



WORLD SHIPPING COUNCIL
PARTNERS IN TRADE

Comments of the
World Shipping Council

Submitted to the
Federal Maritime Commission

In the matter of
**Notice of Inquiry; Solicitation of Views on Requests To
Develop and Release Container Freight Rate Indices for U.S.
Agricultural Exports Based on a Sampling of Service Contracts
Filed With the FMC**

Docket No. 12-07

June 28, 2012

The World Shipping Council respectfully files these comments in response to the Commission's Notice of Inquiry (NOI) in the above-referenced docket published in the Federal Register on May 24, 2012 (77 Fed. Reg. 31013). As explained in more detail below, the Commission's establishment of a rate index for certain cargoes subject to the Shipping Act would violate the service contract confidentiality provisions of the Act and the Commission's own current regulations. That fact alone requires that the rate index proposal be abandoned. In addition, there is no reason why the FMC should enter this arena when the government has not done so for any other transportation mode, and there is no explanation of how the proposed index would reduce the rate volatility market conditions that its proponents contend it is designed to alter. Finally, such a concept would encounter many practical impediments to its implementation. For all of these reasons, the Council urges the Commission not to proceed with the creation of a service contract rate index.

1. An FMC Created Service Contract Rate Index Would Be Inconsistent with the Theory, Purpose, and Plain Language of the Ocean Shipping Reform Act (OSRA)

The Ocean Shipping Reform Act (OSRA) very clearly and intentionally created an entirely different regulatory structure and market structure for ocean carriage service contracting under the Shipping Act. What previously had been a system of contract pricing transparency and common carriage "me too" obligations was replaced with a system of confidential contract carriage with the same kinds of freedoms and risks that exist in other cargo transportation and commercial modes.

OSRA clearly provides that, from a regulatory perspective, service contracts are to be confidential. Period. See 46 U.S.C. § 40502(b)(1) ("Each service contract . . . shall be filed confidentially with the Federal Maritime Commission.") There was no role foreseen for the FMC to reveal in any way any aspect of a confidential contract relating to rates.¹ The FMC has recognized this and its current regulations specifically provide:

"All service contracts and amendments to service contracts filed with the Commission shall, *to the full extent permitted by law*, be held in confidence." 46 CFR 530.4 (emphasis added).

¹ While the Shipping Act does not prevent individual shippers and carriers from disclosing service contract rates if they choose to do so, the Act does provide that mandatory contract filings will be kept confidential by the Commission.

This is consistent with the letter and the spirit of OSRA. The agency's regulations do not say that contracts shall be held in confidence "to the extent that the agency does not include their rates in an aggregated service contract rate index of the agency's choosing."

The purpose of an FMC rate index would be to provide transparency of shippers' rate levels on an ongoing basis, and this purpose is inconsistent with the applicable statute and existing FMC regulations. The purpose of OSRA was to create a new federal regulatory structure under which contract terms that disclose sensitive business information, especially contract rate information, were to be shielded from public disclosure. Under this regime, there is no role for the FMC to inform the market of the level of, or changes in, market rates. That is not a legitimate function for the FMC. Aggregating service contract rate data by commodity would not alter this fact.

The federal government does not create a rate index for rail rates that are transporting the nation's agricultural exports or any other commodities. The federal government does not create a rate index for trucking rates for the nation's agricultural exports or other commodities. The federal government does not produce a rate index for inland waterway or international bulk ocean shipping or international air cargo shipping of agricultural exports or any other commodities. Quite aside from the fact that the Shipping Act forbids it, there is no valid basis or reason for the FMC to create a rate index with confidentially filed contracts for ocean common carriage.

WSC believes that this is so clear and certain that it should resolve any question about the issue. In the interest of being responsive to the agency's Notice of Inquiry, however, the Council provides the following additional comments.

2. The Interests of Financial Traders and Derivative Brokers Are Not Interests Which the Congress Has Directed the FMC to Promote

The Shipping Act is intended to establish a regulatory structure for the nation's international ocean common carriers, NVOCCs, freight forwarders, ports, and shippers. Financial traders and derivative brokers are not within the proper realm of the agency's regulatory interests, responsibilities, or competencies. There is no basis to believe that Congress intended that the FMC would intervene in the market to help financial traders create such a market for shipping futures.

Further, while it is generally agreed by shippers and carriers that rate volatility is in neither's interest, there is no explanation in the NOI of why the FMC believes the proposed rate

index would in fact result in less rate volatility. Absent a convincing economic explanation, there is certainly no basis to assume that such a service contract rate index would reduce rate volatility. In fact, the NOI states that the Commission is being requested by “derivative brokers” to consider establishing this rate index. It is in the commercial interest of such brokers for the market to be more, rather than less, volatile.

3. Inadequate Explanation of the Need for an FMC Created Rate Index

The NOI states: “Some U.S. agricultural exporters have told Commission staff that a properly constructed index would help them increase exports by allowing them to use contracting and hedging strategies to increase the certainty of their transportation costs” [and] “that ocean carriers generally are reluctant to offer them service contract rates that are valid for more than 30 to 60 days, and that this inability to lock in a rate hinders their ability to sell agricultural products for delivery more than 60 days into the future out of fear that changing transportation costs will make the sale uneconomic.”

The exporters are not identified, there has been no FMC fact-finding that supports this statement, and we do not believe this statement is correct.

Ocean carriers are more than willing to contract for cargo shipments that would be profitable. Ocean carriers have every economic incentive to sign contracts with defined rates of a longer duration than 30 to 60 days, if the carrier and shipper can agree on the terms, including price. Carriers are generally willing to provide “certainty” about rates for the duration of a service contract; it is the challenge of reaching mutual agreement on what those rates should be that can limit the agreed contract’s duration. Shorter term contracts exist by the agreement of the parties, and/or their inability to agree on the terms of a longer term agreement. It would be economically illogical for a carrier to be unwilling to “increase the certainty of an exporter’s transportation costs” and “lock in a rate that is valid for more than 30 to 60 days” if the rate will yield a sufficient financial return for the carrier.²

² U.S. export dry cargo container shipping rates, particularly for commodities, tend to be low. For example, the westbound or U.S. export Trans-Pacific trade remains a “backhaul” trade, where revenue levels for an ocean carrier have been estimated to be roughly one-third of the revenue for the eastbound or U.S. import head-haul trade. This is not by intent or design, but is simply a reflection of the market’s cargo volumes, the commodities being transported, and market rates for transportation. It is a current fact that U.S. agricultural dry container commodity exporters pay less to transport their products than shippers of higher value imports, such as U.S. retail importers. Agricultural commodity shippers may be operating in frequently changing markets, with thin margins, and unable or unwilling to make a long-term contractual commitment at rates and volumes that would be mutually agreeable to both the ocean carrier and shipper. The fact is, however, that within the round-trip economics of a U.S. Trans-Pacific liner service, the revenues a carrier obtains from imports far exceed the revenues it

The issues involved in the decision about the duration of a service contract are issues for the contracting parties to address, not the FMC or a government created rate index. In any event, there is no basis to believe either that establishing a rate index would change any of these market forces or that artificially doing so would produce a desirable result.

4. The Baltic Dry Index Does Not Provide a Justification for an FMC Service Contract Rate Index

The NOI states: “These agricultural exporters also point out that they have excellent visibility into bulk shipping rates through the Baltic Dry Indexes, but have no similar visibility into container shipping rates for exports.” This statement provides no value or meaning in the context of whether the U.S. government should establish a container shipping rate index derived from filed service contracts.

First, the Baltic Dry Index is not a government created index. These comments by WSC express no view on rate indexes created by non-governmental entities, but are submitted solely in response to the FMC’s NOI about whether it should create a rate index.

Second, the Baltic Dry Index is not an index developed by extracting and compiling specific, actual rates from specific, actual bulk shipping contracts. It is an index developed by a private sector group of ship brokers, based on these ship brokers’ opinions of what the prevailing ship charter rates are to charter an entire vessel.

Third, the Baltic Dry Index does not measure the same thing as an FMC service contract container rate index would measure. The Baltic Index measures the estimated going rate to charter an entire bulk ship. It thus seeks to provide a reasonable estimate of what an agricultural exporter (and we are obviously considering very large exporters who are shipping enough volume to charter an entire bulk vessel, not small shippers) might expect to pay to charter a ship to move grain from a U.S. port to North Europe or Asia, for example. In container

receives from exports, and thus imports can be characterized as subsidizing the export leg of the service. (See, e.g., “*Economist: Ocean freight costs aid U.S. exports*”, American Shipper, November 5, 2010.) Carriers would certainly welcome export shipping rates producing equal or greater revenues than import rates, but export freight rates would have to increase very dramatically to even get close to producing the revenues of the import leg of the service. And, if export rates did increase that much, we would expect many export shippers, such as exporters of waste paper (the leading U.S. containerized export commodity) would be adversely affected. Basic economics dictate that it is the round-trip economics of a service that will drive the capacity, equipment and service commitments that a carrier must make. Within these constraints, ocean carriers will continue to look for opportunities to serve export shippers on the basis of mutually agreeable contract terms.

shipping, however, no exporter charters an entire ship; it contracts for and books a small percentage of the space on a carrier's regularly scheduled service comprised of a string of vessels. More importantly, with a time chartered bulk vessel, the only asset at issue is the ship and the only service is the movement of the ship and its cargo from one port to another.

With a service contract for container carriage, the ship space is only one piece of the commercial transaction. The carrier's provision of the empty container equipment in specified volumes at specific inland locations at the needed times is just as, if not more, important to understanding the operational commitments and costs and reaching a contractual agreement. An agricultural exporter is often shipping its goods from an area that is a "container deficit location" away from major urban areas. Container availability, including the carrier's ability to commit to position empty equipment to the shipper's premises at the times, location and volumes needed (and to forego the possible revenue that might be available from alternate uses of this equipment) also depends on the shipper's ability and willingness to commit to specific volumes, at specific times, at specific, reliable rates that make economic sense for the carrier. That can be a challenge for shippers and carriers, but that challenge would not be removed by some kind of FMC compiled rate index.

WSC is aware of no impediment to the private sector creating a container shipping rate index that could be considered analogous to the Baltic Dry Index, as there are certainly knowledgeable transportation professionals who could regularly provide their informed opinions of the going rates to move goods between various points. If there were a sufficient market demand for such a product, there is nothing to prevent its creation by the private sector.

5. Practical Impediments That Would Arise If the FMC Were to Proceed with a Proposal to Create a Service Contract Rate Index

In addition to the above discussion of why the FMC should not proceed with the concept of creating a service contract rate index, the following additional comments are provided to note some of the issues that the FMC would have to address if it were to proceed with this concept.

- a. If the agency were to create an ocean common carrier rate index, it would need to also create a non-vessel operating common carrier contract rate index.³

³ When WSC inquired who the interests were that were advocating the FMC to consider this issue, FMC staff responded that one of the advocates of this concept and the "best person ... to speak with from the ag shipper side" is [name kept confidential], a company that describes itself as "a fast-growing NVOCC", offering freight services to the agricultural industry. We respectfully submit that it is not the business of the FMC to provide NVOCCs with greater, more timely, or more specific visibility into ocean carriers' contract rates. While one may be able to understand why such an NVOCC serving the agricultural industry would want better visibility and access to the rates ocean carriers charge the agriculture

- b. Any such FMC rate index could only provide a selected portion of the rates used to transport these commodities. If the agency were to create a rate index based on filed service contracts, it would disclose rates for the covered commodities if they were exported by an ocean common carrier out of a U.S. port, but it would not disclose the rates for the same commodity, being exported by the same shipper or similar shippers:
- Out of a Canadian port
 - Out of a Mexican port, or
 - Out of a U.S. port if moved by a bulk carrier.
- c. The FMC has a pending Notice of Inquiry on the issue of “Canadian cargo diversion” instigated by Washington State port interests who believe U.S. trade through Canadian ports is benefitted in inappropriate ways by various U.S. policies. We note that an FMC rate index disclosing the rates for moving goods through Puget Sound ports would identify a benchmark rate that would allow those interested in shipping through British Columbian ports to know the price they need to beat to capture such cargo.
- d. An FMC rate index would give Canadian exporters, and exporters in other parts of the world, visibility into the rates being charged to U.S. exporters, but not vice versa. It is not clear to us why this would be in the interests of U.S. exporters.
- e. An FMC rate index would provide U.S. government-created visibility into liner shipping rates applicable to a commodity, but not into rail, barge, or bulk shipping rates for the same commodity. For example, grain shipments from the Midwest can be shipped via containers, via barge down the Mississippi and then onto a bulk vessel, or by rail to an export port and then onto a bulk vessel. There is modal competition for shipping various agricultural commodities. An FMC rate index would provide government sponsored rate transparency only for one mode’s rates. We can identify no sound reason for the government to try to establish rate transparency only for one mode that competes for cargo transport services, or for the government to become engaged in such matters.

industry, such an objective is completely at odds with both “rate confidentiality” and the philosophical foundation of OSRA. Even if the Commission determined to proceed with this concept, which WSC would strongly oppose, “a nondiscriminatory regulatory process” would clearly require the Commission to construct simultaneously a parallel NVOCC contract rate index for the same goods and trades, notwithstanding the fact that the agency presently exempts NVOCC contract rates from a filing requirement. See 46 U.S.C. § 40101(1).

- f. A meaningful service contract rate index for containerized shipments would need to incorporate knowledge of the volume of cargo that is being moved at a particular rate. The FMC does not know this. For example, agricultural exporter A has a service contract with Carrier F that has a minimum volume commitment of 50 FEUs over 6 months at rate X. Exporter B of that commodity has a service contract with Carrier G that has a minimum volume commitment of 500 FEUs at rate 1.5X. The FMC rate index is to be based on the filed contract rates. During the time period selected by the rate index (weekly?), Carrier F moves 150 FEUs for Exporter A at rate X, and Carrier G moves 5 FEUs for Exporter B at rate 1.5 X. What is the resulting FMC rate index?
- g. Additionally, some service contracts include commodity rates that the shipper never uses. Further, some service contract volume commitments are *total* volume commitments and are not commodity specific.
- h. FMC service contracts may have port-to-port rates, port-point rates, or point-point rates. Disclosure of “point” contract rates could disclose directly or by deduction the identity of a particular shipper. In such a situation, an FMC rate index would be violating contract confidentiality. This cannot be remedied as the NOI seems to imply by combining port and point rates in an index, because such a combination would be a distortion of the true pricing dynamics in the contracts and in the market, and could in fact be misleading.

6. Conclusion

The Shipping Act and the FMC’s regulations could not be clearer that service contract rate information filed with Commission is to remain confidential. The aim of the rate index proposal described in the NOI is to make service contract rate information public. There is no way to reconcile the inconsistency between the governing statute and the NOI’s proposal. Even if the Commission had authority to undertake such an exercise, which it does not, there is no evidence or credible theory upon which to conclude that the proposed index would have any effect on the market forces that the proposal seeks to alter. Finally, the practical problems with the concept are many, and the probability of unintended negative consequences is high. The Council therefore respectfully urges the Commission not to proceed with a service contract rate index proposal.

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