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Ms Rose Webb
Chief Executive Officer
Competition Commission
Room 3601, 36/F., Wu Chung House
213 Queen's Road East
Wanchai
Hong Kong

Dear Rose,

Consultation under section 16 of the Competition Ordinance regarding a proposed block exemption order for certain liner shipping agreements

The Hong Kong General Chamber of Commerce is pleased to submit its comments, as set out in detail in the attached, regarding the proposed block exemption order ("BEO") in relation to certain liner shipping agreements.

As you will note from the attachment, we are not sufficiently convinced that the Commission's proposals as set out in the consultation documents lend themselves to a complete or partial BEO denial respectively for Voluntary Discussion Agreements and Vessel Sharing Agreements.

We would also suggest that the Commission review its approach under the BEO application process, which, in this instance, appears to deviate from the Guideline on Investigations and has therefore given rise to considerable concern.

Yours sincerely,

Shirley Yuen
CEO

Att.

HONG KONG GENERAL CHAMBER OF COMMERCE
RESPONSE TO COMPETITION COMMISSION'S "PROPOSAL TO ISSUE A BLOCK EXEMPTION ORDER IN RESPECT OF VESSEL SHARING AGREEMENTS" ("THE PROPOSAL")

Executive Summary

- Under the Proposal, the block exemption order would be restricted to vessel-sharing agreements ("VSAs") between shipping lines whose market shares do not exceed 40 per cent. VSAs above that limit, and voluntary discussion agreements ("VDAs") between shipping lines, would be excluded from the block exemption order, and prohibited. By contrast, the block exemption order in Singapore covers both VSAs and VDAs, although under the former parties to liner shipping agreements with an aggregate market share of above 50% are required to file their agreements with the Competition Commission of Singapore, in addition to the fulfillment of other conditions and obligations in the Block Exemption Order, to qualify for the block exemption.

- By introducing a much more stringent regime for liner shipping agreements than Singapore, the Proposal could harm Hong Kong container port's competitive edge, given that it competes for transshipment business with ports in these locations, and transshipment accounts for 69 per cent of Hong Kong port's business.

- The Commission's final decision on this application for block exemption should therefore only be made after a very rigorous assessment of whether liner shipping agreements outside the scope of the proposed block exemption actually harm competition, and if so, whether they produce efficiencies which outweigh the harm to competition. It appears from the Proposal than no such rigorous assessment has yet been conducted.

- A refusal to extend the block exemption order to all liner shipping agreements does not automatically mean that those outside its scope are automatically in breach of the law, as the Proposal seems to imply. A separate investigation would have to be conducted in respect of those agreements before concluding whether they are in breach of the law, according to the procedures set out in the Commission's Guideline on Investigations.

Introduction

It has been HKGCC's consistent position that, especially in a small open economy like Hong Kong, regulatory intervention in the market should only be contemplated where a detailed Regulatory Impact Assessment ("RIA") shows that the benefits of intervening clearly exceed the costs. This is consistent with the Government's stated policy of light touch regulation, positive non-intervention, and "big market, small government". Under the Competition Ordinance ("CO"), the need for a cost versus benefit analysis can be seen in the framework for assessing agreements under the First Conduct Rule. First, there must in principle be a perceived need to intervene, i.e. to stop an agreement harming competition.[1] However, even if it can be shown that an agreement harms competition, intervention will not be justified if the agreement creates "overall economic efficiency", i.e. where the costs of losing the efficiencies arising from the agreement are greater than any benefits in of preventing harm to competition.[2] The same basic framework applies, whether the Commission is assessing an individual arrangement with a view to issuing a decision, or a category of agreements with a view to issuing a block exemption order.

In the Proposal, in spite of its title, the Commission is proposing to *refuse* (not *issue*) a block exemption order for liner shipping agreements (except for VSAs up to a certain market share level, namely 40 per cent) on the grounds that (a) they harm competition and (b) the Commission is not satisfied that they fulfil the criteria for exclusion on the grounds of "overall economic efficiency". It is also proposing to give the shipping lines a "grace period" of six months to ensure that their agreements comply with the CO, implying that (to the extent not covered by the block exemption) they contravene the CO and that the Commission may take enforcement action against them.This contrasts starkly with the position in Singapore, where its Commission only last year reached the opposite conclusion, renewing its block exemption for liner shipping agreements (both VSAs, at a higher market share cap that does not result in a loss in exemption status by default should the threshold be exceeded, and VDAs) for a further five years.

The potential impact of such a decision on Hong Kong, if it proceeds, should not be underestimated:

- The bulk of the cargo handled at Hong Kong container port is transshipment traffic - 69% according to the Proposal. On the Far East-Europe trades (at least), shipping lines have alternatives to Hong Kong as a hub for transshipment traffic, including Singapore and Mainland China ports. To subject the shipping lines to a much stricter regime in Hong Kong than in Singapore, as the Proposal would do, raises questions as to how this

[1] S 6(1).
[2] Sch 1 para 1.

could impact on the future business of Hong Kong port, particularly since it has already lost ground to Singapore and China.

- Such an approach also seems difficult to reconcile with Government policy. As the Government has said recently:

  "The port has always been a key factor in the development and prosperity of Hong Kong, which is strategically-located on the Far East Trade routes and is in the geographical centre of the now fast developing Asia-Pacific basin".[3]

  Moreover, the Government has recently set up the Hong Kong Maritime and Port Board, one objective of which is to "foster the long term development of Hong Kong's maritime industry and port".[4]

It seems unlikely that the CO was intended to harm critical Hong Kong industries, or to be enforced in a way which would do so. This would be the antithesis of competition. But at the very least, given the potential impact of the Proposal, **the Commission's final decision should only be made after a very rigorous assessment of whether liner shipping agreements actually harm competition, and if so, whether they produce efficiencies which outweigh the harm to competition. It appears from the Proposal that no such rigorous assessment has yet been conducted**. In particular, the Proposal does not demonstrate clearly that liner shipping agreements harm competition, or even if they did, that VSAs (above the 40 per cent market share cap) and VDAs have no efficiency benefits which outweigh the harm to competition. We shall deal with each of these matters below. Finally, we have some major concerns about the process which the Commission is adopting in this matter, which we shall also explain below.

Harm To Competition

In proposing to issue a block competition order for VSAs (subject to a market share cap) but not VDAs, the Commission seems to assume that VSAs and VDAs harm competition, contrary to Section 6(1) (otherwise there would be no prohibition from which they would need to be excluded). But the analysis in the Proposal does not clearly establish that this is the case.

As regards VSAs, the Proposal itself notes that, while VSAs provide for "upstream" capacity-sharing, they do not affect competition for customers "downstream":

> "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 no VSA customers members) on price and other competitive parameters such as customer service".[5]

As regards VDAs, the Commission states that recommended fee scales or reference prices of an association of undertakings "*may*" be considered to have the object of harming competition,

[3] "Hong Kong: The Facts: the Port" (April 2016) available at www.gov.hk.
[4] http://www.hkmpb.gov.hk/en/mpb/objectives.html
[5] Para 4.10.

even when they are not binding", and that sharing of commercially sensitive information between competitors "*may"* also harm competition.[6] Clearly "may" will not be good enough in a final decision: the Commission would have to demonstrate that VDAs *do* have the object or effect of harming competition. But the Proposal itself seems to indicate that VDAs do not harm competition, at least on price. The Commission finds that VDAs may actually undermine rate stability and contribute to rate volatility[7], and do not necessarily increase prices[8]. The Commission also notes that:

> "Parties can and do deviate from the recommended VDA rates, which suggests that in practice the VDA guidelines will not affect actual market rates. Certain users of liner shipping services which participated in the preliminary consultation indicated that, at least with respect to freight rates, VDA guidelines may not even be referred to as part of relevant rate negotiations."[9]

With these findings, it is difficult to see how the Commission can conclude that recommended fee scales or references prices in this case "may be considered to have the object of harming competition, even where they are not binding."

The concept of the "object" of harming competition was derived from EU competition law. In apply this concept, the European Court has held that the coordination must *in itself* reveal a sufficient degree of harm to competition, looked at in its economic and legal context.[10] Given the concrete available evidence cited by the Commission that VDAs have not in practice affected competition on price, it is difficult to see how VDAs could be said to have either the object or the effect of harming competition.

HKGCC has no view on whether or not VDAs harm competition. Our only view is that the Proposal does not set out clearly that they do, and that more evidence needs to be gathered from stakeholders on this subject so that the Commission can form a more definitive view.

<u>Efficiencies</u>

As regards VSAs, on the assumption that they cause some harm to competition (which as noted above seems dubious, even according to the Proposal itself), the Proposal finds that the efficiencies they generate outweigh the harm to competition. Nevertheless, the Commission proposes to limit the benefit of the block exemption only to agreements where the parties' market shares do not exceed 40 per cent. We cannot see any logical reason for any such cap:

- The Commission recognises that, while VSAs allow for capacity-sharing "upstream", they do not affect competition for customers "downstream". So if there is no effect on competition at that level, why is any market share cap at that level necessary or appropriate?

[6] Para 4.73.
[7] Section 4.93.
[8] Section 4.94.
[9] Para 4.111.
[10] C-67/13P *Groupement des Carte Bancaires v Commission* para 53.

- The Commission goes on to note "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"[11]. Clearly, the ratio of actual efficiencies to hypothetical potential harm would be even greater if no market share cap was imposed – so imposing such a cap seems illogical and counter-productive.

- It seems arbitrary that parties whose combined market share is 40 per cent should benefit from the block exemption but those whose combined market share is, say, 46 per cent should not, and be left with the uncertainties and costs of having to apply for an individual decision from the Commission. Such a cap may even have the counter-productive effect of restricting competition, by encouraging shipping lines to compete less aggressively for market share, lest they cross the market share threshold and thereby lose the benefit of the exemption.

- It is noteworthy that although there is a 50% market share threshold in Singapore, this does not automatically lead to a disqualification from block exemption in the event that the prescribed limit was surpassed. Instead, the Singapore Commission would conduct an assessment based on information provided by applicant parties to determine whether a higher than above market share would harm competition or reduce efficiency. This is in contrast to the rigid and simplistic approach proposed by the Commission, which assumes that anything in excess of the recommended (and lower) threshold inhibits competition and compromises economic efficiency.

As regards, VDAs, the Singapore Commission stated last year, without distinguishing between VSAs and VDAs, that: "the economic benefits resulting from liner shipping agreements are significant and enough to outweigh any such possible anti-competitive effects. .. In particular, they enable the connectivity of Singapore's container port with consequent broader benefits to the Singapore economy, and facilitate cost savings for the liners from resultant economies of scale."[12] It reached this conclusion after commissioning a consultancy study "which was based on both quantitative and qualitative information provided by industry stakeholders" as well as its own consultation with key industry stakeholders.[13]

By contrast, in the Proposal, the Hong Kong Competition Commission rejects each one of the efficiencies for VDAs put forward by the shipping lines.

As noted above, HKGCC has no view on whether or not VDAs harm competition. Nor do we have any view on whether or not, assuming they do harm competition, they have efficiencies which outweigh any such harm. Our view is only that the Proposal does not set out clearly whether or not they have such efficiencies, and that more evidence needs to be gathered from stakeholders on this subject so that the Commission can form a more definitive view.

[11] Para 4.56.
[12] "CCS's response to the public consultation of May 2015 on the proposed recommendation to the Minister on the Competition (Block Exemption for Liner Shipping Agreements) Order" para 5, available at www.ccs.gov.sg.
[13] N12 above.

Given the stark difference between the Singapore approach to VDAs and the proposed approach in Hong Kong, it is incumbent on the Commission to explain the reasons for this difference. This is particularly the case since:

- In reaching its decision, the Singapore Commission took into account "the [relatively small] size of the Singapore economy, that Singapore is not a major port of origin or destination, and that a very large proportion of Singapore's container cargo throughout involves transhipment"[14] - all factors which apply to Hong Kong as well.

- The Singapore Commission appears to have conducted more extensive consultations and studies than has the Commission, at least to date. It is not clear whether the Commission had access to the information available to the Singapore Commission in reaching its preliminary views.

Process Issues

We are concerned about the process that the Commission is following with regard to the Proposal. It seems from Section 6 of the Proposal ("Transitional Arrangements") that the Commission is not only proposing to decide on the application for a block exemption order. In addition, by proposing to give the shipping lines a transitional period to make any necessary changes to comply with the CO, the Commission seems to be implying that the current arrangements are in breach of the CO. Our concerns are as follows:

1. The Commission may refuse an application for a block exemption order if it is not "satisfied" that the criteria for exclusion are fulfilled in Schedule 1 paragraph 1. This is a subjective test. If the Commission does refuse the application, this is *not* equivalent to a decision that the current arrangements are in breach of the CO, as Section 6 seems to imply. The latter decision involves applying an objective test of whether the arrangements have the object or effect of harming competition and if they do, whether they fulfil the criteria for exemption.

2. For a breach of the CO to be established, the burden of proof is on the Commission to demonstrate to the requisite standard that the arrangements (a) have the "object" or "effect" of harming competition contrary to Section 6(1) and (b) do not fulfil the criteria for exclusion under Schedule 1 paragraph 1 (or indeed any other exclusions in Schedule 1). The burden of proof is not on the parties which are subject of an investigation into a suspected breach of the ordinance to prove to the satisfaction of the Commission that the arrangements do not harm competition, or (if they do) that the exclusion criteria are satisfied. As noted in Section 3 above, it seems from the Proposal that the Commission has insufficient evidence at this stage to reach any assessment on whether there is a breach, or to impose any transitional period for compliance.

3. A Commission investigation should follow the procedures set out in its own Guideline on Investigations, including the requirement that investigations be conducted *in confidence*:

[14] Para 9.

> "The Commission will generally investigate in private to protect the interests of all persons involved and will not make disclosures except where appropriate. To this end, the Commission will not normally comment on matters it is considering or investigating."[15]

Implying that the shipping lines are in breach of the CO in stating that the Commission proposes to give the shipping lines six months to comply with it, as section 6 of the Proposal does, would seem to contravene the Commission's own policy on confidentiality. As noted above, a decision to refuse an application for a block exemption application does not necessarily imply that the parties are in breach of the CO. HKGCC submits that the correct approach that should have been adopted in the Proposal is to set out the Commission's preliminary views on the block exemption application itself, and not to comment on the progress of any investigation and proposed transitional steps. In other words, Section 6 is inappropriate and should not have been included in the Proposal. The application for a block exemption, and the investigation into a suspected breach of the CO, are separate processes which should not be conflated.

Conclusions

Given the potentially serious impact to Hong Kong which the Proposal would have, by disrupting commercial arrangements which have been in place for many years, the Commission should proceed extremely cautiously and thoroughly. Before making any decision to refuse the application for a block exemption in respect of VSAs (above the 40 per cent threshold) and VDAs, it should demonstrate clearly that they harm competition, and that they do not produce efficiencies which outweigh that harm. The Proposal as it stands does not do so. In addition, the Commission should in future adhere to its Guideline on Investigations, and avoid conflating the investigation process with the process of assessing an application for a block exemption or decision, as it seems to have done in this case.

[15] Para 6.1.