

Testimony of

Stanley O. Sher

On Behalf of the

World Shipping Council

Regarding

**Federal Maritime Commission Management and
Regulation of International Shipping**

Before the

**House Sub-Committee on
Coast Guard and Maritime Transportation**

June 19, 2008

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THE WORLD SHIPPING COUNCIL

My name is Stanley Sher. I am Acting President of the World Shipping Council. The World Shipping Council (“WSC” or the “Council”) is a non-profit trade association of over twenty-five international ocean liner shipping carriers, established to address public policy issues of interest to the international liner shipping industry. The Council’s members include the leading liner companies from around the world. The Council’s member lines represent the full spectrum of carriers from large global lines to niche carriers, offering container, roll-on/roll-off, and car carrier service as well as a broad array of logistics services. The liner shipping companies regulated under the Shipping Act are also Council members, and the Council therefore has a strong interest in ensuring that the industry operates under a U.S. legal regime that is fair, stable, predictable, and flexible enough to support the huge capital investment and innovation necessary to continue to carry the ever-increasing volume of America’s foreign trade.

The Industry Today

This hearing is entitled “Federal Maritime Commission Management and Regulation of International Shipping.” I will return to that subject in a moment. In order to make sense of that topic, however, it is necessary to understand what the industry does and how it operates.

“Globalization” is not an abstract concept for container carriers. The carriers are an integral and indispensable part of it. Today, over 1,500 ocean-going liner vessels, mostly containerships, make more than 26,000 calls at U.S. ports each year, offering faster, more flexible and more efficient services. The liner industry has made extraordinary investments to

keep pace with exponential growth in U.S. international trade. To give you a feel for the size of that growth, over 29 million international cargo container units (TEUs) transited U.S. ports in 2007, equating to more than half a million containers every week.¹ In 1998, when the Ocean Shipping Reform Act (OSRA) was passed, that number was just over 15 million TEUs, an increase of 87% in nine years.

This country's international trade has grown worldwide, but nowhere more than with Asia. The large majority of those containers flow through ports on the West Coast. In the largest U.S. port complex, Los Angeles/Long Beach, international container traffic has more than doubled since 1998 – from 5,144,439 TEUs in 1998 to 10,661,646 in 2007. Other U.S. ports on both coasts have also experienced significant growth.

Ocean carriers could easily have been overwhelmed by this growth in trade. Instead, they made the huge investments necessary to provide the service their customers demanded. In recent years, the liner shipping industry has invested over \$200 billion in new vessels, accompanying terminal facilities, containers, chassis, and other equipment. As a result, service options for U.S. importers and exporters have grown significantly. Vessel space for over seven million U.S. container loads was added during 2001 to 2007 alone, a 60% increase. Total vessel capacity of the worldwide active fleet is expected to increase by another 13% in 2008. Not only is overall vessel capacity increasing, the average size of vessels has also grown. The largest vessels in the world fleet in 1990 were 4,409 TEUs, which increased to 7,200 TEUs by 2000. Ships larger than 12,000 TEUs are on order today, representing further future increases in capacity between 2008 and 2010, and continued capital investment by the industry.

¹ International cargo container units are measured in Twenty-foot Equivalent Units (TEUs); however, most containers are equal to two TEUs.

In short, cargo demand has grown very rapidly along with the global economy, and ocean carriers have historically met that demand. Presently, for the first time in over 20 years, shipping space in the U.S. export trades is very tight. I address the specifics of that aberration later in my testimony.

Container shipping has been a genuine success story in the last two decades. It has over that period provided U.S. exporters and importers with superior service at reasonable rates. This has promoted and facilitated the global commerce that is critical to the economy of the United States and the economies of the rest of the world. But like other global industries, the carriers face enormous challenges. These multiple and simultaneous challenges have required the industry to become ever more efficient, and for each carrier to examine each service that it offers to ensure that it is sustainable in a volatile economic and regulatory world. I describe some of those challenges below, not only because of their importance, but because some of the responses to these challenges can be facilitated, in part, by a wise and insightful administration of the regulatory process.

a. Fuel Now Represents Over 60% of Vessel Operating Costs.

Fuel price spikes have affected the shipping industry in the same dramatic way that they have affected individual motorists and other transportation modes – two of which, truck and rail, we rely upon heavily to provide the inland portion of the door-to-door service we offer to our customers. Although ocean shipping is by far the most energy-efficient means of transporting cargo on a ton/mile basis, we are still an energy-intensive and reliant industry. Whereas a few years ago fuel costs were in the range of 15-20% of total vessel operating costs, that number is now in excess of 60%. Fuel costs for vessels have more than doubled since early 2007, and increased 25% in just the past 6 months. The fuel bill for a new modern containership of 7,750

TEUs sailing between U.S. and Asia now exceeds \$50,000,000 annually. Just as it has in the rail industry, where we have seen rates for inland transportation of shipping containers rise 25-35% in the last eighteen months, the rapid run-up in fuel prices has forced the shipping industry to closely examine operating efficiencies and the financial contributions of every offered service.

b. Environmental Challenges Will Further Increase Costs.

The liner shipping industry, through the World Shipping Council, has embraced fundamental changes to the international convention for reducing air pollution from ships. Recognizing the public health benefits of substantially reducing air pollution from ships, the Council was an early supporter and champion of a U.S.-sponsored proposal at the International Maritime Organization (IMO) to substantially tighten the MARPOL Annex VI provisions dealing with vessel air emissions. That proposal has now been agreed to by the responsible working group at IMO, and is scheduled for final approval in October. Assuming that Congress enacts the implementing legislation for the revised Annex VI, this agreement will in the coming years dramatically reduce the nitrous oxides, sulfur oxides, and particulates emitted by ocean vessels. Those reductions will come through technical changes and retrofits to vessel engines and through conversion to low-sulfur fuel when vessels are closer to shore. The expected benefits are projected to be significant, but so are the costs. The low sulfur fuel that ships will burn in the future costs more, and that will push the 60% of operating costs associated with fuel that I mentioned earlier even higher. That will have economic impacts on carriers and their customers.

Also in the area of vessel emissions, the IMO has begun work in earnest on evaluating measures to address greenhouse gas emissions from vessels. Design changes, fuel taxes, speed

reductions, and other proposals have been made. Each of those proposals carries costs and implications for service worldwide.

In addition, wholly independent of the IMO, individual container carriers and terminal operators have been actively investing in pollution control systems on their ships and in their terminals to address environmental concerns.

c. Infrastructure Constraints Hurt Productivity, Drive Up Costs, and Exacerbate Environmental Challenges.

Although ocean carriers have made the investments necessary to provide adequate vessel and container capacity to carry the world's containerized cargo, land-based infrastructure investments have not kept pace. For economic and geographic reasons, major ports also tend to be places with large populations. People and goods trying to move at the same time using over-subscribed roads, bridges, and railroads cause congestion, and congestion means delays, higher costs, and increased air emissions from truck and locomotive engines. The federal government plays a role in financing public infrastructure. States and localities also share in those costs, but under any analysis the available resources are inadequate to the task at hand. The result is that cargo that moves freely over the oceans often encounters infrastructure-related delays getting to or coming off of a ship.

d. Cargo and Vessel Security Requirements Present a Continuing Need to Balance Public Safety With the Free Flow of Commerce.

Especially since the terrorist attacks in 2001, cargo and ship security has represented a continuing joint government/industry challenge. The Council was an early supporter of the C-TPAT program and supports the Department of Homeland Security's pending "10+2" proposal for increased supply chain visibility. Our members daily submit tens of thousands of pieces of information to the government for the purposes of identifying high-risk cargo for thorough

screening by government security personnel. These efforts are today a necessary part of doing business in a less secure world, and the industry has supported the United States government and governments around the world in their efforts to develop practical and effective security systems. These efforts too, however, come at an operational and financial cost, one that must be reflected in the price of services.

These examples of the challenges facing the liner industry are simply reflections of the global economic and environmental situation in which we collectively find ourselves. I do not raise them by way of complaint or by way of a request that this Subcommittee do anything about them. Instead, I raise them because I think that they provide some insight into what the organization and the regulation of the industry in the future might look like.

The Industry Tomorrow – The Changing Role of the FMC

One common thread among the challenges that the industry faces is that they often combine commercial issues with regulatory issues. Both at the national level and at the international level, the liner shipping industry and the government will of necessity have to work together to ensure that this critical link in the international economy continues to be capable of performing the functions that shippers, manufacturers, and consumers across the globe depend upon and indeed take for granted. For example, although fuel costs at first glance appear to be a solely commercial issue, the fact is that low-sulfur fuel requirements and likely future greenhouse gas regulations from the IMO will affect these costs. Security is another area in which government regulations and industry implementation of those regulations are equally essential elements of an effective system. Similarly, landside infrastructure solutions

increasingly rely on public/private partnerships – formal or de facto – in order to keep freight moving.

Governments and industry have in recent years been required by circumstances to work together more closely to keep trade moving in a secure and environmentally responsible way. The future will amplify that trend. The other related and less appreciated trend that has emerged is that industry participants – carriers, marine terminal operators, and ports – have of necessity in recent years had to work more closely together to solve problems that either the government could not solve for political or fiscal reasons, or that were not the government's to solve in the first place. It is at this center where the government and individual industry players meet in seeking solutions to increasingly complex and interrelated commercial, environmental, and trade mobility problems that I believe the Subcommittee might productively focus its attention as it considers what is next for the Federal Maritime Commission.

One of the traditional and continuing roles of the Commission has been to review and monitor carrier, port, and marine terminal operator agreements that these industry players are required to file with the Commission when cooperating with respect to service or commercial issues. In the years before the passage of the Ocean Shipping Reform Act (OSRA) in 1998, many of those agreements were “conferences,” groups of ocean carriers that banded together to offer common rates and service agreements. Since OSRA, most of the conferences serving the United States have disappeared.

Today, and this is not well understood, the majority of the ocean carrier agreements on file with the Federal Maritime Commission (166 of 236) are vessel sharing agreements of one type or another. Under these efficiency enhancing arrangements, a group of carriers, typically between two and four, share space on one another's ships. These arrangements allow for each

participating carrier to serve more ports with greater frequency at a lower capital cost. The result is that customers get better service and a greater number of competing carriers from which they may choose. These agreements range from very simple arrangements to charter space on other carriers' ships to substantially integrated services that share terminal facilities and engage in long-range planning for vessel deployment in addition to sharing space on vessels. These types of agreements have been consistently praised by shippers for their contribution to increased service quality. These agreements have been facilitated, and at the same time carefully reviewed, by the Commission.

There is another class of agreements that has grown in importance over the past several years, including agreements between carriers, ports and terminal operators that seek to address the environmental and infrastructure challenges that are facing our industry. These agreements demonstrate both the amount of change that the industry has undergone since OSRA and also the reason why Shipping Act agreements are becoming an integral part of solutions to problems that increasingly test the entire intermodal transportation system. I believe that of necessity this class of agreements will become the most important type in future years, and I think that they will define the relationships among industry participants and the federal government. They are, in short, the future of the FMC.

One example of such agreements is the West Coast MTO Agreement. This agreement is made up of marine terminal operators, or "MTOs," not carriers. MTOs, like ocean common carriers, may file certain types of agreements with the Federal Maritime Commission and thereby obtain authority to undertake collective activities that might otherwise be prohibited under the antitrust laws. The West Coast MTO Agreement was formed to deal with the very serious port congestion and environmental problems in the ports of Los Angeles and Long Beach, California,

the nation's largest port complex. All cargo arriving at or leaving those ports does so either by truck or rail, and the volume of trucks necessary to move the cargo entering and leaving the port had grown to the point that it was causing substantial delays at the terminal gates. That meant that trucks would idle for long periods of time, reducing throughput efficiency and contributing to an already substantial air quality problem.

The MTO agreement, filed with the FMC under the Shipping Act, was used to set up a program called "PierPASS." Under that program, the marine terminal operators that provide vessel loading and unloading services at the ports agreed that they would open additional gates and provide expanded services during nighttime hours. To encourage use of the night shifts, they adopted a charge on cargoes entering and leaving the ports during normal daytime work hours, and the money collected was used to help defray the costs of extending the operating hours of the terminals into the night. As a result of this program, nearly 40 percent of truck traffic (over 8,000,000 truck trips since 2005) has been moved to off-peak hours, reducing congestion on port area highways and greatly reducing the waiting times for trucks serving the ports. Trucks come and go more quickly without waiting in line. Air pollution is decreased, and truckers can make more trips during a workday, allowing them to earn more money. Moreover, the effective throughput volume of the ports has been expanded – with no expenditures for the construction of additional physical infrastructure and no government money required. By all measures, the undertaking has been a success, and one that has succeeded where numerous attempts at local and state government solutions had failed.

Another agreement filed with the FMC under the Shipping Act that is providing a creative and efficiency-enhancing solution to port congestion problems (at both seaports and inland rail yards) is a chassis pool program created under the auspices of a carrier agreement

called the Ocean Carrier Equipment Management Association (OCEMA). A long-standing problem at many U.S. marine terminals and rail yards is that the truck chassis used to transport shipping containers (which can be transferred from ships to trucks to trains without being unloaded) are owned by different shipping lines. Traditional practice has been that, when a trucker arrives at a port to pick up a container transported by a particular ocean carrier, the container must be matched with a truck chassis owned or leased by that same ocean carrier. In addition to slowing the loading process, this practice requires many more chassis to be stored on a terminal than would be the case if the trucker could use any available chassis.

The system being implemented under the OCEMA agreement in many parts of the country today allows carriers to contribute chassis to a common pool of equipment and to draw any chassis from that pool. This has reduced the number of chassis that need to be maintained at any location. That has freed scarce terminal acreage. This in turn allows for expanded throughput capacity without the need to consume additional surrounding land. In addition, because containers and chassis no longer have to be matched according to the owner of the equipment, this system, like PierPASS (although by a different mechanism), reduces truck waiting times – thus reducing air pollution, speeding cargo processing through the terminal, and allowing truckers to make more trips, save fuel, and earn more money. Again, no government funds are required. Both the Department of Transportation and the U.S. Environmental Protection Agency have publicly praised this efficiency-enhancing arrangement. And importantly, it has only been made possible by a creative use of the regulatory process.

I believe that these two examples, one involving marine terminal operators and one involving ocean common carriers, are typical of the kinds of agreements that we will see more of in the coming years. Although investment in ships – the leg of the international intermodal

system for which carriers are responsible – has more than kept up with rapidly escalating demand, the same is not true of the U.S. highway, bridge, and rail assets that must move cargo to and from the nation’s ports before and after the cargo is transported by ship. Because it will require billions of dollars to build out of these land-side transportation bottlenecks, and because trade volumes are expanding more rapidly than are the public funds necessary to relieve choke points in the system, the availability of a mechanism that allows the industry to collaborate to create additional capacity through increased efficiency is vital to economic growth. The Shipping Act agreement filing and FMC oversight regime is not the only tool for allowing such solutions, but it has allowed solutions where no others have yet appeared.

The Commission has recently become involved in review and oversight of an even newer type of agreement. The public ports operated by the cities of Long Beach and Los Angeles have in the past eighteen months engaged in wide-ranging discussions and agreements dealing with environmental, operational, and capital construction projects at the two neighboring ports. Because these ports are “marine terminal operators” under the Shipping Act, their agreement falls under the FMC’s jurisdiction. As the ports come closer to transitioning from planning and discussion to implementation of their various programs, which run the gamut from requiring cleaner trucks operating at the ports to collecting fees to finance bridge replacements, affected parties have increasingly engaged the Commission with concerns about operational impacts, discrimination against certain service providers, compliance with the Shipping Act by the ports, and other issues associated with the ports’ programs.

The Commission is, frankly, learning as it goes with respect to this new form of MTO agreement. Some would argue that it has gotten in the way, and some would argue that it has not gotten in the way enough. The challenge for the Commission of course is to get the regulatory

balance right in the end. In that process, it is important that the Commission allow agreement parties reasonable flexibility to formulate business solutions to current industry challenges. One thing is clear at this stage, however. The Commission has become a significant player in the new and evolving issues – efficiency and the environment – and can be a useful and effective mediator in these areas.

In sum, while any regulatory regime can be improved, the Shipping Act, as comprehensively revised by OSRA in 1998, provides a flexible and robust structure under which industry participants can act jointly to solve problems that require industry-wide solutions while at the same time providing the regulatory oversight and the transparency that are necessary to prevent today's innovative solutions from becoming tomorrow's unintended problems. That existing statutory structure so far is proving remarkably adaptable to the new private-sector joint solutions with which industry participants are experimenting.

The OSRA structure has provided a framework for private sector solutions to a growing list of challenges to the global transportation system. Importantly, at the same time, OSRA has successfully created, and the FMC presides over, an environment of carrier competition that ensures a wide choice of service and rate levels for customers to access depending on the needs of their individual supply chains. I believe it will continue to do so. But continued success requires that the FMC will have to work smart, stay engaged, and be prepared for the fact that the next ten years will likely bring unforeseen changes to the industry that will require a flexible response. I believe that the Shipping Act, as it presently stands, provides the Federal Maritime Commission with the tools necessary to craft those responses.

In my statement above, I have sought to put the FMC and its regulatory process in perspective, and made suggestions concerning long term future trends and the role of the FMC.

There are, however, two recent developments in which the Subcommittee may have an interest and on which I would like to comment. These are the recent surge in U.S. container exports and the decision by the European Union to eliminate its so-called block exemption for shipping conferences.

The Recent Surge in U.S. Container Exports Presents a Challenge for Carriers and Shippers

In the 10 years since OSRA was enacted, U.S. exporters and importers transporting their cargoes on containerhips in the foreign commerce of the United States have enjoyed superior service at reasonable rates. Container shipping, however, like most international businesses, is subject to swings in the market, some of which may be steep, unanticipated, or both. This is presently occurring in the U.S. export trades, which have seen a sharp surge in cargoes due to a number of economic market factors, but principally the decline in the value of the U.S. dollar, which makes our exports more competitive, and increased consumer demand in emerging countries like China and India.

The surge in U.S. exports, which began in 2007, is continuing. Last year container exports increased about 17%, and they are expected to increase about 10% or 11% this year. Correspondingly, imports have declined by roughly 10% over the U.S. West Coast thus far in 2008. As a result, while there is growing demand for export shipping space, the amount of capacity in the trade is driven by the traditional “headhaul” or import demand from Asia, which is calibrated to meet the requirements of the higher volume cargo being imported into the U.S. When import demand was growing at double digit levels as was the case over the last five plus years, there was a constant increase of capacity entering the Transpacific which provided for

growth in export demand even though exports have not, until very recently, grown at anywhere near the rate of growth of the inbound market to the U.S.

Over recent months, we now have seen a very unusual situation develop in which export capacity, both containers and vessel space, has become, for the first time in over a decade, tight. For the past decade or more, a U.S. exporter could book cargo on a containership on two or three days notice. Now, in an unprecedented reversal of that history, export bookings in some trades must be made well in advance. Carriers are finding it more challenging than ever to satisfy this demand, and some outbound vessels are booked weeks in advance of sailing. Nevertheless, export ocean transportation rates, which have historically been a fraction of the rate levels for inbound shipments, remain low even with recent increases. Rates for most exports were lower at the end of 2007 than they were 7 years ago.

The shortage of export space is created by some very basic operational constraints. Container ships arriving in the U.S. from Asia are for the most part well utilized, and due to the commodities being shipped – garments, electronics, footwear, and other relatively light weight consumer items – vessels carry a volume of loaded containers that approaches the “nominal” design capacity of the vessel. Export cargoes, however, weigh more than import cargoes; as a result, the container vessels leaving the U.S. can accommodate only about 50% or 60% of their volumetric capacity with full export containers before approaching the “dead-weight” capacity of the vessel. As a result, far fewer loaded containers carrying commodities like wastepaper, cotton, scrap metal, machinery and agricultural products can be loaded on a vessel sailing from the U.S. to Asia than can be loaded in the inbound direction. Carriers must also “balance” their container fleet by repositioning some containers back to Asia empty to have enough equipment to accommodate the demand for shipments from Asia to the U.S. If this were not the practice,

Asia would soon run dry of containers, shippers in Asia would not have sufficient equipment to meet demand, and an enormous excess of containers would accumulate in the U.S. This is not a sustainable result.

Carriers are individually working with their customers to do whatever is possible to alleviate this unprecedented shipping pinch. More generally, carriers have met with shippers collectively in shipper or carrier forums and other industry events to address this issue. Carriers will continue to work with their customers on both fronts. While the FMC has an important role to play in this dialogue, the near term capacity issues are, at bottom, a commercial challenge having little to do with regulatory rules or the Shipping Act. They are caused by a sudden shift in market conditions promoted by the weak dollar.

The European Union's Repeal of the Block Exemption for Conferences

Finally, there is one regulatory development outside the U.S. on which I would like to comment, namely, the decision by the European Union to eliminate the so-called "block exemption" for shipping conferences, which becomes effective later this year. A logical question is how this development impacts the U.S. regulatory system, or, to put it another way, should the U.S. follow Europe?

While this development should not be ignored, and, we understand, will be the focus of FMC study, it is premature to consider following this European development. First of all, the change in EU law does not affect the U.S. regulatory scheme. Both systems can and will exist side-by-side. We should not forget that the EU has still retained an antitrust exemption for ocean carriers permitting them to share assets and coordinate service. Further, concerning its repeal, the EU is in the minority on this issue. Apart from the EU, virtually all of our trading partners maintain an antitrust exemption for ocean carriers.

Second, and this is often overlooked, the EU and U.S. systems are not comparable. The prior European system and experience is markedly different than that of the U.S. In the mid 1990s, when the antitrust exemption for ocean carriers was under review in both the United States and Europe, the countries took sharply different approaches. The EU embarked on a course of litigation and confrontation. This eventually resulted in a series of legal decisions which essentially gutted the system and indeed, resulted in the absurd requirement that for the antitrust exemption to be applicable, the carriers must fix uniform prices. This European system was simply unworkable. In my view, it contained the seeds of its own demise. In contrast, in the U.S., the system was comprehensively reformed. It was made more flexible. It also provides more clarity and certainty than the EU system. This new system was supported by carriers, shippers, labor and ports and was embodied in OSRA. So the U.S. developed a flexible and responsive system that is different from and a decade ahead of the European system. There was a palpable need to change the European system. There is no such need in the U.S.

Third, in Europe there was a simple statutory exemption from the competition laws solely for “conferences.” There was, surprisingly, no European government oversight of this exemption. In contrast, the U.S. antitrust exemption is only part of a larger, comprehensive regulatory scheme. The U.S. exemption not only applies to carriers, but also to U.S. marine terminal operators. In addition, the U.S. regulatory scheme contains some 30 prohibitions providing far-reaching protections to shippers, and provides for investigations, double damages and private complaints. It also has a licensing requirement covering thousands of intermediaries as well as protections against discrimination in U.S. trades. Therefore, unlike Europe, the antitrust immunity for ocean carriers is only a part, and a relatively small part, of a broad regulatory scheme.

What the European change does offer is the opportunity to examine the system and learn from it. As noted, we understand that the FMC intends to review and report on the European experience under its new system. The Commission will receive the full cooperation of the industry. That study should be helpful in assessing the desirability of any changes to the U.S. system. Our view is that the present OSRA system works well, and that those who would change it have the burden of showing that change is necessary. At this point, there is no evidence that such a change is needed. The FMC's report, however, should provide the facts and analysis which would help to focus any future debate.

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