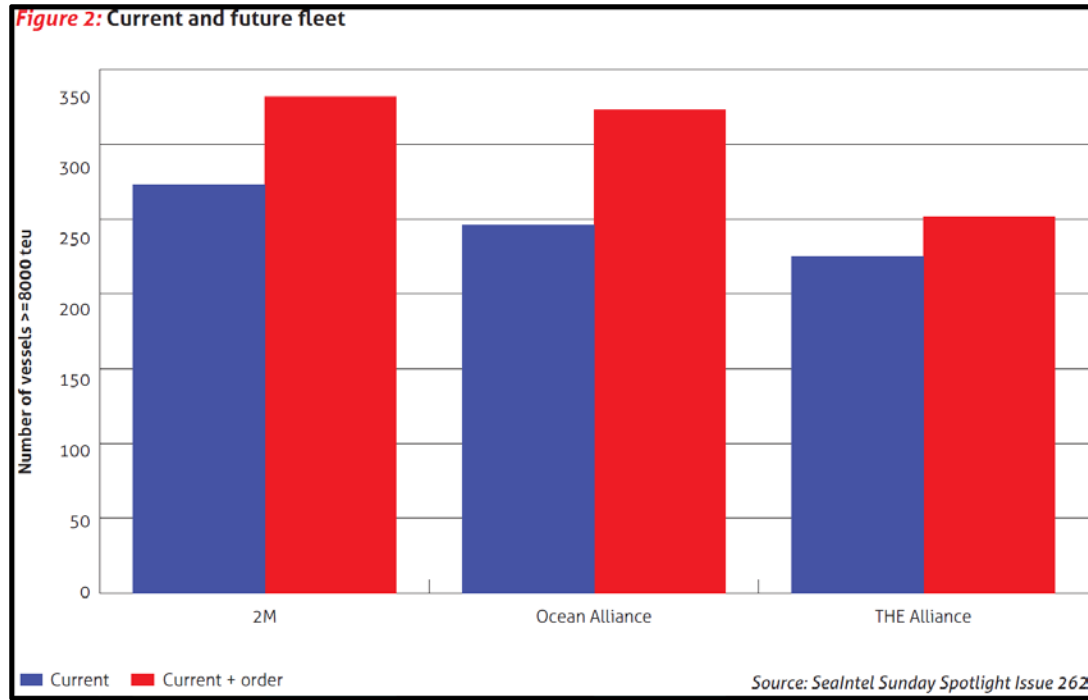
Alliance	Asia-Europe w/b	Asia-Mediterranean w/b	Transatlantic w/b
2M (without HMM participation)	37%	39%	35%
THE Alliance	26%	21%	31%
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# Comparative fleet portfolios show continued competitive balance between Alliances

Figure 3: Capacity (current + order)



# Current and Future Fleets of the three Alliances



### 3. Competition issues

- > Continued price competition.
- > Capacity decisions of Alliances.
- > Vertical impact.
- > Contestability of trades.

# Price competition

- > Lines compete on price both within an Alliance and outside it: cooperation on price between Alliance members is not permitted by the alliance agreements.
- > Very low rates since 2008 financial crash is evidence of a highly competitive market
- > Commission Decision and Commitments offered by Lines increase transparency of price communications and "aim to increase price transparency for customers and to reduce the likelihood of co-ordinating prices" (Commission Press Release, 7 July 2016).



# Revenue sharing Alliance agreements?

- > Price cooperation between carriers has been exempted in transatlantic airline alliances (e.g. BA/AA/IB, 14 July 2010).
- > Open question whether the market and regulatory conditions making such agreements pro-competitive in air services also apply in Liner markets.
  - > Airline revenue sharing agreements are created by the prohibition on mergers (e.g. EU Regulation 1008/2008 and its prohibition on non-EU parties owning majority share or control of EU carriers and equivalent rule in US law)
  - > Airline “metal neutral” revenue sharing agreements are attempt to get as near as possible to mergers through highly integrated JVs.
  - > No such regulatory constraints on mergers exist in shipping sector and difficult to see how revenue sharing would meet indispensability test of Article 101(3) TFEU.

# Criticism of Lines' pricing behaviour

H. Mørch, Director DG Competition (EMLO 2016 speaking notes):

- > Alliances are a logical response to the difficulties faced by the industry. Alliances, generally, create efficiencies.
- > A pass-on of efficiencies to consumers will occur if there are sufficient competitive pressures on Lines (hence the 30% market share condition in Consortia BER, Article 5).
- > But are these pro-competitive factors still present with three Alliances, each with market shares at the edge of the 30% threshold?

Mr Mørch highlighted four concerns:

- > Acknowledged that there was independence of pricing within Alliances, yet concerned that joint setting of capacity may “still influence prices”.
- > Commonality of costs may lead to price alignment.
- > Information exchanges in the running of joint operations (which is permitted) may lead to collusion (not permitted).
- > Vertical impact of access to port facilities may be negative.

# ARE THESE FEARS JUSTIFIED?

# Capacity decisions by Alliances and prices

- > Alliances create framework for joint fleet operations and agreement on tonnage/fleet to be deployed to provide service.
- > Consortia BER (Regulation 906/2009):

*“For the purpose of establishing and running a joint service, an essential feature inherent in consortia is the ability to make capacity adjustments in response to fluctuations in supply and demand” – Recital 5*

*“[BER allows] capacity adjustments in response to fluctuations in supply and demand” – Article 3(2)*

- > EU law prohibits limitations of capacity, e.g. artificial limits on capacity by “freezing” or “roping off” % of ship capacity (e.g. TAA decision, 1994)

# Alliance Capacity Decisions (continued)

- > How would joint setting of capacity influence prices that are individually set by Alliance members?
- > Capacity levels have an influence on price (e.g. scarce capacity will lead to higher rates), but capacity levels are influenced by cyclical factors.
- > Decisions of Alliances to adjust their fleet deployment to meet demand are micro-management and/or defining the Alliance's service, rather than attempts to artificially limit capacity to push rates up.
- > Re-adjusting an Alliance's capacity in light of market conditions is not artificial capacity regulation but redefining the Alliance's service offering.
- > A causal link between prices and Alliance capacity decisions is not supported by empirical evidence.

# Commonality of costs and price alignment

- > Alliance members operate broadly similar ships with similar costs, servicing customers with generally similar requirements.
- > Operational costs are a factor in setting price levels to customers, but there is no evidence of a pattern of price alignment as a result.
- > Commission Decision of 7 July 2016, para 70:  
*"The commission...did not find evidence of [an agreement...on price changes] between the Parties".*

# Information exchanges and the temptation to collude

- > Lines members of Alliances are permitted to exchange information necessary to operate their (lawful) joint services.
- > 2008 Maritime Guidelines, at paragraph 40:

*"In the liner shipping sector, exchanges of information between shipping lines taking part in liner consortia which otherwise would fall under Article [101(1)] of the Treaty are permitted to the extent that they are ancillary to the joint operation of liner transport services and the other forms of co-operation covered by the block exemption."*
- > Exchanges of information on price, customer identities and contractual terms or future investment plans would infringe EU competition rules and would certainly be outside scope of Alliance agreements.
- > Commission Decision of 7 July 2016, para 70:

*"The commission...did not find evidence of [an agreement...on price changes] between the Parties".*



# Vertical effects

- > Alliances have significant market shares and, when negotiating access to terminal services, are powerful joint purchasing groups.
- > EU Horizontal Guidelines 2011, at paragraph 201: joint purchasing *“can lead to lower prices or better quality products or services for consumers”* but can also have negative effects (e.g. foreclosing access to facilities by competitors).
- > US regulators (the FMC) have been more interventionist here: e.g. clearing P3 Alliance on condition of individual negotiation with terminals by members. EU regulators have been more permissive.
- > Compared to aviation alliances with extensive ‘behind and beyond’ cooperation from hub airports (e.g. code sharing), Liner Alliances have generally not developed inland cooperation or joint feeder cooperation.

# Vertical impact of Alliances on EU terminals

- > An analysis of the impact of Alliances on major EU hub ports shows that Alliances are either competitively balanced in key ports (e.g. they each have a terminal at the relevant port) or they all use third party providers of terminal services.
- > This is a more dynamic pro-competitive situation and concerns about Alliances' vertical impact appear unjustified.

# Vertical impact of Alliances – alternative terminal services providers at key EU hub ports

	OCEAN Alliance	2M	THE Alliance	Hutchison Port Holdings	DP World	PSA
Antwerp	X	X	X		X	X
Felixstowe				X		
Hamburg			X			
Rotterdam	X	X	X	X	X	
Southampton					X	
Algeciras		X	X			
Marseille-Fos	X	X			X	
Piraeus	X					

Source: websites of Hutchinson, PSA, APM Terminals etc.

# Contestability of markets

- > In aviation sector, the three global alliances (Oneworld, STAR and SkyTeam) face competition from powerful competitors operating outside Alliances: Emirates, Gulf Air, Etihad, and Virgin all operate outside Alliances.
- > Liner sector is much more concentrated as a market with three Alliances in operation from 1 April 2017.
- > What happens to non-Alliance Lines such as Zim? Niche market strategy?

# Global Shippers Forum, November 2016

- > Possibility of new entrants outside Alliances?

*"The growth of global alliances has produced barriers to entry for new entrants and has made it almost impossible for independent carriers to compete on global trades."*

*"Independent carriers have had to retreat to provide local or regional services or feeder services to the hub ports as a consequence of the global alliances and mega-ships."*

Source: Global Shippers Forum: "The Implications of Mega-Ships and Alliances for Competition and Total Supply Chain Efficiency: An Economic Perspective" (November 2016)

- > But the survival of 3 Alliances is a consequence of market forces rather than the choice of carriers.
- > ZIM appears to be pursuing independent strategy, exploiting nice opportunities. Not excluded but pursuing different market strategies.

# Future regulatory framework for Alliances

- > The three shipping Alliances will each be in operation from 1 April 2017.
- > They will be entering a difficult economic climate, and political turbulence may lower demand (e.g. impact of Trump trade policies, Brexit, protectionism, etc.)
- > Regulation 906/2009 expires in April 2020 and the Commission will conduct assessment for renewal or expiry of the BER.
- > Is Consortia BER suitable for the liner environment of 2017 -2025?

- > Should market share thresholds be revised?
- > The 3 Alliances have large but competitively balancing market shares.

Alliance	Asia-Europe w/b	Asia-Mediterranean w/b	Transatlantic w/b
2M (without HMM participation)	37%	39%	35%
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*Source: Alphaliner*

- > Does BER address issues created by modern Alliances? Or is it only suitable for smaller e.g. north south "thin" trades (like EU-South Africa or EU- South America)?
- > BER is a convenient safe harbour for Alliances but revision in light of modern market conditions is timely. Useful to retain BER to assist compliance.



# Conclusions

- > The Liner market faces daunting challenges: cyclical overcapacity; price volatility; and an uncertain political and trade environment.
- > Ultra-large (20,000+ TEU) container ships may have reached the limit of incremental efficiency gains and attainment of economies of scale and scope.
- > Alliances are the only effective arrangement for delivering high quality services with fleets of such mega-carriers; individual services are not a viable alternative.
- > Regulators in the EU and US have been sympathetic and overregulation has been avoided.
- > Further consolidation may still happen.

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