



# DEPARTMENT OF JUSTICE

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Statement

of

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Before the

House Committee on the Judiciary

on

H.R. 3138

The Free Market Antitrust Immunity Reform Act of 1999

Washington, D.C.  
March 22, 2000

Good morning, Mr. Chairman and Members of the Committee. It is a pleasure to be back before this Committee to discuss promoting competition in ocean shipping, this time to testify in support of H.R. 3138, a bill that would remove the antitrust exemption for ocean carriers from the Shipping Act of 1984. The bill would phase out the exemption for intercarrier agreements after one year, while not affecting the immunity for marine terminal operators.

As I testified here last May, when this Committee was examining competition in the context of the Ocean Shipping Reform Act of 1998, the Antitrust Division believes as a general proposition that competition under the antitrust laws is the way to provide consumers with the best products and services at the most affordable prices. We do not believe that the ocean shipping industry has extraordinary characteristics that warrant departure from normal competition policy. Price fixing and other anticompetitive practices by conferences over the years have imposed substantial costs on our economy through higher prices on a wide variety of goods shipped by ocean transportation. In the current era of expanding globalization of trade, in which we are ever more dependent upon an efficient transportation system, it is all the more important that our public policy promote full and open competition.

### **History of Competition Policy in Ocean Shipping**

Over the last century, our national policies concerning ocean shipping have

resembled an awkward minuet, sometimes taking a step toward competition, sometimes taking a step toward regulation, and sometimes trying to go in both directions at once. It is instructive to review those policies and the assumptions upon which they rest, in order to determine the appropriate policies in today's economic environment.

At the time Congress was considering what became the Shipping Act of 1916, which included an exemption from the antitrust laws for ocean shipping conferences, conference agreements among ocean carriers were already prevalent. A 1914 report of the House Committee on the Merchant Marine and Fisheries, known commonly as the "Alexander Report," found that these shipping conferences had effectively monopolized nearly every American foreign trade route, through price-fixing, allocation of markets, and pooling of revenues. They had successfully conspired to drive competitors from the market or coerce them to join the conferences, through the use of conference-subsidized "fighting ships" that systematically undercut competitors' rates for however long it took to drive them out of business. Conferences also were using "deferred rebates" to lock customers into exclusive long-term relationships that made it even more difficult for competing carriers to break into the market; these rebates were not based on cost savings derived from large volume commitments but, rather, were simply rewards

for shipping exclusively with conference carriers throughout a given period. Furthermore, they were payable only after the shipper had continued the exclusive relationship throughout an additional period, thereby imposing a substantial monetary penalty on a shipper that dared to go outside the conference. Some conferences went so far as to blatantly refuse to carry shipments for shippers who had patronized non-conference carriers.

In the words of the House Committee on the Merchant Marine and Fisheries in its report on the 1916 Act, Congress had two possible courses of action: either prohibit conference agreements and allow competition to take root, or accept conference agreements and regulate their rates and practices. Congress opted for the regulatory approach, influenced substantially by the fact that ocean shipping was predominantly international in character and our major trading partners at the time, lacking comprehensive antitrust laws, generally condoned the conference system.

In the 1916 Act, Congress outlawed deferred rebates and fighting ships and required that conferences be open to all carriers who desired to join. Congress prohibited conferences from refusing to carry a shipper's cargo in retaliation for the shipper's use of non-conference carriers. However, the 1916 Act also expressly conferred an exemption from the antitrust laws for conference agreements on

shipping rates, pooling arrangements, and shipping route allocations, as long as those agreements were first submitted to and approved by the newly created U.S. Shipping Board (the body that later became the Federal Maritime Board and, eventually, the Federal Maritime Commission).

Following enactment of the 1916 Act, and particularly in the years after World War II as carriers once again were faced with overcapacity and competition from non-conference carriers, conferences began making extensive use of “dual rate” contracts to bind shippers to the conferences and stave off non-conference carrier competition. These dual-rate contracts, also referred to as “loyalty contracts,” offered discounted rates to shippers who agreed to use only conference carriers; they differed from the outlawed deferred rebates only in that the shipper could obtain the discount at the time it paid for a shipment. The Federal Maritime Board never challenged dual-rate contracts, but the Supreme Court ruled in Federal Maritime Board v. Isbrandtsen Co., 356 U.S. 481 (1958), that dual rate contracts, while not specifically prohibited by the Shipping Act, nevertheless violated a provision of section 14 of the Act that prohibited resort by carriers to discriminating or unfair methods because a shipper has patronized another carrier. The policy set by Congress in the 1916 Act, the Court held, was to allow a conference to deal with competitive issues among conference members themselves,

but to prohibit anticompetitive conduct undertaken by a conference or its members toward non-conference carriers.

In the wake of the Isbrandtsen decision, Congress amended the 1916 Act in 1961 to permit dual-rate contracts, though limiting the permissible discount to 15 percent. At the same time, Congress also amended the Act to require the filing of tariffs, to transfer the Board's authority to an independent Federal Maritime Commission, and to give the Commission the power to disapprove agreements between and among carriers that were "contrary to the public interest."

The Commission interpreted its public interest authority to encompass consideration of antitrust principles and, in Federal Maritime Commission v. Aktiebolaget Svenska Amerika Linien, 390 U.S. 238 (1968), the Supreme Court upheld that interpretation, along with the Commission's determination to approve conference restraints that conflicted with antitrust principles only if a conference could "demonstrate that the . . . rule was required by a serious transportation need, necessary to secure important public benefits or in furtherance of a valid regulatory purpose of the Shipping Act."

Carriers complained that the Commission's approach led to protracted proceedings that created regulatory uncertainty. Then, in 1979, the Department of Justice prosecuted a number of U.S. and foreign ocean carriers and their executives

for violations of the antitrust laws with respect to anticompetitive behavior that exceeded the scope of approved conference and other carrier agreements in effect at the time. Carriers called for legislative changes, and, in 1984, Congress substantially rewrote the 1916 Act.

The Shipping Act of 1984 addressed both of these issues. Congress broadened the antitrust exemption for carrier agreements and streamlined the process for obtaining Commission approval of those agreements. The exemption from the antitrust laws now covered not only agreements that had gone into effect under the Act, but also activities, “whether permitted under or prohibited by this Act,” if they were undertaken “with a reasonable basis to conclude” that they were pursuant to an effective agreement. The antitrust exemption was further expanded to cover intermodal through rates incorporating rail, truck, and ocean legs. The 1984 Act abolished the Commission’s public interest standard for reviewing carrier agreements. A carrier agreement would no longer require Commission “approval,” but would go into effect -- and thereby become immunized from the antitrust laws - - 45 days after filing or submission of any additional information requested by the Commission. Once an agreement has been filed, the only way it can be challenged is if the Commission seeks to have a court enjoin the agreement on grounds that it is “likely, by a reduction in competition, to produce an unreasonable reduction in

transportation service or an unreasonable increase in transportation cost.” (To the best of our knowledge, the Commission has never filed such a challenge.) The Act made clear that Commission enforcement would be the sole remedy for any conduct prohibited by the Act.

The 1984 Act otherwise retained the common carrier provisions of the 1916 Act, as amended in 1961, under which the conferences were required to file published tariffs with the Commission, and retained and somewhat expanded the list of explicit prohibitions against specific acts, including the prohibitions against fighting ships and deferred rebates. The Act provided for the use of service contracts in limited circumstances. Additionally, the Act directed that a study commission be established to make recommendations to Congress about further legislative changes that might be warranted.

The study commission was formed, but it was unable to reach a consensus on recommendations. The commission issued its report in 1992, and Congress began work on what would become the Ocean Shipping Reform Act of 1998. The 1998 Act took some notable competitive steps in the right direction, but it stopped short in some important competitive respects.

On the procompetitive side, the 1998 Act better guarantees that conference members can take “independent action”-- that is, may negotiate service contracts



with a shipper at rates that differ from the conference tariff -- and thereby compete for large volumes of business by offering discounted rates. The 1998 Act improves on the 1984 Act not only by requiring shipping conferences to permit individually negotiated service contracts, but also by helping protect carriers from anticompetitive pressure from the conferences by prohibiting the conferences from requiring carriers to disclose the rates in those service contracts.

On the other hand, the 1998 Act allows conference members to adopt so-called “voluntary” guidelines regarding individual service contracts, which a conference can use, along with its already significant influence over its members, to signal them as to expected behavior. At a minimum, this can be used to discourage vigorous competition with respect to individual service contracts.

These and other provisions of the 1998 Act perpetuate the conference system, either by facilitating intercarrier agreements that would be unlawful in the absence of an exemption or by restricting the ways in which conference members can meaningfully compete on an individual basis for the business of large and small shippers alike. The conference system could not exist in the absence of an antitrust exemption. Surely it is appropriate to ask whether such an exemption makes sense, especially at a time when countries all over the world are turning to competition, rather than regulation, as the best hope for economic prosperity.

## **Revisiting the Rationales for the Antitrust Exemption**

What we have today is a regulatory statute that has gone through a number of revisions and fine-tunings in an effort to create a regulatory environment that offers shippers some limited benefits of competition, while protecting carriers from full competition. We know the benefits of competition: low prices, innovative service, and efficient operations. Yet, shippers have been denied the full benefits of competition because carriers have been able to persuade policy makers over the years that the ocean shipping industry has certain characteristics that make it necessary to protect carriers from competition.

Supporters of the antitrust exemption for ocean carriers have been reciting essentially the same rationales from the beginning. Whatever may have been the force of those rationales at the time the exemption was first enacted in 1916, they have become increasingly dubious in the years since, and, when they are floated in the current economic and legal environment, they quickly take on water and begin to list.

Let me review those rationales with you today and explain why, in our view, they do not justify a departure from the competitive principles that other industries throughout our country -- and much of the world -- have come to live by. They tend to fall into two categories: those based on the economics of shipping and

those based on the international nature of the business.

A consistent theme of those supporting regulation, rather than competition, at the time of the 1916 Act was that carriers needed protection from the consequences of “too much” competition. Absent an exemption that would allow collective decision making by carriers, it was feared that carriers would engage in rate wars that would lead, in the words of the Alexander Report, to “the elimination of the weak and the survival of the strong.” It has been noted that the ocean shipping industry has high capital costs and that fixed costs are a high percentage of total costs. In such circumstances, concerns were expressed that carriers would be unable to cover their capital costs, which would ultimately drive inefficient carriers out of the market.

Note the implications of such arguments: carriers should be exempt from the antitrust laws because, absent the ability to collude, prices would be lower. As the General Accounting Office stated in a 1982 report to Congress, a primary objective of shipping conferences “is to increase the profits realized by their members as a group.” This is the *raison d’être* of a cartel. But, simply because competitors desire to collude in order to maximize their joint profits does not mean that it is good public policy to allow them to do so.

Furthermore, this rationale is difficult to accept, even on its own terms.

Arguments based upon concerns about “ruinous” or “destructive” competition are often made, but not easily substantiated. Congress has heard them many times before, often with respect to transportation industries such as railroads, airlines, and motor carriers. At one time or another, each of those industries was subject to pervasive federal regulation and enjoyed a broad exemption from the antitrust laws. Over time, however, each of them has been substantially deregulated and the applicable antitrust exemption has been curtailed or eliminated, with the result that competition has increased for shippers and consumers, and without the parade of horrors predicted by industry. In fact, economists have often found that a “regulated” cartel yields the worst of both worlds: high prices and low profitability, as companies over-invest in capacity and lose the incentive to innovate and operate efficiently. Certainly, recent events have demonstrated that the ocean shipping exemption has not saved U.S. carriers.

Also at the time of the 1916 Act, concerns were expressed that the international character of ocean shipping somehow made it inappropriate to subject the industry to antitrust laws. It was said that it would be unfair to apply U.S. antitrust laws just to U.S. carriers, but that attempting to apply them to foreign carriers would provoke our trading partners. Whatever may have been the validity of such a concern at that time, it has no continuing validity today. There has been

no doubt for many years that U.S. antitrust laws can properly be applied to persons engaged in foreign commerce with the U.S. and that the transportation of freight between the U.S. and a foreign country falls well within that principle. Thus, foreign carriers serving the U.S., no less than U.S. carriers serving the U.S., are subject to our antitrust laws with respect to those activities. Furthermore, the prospect that antitrust enforcement would create international disputes is far less now than then. In intervening years, foreign governments have made a pronounced shift to embrace free-market competition and to adopt and apply antitrust laws. Indeed, it is ironic to note that the most significant recent antitrust enforcement action with respect to ocean shipping in U.S.-Europe trades was taken by the European Commission a few years ago, when it imposed fines on U.S. and foreign carriers operating between the United States and Europe after determining that they had exceeded the scope of the applicable European exemption. Surely this puts to rest any contention that it would be inappropriate, as a matter of fairness or comity, for the United States to apply its antitrust laws to carriers operating to or from the U.S.

Perhaps a final rationale -- and one that reflects both the economic and international character of shipping -- is that some foreign countries subsidize their state-controlled carriers and operate them for reasons other than profit. This was a

significant concern to U.S.-flag carriers in the 1970s, but Congress has already dealt with that. The Shipping Act of 1984 contained provisions giving the Commission powers to disapprove rates of such carriers that were below a just and reasonable level.

In our view, the case for a broad exemption from the antitrust laws has never been a strong one and is especially weak today. Congress has acted decisively over the past 25 years to deregulate other transportation industries -- railroads, airlines, and motor carriers -- despite predictions that ruinous competition would harm carriers and consumers alike. The case for continuation of the antitrust exemption for ocean carriers is no stronger. Indeed, at a time when the U.S. model of deregulation -- coupled with appropriate antitrust enforcement -- is one of our most successful “exports,” the antitrust exemption for ocean shipping seems badly out of step with the times.

## **Conclusion**

Mr. Chairman, as I stated in my testimony last summer, the 1998 Act took an important but limited step forward toward more competition in ocean shipping. We now think the time has come for Congress to finish the job of establishing competition as the touchstone in this important industry by enacting your legislation to remove the antitrust exemption for ocean carriers. We believe that the ocean

shipping marketplace has the hallmarks of being one that can benefit, no less than other industries, from healthy competitive market forces.

Rather than continue to tinker with a regulatory structure and attempt to legislatively define which specific anticompetitive practices should be tolerated in which circumstances, we urge Congress to enact your legislation and allow competition to flourish -- subject only to the constraints imposed by our antitrust laws -- in the same way they do in the rest of our economy. A competitive marketplace protected by the antitrust laws will do more than the most carefully constructed regulatory scheme to allow competitive forces in the ocean shipping industry to benefit consumers, shippers, the economy, and ultimately the ocean shipping industry itself.