

**U.S. DEPARTMENT OF TRANSPORTATION
SURFACE TRANSPORTATION BOARD**

ORIGINAL

GOVERNMENT OF THE TERRITORY
OF GUAM,

Complainant,

Vs.

STB DOCKET NO. WCC-101

AMERICAN PRESIDENT LINES, LTD.,
MATSON NAVIGATION COMPANY,
AND SL SERVICE, INC., f/k/a SEA-
LAND SERVICE, INC.,

Defendants.

**INTEVENOR CARIBBEAN SHIPPERS ASSOCIATION'S
RESPONSE TO SUPPLEMENTAL SUBMISSION BY
DEFENDANT MATSON NAVIGATION COMPANY**

Introduction

Defendant Matson Navigation Company ("Matson") by letter dated May 31, 2006 submitted to the Surface Transportation Board ("STB") a document entitled "Competition in the Noncontiguous Domestic Maritime Trades" dated May 2006 and issued by the Maritime Administration.

Matson has represented that the document updates a March 1997 Study issued by the Maritime Administration. Matson further states that this May 2006 document is "relevant to the issue whether there is a prima facie case that there is effective competition in the Guam Trade". Matson then notes that such a showing would merit "bifurcating Phase III of this proceeding". Phase III of Docket WCC-101 involves a ruling on the merits of the rate reasonableness claim of the Government of Guam.

216737



ENTERED
Office of Proceedings

JUN 12 2006

Part of
Public Record

REPLY COMMENTS

(I)

The proceedings in Docket WCC-101 have become so protracted that any decision on the merits would be substantively irrelevant. The existence of this proceeding however has been used by the STB to foreclose the establishment of any meaningful standards for the determination of the reasonableness of water carrier rates in the noncontiguous domestic trades.

The May 2006 Study is admittedly based upon a private document prepared by Reeves & Associates and entitled "Competitiveness in the United States Domestic Noncontiguous Liner Shipping Markets, June 2004" (hereinafter the 2004 Reeves document). The 2004 Reeves document was prepared for the DC based lobbying arm of the carriers in the domestic trades—Maritime Cabotage Task Force. (See May 2006 Study at page iii, n.2, page 1, n. 9, page 2, n. 11, etc.).

Matson purports to submit this one-sided document to the STB in relation to a stale rate complaint involving the Guam Trade. However, the document itself purports to provide an analysis of, discuss and comment upon all of the domestic trades. Matson is essentially seeking to have the STB take official notice of this document and presumably use information in this document in the STB's decision.

The STB may not take official notice of the contents or information contained in an extra-record document, and use that information in its decision making process, without affording the opposing parties the opportunity to reply to and comment upon the information. See 5 USC 556(e). The May 2006 Study is based upon the 2004 Reeves document. Matson, as part of and the moving force behind the Maritime Cabotage Task

Force, should be required to produce and properly file the 2004 Reeves document.

NOTHING LESS WILL SUFFICE TO PRESERVE THE NECESSARY DUE
PROCESS REQUIRED BY THE FEDERAL ADMINISTRATIVE PROCEDURE ACT.

(II)

The Guam trade is intrinsically entwined with the Hawaii trade. Guam may only be reasonably served on a "pass-by" basis. This is a fundamental fact. It is also established and certainly not disputed by the defendant carriers that parallel pricing exists as a matter of reality in both the Hawaii and Guam trade. It was recently noted that Matson and CSX Lines (now known as Horizon Lines) utilize a Matson vessel for the Wednesday sailings from Los Angeles to Honolulu and on to Guam. This information was disclosed by carrier verified statements in April 2002 as well as by press releases in July 2001.¹

Attached hereto, and identified as Attachment A, is a White Paper submitted in April 2005 that discusses the level of competition in the Hawaii and Guam Trades.² The White Paper further contains a comparison of the rates and pricing in the Hawaii/Guam trade and the international trade to Japan and China by Matson. The Hawaii rates are five (5) times higher than Japan rates and eight (8) times higher than the China rates. (White Paper at page 7).

It is plain that these domestic carriers' rates and services are not competitive on an international basis. As of June 2002 the Maritime Administration estimated that 97% of all U.S. international cargoes moved on foreign vessels. The idea that the STB can create

¹ What is actually occurring between these companies is subject to debate. However the service arrangement which is clear is that subsequent to this arrangement there was a reduction in vessel capacity in the Hawaii and Guam trade. Capacity (i.e. 'supply') agreements between purported competitors are per se violations of the federal anti-trust statutes.

² "Competition (or Lack Thereof) in a Trade Lane with Only Two Competitors", Dechter, B., Domestic Maritime Conference, April 11-12, 2005.

an effective methodology to measure rate reasonableness on an “overall” or “aggregate” basis is unrealistic at best.³ A fundamental component would be the international services of defendants—an area wherein they are not competitive without cross subsidy from domestic transportation revenues. A further basic tenet of commerce law regulation is that cross subsidization is not permitted.

(III)

The STB recently issued decisions and orders regarding railroad stand alone costing which acknowledged the very limited circumstances under which SAC can be applied. See; *Rate Guidelines—Non-Coal Proceedings*, STB Ex Parte No. 3447 (Sub-No. 2), April 24, 2006. The National Industrial Traffic League, in Comments submitted in STB Ex Parte No. 657, *Rail Rate Challenges Under Stand Alone Cost Methodology*, noted that SAC cost methodology had evolved to the “point of practical irrelevance” for the average shipper. The League noted a SAC case cost a minimum of \$3 Million for a complainant and another \$5 Million for a carrier defendant to present. The Chairman of the STB, in a speech on March 23, 2004, acknowledged these cost estimates.

The carriers have continually advocated a Stand Alone Cost methodology for use in Docket WCC-101. It is now recognized that such an approach is not only impractical but would involve rail statutory criteria. The attempt to insert “competition” as a threshold showing of rate reasonableness would have the STB import provisions of Part A of the ICC Termination Act of 1995 into Part B. That approach would create reversible error.

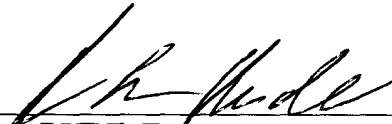
³ The Association in a filing dated July 7, 2005 noted that it was the belief of the Association that the proceedings in STB Docket No. WCC-101 had become a futile exercise. It has been 8 years since the filing of the complaint in WCC-101. This proceeding is no closer to resolution today than the day that the complaint was filed. If the STB were to inject into this docket a Part A Rail statutory requirement, any possibility of resolution of this proceeding would totally evaporate.

Conclusion

Wherefore, it is respectfully submitted that the STB decline to accept the May 2006 Document into the record at this time. That in the event that Matson desires to present the underlying factual analysis for the conclusions contained in the May 2006 study, that Matson properly move to supplement the record and all other parties be provided with the opportunity for review and comment.

Dated: 8 June 2006

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Rick A. Rude', is written over a horizontal line.

RICK A. RUDE, Esq.

Suite 103

207 Park Avenue

Falls Church, VA. 22046

(AC 703) 536-3063 Tele.

(AC 703) 536-4841 Fax.

Certificate Of Service

I hereby certify that a copy of this document has been served, by first class mail, postage prepaid, upon all parties of record in this proceeding.

Dated this 8th day of June 2006 at Falls Church, VA.



Richard A. Allen
888 -17th St., N.W.
Suite 600
Washington, D.C. 20036

C. Jonathan Benner
401 Ninth St., N.W.
Suite 1000
Washington, D.C. 20004

Edward D. Greenberg
1054 31st St., N.W.
Washington, D.C. 20007

Joseph A. Guthrie
Deputy Attorney General
287 West O'Brien Drive
Hagatna, Guam 96910

Robert Basseches
901 New York Avenue, N.W.
Washington, D.C. 20001

Robert Zuckerman
Horizon Lines
2101 Rexford Road
Charlotte, N.C. 28211

Kevin C. O'Rourke
Matson Navigation Co.
555 - 12th Street
Oakland, CA. 94607

ATTACHMENT 'A'

Domestic Maritime Conference

WHITE PAPERS



April 11 & 12, 2005
Hilton Head Island Marriott Beach
& Golf Resort
Hilton Head Island, South Carolina

Commonwealth
BUSINESS ♦ MEDIA

The Journal of
Commerce
CONFERENCES

Competition (or Lack Thereof) in a Trade Lane with Only Two Competitors

By Brad Dechter, President, DHX- Dependable Hawaiian Express

General

If you are a shipper moving product by container load to Hawaii, you probably know that there are only two ocean carriers serving Hawaii — Matson Navigation Co. and Horizon Lines. If you talk to these carriers, and ask them to bid on your business, they will act like they are interested, take down all your facts and figures, and tell you they will “sharpen their pencil” and give you a rate. Which they will. They may even come back to you a few times and adjust their quotes, if you push them for a better rate. In the end, you may feel you bargained hard and got a good “deal” and be happy about the results of your efforts.

If you try to go a different option, and talk to a freight forwarder, and you are located east of the Mississippi River, the forwarder *may* do better price-wise. But, from the West Coast port cities, the forwarder will be hard-pressed to match the carrier’s rates. This is because in a duopoly, especially in the state it exists today, there is no reason for the ocean carrier to help the forwarder (or the beneficial cargo owner). Only when there are a multiple of ocean carriers attempting to maximize profits in a trade lane or are forced to truly compete are the forwarders decisions as to who they use important to the carrier—particularly when the two carriers are not competitors, but what I call “peaceful coexistsers.”

The trade lane

You need to have better knowledge of the Hawaii trade lane to understand that a lack of true competition exists in this trade lane. You have Matson Navigation Co. (Matson), one of the most profitable ocean carriers worldwide, who control 70 percent of the business going to Hawaii. We, at DHX (Dependable Hawaiian Express), know them well. We believe we are their largest single customer. Matson has recently invested in two new ships and is in the process of buying two more ships. They own a substantial portion of the company stevedoring their ships, they operate their own freight terminals, and they own their own barges in Hawaii. In other words, they vertically control the quality of their service, from beginning to end. They also own their own intermodal company, so they control the rail aspect of their moves to the West Coast.

The competition to Hawaii that Matson faces has always been weak. This goes back to 1968 when Seatrain Lines entered the Hawaii market. Matson ended this competitive threat by buying Seatrain in 1974. U.S. Lines then took over as Matson’s competitor, and U.S. Lines then went bankrupt in 1986. Sealand Services took over in 1986. Sealand, owned by the railroad CSX, was split up in December of 1999 and the international portion of the business sold to Maersk. The domestic ocean carrier portion of Sealand was then renamed/reincorporated as CSX Lines. CSX Transportation subsequently sold CSX Lines to the Carlyle Group in February 2003, which renamed the service Horizon Lines. After one year, Carlyle resold the ocean carrier to another private investor, Castle-Harlan — and Carlyle made a \$300 million profit turning over the company after approximately one year. Through all these ownership changes, it is important to realize that no real money was spent on new ships within the Hawaii trade lanes — there was no capital investment in new vessels. Sealand purchased U.S. Lines’

old ships and used those. Horizon Lines took over the Sealand ships. The average age of a Horizon Lines vessel to Hawaii is 28 years old.

Horizon currently uses a "turnkey approach" to Hawaii. They use CSX Transportation for intermodal work, they use Maersk terminals and facilities to stevedore their vessels (except in Hawaii where they operate their own terminal) and they use Young Brothers Barges to move the freight to the outer islands in Hawaii. In other words, they don't use their own operations to control the quality of their base business. During any Christmas season, should you use Horizon Lines, there is the good chance your freight to the outer islands will be delayed. Why? Because Young Brothers takes care of the higher paying local customers first.

Why is the above important? Because in a trade lane with only two carriers, if one of them consistently underperforms the other and does not "rise" to the level of competition, then you have no real competition, particularly when the rates each carrier charges is identical to the other. Of course, the fact that Matson fought so hard to keep APL out of the trade lane in the late 1980s, and they recently paid \$30 million more than they previously had to purchase their last two ships and, by doing so, keep another new competitor out of the Hawaii trade lane, tells us all that they know they've got a good business and they want to keep it that way with no real competition. Matson has done well for themselves with their strategic planning, so we do need to give them credit and admiration for what they have accomplished.

Impact of no competition on freight-forwarder pricing

The above industry framework impacts the way that the freight forwarder is treated in Hawaii, and helps keep the ocean pricing to Hawaiian consumers artificially high. In Alaska and Puerto Rico, where there are varying levels of ocean service among three or more carriers, the forwarders are given confidential contracts based on their volumes to destination. The forwarders can then control how the freight is moved, with what carrier, to maximize service to the customer, as well as their own profits. These contracts allow the forwarders to give different pricing structures based on the level of service required, and also reduce the cost of the freight to the smaller shipper.

In Hawaii, the forwarders have no contracts — Matson and Horizon refuse to do this because they look at it as a way of reducing their profits and allowing someone else to control what they consider "their freight." (In my opinion, if there were a third carrier, they wouldn't be able to consider it their freight.) Hence, a forwarder like DHX-Dependable Hawaiian Express, who may be shipping 10,000 containers a year to Hawaii, pays the same price as the shipper shipping a single container to Hawaii. There is also no price differentiation based on quality of service — Matson sets the prices and Horizon matches it. Over the past seven years, Matson and Sealand, and CSX and Horizon have walked virtually "lock step" together through rate increases, fuel surcharge increases, hazmat surcharges and a new terminal handling charge. There is no difference in price and Horizon can't compete based on service.

Matson must realize this; they have worked with Horizon Lines to try to ensure Horizon Lines can at least offer some levels of service that appear competitive:

On Oct. 16, 2000, CSX Lines announced a mid-week service from Los Angeles to Hawaii called the "Midweek Express." Matson already had such a service.

On July 20, 2001, Matson and CSX announced they had entered into an "extension" of a prior existing agreement and thereafter CSX Lines ceased operations as a vessel carrier of the Midweek service and began to compete with Los Angeles-based freight forwarders as a freight forwarder. (It is rumored that CSX was paying Matson roughly \$1,500 per container for the same freight other forwarders must pay Matson more than \$4,000 for). Matson provides Horizon with 140 slots per sailing under this arrangement. CSX Lines discontinued its own vessel service thereby reducing capacity and making Matson the only vessel carrier providing the Midweek service. At the same time, Horizon was able to reduce its vessel rotation, reducing costs and increasing profits in the trade lane as well as for themselves.

As a result, CSX Lines, and now Horizon Lines, conduct business de facto as a freight forwarder, using Matson's vessel service. Matson is providing Horizon Lines with volume pricing contracts but refuses these same contracts to other freight forwarders such as DHX-Dependable Hawaiian Express.

The point is, the "competitor" is a customer, and one who has extremely preferred rates.

Impact of no competition on nonforwarder pricing

You should also learn there are contracts to certain customers of Matson and Horizon Lines. The ocean carriers may tell you they don't have them but they do. They call them "Memorandums of Understanding." They even publish them in a "secret tariff" that exists that neither refer to on their Web sites, one that each of them subscribes to of their competitors tariffs, so that Horizon and Matson do nothing to reduce potential profits in the overall marketplace and which allows them to regulate the overall pricing in the trade lane. Through this mechanism, since they both are asked to bid and normally know the volumes and service requirements of the customer, they have developed the unique skill of categorizing accounts with larger volumes into certain pricing levels, hence regulating the overall market profitability between them. Talking to others in other domestic trades, I have noted this is fairly common. The domestic offshore trades have become oligopolies under which price leadership is effectuated by means of exchanging pricing information through tariffs and tariff filings. Taking an example out of Matson's Tariff 2034 (the "secret tariff") or the Horizon equivalent, Costco comes to mind. If a specific city is named with certain commodities to be shipped, and the rate applies only if 30 containers a week or more are shipped, it is virtually a contract. (The old adage if it looks like a duck and walks like a duck and smells like a duck, then it is probably a duck, applies here.)

The carriers publish the rates to signal one another what they have negotiated with a customer. This sets the boundaries for future customers that may arise with similar volumes-commodities. The other carrier then publishes the same commodity, acknowledging the pricing framework, even though the potential customer will never use them. This is totally contrary to the practices in any international trade lane.

Industry sources informed me that the combined westbound sailings of Matson and Horizon to Hawaii in 2004 were at 94 percent capacity. Thus, without any competition, there is no reason, incentive or logic for Matson and/or Horizon Lines to reduce pricing. A 1995 U.S. Department of Transportation report found that competition under ICC regulation was actually working to establish the price and rates structures in the domestic trades. This same report found that the Federal Maritime Commission had investigated rate levels in the Hawaii trade only twice between 1985 and 1990 and found on each

occasion that the rates were too high. The ICC, on the other hand, did not regulate carrier rates beyond the filing of tariffs.

DHX-Dependable Hawaiian Express also did studies. Our analysis of the Hawaii rate structures showed that from 1994-1998 the industry had competition based upon a dichotomy in the rates and services provided. In September 1998, the carriers started openly matching and mirroring each others rates, including accessorial, surcharges, inland trucking charges and the like. On less-than-truckload commodity items, the rates between the two carriers have been identical since 1998. Rate increases filed by each carrier, as well as newly imposed surcharges and handling charges, have been the same since 1998.

Analysis of the impact of no competition

So, what does the above mean?

It means that there is a disparate rate structure in the marketplace — single shippers may be able to match forwarder rates by using the tariffs, while forwarders cannot compete with large shippers because they are not afforded the same contracts based on volumes. The ocean carriers, despite my repeated attempts, refuse to negotiate contracts with our company.

It means that smaller shippers will pay more than larger shippers, but this is not necessarily bad — the larger the shipment, the cheaper the rate — that is the way it has always worked in transportation. However, the fact that the smaller shippers' forwarders are not entitled to a somewhat less expensive rate because of their volumes, means that the smaller shippers are paying disproportionately more and subsidizing the larger shippers rates.

Because of the way the Jones Act is written, along with the trade lane as Matson has shaped it with their strategies, Matson will continue to fight in Washington to protect its trade lane and the lack of competition within it. As it does so, the dysfunctional level of competition will continue to exist in the routes to the state of Hawaii, and the populace will be paying artificially high prices due to inflated ocean rates caused by a lack of competition between two carriers.

Inherent in the above three items are two facts that have occurred since 1998. First, rate increases on commodity rates that the carriers have made available to the freight forwarders have greatly exceeded the increase on similar commodity of like-type rates made available to those shippers with contracts. Second, the freight forwarder is obligated to quote "over-tariff" prices in order to profit, which means it can't compete with the containerload pricing the ocean carriers have in their tariffs. The result is that the lack of freight forwarder volume pricing blunts or otherwise severely impairs the forwarders ability to compete with the ocean carriers in a two-competitor trade, with only one competitor adequately (indeed excellently) servicing the trade lane.

Solution

What's the solution?

Give the forwarders volume pricing — force the carriers to contract with the forwarders as they do with single shippers.

My opinion is that the rates provided to forwarders are substantially higher than the contract rates that are provided to proprietary shippers-beneficial owners. Additionally,

the refusal of Matson and Horizon to provide freight forwarders with volume pricing (such as that which was eliminated in 1998) results in the marginalizing of forwarder competition and adversely impacts the ability of the forwarder to provide a "competitive rate" to shippers, both large and small, as well as increases the costs to both, because of their inability to "team up" with the forwarder and use the forwarders volumes to their advantage. It also increases the difference in rates to the public — those without contracts pay much more than those with — at least 20 to 25 percent more according to our studies. I leave you with this last thought:

The cost of shipping a 40-foot-high cube container of freight-all-kinds freight to and from the West Coast and Hawaii compares to Japan and China (including both to and from costs, all in, port to port) as follows:

Japan:	To Japan, \$ 1,175	From Japan, \$ 3075	Total: \$ 4,250
China:	To Hong Kong, \$ 730	From Hong Kong, \$2,845	Total: \$ 3,575
Hawaii:	To Hawaii, \$6,046	From Hawaii, \$4,327	Total: \$10,373

These are both the eastbound and westbound FAK rates. As you can see, even if Matson's vessels came back totally empty, which they do not, the pricing offered in the Hawaii trade lane appears to me to be exceptionally high.

On a per nautical mile basis, the pricing is as follows for a round-trip container:

Tokyo:	\$.439 (\$4,250/9,688 nautical miles round trip)
Hong Kong:	\$.280 (\$3,575/12,760 nautical miles round trip)
Hawaii:	\$2.328 (\$10,373/4,456 nautical miles round trip)

Additionally, it is my thought that with the increases in capacity to be introduced into the trans-Pacific trade during 2005 and 2006, shippers will actually see the rates between Asia and the U.S. decline slightly. If history holds true in the Hawaii trade, prices will be increasing and the disparity shown above will actually increase.

What's the cause of these pricing differences?

There is clearly a lack of competition.

Why haven't these pricing differences previously caused any outcry or uproar by a large number of consumers in Hawaii?

This trade lane, as well as the Hawaiian Islands, have evolved and changed tremendously over the past 40 years or so. During that period, Matson has done a good job, albeit at a very high price, of taking care of the islands. As a result, as the scenario has evolved, there has been almost a "willful indifference" to accept the pricing Matson dictates, given the other alternatives the islanders have available.

*Brad Dechter can be contacted via e-mail at:
bdechter@dhx.com*