Drafting & Negotiating Contracts for Vessel Operations

Issues in Charter Parties for Ocean Going Vessels

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Drafting & Negotiating Contracts for Vessel Operations

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Pool and Alliance Agreements of Ocean Common Carriers and Antitrust Regulation

Dr. Andrei Kharchenko, American Law Institute,
March 12, 2020

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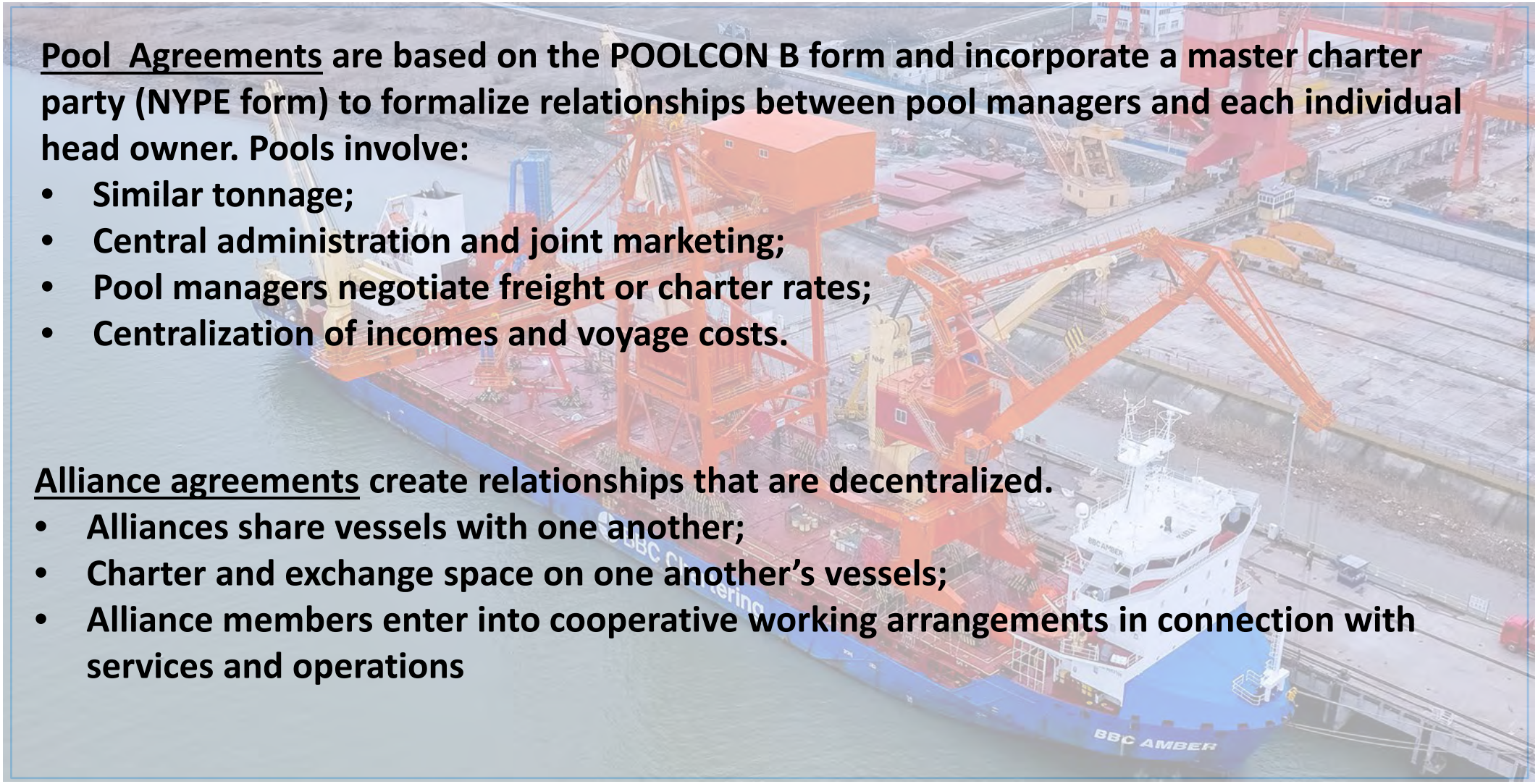
Vessel pools and alliances



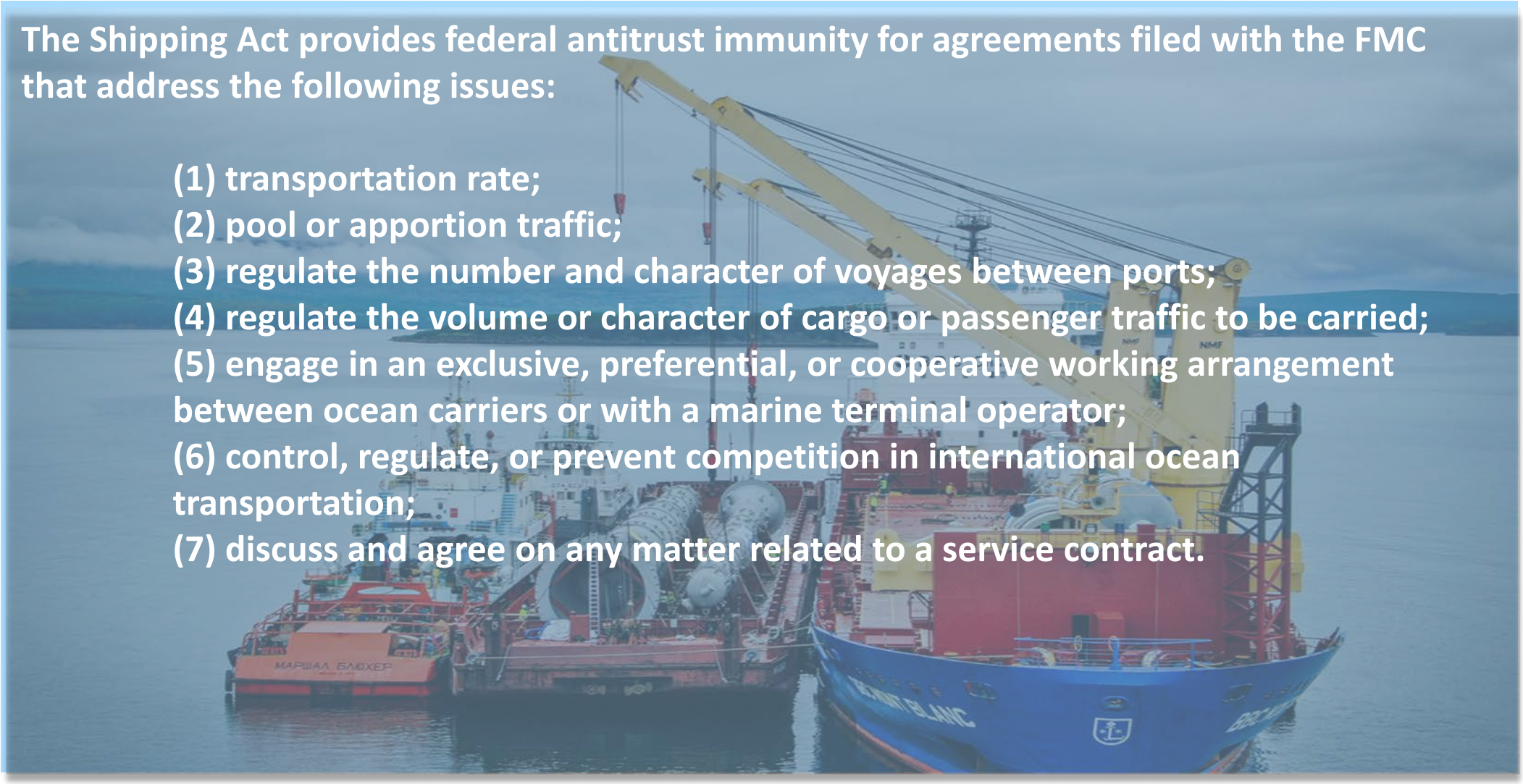
Pool Agreements are based on the POOLCON B form and incorporate a master charter party (NYPE form) to formalize relationships between pool managers and each individual head owner. Pools involve:

- **Similar tonnage;**
- **Central administration and joint marketing;**
- **Pool managers negotiate freight or charter rates;**
- **Centralization of incomes and voyage costs.**

Alliance agreements create relationships that are decentralized.

- **Alliances share vessels with one another;**
- **Charter and exchange space on one another's vessels;**
- **Alliance members enter into cooperative working arrangements in connection with services and operations**

The Shipping Act of 1984 and antitrust regulation



The Shipping Act provides federal antitrust immunity for agreements filed with the FMC that address the following issues:

(1) transportation rate;
(2) pool or apportion traffic;
(3) regulate the number and character of voyages between ports;
(4) regulate the volume or character of cargo or passenger traffic to be carried;
(5) engage in an exclusive, preferential, or cooperative working arrangement between ocean carriers or with a marine terminal operator;
(6) control, regulate, or prevent competition in international ocean transportation;
(7) discuss and agree on any matter related to a service contract.

Process of obtaining antitrust immunity

- Pool and alliance agreements must be filed with the FMC.
- The FMC reviews each filed pool or alliance agreement and can seek information about it.
- Each agreement is analyzed by the FMC with a four-tiered approach, considering
    1. Change of vessel capacity by more then 5%;
    2. Review of senior management committee minutes;
    3. Review how changes relate to change in freight rates;
    4. Review of confidentially filed carrier data for completeness and accuracy.

- If the FMC takes no action on such an agreement, that agreement becomes effective, and, pursuant to § 40307(a), the federal antitrust laws.
- A carrier must act continuously and unreasonably to violate antitrust law. 46 USC 41102.

NB: Close cooperation which eliminates cooperation is in violation of the Act
Market concentration is a useful indicator of violative effects. The bigger it is the more scrutiny pool/ alliance members will face.

Frank LoBiondo Coast Guard Authorization Act of 2018

Section 704 focuses upon alliances' and pool's impact(s) on certain covered services with respect to a vessel:

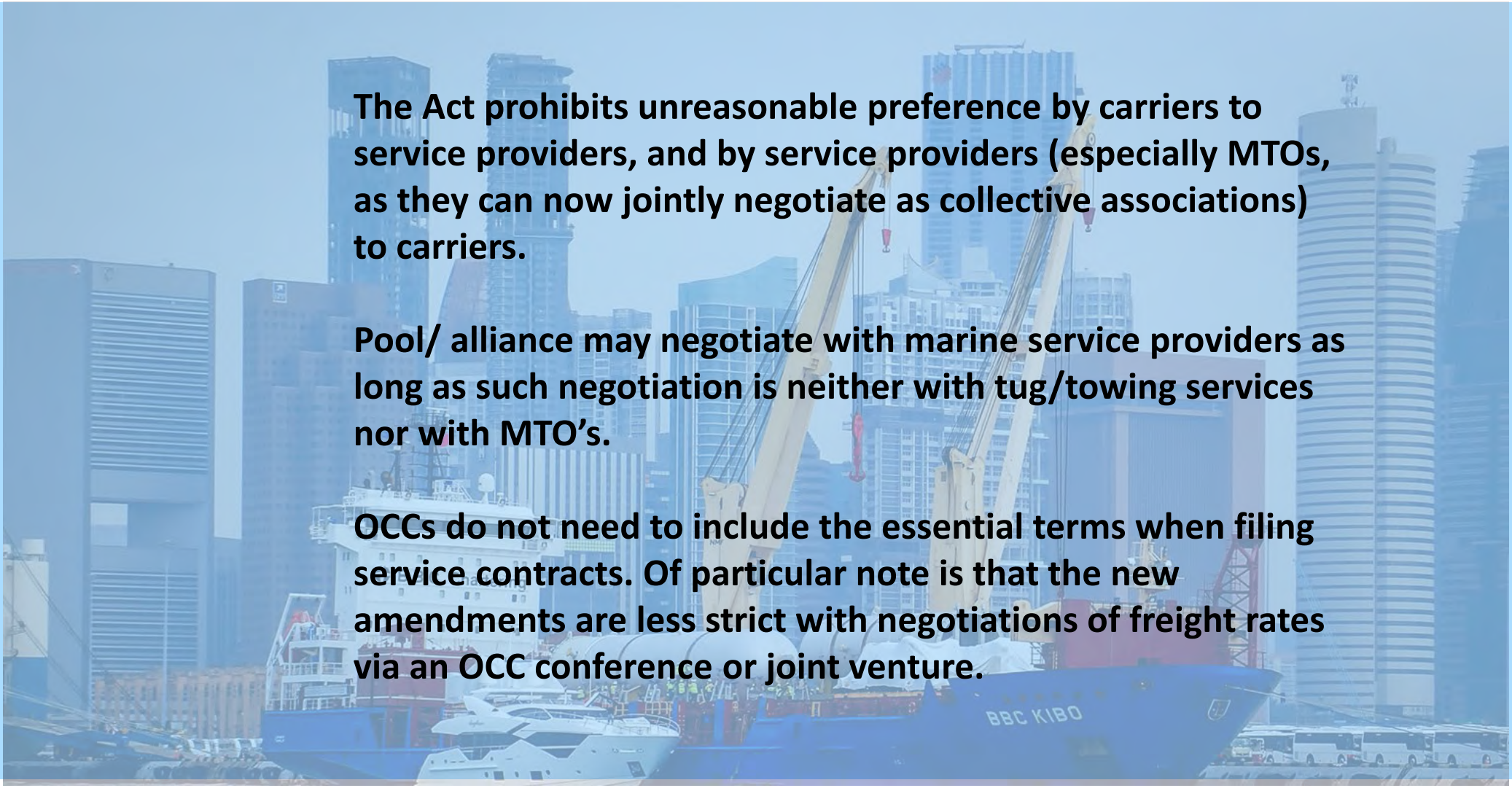
(A) the berthing or bunkering of the vessel;

(B) the loading or unloading of cargo to or from the vessel to or from a point on a wharf or terminal;

(C) the positioning, removal, or replacement of buoys related to the movement of the vessel; and

(D) towing vessel services provided to such a vessel.

Takeaways



The Act prohibits unreasonable preference by carriers to service providers, and by service providers (especially MTOs, as they can now jointly negotiate as collective associations) to carriers.

Pool/ alliance may negotiate with marine service providers as long as such negotiation is neither with tug/towing services nor with MTO's.

OCCs do not need to include the essential terms when filing service contracts. Of particular note is that the new amendments are less strict with negotiations of freight rates via an OCC conference or joint venture.

POOL AND ALLIANCE AGREEMENTS OF OCEAN COMMON CARRIERS AND ANTITRUST REGULATION

Introduction

Over the last years the ocean freight transportation industry has been challenged by global supply and demand disparity throughout the market, affecting both carriers and shippers. On occasion, there is overcapacity in the market, causing a major decline in the rates. There are also occurrences in which demand quickly increases, causing the rates to spike. Ocean carriers have benefited from these periods as increased demand triggers increased rates which can become unstable and, in turn, present a challenge to shippers in allocating and purchasing space.[1]

The last decade has seen significant changes to the ocean transportation services marketplace, with mergers and acquisition activity among shipping lines reducing the number of major ocean carriers serving the international trade, the bankruptcy of a top-ten ocean carrier, and the formation of three global alliances in container trade – 2M, OCEAN, and THE.[2] In addition, most ocean carriers started to incorporate strategies, such as mega-ship building, slow steaming (conserve fuel to increase transit times), vessel idling (removing vessels from rotation during slow periods), and internal cost-cutting.

Vessel Pools and Alliances

The alliance, or pool agreement, is the primary tool of horizontal cooperation, as it allows parties to discuss trade-specific economic conditions and to adjust the number of deployed vessels to maximize efficiency and minimize risk. A pool is not an integrated business organization, but a competition among its members in all sectors – sales, marketing, freight-pricing, strategy, finance, and office and other operations. Individual companies compete not only with the other members of their pool, but also with each other across pools.[3] Pools are formed by customized, individually negotiated contracts, pooling agreements, which often include a master charter party (often a common time charter).[4] There are many

[1] https://www.logisticsplus.net/understanding-the-new-ocean-carrier-alliances/
[2] Statement of Michael A. Khouri Chairman of Federal Maritime Commission before the United States Senate Committee on Commerce, Science and Transportation Subcommittee on Security, April 4, 2019, 8, available at https://www.commerce.senate.gov/services/files/F6DD1ADF-0A95-4E4F-9EC6-BF62AF1D2E66
[3] Statement of Michael A. Khouri Chairman of Federal Maritime Commission before the United States Senate Committee on Commerce, Science and Transportation Subcommittee on Security, April 4, 2019, 6, available at https://www.commerce.senate.gov/services/files/F6DD1ADF-0A95-4E4F-9EC6-BF62AF1D2E66
[4] Lorenzon, F., and Nazzini, R., op. cit., p. 97.

similar features of different pooling agreements, such as tonnage, central administration, joint marketing, negotiation of rates, and centralization of incomes and costs.[5]

Vessels united in a pool can react much quicker and more effectively to market demand and perform shipments efficiently in a more coordinated manner. The number of ballast legs is minimized and marketing, financing and vessel utilization is maximized.[6] An alliance is also less centralized than a pool. Alliance members share vessels and vessel space and enter into cooperative working arrangements to improve operating performance and efficiency. Members do not charter vessels to the alliance or its governmental body, but operate and share vessels and space only with one another.

The Shipping Act of 1984 and Antitrust Regulation

The Shipping Act of 1984 establishes a uniform framework by which the federal government regulates entities including, in relevant part, ocean common carriers. The Act has four specific purposes, one of which is to grow and develop United States exports through competition, efficient transportation, and increased reliance on the marketplace. The Act provides immunity for antitrust infractions to agreements filed with the Federal Maritime Commission ("FMC") that also do one of the following:

(1) discuss, fix or regulate rates, including capacity accommodations and other service conditions;
(2) pool or apportion traffic, revenues, earnings, or losses;
(3) allocate ports;
(4) regulate the number or character of voyages between ports;
(5) regulate the volume or character of cargo (including passengers) to be carried;
(6) engage in exclusive, preferential or cooperative working arrangements between or among themselves or a marine terminal operator;
(7) regulate or prevent competition in international ocean transportation; or
(8) agree on any matter related to a service contract.

The FMC reviews and, at times, investigates each pool or alliance agreement it receives via filing.[7] If the FMC takes no action on such filings, it becomes effective and, under § 40307(a), receives antitrust immunity as federal antitrust laws like the Sherman and Clayton Acts "do not apply to [it.]" Thus, activities that are described in § 40301 and undertaken for an agreement filed with the FMC are immune from federal antitrust laws.

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[5] EC Competition Law in the Trump Sector, Rosa Greaves, University of Olso, at 25.
[6] See Lorenzon, F., and Nazzini, R., Setting Sail on a Sea of Doubt: Tramp Shipping Pools, Competition Law and the Noble Quest for Certainty, in Competition and Regulation in Shipping and Shipping Related Industries, Martinus Nijhoff Publishers, Leiden – Boston, 2009, p. 96-97.
[7] 46 U.S.C.A. § 40304.

Agreements that pool and alliance members have permissibly filed with the FMC include space charter agreements, exclusive two-party agreements to share vessels within a limited geographic area, joint service agreements, cooperative working agreements, terminal rate discussion arrangements. The FMC analyzes each of these agreements by "a four-tiered" approach. The first tier is an immediate review of advance notifications of cancelled alliance sailings or other changes in vessel capacity that affect an individual alliance's weekly vessel supply by more than five percent of its prior average. The second tier consists of a careful review of submitted minutes of the most senior agreement committees that make vessel deployment decisions to assess medium or long-term capacity and its potential to affect freight rates. The third tier examines changes in pool members' current and projected vessel capacities its potential to affect freight rates. The fourth tier reviews confidential carrier data submitted by the pools to ensure it is complete and accurate and to identify any potential issues that may arise.[8]

The FMC considers "all the relevant factors in its unreasonable-preference analysis", including: a) commodity characteristics like size, weight or special handling needs; b) competition from (and the fair interest of) other carriers, traffic and cargo quantities, service costs and profit, public convenience, and circumstances of the respective customers – this consideration primarily seeks to determine the existing extent of competition; c) if the filing is or relates to a marine terminal lease(s), the market conditions, available locations and facilities, and the nature and character of potential lessees; and d) the need to ensure adequate and consistent service and service pricing for a port's carriers or shippers to promote a port's general economic health.[9]

An ocean carrier must act continuously and unreasonably to violate antitrust law.[10] This standard comes from a recent interpretive change and, while abstract, does not generally threaten reasonable and/or recent activities. The FMC reviews all carrier agreements before their implementation and may enjoin those that are "likely, by a reduction in competition, to" unreasonably reduce services or increase costs – i.e., agreements that are anticompetitive.[11] Based on recent developments, anticompetitive agreements are generally any that result in such close cooperation as to eliminate cooperation altogether. Anticompetitive agreements violate antitrust law and, thus, also violate the Act. Market concentration is a useful indicator of violative effects; indeed, the more market share (in an industry) a party has, the more scrutiny their actions receive.[12]

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[8] Statement of Michael A. Khouri Chairman of Federal Maritime Commission before the United States Senate Committee on Commerce, Science and Transportation Subcommittee on Security, April 4, 2019, 8, available at https://www.commerce.senate.gov/services/files/F6DD1ADF-0A95-4E4F-9EC6-BF62AF1D2E66 at 8.
[9] *Id* at 18.
[10] 46 U.S.C. § 41102.
[11] 46 U.S.C. § 41307.
[12] For instance, The Alliance comprised nearly 30% of the ocean container shipping industry, which indicated (but did not determine) a potential antitrust violation due to excessive market power.

Economic Conditions Leading to the Amendments of the Shipping Act

2018 was a comparatively stable and violation-free year for the container shipping industry, including COSCO Shipping's acquisition of a majority interest in Orient Overseas Container as well as a merger of three Japanese container lines (K, MOL, NYK) into Ocean Network Express. The new fuel regulation ("IMO 2020") requires, starting January 2020, that ocean carriers use either (i) 0.5% Sulphur-fuel or (ii) install scrubbers with 3.5% Sulphur fuel.

The benefits of mega-ship growth and market consolidation (from mergers or pool-creation) include greater economies of scale in the supply chain between shippers, ports, terminals and, ultimately, consumers. However, the failure to account for costs imposed on third parties (negative externalities) can lead to inefficient production decisions. In liner shipping, this includes extra-optimal quantities of mega-ships, pools or alliances. Thus, it is important to discuss and even debate whether a given action maximizes efficiency across the entire supply chain, rather than focusing primarily on minimizing carrier costs.[13]

Interestingly, port costs shouldered by mega-ships are significantly larger than those borne by normal vessels. However, this is only the tip of the iceberg, as many do not see that accommodating larger ships imposes larger infrastructure costs due to their requirements for bridge height, river width or depth, or port equipment alteration. In many countries, much of these costs is borne by the public sector – that is, taxpayers.[14]

Frank LoBiondo Coast Guard Authorization Act of 2018

On 4 December 2018, the U.S. President signed into law the Frank LoBiondo Coast Guard Authorization Act of 2018, introducing in Title VII "Federal Maritime Commission Authorization Act of 2017", amendments to the Shipping Act (46 U.S.C. § 40101-41309), effective as of that date. Since 1998, amendments to the Act address antitrust issues related to widespread consolidation and ocean carrier alliances that seek to improve efficiency and reduce oversupply of capacity. The amendments increase the authority of the FMC to monitor potential anti-competitive behavior by ocean carriers and maritime transport operators. They aim to protect U.S. ports and providers of certain maritime terminal operator services and tugboat operators - important links in the U.S. and global supply chains - and potential investments in related infrastructure.[15]

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[13] The Implications of Mega-Ships and Alliances for Competition and Total Supply Chain Efficiency: An Economic Perspective, November 2016, at 7.
[14] Id. at 16.
[15] Anitta Premti, New antitrust amendments to the U.S. Shipping Act, Article No. 31 [UNCTAD Transport and Trade Facilitation Newsletter N°81 - First Quarter 2019] available at https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2008

The Act amends multiple sections in the Shipping Act with the design of prohibiting anti-competitive behavior that would have a materially adverse effect on U.S.-based maritime infrastructure, marine services and equipment providers. Section 703 requires the FMC to conduct "an analysis of the impacts on competition for the purchase of certain covered services by alliances of ocean common carriers" on an annual basis. This statutory mandate is intended to promote active FMC oversight of all ocean carrier alliances to ensure that United States infrastructure interests are not disadvantaged.
However, the FMC will now defer to the Department of Justice ("DOJ") for interpreting and applying US antitrust law. Section 704 focuses upon alliances' impact on [certain vessel services, including]: (a) the berthing or bunkering of the vessel;(b) the loading or unloading of cargo to or from the vessel to or from a point on a wharf or terminal; (c) the positioning, removal, or replacement of buoys related to the movement of the vessel; and (d) ... towing vessel services provided to such a vessel.[16]

Overall, the new amendments allow the FMC to investigate (and the DOJ to determine) antitrust violations with a much broader scope that examines the size of negotiating parties, the advantage of one party over another, and the context of alleged antitrust violations. If there is a primary takeaway from these changes, it is that the overall intent, the aggregate actions, and the ultimate detriment to the US economy will be the deciding factors for whether a violation of the Act occurs.
Indeed, the Commission primary concern "is whether ocean carrier bunker charge adjustment formulas are clear and definite the FMC reports to the DOJ and whether the DOJ acts".[17]

Ocean common carriers ("OCC") may negotiate with marine service providers, although the new changes are stricter with respect to United States tugboats and towing vessels. A pool may negotiate with marine service providers only if such negotiation is neither with tug/towing services nor with marine terminal operators ("MTO"). Typically, marine service providers are seen as more vulnerable and thus receive greater protection than other third-party marine service providers (except of course tug/towing service providers, who enjoy even greater protection than port service providers). That said, Marine Terminal Operators ("MTO") are allowed to negotiate, independently or jointly in their own alliances, with ocean carriers and pools as long as they consent to do so with such carriers and file with the FMC any and all agreements between themselves and/or the carriers.

This joint negotiation, however, cuts both ways as collective bargaining can disadvantage smaller associations of carriers. At the same time, the Act prohibits carriers from giving unreasonable preference to service providers, or vice versa (especially terminal operators, as they can now jointly negotiate as

[16] Michael Cavanaugh, Congress Amends the U.S. Shipping Act, Broadening FMC Regulatory Authority, https://www.hklaw.com/en/insights/publications/2018/12/congress-amends-the-us-shipping-act-broadening-fmc
[17] See Statement of Michael A. Khouri Chairman of Federal Maritime Commission before the United States Senate Committee on Commerce, Science and Transportation Subcommittee on Security, April 4, 2019.

collective associations).[18] The Act does, however, permit "differential treatment among similarly situated parties only where valid differences in underlying circumstances actually motivated the decision-maker *at the time*."[19] Further, tying arrangements raise antitrust concerns.[20]

Lastly, the FMC announced that OCCs do not need to include the essential terms when filing service contracts. Of particular note is that the new amendments are less strict with negotiations of freight rates via an OCC conference or joint venture. Essential terms are the origin/destination ports, ranges of ports, cargo involved in the shipment(s), duration of the service contract and the minimum volumes contained therein. The FMC found that publishing these terms no longer contributed to a competitive environment (in the context of container shipping, that is). However, the FMC, refused to eliminate the carrier confidential service contract filing requirement.

Conclusion

A process of consolidation of ocean carriers that started with the container operators shifted to other segments: multipurpose, bulk and liquid. As alliances or pools of vessel owners can decrease freight rates compared to ones offered by individual owners, the increased bargaining power of pools of OCC can be detrimental to the economic interests of MTOs. At the same time, port infrastructure must be developed to accommodate larger vessels and increased marine traffic. It is crucial that MTO's can recover their costs in a normal course of doing business without being overly burdened. The FMC is aware of the ever-increasing pressure of industry consolidation and port congestion, its impact on U.S. exporters and their need for efficient ocean transportation in reaching foreign markets.[21] For that reason, preventing pools and alliances from negotiating with MTO's protects competition and national interests. While it will doubtfully have an immediate effect, in the long run we may see further development in renovating old ports and building new ones throughout the country.

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[18] *See* 46 U.S.C. § 41106.

[19] Port Elizabeth Terminal & Warehouse Co v. Port Authority of NY and NJ, 2019 WL 1763071, at 9.

[20] "A tying arrangement is an agreement between a seller and a buyer under which the seller agrees to sell a product or service (the tying product) to the buyer only on the condition that the buyer also purchases a different (tied) product from the seller or agrees not to purchase the same from another seller. Tying arrangements can also be used to combine services, leases, franchises, licenses..." *Infra* at 10.

[21] Statement of Michael A. Khouri Chairman of FMC before the United States Senate Committee on Commerce, Science and Transportation Subcommittee on Security, April 4, 2019, 8, available at https://www.fmc.gov/wp-content/uploads/2019/04/KHOURITestimony442019.pdf