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Working Party No. 2 on Competition and Regulation

COMPETITION CONCERNS IN PORTS AND PORT SERVICES

-- Submission by the US Department of Justice and the US Federal Trade Commission --

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1. Introduction

1. This submission begins in Part 2 with a description of U.S. ports, their ownership and management structure, and some ongoing developments in this sector. Part 3 outlines general competition concerns that affect infrastructure markets such as ports, and discusses the application of competition and economic principles in the analysis of operational and restructuring issues related to ports. Part 4 summarizes the statutory federal antitrust exemption for marine terminal operators and the role of the Federal Maritime Commission in regulating U.S. ports.

2. The U.S. Ports System

2. America's ports play an important role in handling merchandise trade moving to and from other ports around the world. Each year, these ports handle exports produced at U.S. factories and farms and imports of goods such as automobiles, machinery, electronics, apparel, shoes, toys, and food. American households depend on the nation's container seaports for everyday items, and American businesses depend on these seaports for facilitating the exchange of merchandise with trading partners around the world.[1]

3. There are 183 commercial deep draft ports in the U.S., dispersed along the Atlantic, Gulf of Mexico, Pacific, and Great Lakes coasts. Included in that number are the seaports of Alaska, Guam, Hawaii, Puerto Rico, Saipan, and the U.S. Virgin Islands. These ports are geo-economic entities, with a precise geographic location and fixed capital assets. They have diverse management structures, ranging from large landlord ports composed of multiple terminals operated by competing Marine Terminal Operators (MTOs) to small privately-owned ports.

4. There is no single national port regulatory authority in the U.S. Instead, regulatory authority is distributed throughout all three levels of government: federal, state, and local.

5. The U.S. Constitution grants the federal government exclusive jurisdiction over the navigable waters of the U.S., including its deep draft channels and harbors – authority delegated primarily to the Coast Guard and the U.S. Army Corps of Engineers. But federal jurisdiction over harbors stops at the water's edge. "Port authorities" in the U.S. are instrumentalities of state or local government established by enactment or grants of authority by state legislatures. Neither Congress nor any federal agency has the power to appoint or dismiss port commissioners or staff members, or to amend, alter, or repeal a port authority charter. Certain port activities are subject to federal law and jurisdiction, particularly those pertaining to foreign and interstate commerce.

6. The term "port authority" is not restricted to autonomous or semi-autonomous, self-sustaining public bodies. In fact, some port authorities are subject to certain state controls; many more are integral administrative divisions of state, county or municipal government.

7. There are also numerous commercial ports and terminals where no "port authority" exists – ports in which facilities are all privately owned and that frequently serve as bulk shipping facilities adjacent to a large industrial enterprise, such as an iron ore company or an electrical utility. There are also privately-owned and -operated ports that provide public services that are in most ways similar to those offered by public seaport terminals. Examples include the Port of Searsport, Maine, which is owned by the Bangor & Aroostook Railroad; and Benicia, California, where the port is owned by a private shareholder-owned corporation, Benicia Port Holdings. Some port authorities own facilities in two or more ports. The South Carolina State Ports Authority, for example, owns and operates marine terminal facilities in the ports of

[1] U.S. Department of Transportation, Maritime Administration.

Charleston, Georgetown, and Port Royal, South Carolina, which are located across 100 miles of the Atlantic coast. The basic distinction is that a "port" is a geo-economic entity whereas a "port authority" is a government entity.

8. Technological innovations over the past half-century have led to a decrease in cargo handling costs at many container ports. Of those innovations, containerization has led to the largest reductions in general cargo handling costs at ports. The advent of containerization facilitated a shift in how and where general cargo products are shipped, and in response to those changes, billions of dollars have been spent by container lines on new ships, by ports on their intermodal infrastructure, and by marine terminal operators on berths and equipment.

9. In container liner trades, cargo units have been standardized along the lines of the twenty-foot equivalent unit (TEU) intermodal container, and this standardization has allowed ports and liner companies to invest in mechanized systems and equipment to automate the cargo transport process and raise productivity.[2] By automating the process, containership operators have been able to speed the loading and unloading of vessels, increasing the amount of time a vessel is at sea rather than in port, and allowing the vessel operator to benefit from increasing economies of scale.

3. Identifying Competition Issues in the Ports Sector[3]

10. Ports, like other infrastructure sectors, are often characterized by capital stocks of sufficiently high fixed and sunk costs that their economies of scale are not exhausted at existing and forecast levels of demand, rendering duplication of facilities potentially costly and inefficient. Economists and other experts have responded to this issue with three broad categories of solutions:

- Separate the "natural monopoly" portions of a sector from those activities that may be efficiently opened up to competition; that is, continue some sort of regulation of the natural monopoly portions – for example, the price of access – while allowing competition to replace regulation for the remaining activities. The paradigmatic example of this strategy was the 1982 breakup of AT&T as the result of an antitrust suit brought by the U.S. Department of Justice,[4] but there are many other examples worldwide in many other sectors, such as railways.[5] An important detail is whether the "separation" is to be complete or would only require increased transparency of operations within an enterprise that remains vertically integrated.[6]

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2 Stopford, Martin. *Maritime Economics: 3rd Edition.* Routledge: New York (2009), 508.

3 See generally Russell Pittman, *Competition Issues in Restructuring Ports and Railways, Including Brief Considertation of these Sectors in India*, EAG 09-6 (November 2009), available at http://www.justice.gov/atr/public/eag/251856.pdf. The discussion in this part focuses on port/terminal commercial relationships with cargo owners, and not on other types of users such as steamship lines, stevedoring companies, etc.

4 Brennan, Timothy J., "Why Regulated Firms Should Be Kept Out of Unregulated Markets," Antitrust Bulletin 32 (1987), 741-793.

5 Newbery, David M., Privatization, Restructuring, and Regulation of Network Utilities, Cambridge, MA: MIT Press, 1999.

6 Pittman, Russell, "Vertical Restructuring (or Not) of the Infrastructure Sectors of Transition Economies," *Journal of Industry, Competition and Trade* 3 (2003), 5-26. On structural separation more broadly, see OECD Recommendation of the Council Concerning Structural Separation In Regulated Industries, *available at* http://www.oecd.org/dataoecd/24/49/25315195.pdf.

- Seek innovative ways to create competition among vertically integrated providers, where the economies of scale in the capital stock either have been reduced by technical change (telecoms) or persist in some aspects of scale but not others (railways). In railways, where economies of system size are typically exhausted before economies of density,[7] most of the countries in the Americas have chosen to rely upon competition among integrated providers competing at common points rather than seeking vertical restructuring and access by competing train operating companies to a common track.[8]

- Finally, and alternatively, renew strenuous attempts to achieve efficient operations within the traditional context of government ownership or government regulation. The literature on "incentive regulation" has constituted a spirited attempt to correct some of the well documented flaws of older systems of regulation without jettisoning regulation altogether.[9]

11. Increasingly, experts have recognized that competition may take unexpected forms. Railways face competition from motor or water carriers for many commodities. Cable television providers are increasingly offering telecommunications services, as are internet service providers; correspondingly, telecommunications services providers have begun offering cable television services. In the case of ports, it may be inefficient and unnecessary to create additional competition among terminals *within a single port* if there is competition *among ports*.

3.1. Competition in a Systems Context

12. Seaports are one component of a vertical chain that carries a product from producer to customer. This chain may include inland transport from producer to port, the multiple port services themselves, water transport, port services at the destination port, and inland transport to the final customer – as well as intermediate terminals at various stages for freight consolidation, plus agents offering to arrange particular steps, such as freight forwarders and third party logistics providers. Together these components constitute a system.

13. Competition analysis begins with market definition and analysis of the choices faced by both goods producers and goods customers. In defining the relevant market for a particular port, the issue on the producer side is whether that port has market power vis-à-vis that producer: is the producer forced to pay what the port charges if the producer is to sell its product, or does the producer enjoy other, economic alternatives? Such alternatives might be other ports, but they might also be other types of customers for the goods produced.

3.2. Market Definition on the Goods Producer Side

14. In the case of iron ore, for example, an important commodity for ports, a miner and processor of iron ore who wishes to export its product may be economically "captive" to one port, or may have several other ports among which to choose, depending upon his location, upon the internal transport options potentially serving alternative ports, upon the terminal facilities available at these alternative ports

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7 Savignat, M.G., and C. Nash, "The Case for Rail Reform in Europe – Evidence from Studies of Production Characteristics of the Rail Industry," International Journal of Transport Economics 26 (1999), 201-217.

8 Pittman, Russell, "Options for Restructuring the State-Owned Monopoly Railway," in Scott Dennis and Wayne Talley, eds., Railroad Economics (Research in Transportation Economics, v. 20), Boston: Elsevier, 2007.

9 Laffont, Jean-Jacques, and Jean Tirole, Competition in Telecommunications, Cambridge, MA: MIT Press, 2000.

(including whether he owns one such terminal himself), and upon the ability of alternative ports to serve as intermediaries to its ultimate customers – for example, the steel producers of another country. There may also be other economic options, such as other customers. For instance, there may be steel producers within his country or within a neighboring country that are economically reached by land transport who would pay a price for iron ore comparable to the (net) price received from those at the end of the sea voyage.

15. These possibilities are examined for important producers in the hinterland of the port to determine whether the particular port constitutes a market from their standpoint and whether a terminal owner would be able to exercise market power within the port. If a particular port is not a market from a competition standpoint, there is no concern about one firm controlling a large share of the traffic passing through that port. Returning to the systems context, if the iron ore producer can substitute economically between one vertical transport chain (system) that uses terminals in port X and another that uses terminals in port Y, then the question of competition at the level of individual terminals within a single port loses much of its importance.

16. One useful source of information for market definition may be "natural experiments." For example, one study found that

> *In the summer of 1997, the Union Pacific (UP) railroad … experienced a severe shortage of intermodal rail cars and locomotives in the [Southern California] region. This equipment shortage and the resulting backlog of containers for departure from the Ports of Los Angeles and Long Beach reached such a critical level that UP took the unprecedented step of chartering an APL ship – to transport containers from these ports, through the Panama Canal, destined for the Port of Savannah.*[10]

17. Similarly, another study found that when congestion in the ports of Los Angeles and Long Beach threatened to delay the delivery of imports to large US retailers as the Christmas season of 2004 approached, "some diverted their cargo to other West Coast ports or to all-water routes [i.e., through the Panama Canal]. From July through mid-November 2004, over a hundred ships were diverted to Oakland [California], Manzanillo [Mexico], and other ports…."[11]

18. A market definition exercise for different producers of the same commodity seeking to ship from a particular port, or for producers of different commodities seeking to ship from the port, may yield different answers regarding the scope of the relevant market. For example, containers may travel to the port as easily by motor carrier as by rail carrier, so in a region better served by roads than by rail, a producer using containers may enjoy more economic options – a broader relevant market – than a producer of a bulk good like iron ore that typically travels by rail. A terminal owner may be able to discriminate across different producers, exercising market power to "captive" shippers and offering competitive prices to those with more options. Thus the presence of some users of a particular port with multiple port options may offer little or no protection from monopoly abuses affecting other users who lack such options.[12]

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10 Talley, Wayne K., Port Economics, London: Routledge, 2009.

11 Bonacich, Edna, and Jake B. Wilson, Getting the Goods: Ports, Labor, and the Logistics Revolution, Ithaca: Cornell University Press, 2008.

12 ABA Section of Antitrust Law, *Market Definition in Antitrust: Theory and Case Studies*, Chicago: American Bar Association (2010).

3.3. Market Definition on the Goods Buyer/Customer Side

19. This market definition exercise for a port is then performed from the standpoint of the buyer/receiver of goods, with the same corresponding questions and issues raised. A steel mill receiving iron ore shipped via bulk freighter, a grain processor receiving wheat carried by bulk container, a large retailer receiving consumer goods carried by container – each of these may have very different sets of economic alternatives to a particular port, but in each case the same group of questions is asked: If the port charges monopoly prices, can the sender reach the receiver economically via another port? If a single port or a group of ports charges monopoly prices, can the receiver obtain the same goods via land transport, from domestic or other international producers? Market power and potential abuse by a port or group of ports vis-à-vis a single important receiver will not likely be tempered by the presence of other receivers who have more options (i.e., whose relevant supply markets are broader).

3.4. Intraport and Interport Competition

20. An important consideration in defining the relevant market is whether there is *intraport* competition – competition among different terminal operators within the port – or whether *interport* competition is sufficient to protect goods producers and buyers from anticompetitive behavior by the port in question.[13]

21. If all significant customers enjoy economic alternatives for their outputs, whether other ports or other kinds of options – which is another way of saying, if the port is not an economic market from the standpoint of any significant customer – then no single terminal owner can have market power in that port alone, and the terminals of the port may be placed under the control of a single private owner with no risk of monopoly abuses to follow. However, if this is not the case – if for certain exporters or importers of iron ore or petroleum or grain or manufactured goods carried in containers, the port is the only economic alternative – then the port constitutes an economic market, and restructurers may want to seek to create intraport competition: different terminals within the port offering the same services competing for the business of carriers serving importers and exporters.

22. Similarly, if, rather than a single port, it is a group of ports that constitutes an economic market from the standpoint of significant customers, the structure of that market becomes relevant. The issue is whether one firm may end up controlling sufficient terminal capacity for particular commodities in that group of ports – for example, in one broad area of one coast of a particular country – that it holds a position of market power over senders and receivers of those commodities.

23. Whether the focus of the competitive inquiry is intraport or interport competition, three ongoing international trends should be noted. The first is the continuing worldwide improvement in inland freight transport, tending to gradually increase the ability of users to substitute among ports economically and thus to reduce the focus on intraport as compared with interport competition.[14] The second is the growth – both

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13 Notteboom, Theo E., "Consolidation and contestability in the European container handling industry," Maritime Policy & Management 29 (2002), 257-269.
De Langen, Peter W., and Athanasios A. Pallis, "Analysis of the Benefits of Intra-Port Competition," International Journal of Transport Economics 33 (2006), 1-17.
Phang, Sock-Yong, "Competition Law and the International Transport Sectors," Competition Law Review 5 (2009), 193-213.
Talley, Wayne K., Port Economics, London: Routledge, 2009.
ABA Section of Antitrust Law, *Market Definition in Antitrust: Theory and Case Studies*, Chicago: American Bar Association (2010).

14 McCalla, Robert J., Brian Slack, and Claude Comtois, "Dealing with globalization at the regional and local level: the case of contemporary containerization," The Canadian Geographer 48 (2004), 473-487.

internal and through merger – of large multinational terminal operating firms.[15] This is notably a trend regarding container terminals, the fastest growing area of port operations.[16]

24. The third trend is vertical rather than horizontal. Increasingly over the past few years, ocean shipping lines have been – in addition to horizontally integrating – vertically integrating into the ownership and operation of container terminals, while bulk producers of iron ore, coal, and petroleum have been vertically integrating into the ownership and operation of the specialized bulk terminals used for their products.[17] In a market with a small number of competitors – frequently the case now regarding container terminals, bulk goods terminals, and ocean shipping lines – could control by one competitor of an important facility such as a port terminal be used anticompetitively, by either denying access to the facility to competitors or allowing access under unfavorable terms?

4. Antitrust Exemption for Ports

25. Mergers involving port facilities are subject to the U.S. antitrust laws. The Shipping Act of 1984,[18] however, provides antitrust immunity to certain joint conduct of "marine terminal operators" (MTOs), defined as entities "engaged in the United States in the business of providing wharfage, dock or warehouse, or other terminal facilities in connection with a common carrier."[19] For this reason, the U.S. antitrust agencies have had relatively little enforcement experience in the ports sector. The Federal Maritime Commission (FMC), an independent federal agency responsible for administering the Shipping Act, has jurisdiction over the practices and agreements of MTOs. Agreements between MTOs or between MTOs and common carriers to "discuss, fix, or regulate rates or other conditions of service" or to "engage in exclusive, preferential, or cooperative working arrangements, to the extent the agreement involves ocean transportation in the foreign commerce of the United States," must be filed with the FMC, and 45 days after filing, automatically receive an exemption from the U.S. antitrust laws, unless the FMC successfully convinces a court that the agreement is likely, by a reduction in competition, to result in an unreasonable reduction in transportation service or an unreasonable increase in transportation cost. While the public can comment on the effects of a proposed agreement, there is no third party standing to bring suit to enjoin the implementation of a filed agreement.[20]

Notteboom, Theo E., "Consolidation and contestability in the European container handling industry," Maritime Policy & Management 29 (2002), 257-269.
Cwinya-ai, Robert Ongom, "International (Global) Competition in the Modern Maritime Transport Industry – The Politics of Port Business and Its Influence on Other (Rail, Road) Modes of Transportation of Goods," 2009.

15 Talley, Wayne K., Port Economics, London: Routledge, 2009.

16 UNCTAD, Review of Maritime Transport 2010, p. 18.

17 Haralambides, Hercules E., Pierre Cariou, and Marco Benacchio, "Costs, Benefits and Pricing of Dedicated Container Terminals," International Journal of Maritime Economics 4 (2002), 21-34.
Slack, Brian, and Antoine Frémont, "Transformation of Port Terminal Operations: From the Local to the Global," Transport Reviews 25 (2005), 117-130.
Cariou, Pierre, "Liner shipping strategies: an overview," International Journal of Ocean Systems Management 1 (2008), 2-13.
De Langen, Peter W., and Athanasios A. Pallis, "Analysis of the Benefits of Intra-Port Competition," International Journal of Transport Economics 33 (2006), 1-17.

18 46 U.S.C. §§ 40101 *et seq.*

19 § 40102(14). MTOs which do not serve common carriers have no ability to assert the immunity from the antitrust laws available to those which do serve common carriers under the Shipping Act.

20 §§ 40301(b), 40307.

26. The FMC cannot deny or modify filed agreements, but must seek a judicial injunction in order to prevent the effectiveness of a filed agreement. The FMC can delay the effectiveness of a filed agreement if it seeks additional information from the parties necessary to analyze its competitive effects. This process, adopted in 1984, was modeled on the Hart-Scott-Rodino merger review procedure.

27. Under a proceeding before the agency, the FMC can take administrative action to ensure compliance with Shipping Act provisions, including a requirement that an MTO may not:

- Agree with another MTO or with a common carrier to boycott, or unreasonably discriminate in the provision of terminal services to, a common carrier or ocean tramp;
- Give any undue or unreasonable preference or advantage or impose any undue or unreasonable prejudice or disadvantage with respect to any person; or
- Unreasonably refuse to deal or negotiate.[21]

28. The FMC can enforce these statutory provisions with civil penalties.[22] Injured parties can file complaints with the FMC, which can award reparations for actual injuries.[23]

29. With respect to agreements filed by MTOs and/or common carriers, if the FMC determines that an agreement "is likely, by a reduction in competition, to produce an unreasonable reduction in transportation service or an unreasonable increase in transportation cost,"[24] the FMC may seek to enjoin the operation of the agreement by bringing a suit for injunctive relief in the federal district court for the District of Columbia. The FMC has done so on one occasion, when it sought in 2009 to block the operation of an agreement between the Ports of Los Angeles and Long Beach that involved discussion and potential coordination of their respective "Clean Truck Programs," which were intended to reduce air pollution caused by trucks used to transport cargo to and from the ports. The FMC alleged that the agreement was likely to reduce competition, increase transportation costs, and decrease transportation service. The district court denied a motion for a preliminary injunction, ruling that the FMC had failed to show that trucking companies would gain market power or that competition between the ports would be reduced, and had failed to show a likelihood of irreparable harm and a balance of equities and public interest in its favor.[25] The case was eventually dismissed.

5. Conclusion

30. Ports constitute an important infrastructure in the U.S. economy. Traditional competition analysis, including examination of competition in a systems context from the perspective of both goods producers and customers, generally illuminates competition issues relating to the sector. However, a statutory antitrust exemption for certain agreements filed by ports with the FMC removes those agreements from the reach of the antitrust laws, and places them instead within the FMC's regulatory jurisdiction.

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21 § 41106.

22 § 41107.

23 §§ 41301, 41305. Note, however, that the Supreme Court has held that the Eleventh Amendment provides sovereign immunity to the states, and thus to port authorities that are arms of the state, from suits by private parties before the FMC. *FMC v. So. Carolina Ports Authority*, 535 U.S. 743 (2002).

24 § 41307(b).

25 *FMC v. City of Los Angeles*, 607 F.Supp.2d 192 (D.D.C. 2009).