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CASE BE/0004

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

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

STATEMENT OF PRELIMINARY VIEWS

TABLE OF CONTENTS

1 INTRODUCTION 3

2 LINER SHIPPING SERVICES AND LINER SHIPPING AGREEMENTS 7

3 OVERVIEW OF EXEMPTIONS FOR LINER SHIPPING AGREEMENTS IN OTHER JURISDICTIONS 13

4 COMMISSION ASSESSMENT OF APPLICATION 19

A Framework for analysis 19

B Vessel Sharing Agreements 20

C Voluntary Discussion Agreements 35

5 SUMMARY AND EXPLANATORY NOTES REGARDING THE PROVISIONS OF THE PROPOSED ORDER 48

6 PROPOSED TRANSITIONAL ARRANGEMENTS 53

ANNEX PROPOSED BLOCK EXEMPTION ORDER UNDER SECTION 15 OF THE ORDINANCE

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 seeks 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.

The Applicant

1.7 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.

1.8 The Applicant currently has 17 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 Marine (Hong Kong) Ltd.;
(f) Hamburg Sud Hong Kong Ltd.;
(g) Hanjin Shipping Co., Ltd.;
(h) Hapag-Lloyd (China) Ltd.;
(i) Hyundai Merchant Marine (Hong Kong) Ltd.;
(j) "K" Line (Hong Kong) Ltd.;
(k) Maersk Hong Kong Ltd.;
(l) Mitsui O.S.K. Line (H.K.) Ltd.;
(m) N.Y.K. Line (H.K.) Ltd.;
(n) OOCL (H.K.) Ltd.;
(o) United Arab Shipping Agency Co. (HK) Ltd.;
(p) Wan Hai Lines (H.K.) Ltd.; and
(q) Yangming Marine Transport Corporation.

1.9 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 such agreements entered into by carriers which are not members of the Applicant would also be covered by any block exemption order which the Commission might make as a result of the Application.

Handling of Application and other steps

1.10 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.[2]

[2] 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,

1.11 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.

1.12 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. The views received in this context have assisted the Commission's consideration of the Application.

1.13 The Commission has held several meetings with the Applicant and issued it with two written requests for information aimed at clarifying and seeking further information on various issues in the Application. The Applicant has separately provided two submissions on specific issues in the Application.

1.14 In addition, the Commission has consulted an industry expert to obtain and verify certain information in relation to the liner shipping industry. The Commission has also obtained general background information from its counterpart agencies in other jurisdictions which provide for exemptions for liner shipping agreements.

The Proposed Order and section 16 consultation

1.15 Based on its preliminary views regarding the Application, the Commission proposes to issue a block exemption order for VSAs ("**Proposed Order**"). The text of the Proposed Order is attached as the Annex to this Statement of Preliminary Views.

1.16 This Statement of Preliminary Views 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);

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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.

(b) the Commission's provisional assessment of the Application and its reasons for the Proposed Order (Part 4);

(c) an explanation of the provisions of the Proposed Order (Part 5); and

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

1.17 In accordance with the procedure set out in section 16 of the Ordinance, the Commission must publish notice of the Proposed Order and consider any representations about the Proposed Order that are made to it ("**section 16 consultation**"). The Commission is therefore seeking views from interested parties (including the Applicant) on the Proposed Order and/or the Commission's provisional position on the Application as detailed in this Statement of Preliminary Views.

1.18 It should be emphasised that the conclusions with respect to the Application in this Statement of Preliminary Views are provisional only. The Commission welcomes substantive information or evidence from parties participating in the section 16 consultation as to whether the VSA activities proposed to be exempted by the Proposed Order meet the terms of the efficiency exclusion. The Commission has, for example, identified certain further information regarding the efficiencies associated with VSAs which would assist the Commission in reaching a final decision as to whether the relevant VSA activities meet the terms of the efficiency exclusion.

1.19 On the basis of the representations received during the section 16 consultation and the Commission's provisional position on the Application, the Commission will then make a final decision on the Application and whether or not to issue a block exemption order under section 15 of the Ordinance.

1.20 While the Commission is not proposing to issue a block exemption order for VDAs for the reasons explained in this Statement of Preliminary Views, the Commission welcomes submissions from all parties on this aspect of its proposed decision on the Application.

1.21 For further details on the section 16 consultation, parties are referred to the Commission's *Notice issued under section 16 of the Competition Ordinance of a proposed block exemption order for certain liner shipping agreements*.

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 (also known as conventional or break-bulk shipping). Most goods may be transported either in containers or general 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.[3]

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 Preliminary Views or included in the scope of the Proposed Order.

[3] 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 Preliminary Views or the Proposed Order (see further paragraph 5.7 below).

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 Preliminary Views, 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 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.[4] 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 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

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

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.[5] Cargo which passes through Hong Kong but for which the ultimate port of origin or destination is elsewhere (including other ports in South China) is considered transshipment cargo. Based on Census and Statistics Department data, around 31% of total container throughput for

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

Hong Kong Port in 2015 was made up of direct cargo, while transshipment cargo accounted for around 69%.[6]

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 2015, the port of Hong Kong provided around 340 container liner services per week connecting to about 470 destinations worldwide.[7] Liner shipping services account for the largest proportion of Hong Kong's ocean trade, with approximately 80% of all ocean trade in Hong Kong estimated to take place through container shipping.[8]

2.23 Hong Kong is therefore recognised as a significant global trading hub, with Hong Kong's port ranking fifth globally in terms of container throughput.[9] In this context, the liner shipping and related industries provide significant economic benefits for Hong Kong. In 2014, for example, the port of Hong Kong and the maritime industry contributed 1.4% to Hong Kong's GDP and employed 2.5% of Hong Kong's labour force.[10] These industries in turn provide an important contribution to the trading and logistics industries, which in 2014 accounted for 20.0% and 3.4% of Hong Kong's GDP respectively and 20.4% of Hong Kong's total employment.[11]

Liner shipping agreements

2.24 The Applicant submits 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 Applicant does not seek a block exemption order in respect of rate-fixing agreements, also known as conferences. Conference agreements were the traditional form of cooperation between carriers and involved the fixing of freight rates and other conditions of carriage on particular routes. The Applicant indicates that conference agreements are no longer representative of the liner shipping

[6] Hong Kong Shipping Statistics, Fourth Quarter 2015, Census and Statistics Department. Total container throughput refers to laden containers for ocean container transport and river container transport.

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

[8] Based on Hong Kong Census and Statistics Department and Drewry estimates in respect of 2013.

[9] Based on Hong Kong Shipping Statistics, Fourth Quarter 2015, Census and Statistics Department, in respect of 2015.

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

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

agreements which currently operate in the industry in Hong Kong, while other forms of liner shipping agreements are not addressed in the Application. The Commission's assessment has therefore focused solely on VSAs and VDAs, and other forms of liner shipping agreement have not been considered.

2.26 The Applicant has 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.

Vessel sharing agreements

2.27 VSAs are agreements between carriers in which parties discuss and 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. For the purposes of

this Statement of Preliminary Views and the Proposed 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 and other terms offered to customers (including freight rates and surcharges applicable to the transportation of cargo and ancillary services, and other terms of service). 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 VDAs also provide for the exchange of other, more general information in relation to trades, such as statistics, reports or other information relating to market trends, economic forecasts, operational or technological developments, and policy or legal issues.

2.34 Finally, 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.

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. In addition, certain parties which participated in the preliminary consultation suggested that the approach of a particular jurisdiction or jurisdictions be adopted in the Commission's decision on the Application.

3.2 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 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 a Convention on a Code of Conduct for Liner Conferences in 1974 (which entered into force in 1983), setting forth certain regulations for conference agreements.[12]

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.[13] 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.

[12] 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 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.

[13] 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.

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 grants an exemption from the relevant competition laws.[14] 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**").[15] Similarly, in Israel, a block exemption limited to VSAs entered into force in January 2013,[16] while in India, VSAs have been exempted from the relevant competition rules by virtue of a series of government notifications.[17]

3.9 In Singapore, a block exemption order for liner shipping agreements (covering both VSAs and VDAs) has been in force since 2006.[18] 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. This block exemption order covers 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.[19]

3.10 In mainland China, international liner shipping agreements are subject to specific sectoral legislation.[20] Liner conference agreements, operational and pricing

[14] 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.

[15] 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).

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

[17] See most recently Ministry of Corporate Affairs Notification of March 2016, which exempted VSAs from relevant Indian competition rules for a period of one year from the date of the Notification.

[18] 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.

[19] Competition (Block Exemption for Vessel Sharing Agreements and Voluntary Discussion Agreements in respect of Liner Shipping Services) Order 2014.

[20] 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.

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.[21]

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, however, the relevant exemption does not contain an express requirement for efficiencies to be passed on to customers. The block exemption order is issued by a government minister as designated under the Singapore Competition Act 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.

[21] 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.

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.[22]

(c) Shortly afterwards, the EU launched a review of its previous block exemption for conference agreements ("**EU Conference BER**").[23] This resulted in the repeal of the block exemption in 2006, subject to a transitional period of two years.[24] 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.[25] 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.[26]

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

[23] 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.

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

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

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

(d) In New Zealand, a Commerce (Cartels and Other Matters) Amendment Bill has been introduced to Parliament, which if enacted will repeal the competition regulation in the Shipping Act and the exemption in the Commerce Act. Liner shipping agreements would then be subject to the general competition regime under the oversight of the New Zealand Commerce Commission.[27]

(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.[28] The Australian Government response to the Harper Review indicated that it "remained open" to this recommendation.[29]

3.16 In some cases, it has been decided not to make substantive amendments to the existing regime following relevant reviews. 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. In Japan, the Japan Fair Trade Commission ("**JFTC**") conducted a review of the antitrust exemptions for international ocean shipping under Japanese law in 2016.[30] While the JFTC concluded that there was no case for maintaining the exemptions from a competition law perspective, the Japanese transport ministry has recently decided to leave the exemptions in place for the time being.[31]

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

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

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

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

[30] 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.

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

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 recently been granted in respect of VDAs and VSAs, though in the case of Malaysia the issuing of price recommendations by parties to such agreements is not covered. In certain jurisdictions, such as Australia and New Zealand, there are proposals that both VSAs and VDAs 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

A 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**").[32]

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

4.4 As noted in the FCR Guideline, the efficiency exclusion covers all objective economic efficiencies, including cost efficiencies and qualitative efficiencies.[33] 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.[34] Efficiencies resulting from the promotion of 'technical progress' may include efficiency gains resulting from economies of scale and increased effectiveness in research and development.[35]

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.[36] This also applies in the context of undertakings or associations of undertakings applying for a block exemption order.

4.6 Against this framework, the Commission's preliminary views on the application of the four conditions of the efficiency exclusion to VSAs and VDAs are set out in Sections B and C which follow.

B Vessel Sharing Agreements

4.7 VSAs involve agreements between competitors in the liner shipping industry to cooperate on certain aspects of their operations. Certain aspects 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 might include a reduction in service variety as between parties to a VSA (in terms of frequencies, port calls, choice of terminal, vessel speed and other service parameters on which shipping lines might compete), where services which would otherwise be provided by parties independently are provided jointly. The provision of a joint service could also potentially allow VSA members to control capacity in a market if the members of the VSA together had a degree of market power in that market. In addition, VSAs could potentially lead to an increase in the commonality of costs between parties to the VSA, since the costs of certain inputs may become aligned where a joint service is provided and/or a VSA might allow for the exchange of commercially sensitive information between the parties. These

[33] FCR Guideline, Annex, paragraph 2.8.

[34] FCR Guideline, Annex, paragraph 2.11.

[35] FCR Guideline, Annex, paragraph 2.12.

[36] FCR Guideline, Annex, paragraph 2.4.

factors could in turn enable parties to align market prices more easily and could ultimately result in higher prices.

4.9 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.

4.10 However, in general VSAs are unlikely to result in significant harm to competition, unless the parties are in position to control capacity in a market. 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 appear to involve any other element of price fixing or allocation of markets or customers.

4.11 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.

4.12 Taking the above into account, the factors relevant to whether VSAs meet each of the four conditions of the efficiency exclusion are considered in the paragraphs which follow.

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

4.13 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.

4.14 Based on its assessment of the Application, the Commission has reached the preliminary view that operational cooperation through VSAs may 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

4.15 According 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. To illustrate the point, the Applicant has provided the following example of the increase in services which [...] was able to offer its customers on the Asia to North Europe trade after it joined [...].

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

4.16 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.

4.17 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.[37]

[37] FCR Guideline, Annex, paragraph 2.11.

4.18 The Commission acknowledges that, in principle, VSAs should allow shipping lines to offer customers broader service coverage and higher service frequency than they would operating alone. In addition, VSAs may facilitate transshipment traffic, which relies on a high degree of connectivity. These issues are assessed in sub-sections (a) and (b) which follow.

(a) Ability to offer customers broader service coverage and higher service frequency

4.19 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.[38] Very significant financial resources are required to operate a vessel, with the purchase price for larger vessels today typically in excess of US$ 100 million.[39] In many cases, carriers would be unable or unwilling individually to offer such a regular service on a number of routes, particularly where smaller carriers are concerned.

4.20 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, each individual carrier should be able to offer a wider range of services to their customers than would otherwise be the case.

4.21 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. From the customer's perspective, this could give rise to a number of benefits. In particular, a customer can obtain access to the services of multiple carriers while avoiding the need to purchase such services separately from each carrier. This may save the customer the time and resources associated with negotiating multiple arrangements, and may lead to lower prices as the customer can contract the entirety of its volumes with a single carrier.

4.22 However, it can be conceived that VSAs would not only expand the service options and frequencies which an individual carrier can offer to its customers, but may also lead to broader service coverage and higher frequencies in the market as a whole. For example, there may be certain routes where a joint service is provided

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

[39] [...].

through a VSA but the individual VSA members would be unwilling or unable to operate the service on a standalone basis without the VSA.

4.23 Further empirical evidence would assist the Commission in formulating a final view on this particular efficiency claim. With regard to the claim that VSAs allow individual carriers to expand the services they offer to customers, the Commission notes the example provided by the Applicant in relation to the increase in services offered by […] after it joined […] and the Applicant has provided further examples relating to the mergers of alliances. However, parties, including the Applicant, could provide further empirical evidence on, for example, the proportions of particular carriers' cargo on particular trades or routes which are carried on the vessels of other VSA members and indicate how this compares or would compare with the scenario where there were no VSAs in place. In addition, empirical evidence showing the extent to which VSAs have allowed carriers to offer broader service coverage and higher frequencies to customers as a whole (rather than from the perspective of an individual carrier) would help the Commission to form a final view in relation to this efficiency claim.[40]

(b) Impact of VSAs on transshipment traffic

4.24 The Applicant and a number of parties which participated in the preliminary consultation have referred to the importance of maintaining Hong Kong's status as a transshipment hub. Hong Kong port 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).

4.25 The Commission considers, on the basis of its preliminary view that VSAs may lead to broader service coverage and higher frequencies in the sense described

[40] The Commission acknowledges that VSAs have been commonly used on trades involving Hong Kong for a long time, such that there may not be existing counterfactual scenarios for the purposes of providing the further empirical evidence outlined above. It should, however, be possible to posit hypothetical counterfactual scenarios, based on for example a situation where the carriers cannot take advantage of VSAs.

above, that VSAs also likely 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.[41] Certain parties which participated in the preliminary consultation referred specifically 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 benefits Hong Kong importers and exporters by ensuring a greater volume of liner shipping services in Hong Kong than might otherwise be the case.

4.26 In addition, VSAs may facilitate transshipment 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 significantly increased where those carriers form part of a VSA. Although the Applicant has not specifically referred to such possible operational or technical benefits, further explanation or evidence of the ways in which VSAs facilitate transshipment for customers in this respect would be helpful for the Commission.

4.27 By facilitating transshipment traffic as outlined above, VSAs may be considered to contribute to "improving production or distribution" for the purposes of the efficiency exclusion.

Cost efficiencies arising from economies of scale

4.28 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 costs per TEU.[42] 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.

4.29 The Commission accepts that larger and more efficient vessels entail cost savings for carriers, as vessel operating costs per TEU carried will be lower.

[41] 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, section 3.3 ("Competitiveness for International Transshipment").

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

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.[43] Cost savings resulting from economies of scale may be categorised as promoting 'technical progress' for the purposes of the efficiency exclusion.[44]

4.30 In principle, the Commission accepts that VSAs may be expected to facilitate the use of these 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 may facilitate cost savings from the use of larger vessels than those previously in use on those secondary trades.

4.31 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). Operational costs for these purposes may include vessel costs, voyage and crewing costs, fuel costs, and port-related costs.

4.32 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. The types of information which could be provided in this regard by the Applicant and other parties include empirical evidence showing reductions in costs for particular carriers through the use of larger vessels and empirical evidence of higher utilisation rates on particular vessels as a result of their use as part of a VSA. The Commission would be interested in information about the

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

[44] FCR Guideline, Annex, paragraph 2.12.

extent to which frequencies might have been adversely affected by VSAs through the consolidation of individual carriers' services on certain routes.

Decreases in the costs of entry and expansion

4.33 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 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 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 […], […] now has space on the alliance's six weekly services, without the need to absorb any additional costs (see further paragraphs 4.15 to 4.16 above).

4.34 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. The ability of a carrier to offer its customers slots on another VSA members' service necessarily involves the entry or expansion of that carrier on the relevant route or service. In addition, 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.

4.35 Nonetheless, the Commission sees 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 can be expected to increase competition on the trade.

4.36 As mentioned, a large capital investment is required to purchase a sufficient number of ships to operate a service on a particular trade. VSAs permit carriers to offer services without the same vessel commitment as operating independently, and as such this may be considered to lower the costs of entry and/or expansion associated with operating on that trade.

4.37 This feature of VSAs may be particularly significant for smaller carriers, which would, if operating on their own, be unlikely to provide many of the services they can provide as a result of their participation in a VSA. 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 should enable smaller carriers to

compete on specific trades they would not be able to serve without the VSA. In this sense, VSAs may reduce smaller carriers' costs of entry and/or expansion. 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.

4.38 One party which participated in the preliminary consultation has, however, argued that this increase in competition may not occur as a significant number of smaller carriers have been acquired by larger carriers after joining a VSA. However, to the extent that smaller carriers remain independent entities, the Commission's considers that they should be able to benefit from lower costs of entry and expansion in the sense described. Examples of smaller carriers participating in VSAs (and which today remain independent) include Pacific International Lines (PIL), Sinokor Merchant Marine, and Wan Hai Lines.

4.39 In order to form a final view in relation to this efficiency claim, the Commission would benefit from further examples of carriers, particularly small ones, expanding their service offering by entering into VSAs.

Preliminary view on the first condition

4.40 On the basis of the efficiencies mentioned above, the Commission's preliminary view is that VSAs appear likely to satisfy the first condition of the efficiency exclusion (though as outlined further substantiation of certain aspects of the efficiency claims would assist the Commission in reaching a final conclusion in this respect).

4.41 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

4.42 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.[45]

4.43 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

[45] FCR Guideline, Annex, paragraph 2.13.

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.[46] 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

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

4.45 As elaborated above, the Commission accepts in principle that VSAs should give rise to broader service coverage and higher service frequency. Such efficiencies can be expected in and of themselves to benefit customers (i.e. the broader service 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 do indeed increase service coverage.

4.46 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 has 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.

4.47 The Commission accepts that the benefits of VSAs in terms of a broader service coverage and/or higher service frequencies may be less likely to be generated or fully exploited, and passed on to customers, if the VSA members are not subject to effective competition from outside the VSA. On this basis, the Commission proposes that the Proposed Order applies only where the combined market share of VSA members does not exceed a particular market share limit (see further Part 5 and the Proposed Order below).

Lower freight rates

4.48 The Applicant has argued that cost savings to carriers from better utilisation

[46] FCR Guideline, Annex, paragraph 2.15.

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.[47]

4.49 As a matter of general economic principle, the Commission considers that VSA members will be incentivised to pass any cost savings as a result of VSAs on to customers, provided they are subject to effective competition. The presence of effective competition will mean that carriers can be expected to attempt to win customers by passing on cost efficiencies in the form of lower prices. As mentioned, to address the need for VSAs to be subject to effective competition, the Commission proposes limiting the benefit of a block exemption order to VSAs where parties do not exceed a particular market share limit.

4.50 Certain parties which participated in the preliminary consultation have raised doubts as to the extent to which cost savings are in fact passed on to customers. They have indicated that the current low rates across the liner shipping industry are instead attributable to weak customer demand due to a slowdown in economic growth, coupled with excess capacity resulting from the purchase of increasingly large container vessels by carriers in recent years.

4.51 The Commission appreciates that market forces will inevitably impact rates, but does not agree that this necessarily means that cost savings from VSAs are not passed on to customers. Although it may be the case that rates would have decreased in any event due to current market conditions, VSAs may permit carriers to decrease rates to a greater extent as a result of additional cost savings.

4.52 Nonetheless, further empirical evidence demonstrating the pass on of cost savings from VSAs to customers would assist the Commission in formulating a final view on this issue. The data which could be provided include empirical evidence of reductions in freight rates following cost savings from the use of larger vessels and empirical evidence of freight rate changes as a result of higher utilisation rates on particular vessels through their use as part of a VSA.

Greater choice of carriers

4.53 The Commission agrees that VSAs may in principle decrease the costs of entry and expansion for carriers (in particular smaller carriers), by allowing them to offer services on specific trades without incurring the additional costs associated with

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

providing a service on an individual basis.

4.54 VSAs can therefore be expected to benefit customers by increasing the choice of carriers available, since more carriers will be able to offer services on particular trades. The presence of a higher number of carriers on a route will also entail a greater degree of competition to the benefit of customers, in particular since carriers continue to compete on price and market their services separately when parties to a VSA.

4.55 Further empirical evidence demonstrating the extent to which customers in Hong Kong benefit or have in fact benefitted from VSAs in terms of additional choices of carriers and the extent to which this translates or has translated into lower freight rates for example would assist the Commission in formulating a final view on this point.

Preliminary view on the second condition

4.56 The Commission has reached the preliminary view that consumers of liner shipping services likely receive or will receive a 'fair share' of the efficiencies generated by VSAs, provided the combined market share of VSA members does not exceed the market share limit as proposed in the Proposed Order. In reaching this view, the Commission has noted the relatively more limited potential for harm to competition to arise from VSAs relative to the more obvious nature of the efficiencies generated by such agreements. As such, it is more likely that the benefits accruing to customers compensate them for any actual or likely harm to competition associated with VSAs. As outlined above, further substantiation regarding the extent to which certain efficiencies are passed on to customers would help the Commission to reach a final decision regarding the application of the second condition.

Third condition: indispensability to the attainment of efficiencies

4.57 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".[48]

4.58 The potential restrictions on competition arising from VSAs appear to be

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

reasonably necessary to attain the efficiencies outlined under the first condition 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 arising from the VSAs would not be achieved.

4.59 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 Proposed Order permits certain specified activities related to VSAs but excludes conduct such as price fixing, customer allocation and output limitation from the scope of the exemption. 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 Proposed 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 Proposed 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 reasonable period of notice. These proposed 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 Proposed Order.

4.60 There also does not appear to be an economically practicable and less restrictive means of achieving the efficiencies. 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 considerably more restrictive effect on competition than VSAs.

4.61 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).

4.62 However, it might be expected that the provision of joint services through more integrated VSAs will achieve additional efficiencies compared to the use of slot exchange or charter agreements alone. The operation of a joint service may, for

example, give rise to cost savings and permit VSA members to offer additional frequencies or routes (which they would 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 suggests that the use of all forms of VSAs should be permitted (subject to the conditions of the Proposed Order) in order to achieve full range of VSA efficiencies.

4.63 On this basis and taking into account the conditions which the Commission would propose to include in the Proposed Order, the Commission's preliminary view is that restrictions on competition resulting from the VSA activities permitted by the Proposed Order are indispensable to the attainment of the efficiencies associated with VSAs.

Fourth condition: no possibility of eliminating competition

4.64 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 more harm to competition caused by an agreement, the greater the likelihood that the undertakings concerned are afforded the possibility of eliminating competition.[49]

4.65 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 seven and ten 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 30%.[50] 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 […].[51]

4.66 In any event, as mentioned, the Commission proposes to make the benefit of

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

[50] The trades in question are the following: Transpacific, Asia to North Europe, and Asia to Mediterranean. The relevant market share figures are based on data from Drewry Maritime Research and calculated based on total nominal TEU in 2015.

[51] The relevant market share figures are based on data from, respectively, […] and […] and calculated based on cargo liftings per carrier in 2014.

a block exemption order available only in respect of VSAs where the parties to the agreement do not exceed a particular market share limit in a market.

4.67 Second, VSAs, as permitted under the Proposed Order, will not permit any element of price fixing, output limitation or customer allocation or provide for joint marketing or pooling of revenues. As such, parties to VSAs may still compete for customers on such key parameters as price. A number of parties which participated in the preliminary consultation, including users of liner shipping services, confirmed that there is indeed significant competition for customers both between members of a VSA and between carriers within a VSA and carriers outside the VSA.

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

Preliminary view with respect to VSAs

4.69 Based on the above, the Commission is proposing that a block exemption order be issued in respect of VSAs (that is, the Proposed Order). In particular, the Commission has reached the preliminary view that VSAs likely fulfil the four conditions of the efficiency exclusion, provided that they meet the conditions of the Proposed Order. As noted, certain further information would help the Commission to reach a final decision in this respect.

4.70 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 arising from the agreements would not be realised.

4.71 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.[52] The particular features of the liner shipping industry outlined above, which have led to the capacity sharing and other forms of operational cooperation which occur in VSAs, may be noted in this regard.

[52] Applications Guideline, paragraph 5.4.

C Voluntary Discussion Agreements

4.72 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 and/or other terms offered to customers through VDAs may give rise to significant competition concerns under the Ordinance.

4.73 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.[53] In addition, the sharing of competitively sensitive information between competitors (which may include pricing and other terms offered to customers) may also harm competition. Where competitors share information on their future individual intentions or plans with 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.[54]

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

4.75 In the paragraphs which follow, it is considered whether VDAs meet each of the four conditions of the efficiency exclusion. Given that certain 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.

4.76 The exchange of other, more general information through VDAs may or may not amount to a contravention of the Ordinance, depending on the nature of the information concerned. As a general matter, the exchange of publicly available information is unlikely to involve a contravention of the first conduct rule, while the exchange of historical, aggregated and anonymised data is less likely to harm competition.[55] Certain of the information currently exchanged between carriers through VDAs can thus be exchanged without risk of contravening the Ordinance regardless of whether VDAs meet the conditions of the efficiency exclusion.

[53] FCR Guideline, paragraph 2.36.

[54] FCR Guideline, paragraphs 6.39 and 6.40.

[55] FCR Guideline, paragraphs 6.47 and 6.48.

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

4.77 According to the Applicant, the efficiencies brought about by VDAs are as follows:

(a) rate stability;

(b) service stability; and

(c) rate and surcharge transparency.

4.78 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.

Rate stability

4.79 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.

4.80 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) Whether rate stability amounts to an efficiency

4.81 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.

4.82 It can be noted that price or rate stability which is the result of coordination between competitors can generally be expected to entail rates for customers which are higher than would otherwise be the case. In the case of VDAs, carriers coordinate on prices by exchanging rate information amongst themselves and formulating recommended rate guidelines. As a matter of principle, such coordination gives 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).

4.83 Although, as the Applicant has pointed out, current market conditions may 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 the current significant overcapacity in the market), this may not be the case in future if market conditions are more favourable to carriers. In addition, 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 4.100 below).

4.84 Thus, in order to conclude that rate stability 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 to a greater extent than the harm they may suffer as a result of the possibility of higher rates. 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.

4.85 The Commission does not have any evidence that customers would receive sufficient benefit in this respect. Some customers who participated in the preliminary consultation agreed that they value rate stability as it enables them to better plan ocean transportation costs. However, 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. In any event, even if certain customers value rate stability, it has not been demonstrated that they prefer and benefit from rate stability to a greater extent than the harm they may suffer as a result of higher rates through VDAs.

4.86 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 any evidence that this is the case.

(b) Whether VDAs in fact result in rate stability

4.87 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".[56] In the Commission's preliminary view, the Applicant has not done so.

4.88 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.

4.89 The data provided by the Applicant and the feedback from a number of parties which participated in the preliminary consultation provide some support for

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

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.

4.90 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).[57] 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 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.[58]

4.91 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. Without more, the data provided by the Applicant does not 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.

4.92 Second, the Commission's own assessment and feedback received during its preliminary consultation suggest that VDAs may not in fact have the claimed

[57] 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.

[58] These alternative explanations for the comparatively higher level of rate volatility on the Asia to Europe trade than on the Transpacific trade are borne out by a 2012 study prepared by the US Federal Maritime Commission ("**FMC Study**") (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*).

moderating effect on the rates sought by carriers, and may possibly undermine rate stability in certain respects.

4.93 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 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 parties participating in the preliminary consultation put forward the view that GRIs announced through VDAs create more rate volatility than might otherwise be the case.

4.94 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 (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$[…] was announced on the Shanghai to Los Angeles trade in 2013, but in the end average rates in fact reduced by US$[…].[59] 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. 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.

Service stability

4.95 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.

[59] 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.

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 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.

4.96 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.

4.97 First, with regard to the claim that improved access to information through VDAs facilitates vessel deployment and investment decisions, it is in principle possible that this could be the case. However, the Applicant has not provided sufficient evidence of a causal link between VDAs and improved service levels as a result of improved investment or vessel deployment. 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 4.101 to 4.104 below.

4.98 In addition, the Commission notes that there is a significant volume of information regarding supply, demand and other market trends which is publicly available outside of VDAs and could be used with respect to decisions on vessel deployment and investment in tonnage and infrastructure. Indeed, the Applicant acknowledges that such information is regularly consulted by carriers. Such information includes port and terminal statistics, information from government sources, and publications from industry data providers (typically on a paid subscription basis) such as Alphaliner, Drewry, SeaIntel, and Lloyds List.

4.99 Although, as the Applicant argues, publicly available information may in some cases be less easy for smaller competitors to use or less current than the equivalent information shared through VDAs, certain information currently exchanged through VDAs can in any event be exchanged without risk of contravening the Ordinance (see further paragraph 4.76 above and more generally the FCR Guideline). As such, some of the relevant information can be exchanged regardless of whether VDAs meet the conditions of the efficiency exclusion and/or regardless of whether the Commission issues a block exemption order for VDAs.

4.100 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 allow carriers to remain in the market, thus negatively impacting service stability. However, the argument that VDAs mitigate against unsustainable prices necessarily suggests that VDAs 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.

4.101 Finally, 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.

4.102 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 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.

4.103 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.[60] However, this is not sufficient to demonstrate that the absence of rate discussions on the Asia to

[60] 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.

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 (mentioned in paragraph 4.90 above), which could equally account for such differences.

4.104 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 sufficient to establish that VDAs result in service stability.

Rate and surcharge transparency

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

4.106 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.

4.107 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).

4.108 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).[61] In addition to these *ad hoc* surcharges, a number of common surcharges such as BAF, CAF and THCs mentioned 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 submitted by the Applicant, 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.

4.109 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.[62] 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.[63]

4.110 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.

4.111 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. Certain users

[61] 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.

[62] 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.

[63] 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.

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

4.112 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

4.113 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.

4.114 The Commission does not accept that this argument can be taken into account for the purposes of applying the efficiency exclusion.

4.115 The Application 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 and do not concern any particular efficiency created by VDAs as such. It has not been explained, for example, why the issuing of rate guidelines and/or the exchange of future information on rates through VDAs would facilitate transshipment traffic.

4.116 The views received by the Commission in the preliminary consultation in any event 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 the third 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.[64] 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*.

4.117 On the other hand, the Commission's preliminary view is that VSAs may result in greater levels of connectivity and frequency of services, which, as mentioned, are important factors in facilitating transshipment traffic (see further paragraphs 4.25 to 4.27 above). The Commission is proposing to issue a block exemption order for VSAs.

Preliminary view on the first condition

4.118 On the basis of the above, the Commission's preliminary view is that VDAs do not fulfil the first condition of the efficiency exclusion.

Second, third and fourth conditions

4.119 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.

4.120 With respect to the second condition, since the Commission's assessment suggests that VDAs do not 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.

4.121 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 4.83 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 future if market conditions are more favourable to carriers. The Applicant acknowledges that surcharges are a way for carriers to recover certain ongoing costs

[64] Such factors are also listed in the Hong Kong Maritime Industry Council report, cited in footnote 41 above, in Executive Summary, section 3.3.

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.

4.122 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.[65] As such, the restrictions on competition to which VDAs give rise seem unlikely to be indispensable to the attainment of efficiencies.

4.123 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.[66] 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). In this sense, individual service contracts with rates fixed for the duration of the contract represent an economically practicable, less restrictive – and arguably more effective – way for parties to achieve rate stability.

4.124 In addition, there is a wide variety of publicly available information on many issues of relevance to both carriers and shippers. Based on the Applicant's submissions and the views received in the preliminary consultation, it appears that carriers and shippers can and do refer to such information in their decision-making on issues such as vessel deployment and investment in tonnage (in the case of carriers) or in their negotiations regarding liner shipping services (in the case of shippers). It is therefore doubtful to what extent competitively sensitive information exchanged between carriers through VDAs and the publication of VDA rate and surcharge guidelines can be considered 'indispensable', respectively, to the attainment of service stability and rate and surcharge transparency.

4.125 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

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

[66] 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.

competition".[67] As noted in paragraph 4.73 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. In any event, since the Commission's assessment suggests that the preceding conditions in the efficiency exclusion would not be fulfilled, the efficiency exclusion would not apply to VDAs regardless of whether or not the fourth condition is met.

Preliminary view with respect to VDAs

4.126 Based on its assessment of the Application, the Commission's preliminary view is that the Applicant has not demonstrated that VDAs meet the terms of the efficiency exclusion. The Commission therefore would not propose to include VDAs in the scope of the Proposed Order.

4.127 Proposed transitional arrangements in respect of VDAs are outlined in Part 6 below. These arrangements would also cover any VSAs which do not benefit from the Proposed Order.

5 SUMMARY AND EXPLANATORY NOTES REGARDING THE PROVISIONS OF THE PROPOSED ORDER

5.1 The Proposed Order for VSAs is attached as the Annex to this Statement of Preliminary Views. This Part provides a summary and explanation of the provisions of the Proposed Order.

Overall approach

5.2 The Proposed Order sets out a number of specific activities carried out in VSAs which the Commission considers should benefit from a block exemption. The Proposed Order also contains certain conditions, including a market share limit and a list of non-exempt activities, to which the exemption would be subject. Other provisions relate to the commencement, term and review of the Proposed Order and the definitions used in the Proposed Order.

Commencement, review and duration

5.3 Paragraph (1) specifies the date on which the Proposed Order would enter into force. If the Commission decides to issue a block exemption order following the

[67] FCR Guideline, Annex, paragraph 2.19.

section 16 consultation, this date is likely to be the date on which the Commission issues its decision in this respect.

5.4 Paragraphs (2) and (3) deal with the review of the Proposed Order by the Commission:

(a) In accordance with sections 15(4) and 19(1) of the Ordinance, the Commission must commence a review of the block exemption order on a date to be specified in the order, which may not be more than five years after the date of the order. The Commission proposes in paragraph (2) that it would commence a review of the Proposed Order four years after the commencement date of the Proposed Order.

(b) In addition, section 19(2) of the Ordinance permits the Commission to commence a review of a block exemption order at any time it considers appropriate. When considering whether or not to conduct a review of block exemption order under section 19(2), the Commission must take account of the list of matters specified in section 19(3) of the Ordinance. The Commission has therefore made provision for the section 19(2) review mechanism in paragraph (3) of the Proposed Order.

5.5 Section 15(3)(b) of the Ordinance provides the Commission with the discretion to specify a date from which a block exemption order is to cease to have effect. Under paragraph (4), the Proposed Order would continue in force for a period of five years from its commencement date, unless the Commission decided to vary or revoke the Order at an earlier time in accordance with section 20 of the Ordinance.

Definitions

5.6 Paragraph (5) sets out the defined terms which are used in the Proposed Order.

5.7 With respect to the definition for 'liner shipping services', the Commission proposes to exclude services relating to the 'inland carriage of goods occurring as part of through transport' from the definition. This means that any VSA-related arrangements between carriers regarding such services would not be covered by the Proposed Order. Though some VSAs do contain authorities for the members to jointly negotiate and procure inland services in varying degrees, the Applicant has indicated that this authority has not been utilised by most VSAs to date other than

with respect to terminals and stevedoring. The Commission considers that the latter 'dockside' activities form part of the provision of liner shipping services, and thus would not be excluded from the Proposed Order as involving the 'inland carriage of goods'. Such activities could be considered to fall within the scope of paragraph (6)(c) of the Proposed Order (i.e., 'the joint operation or use of port terminals and related services').

5.8 The Commission does not propose to limit the definition of 'liner shipping services' to the carriage of a particular type or types of cargo. In this respect, the Commission notes that VSAs may cover cargo carried in both containerised and non-containerised form (i.e. break-bulk cargo).

5.9 The definition of 'transport user' is intended to cover all customers of liner shipping services, including shippers, consignees, freight forwarders and logistics companies.

5.10 Finally, with respect to 'vessel sharing agreements', the Proposed Order defines such agreements in broad terms, in order to cover the varying degrees and forms of cooperation which may constitute VSAs. As noted in paragraph 2.30 above, it is intended that consortia, slot exchange agreements, slot charter agreements, joint service agreements, slot swap agreements and 'alliances' or 'strategic alliances' would all constitute 'vessel sharing agreements' for the purposes of the Proposed Order.

Excluded agreements

5.11 Paragraph (6) sets out the specific VSA activities which would benefit from the block exemption under the Proposed Order (i.e., the activities that may be considered to be 'excluded agreements' for the purposes of section 15 of the Ordinance). The list of activities provided largely corresponds to that in Article 3 of the EU Consortia BER.

5.12 Paragraph (6)(a) covers the joint operation of liner shipping services and provides a non-exhaustive list of exempted activities in this area. Paragraph (6)(b) refers to capacity adjustments in response to fluctuations in supply and demand (which may be considered necessary for the effective operation of a joint service), while paragraph (6)(c) refers to the joint operation or use of port terminals and related services.

5.13 By virtue of paragraph (6)(d), activities which are ancillary to those in sub-sub-paragraphs (a), (b) and (c) and necessary for their implementation would also be treated as excluded agreements under the Proposed Order. For example, this could

include 'rights of first refusal' (i.e. restrictions on the extent to which VSA members can sell vessel space to or obtain vessel space from non-VSA members), if such restrictions were necessary for the implementation of the VSA.

Conditions

5.14 Paragraph (7) sets out certain conditions which a VSA would need to fulfil in order to benefit from the block exemption in paragraph (6). In this respect, section 15(3)(a) of the Ordinance envisages that the Commission may, in a block exemption order, impose conditions or limitations subject to which the block exemption order is to have effect.

5.15 Paragraph (7)(a) provides that parties must not exceed the market share limit (see further paragraphs 5.16 to 5.22 below). Paragraph (7)(b) sets out certain activities which, if engaged in in the context of a VSA, would prevent the VSA from benefiting from the Proposed Order. These are price fixing, price recommendations or the exchange of pricing information, output restrictions other than the capacity adjustments which benefit from the Proposed Order by virtue of paragraph (6)(b), and allocation of markets or customers. Such activities have significant potential to harm competition and, in any event, are not considered to form part of the usual cooperation which takes place in the context of VSAs. Paragraph (7)(c) provides that each VSA member should be entitled to withdraw from the VSA without financial or other penalty, provided that they give such reasonable period of notice as is agreed between the members.

Market share limit

5.16 Paragraph (8) sets out the market share limit which is referred to in paragraph (7) as a condition of the Proposed Order.

5.17 The market share limit is formulated as follows:

(a) The primary market share limit is set out in paragraph (8)(a). Parties to a VSA would not benefit from the Proposed Order with respect to a particular market where they hold a combined market share of more than the specified percentage in that market.

(b) Paragraph (8)(b) provides that the primary market share limit in paragraph (8)(a) would be deemed not to be exceeded where parties to a VSA held a combined market share of not more than 5% above the primary market share limit for a period of two consecutive years in a particular market. This aims to give parties a degree of flexibility,

recognising that shorter term fluctuations in their combined market shares are unlikely to have a significant long term impact on the market.

(c) Paragraph (8)(c) sets out how market shares should be calculated for the purposes of the market share limit. In particular, parties should refer to the total volume of the goods carried, or the aggregate cargo carrying capacity of the vessels operating in the market, measured in freight tonnes or 20-foot equivalent units. In applying these methods of measurement, all goods carried or vessels operated by a party in the market should be included, regardless of whether the relevant goods are carried or whether the relevant vessels are deployed in the context of the VSA in question. As long as the combined market share of the parties to the VSA does not exceed the market share limit under either of the two methods of measurement, the agreement will be considered to be below the market share limit.

5.18 The Commission is proposing market share limits of 40% and 45% (corresponding to (a) and (b) above respectively) in the Proposed Order.

5.19 It should be noted that the market share limit is intended to set a threshold below which there is a sufficient degree of certainty that the claimed efficiencies arising from VSAs will in fact be generated and passed on to customers. If parties to a VSA exceed the market share limit and thus do not benefit from the Proposed Order, this would not necessarily mean that the efficiency exclusion did not apply in respect of that VSA but merely that the Proposed Order would not apply.

5.20 The Commission does not propose to provide binding rules in a block exemption order or elsewhere on how specific liner shipping markets should be defined for the purposes of calculating market shares.

5.21 As a general matter, however, parties should refer to the guidance on market definition in the Commission's *Guideline on the Second Conduct Rule*, and may also consider relevant case law or precedents where appropriate. The following general principles on geographic market definition can also be noted:

(a) The market for long-distance trades may generally be defined as the 'trade' between two ranges of ports in different geographic regions (for example, Northern Europe to North America or the Far East to the Mediterranean). Ports within the same region at the end of a single trade may generally be considered as substitutable (and thus part of the same geographic market). This is on the basis that such ports are

generally served by a dedicated group of ships and there is the possibility of inland transport or transshipment between ports.

(b) The market for intra-regional and/or feeder trades may generally be defined on the basis of shipping services between two locations within a geographic region (for example, Hong Kong to Vietnam or Hong Kong to the Philippines).

5.22 Of course, the relevant geographic market may be wider or narrower than suggested by the application of these general principles, depending on the characteristics of the trade in question. Ultimately, it would be for parties to assess whether their combined market shares exceeded the market share limit in light of the relevant market definition, and whether the other conditions for exemption in the Proposed Order were fulfilled.

Other issues

5.23 For the avoidance of doubt, the Proposed Order would be without prejudice to the application of the second conduct rule in the Ordinance. Pursuant to section 15 of the Ordinance, a block exemption order only confirms that a particular category of agreement satisfies the efficiency exclusion from the first conduct rule.

5.24 The Commission does not propose to include a filing requirement in respect of VSAs which exceed the market share limit or otherwise. It would be open to parties to a VSA which exceeded the market share limit, for example, to self-assess whether the VSA meets the terms of the efficiency exclusion or to apply to the Commission for a decision under section 9 of the Ordinance.

6 PROPOSED TRANSITIONAL ARRANGEMENTS

6.1 While the Commission does not propose to issue a block exemption order in respect of VDAs (and potentially certain VSAs will not benefit from the Proposed 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 proposes that it will:

(a) allow undertakings which are party to a VDA or a VSA which does not benefit from the Proposed Order a 'grace period' following the Commission's final 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 Proposed Order with respect to the period from 14 December 2015 to the end of the grace period.

6.3 The non-initiation of enforcement action would be 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.

6.4 The Commission proposes that the grace period would end six months from the date of the Commission's final decision on the Application. This period is considered sufficient to allow parties to make relevant changes, noting in particular that parties to many VDAs will already have made changes to their conduct with respect to other jurisdictions following the removal of exemptions covering VDAs in those jurisdictions.

6.5 For the purposes of these transitional arrangements, enforcement action would comprise the initiation of any proceedings before the Competition Tribunal under Part 6 of the Ordinance, or the issuing of a warning notice or an infringement notice under Part 4 of the Ordinance.

ANNEX

PROPOSED BLOCK EXEMPTION ORDER UNDER SECTION 15 OF THE ORDINANCE

* * *

Competition (Block Exemption for Vessel Sharing Agreements) Order [*DATE*]

In exercise of the powers conferred by section 15 of the Competition Ordinance, the Competition Commission issues the following Order:

Commencement, review and duration

(1) This Order comes into operation on [*DATE*].

(2) The Commission shall commence a review of this Order on [*DATE FOUR YEARS FROM COMMENCEMENT DATE OF ORDER*]

(3) Notwithstanding paragraph (2), and subject to section 19(3) of the Competition Ordinance, the Commission may review this Order at any time if it considers it appropriate to do so.

(4) This Order shall continue in force until [*DATE FIVE YEARS FROM COMMENCEMENT DATE OF ORDER*] or until such earlier time as varied or revoked by the Commission in accordance with the Competition Ordinance.

Definitions

(5) In this Order—

"liner operator" means an undertaking which provides liner shipping services;

"liner shipping services" means the transport of goods on a regular basis on a particular route or routes between ports and in accordance with timetables and sailing dates advertised in advance and available, even on an occasional basis, to any transport user against payment, but shall not include any inland carriage of goods occurring as part of through transport;

"transport user" means any undertaking (such as a shipper, consignee or forwarder) which has entered into, or intends to enter into, a contractual agreement with a liner operator for the shipment of goods; and

"vessel sharing agreement" means an agreement or a set of interrelated agreements between liner operators in which the parties to such agreement or

agreements discuss and 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.

Excluded agreements

(6) Subject to paragraph (7), the following activities of a vessel sharing agreement are hereby declared to be excluded agreements for the purpose of section 15 of the Ordinance:

(a) the joint operation of liner shipping services including any of the following activities:

(i) the coordination and/or joint fixing of sailing timetables and the determination of ports of call;

(ii) the exchange, sale or cross-chartering of space or slots on vessels;

(iii) the pooling of vessels and/or port installations;

(iv) the use of one or more joint operations offices;

(v) the provision of containers, chassis and other equipment and/or the rental, leasing or purchase contracts for such equipment;

(b) capacity adjustments in response to fluctuations in supply and demand;

(c) the joint operation or use of port terminals and related services;

(d) any other activity ancillary to those referred to in sub-paragraphs (a), (b) or (c) and which is necessary for their implementation.

Conditions

(7) In order for the activities of a vessel sharing agreement specified in paragraph (6) to qualify as excluded agreements, the vessel sharing agreement shall meet the following conditions:

(a) the parties to the agreement do not exceed the market share limit specified in paragraph (8);

(b) the agreement does not, directly or indirectly, authorise or require liner operators to engage in, or otherwise involve liner operators engaging in, any of the following activities:

(i) price fixing, the issuing of price recommendations, or the exchange of information with respect to prices charged or proposed to be charged by a liner operator to transport users;

(ii) the limitation of capacity or sales, other than the capacity adjustments referred to in paragraph (6)(b); and/or

(iii) the allocation of markets or customers;

(c) the agreement allows liner operators to withdraw from the agreement on giving any agreed and reasonable period of notice without financial or other penalty such as, in particular, an obligation to cease providing liner shipping services in a market, whether or not coupled with the condition that such activity may be resumed only after a certain period has elapsed.

Market share limit

(8) For the purposes of this Order, whether parties exceed the market share limit shall be determined as follows:

(a) parties to a vessel sharing agreement do not exceed the market share limit if they hold, in a market, a combined market share of not more than 40%;

(b) parties to a vessel sharing agreement shall be deemed not to exceed the market share limit in sub-paragraph (a) if they hold, in a market, a combined market share of not more than 45% for a period of two consecutive years;

(c) the market shares referenced in sub-paragraphs (a) and (b) shall be calculated by reference to:

(i) the total volume of the goods carried by each party to the vessel sharing agreement in the market, whether or not the goods are carried pursuant to the vessel sharing agreement; or

(ii) the aggregate cargo carrying capacity of the vessels operating in the market of each party to the vessel sharing agreement, whether or not the vessels are deployed pursuant to the vessel sharing agreement,

in each case measured in freight tonnes or 20-foot equivalent units.

Made [*DATE*].

[*SIGNATORY*]
Competition Commission