Agriculture Transportation Coalition (AgTC)

"The principal voice of agriculture exporters in U.S. transportation policy" -- The Journal of Commerce

Comments of the

Agriculture Transportation Coalition

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

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The Agriculture Transportation Coalition has been cited in the maritime trade press, as the "principal voice of agricultural exporters in U.S. transportation policy." Our membership includes the agriculture and forest product exporters, many of whom are engaged in significant import volumes as well. Virtually all U.S. agriculture exports, from all geographical points in the U.S. (and many in Canada) are represented. These include primarily, but not exclusively, shippers who deliver to their foreign customer in ocean freight containers, both refrigerated and dry. Some of our members also utilize bulk and break bulk ocean transportation modes. All of our members extensively utilize domestic U.S. truck, rail and barge transportation services.

The agriculture and forest products exporter is generally shipping a relatively low margin product, which is generally, but not always, fungible in the eyes of the foreign customer. While certain brands carry some weight in the marketplace overseas, the ultimate consumer of U.S. soybeans, beef, cotton, poultry, almonds and other nuts, wheat, dried fruit, citrus, hay, hides, lumber, paper, dairy, potatoes, etc. etc. is generally unaware of the sourcing company or country. These are shipped in many forms, ranging from raw to processed to packaged ready-to-eat. In addition, there is virtually no agriculture or forest products export that cannot also be sourced somewhere else in the world. The competition is relentless, resulting in thin margins, particularly in comparison to branded consumer goods imported from Asia and elsewhere.

Freight Rate Index – No Consensus Reached Within AgTC Membership

Perhaps no issue addressed by the Federal Maritime Commission has generated a diversity of views amongst the agriculture and forest product export community as the present Notice of Inquiry concerning the development and release of container freight rates indices for U.S. agricultural exports, to be based on a sampling of service contracts filed with the FMC. The responses to the 12 specific questions posed in the NOI reflect the dramatic differences of opinion amongst our membership.

For this reason, it is difficult for the AgTC at this point to provide definitive consensus responses to the specific questions. Similarly, our opinions are divergent on even the broader matters of inquiry, such as whether the shipping public would find targeted U.S. rate indices beneficial, whether the Commission should extract information from service contracts, if indices should be commodity and/or route specific, or more broadly based. As to the positive and negative influences of the greater transparency such indices might provide, there is also dramatic diversity of opinions. Finally, while some of our members have experience in indices and hedging instruments for buying and/or selling their own agricultural commodities, as well as inputs such as fuel and barge and truck transportation, most of our members do not.

Support for Commission's Export Focus

It should be noted that there is one area in which there is uniformity of opinion, strongly held by all AgTC members. It is the appreciation of the Commission's recognition that

that transportation constitutes a substantial component of the total landed cost of US agriculture and forest products, and thus plays a critical role in determining the competitiveness of our US exports in foreign markets. The AgTC lauds the Commission for its interest in the competitiveness of US exports, and for seeking ways, within its authority, to further assist US exporters   We believe the Commission deserves recognition for its proactive initiative towards this objective, consistent with both the President's and Congress' focus on export growth.

The development of mechanisms that will provide an additional transportation pricing tool is of utmost interest to our membership, the agriculture and forest products exporters. Our members sign service contracts, which are filed by the ocean carriers and/or NVOCC's at the Federal Maritime Commission. The subject of the Notice of Inquiry -- how the Commission might access the terms of those contracts and organize the information while honoring the confidentiality of each contract's terms, for the purpose of providing a means for US exporters to better understand pricing in the various trade lanes, deserves serious consideration.

<u>Transparency – Leveling the Playing Field</u>

There is a fundamental imbalance when it comes to the matter of transparency of ocean freight rates. Almost by definition, the ocean carriers have far better insight into the freight rates than do the shippers. There are literally thousands of shippers, but approximately two dozen ocean carriers in the primary international trade routes serving the U.S. and Canada. If an ocean carrier handles, say, 30% of the cargo moving from the U.S. to a destination in Australia, New Zealand, South America, Central America, Africa, that carrier knows, with absolute certainty, how much the shippers on their vessels are paying. Thus, while single carrier knows what 30% of the shippers are paying, each shipper knows only the rate that it is paying. In a larger trade, such as the TransPacific, a large carrier may carry 8% of the cargo, and it thus knows what 8% of the TransPacific shippers are paying. Again, each shipper only knows what it is paying.

The imbalance is compounded by the collective actions of the ocean carriers as they meet and agree upon rates, (or rather, voluntary guidelines for rates.) Those agreed guidelines are obviously based upon each of the participating carrier's view of what the rates should be. A relative handful of carriers, meeting together, produces even greater transparency for those carriers as to the prevailing freight rates. Meanwhile each shipper continues to only have access to only the terms of its own contract(s). Perhaps this is the true reason the ocean carriers are so vigorously opposed to an index. It "levels the playing field" by providing the shipper with much improved visibility into freight rates, still not equal to that enjoyed by the carriers, but closer.

There are, of course, many difficulties in creating a meaningful index. Can the terms of confidential contracts be aggregated in such a way that no individual company's shipments can be identified? Is it possible to assure that a rate intended to be confidential, as between the carrier and shipper, does in fact remain unknown to any other parties? These and other implementation challenges are relevant to the current discussion, and are highlighted by those opposed to the indexes and hedging instruments. But it is our belief that they are not insurmountable, and not dispositive of the fundamental question: Can an index benefit exporters?

Government's Role in Creating an Index

There is no question that the most accurate database for export freight terms, including rates and all other terms, is found in the service contracts filed at the FMC. The question is: how to best access those terms? Those terms are intended by the parties to be confidential. If confidential means that no other person other than the parties to the contract know the terms, it would seem that they are indeed remaining confidential. This would be the case even if included in an aggregated pool of such terms extracted from the filed contracts by FMC staff.

Should FMC staff be engaged in creating an export freight rate index? Is that an appropriate role for the government? Our members are of mixed sentiment as to this question, as the responses to the 12 questions posed in the Commission's Notice of Inquiry reveal.

Agriculture Exports Complex Supply Chain

The transportation of agriculture products is often complex. Typically, they are heavy, significantly heavier than the average import cargo. They test the weight limits of the truck, trail and ocean carriers. Many require exact temperature control and significant numbers require humidity control throughout the voyage. Agriculture and forest products typically originate in inland and rural points in the U.S., which are typically neither in nor near the population centers to which the international supply chain delivers our consumer imports. Finally, there is significant diversity amongst the agriculture/forest product exporters in terms of corporate financial and production size; our membership ranges from the world's largest multinational conglomerates to very small, family-owned businesses.

For these reasons, transportation arrangements for exports are often complex, as are the service contracts, which contain the specific terms. Such, service contract terms govern special handling requirements, equipment, volumes, origins, transloading, temperature, weight limits, advance submission of export documentation, cargo loading cut offs, free time, and yes, even the freight rates. Thus, an index based on the freight rate alone, would only address one basic piece of an export service contract. An exporter or carrier utilizing the index would have to be aware that a multitude of other terms involved in the export movement, will either significantly add or reduce the cost of that movement, relative to the published index.

Following are the questions posed in the Notice of Inquiry followed in each case by representative responses amongst our diverse membership.

1. Is there anything that prevents private index developers and publishers from developing indices of the kind being sought by U.S. agricultural exporters?

I would gather there is something stopping a private industry from creating such a beast and that would be two things. First the contract is said to be confidential. To allow a publication to have this kind of data seems to me would be a breach of contract. Secondly, there is a concern that if one exporter of commodity “A” released his data to the publication, that possibly exporter #2 of commodity “A” wouldn’t relinquish his details and exporter number one has just handed his competitor something he shouldn’t have. There is also no guarantee the data that is given to the private publication to be accurate and true.

I think so or they would have already done it. There is no demand for it and it will only serve to commoditize the freight market.

Indexes don’t exist because of the difficulty of accessing useful accurate information.

Transparency. There is no exchange or forward pricing indicators that exist today until a general rate increase is announced. Forward price indications are key for our business. A market where shippers and carriers and interact and understand where people are willing to buy and sell freight would help our industry immensely.

No reason not to develop such an index – we would definitely use them. Maybe not in our contracts, but as a gauge of the freight market.

Private index providers don’t have access to contracted rates which are spot rates due to the assessorial clauses that allow for increases and limited validity of the rates in the service contracts

2. Has your company used or considered using any existing freight rate index to adjust rates in its export service contracts or to hedge freight rate risk? If so, what is your company's view on the products it used or considered?

No, our company has not and will not be considering a freight index. It can be just as risky with just another name. We want to stick with what we know. Those that ask for it, don’t understand what it could potentially do to the business they have now.

No we have no plans to use a freight index.

The existing indexes have limited lane relationship to our export lanes. We have difficulty in following the relation of current index (FAK) to our ag rates.

Our company hedges risk today on several different markets from commodities futures to bulk vessel contracts. We believe a tool to hedge export container movements would be beneficial and we have considered using those products should a viable market come to existence.

We are reviewing the existing indexes, but there is no existing export information to base the agreed price upon

Currently there isn't an index that correlates with rates on the main export lanes for grain. Our company will use an export index and will hedge our freight risk, once an index that correlates with the market becomes available

3. Would it be appropriate to use service contract data filed confidentially with the Commission to develop indices of the kind being sought by U.S. agricultural exporters (assuming the data is aggregated so as to protect the identity of individual shippers and ocean carriers before being released to the public in the form of an average rate or index)?

I have no problem with an aggregate index. I think focusing specifically on agriculture could send a false signal to the market. The competition for containers is greater than our segment of the market. We need to be sure that price action in an index reflects the market, not just Ag. A better indicator may be an aggregate of the top three or four bulk moving commodities like agricultural products, paper, scrap plastic, scrap metal.

We see no benefit to exporters unless the index is restricted to meaningful shipping categories like frozen meat, chilled meat, hides, etc. By doing that it may preclude carriers from wanting to have much of a range in rates and price "one-size-fits-all". The better rates given for volume would place targets on commodities, that smaller shippers would likely press carriers to minimize ranges.

It would not be appropriate to allow confidential pricing to be used. First of all, most contracts have special "deals" if you will: extra free time at destination, extra free time at origin, etc. that is not quantitative. It does add to the value and one contract might give 5 days and another 20 days of free time. The price will be different between contracts just for that one thing alone. Even if it was okay to share CONFIDENTIAL information, I am concerned the accuracy of the true value will not be included and thus combining apple and orange pricing, then coming up with a median rate index that has no true meaning. Also, no one has stated how all the NRA rates will be brought in to feed these rate matrixes. The FMC doesn't have NRA rates filed with them, so how are they going to have access to these rates? They won't, which will skew the median rates even more. Secondly, will the NVOCC rates be included? We know these rates are below market value as it is so they can then sell the rate with a profit margin. If those rates are added, then the matrix will be even more skewed.

Don't see an issue with aggregated totals, as long as confidentially of contract is not violated

No

No, it's not appropriate to use private, confidential contracts to which the commission is not party to or has influence over. There are certain markets no protection can be afforded to the exporter

Using service contract data is exactly what is appropriate, as long as it is aggregated and no contract counterparties are identified.

4. Should these indices be optimized for use in service contracts, for use in financial hedging instruments, or both?

No

These rates won't tell the whole story. As stated above, there are always extra qualifiers added to each individual contract. What are you receiving for your price, may not be what your competition is receiving down the road at a different price. This is only going to confuse the market. The smarter, more experienced shippers already know where their prices need to be. They are not going to use a rate matrix from the FMC or a private party. The only entity that will use this information is someone like China who is not regulated like we are in the U.S., who can advise their suppliers (our exporters) what the price needs to be based on an index that is going to be on the low side if only the confidential contracts are being used and maybe lower if the NVOCC rates are included. China will then demand to control the freight from their side, exclaiming if we can't meet the matrix rate, then they will handle it. This will lead into more aggravation for the exporter, who now makes a few cents on selling the goods delivered and keeps this country in control as far as homeland security is concerned. The only companies that will gain from this "hedging" are the investment companies. Why add another layer into these small margin transactions whereby the exporter will retain even less profit.

Neither

If it is a good index, it should be optimized for both, but its too early to know. Would like to see an index and have time to study it

I think the only function of the index should be to accurate reflect the market. How the index is incorporated into contracts or reflected in a swap market of some kind should be driven by the market.

Both

An index should be equipment specific and FAK in description of the products

These indexes should be optimized for the use in service contracts, and for the use in financial hedging instruments

5. What kind of competitive issues would the public release of a broadly based or route and commodity specific rate index create for U.S. export shippers or ocean carriers?

Too much info. causes carriers to be less likely to offer independent rates and price more like a conference which is bad for all shippers regardless of size.

It may seem like a helpful thing, but it really is not. Anyone who has worked for a trading company or a bigger agriculture business knows this will only cause another bottleneck in the process, especially for markets where the buyer already wants to control the freight.

It will make the access to our markets easier to enter.

Difficult to say at this time

I think more transparency would come to the market and that would be a good thing. Other side agreements include more potential for longer term agreements, allocations and discussions about executing business.

I would think that our foreign customers would compare our current actual rates with a broad based average listed on a government report and think we were not being honest with them about freight rates. Will the index be as current as our often changing rates, especially with small shipments to very small ports?

Any index, based on contracts, provides the competition in other countries with information not provided to the US exporter. The cost information, made public to other countries and competitors, will have implications and hinder our ability to negotiate competitive freight costs to markets open to everyone.

This should increase the competitiveness of the US containerized exports by reducing the soft costs associated with constant renegotiation, and by providing the option to transfer forward price risk to the derivative markets.

6. If developed using service contract data filed with the Commission, should a U.S. export rate index be route and commodity specific or should it be more broadly based? If the specific rate index would be more useful to your business, explain what type of commodity, specific route, publication frequency, or other index-related factors are most needed.

We believe that the data would have to be aggregated in meaningful commodity blocks by port pairs/country to be meaningful. Then you get right back in the same problem identified in question 3 above.

People who are thinking this whole process through are going to answer with product, origin/destination specific. However, it actually may be harder than one thinks. Even with PIERS reports, you can get how many loads of product “X” was shipped from port “A” to port “B”, one can tell what entity was shipping what. This is already too much information to simply hand out for everyone, include the foreign buyers to see. This is a capitalistic society and it doesn’t stop at face value.

I think a core lane(s) approach would work better. Destinations like China base ports (e.g. Shanghai / Qingdao) and Kaohsiung, Taiwan would be a good gauge to work from. Start small, build out once the concept is proven.

We prefer a more broadly based index at this time, specific route-based index. We ship to some very minor ports but the customers might think they should get base port rates. Secondly, what would this do to competition if the government is posting rates?

Don’t agree with using service contract rates.

The index should be route and commodity specific, 40’ Grain (corn, Soybeans, Wheat, etc.) and Feed Products (Meals, Feed ingredients, DDG, etc) rates from Chicago to Kaohsiung. Published weekly in all-in dollar amounts per 40’

7. Should either or both parties to a service contract have the option of not having their contract rates incorporated into an index?

Both should have to sign off to be included.

No. It should be all or nothing. That being said, these matrix numbers should include shipper, NVOCC, and NRA contract rates, if they are going to be fair.

YES it’s called confidentiality.

Difficult to say without better understanding of end function effect within market

No option to opt out. Index should be all or nothing. No point in a market index if anyone can opt out.

If contracts are to be used, yes, but both parties should have to agree to allow the rates to be used for an index.

The broader the data set the better. If you trade on that lane, that information should be included in the index.

8. If made available by the Commission, how would an export rate index affect your company's export sales?

We believe it could take our some competitive advantage away and make “landed cost pricing” difficult.

It would put more demands on what the rate MUST be. Rate is not everything. Service, equipment, documentation, etc., is needed to make the transaction actually happen.

I believe it will ultimately increase costs because the independent actions

Might enhance future sales if the market were sufficiently liquid and actively traded, export sales might be assisted by enabling us to hedge, especially on sales made further out and with greater exposure to increases/changes in rates

The immediate impact would be to allow us to manage our costs or hedge our risk. The better we can become managing freight risk, the more business opportunities we can generate overseas.
Very little

Provides our competitors with unfair information that is not reciprocated from other markets

An export index has the potential for increasing export sales (provided the rest of the supply chain allows for the trade to happen, grain values at origin, hopper rail and truck economics, value of alternative products, competing countries delivered values, etc)

9. If made available by the Commission, how likely is your company to use an export rate index in its service contracts to adjust rates?

Will not use an index to adjust contract rates. We seek fixed rate pricing for 12 months, don’t want rate adjustment driving that period.

Not at all likely.

We will not.

70% likelihood that we will use an export rate index to provide flexibility in our service contracts.
Initially, we are less likely to use index linked contracts and more likely to use an index to financially hedge our exposure. We would look at index linked contracts over time as the market develops.

It is very likely that we will use an Index linked service contract when a viable export index becomes available.

10. Has your company or related subsidiary traded in freight derivatives? If so, describe that experience and the outcomes obtained?

No

We have already figured out how to cover the differences in freight with our customers. Smart companies are already there.

No, don't typically work with companies that are buying freight derivatives.

Yes. We actively hedge in commodities futures markets and bulk freight markets today.

No experience in derivatives at our company.

We have traded in the derivatives to manage forward price risk. These instruments work as they are intended.

11. If a U.S. export rate index is made available by the Commission, how likely is your company to trade in a derivatives market based on that index?

Won't happen.

Very probable.

Not likely

Maybe 50% likelihood

Depends on liquidity for small shipments to minor ports

We will trade in the derivative market based on an index that correlates with what we see in the physical market.

12. What impact would trading in a freight derivative market based on a U.S. export rate index have on the physical U.S. export container market?

Having a forward market should increase containerized export by allowing shippers to offer deferred delivered values. Today Shippers cannot offer deferred delivered values without assuming enormous amounts of risk

Could certainly influence carriers from deploying specialized equipment like reefer in market where the pricing has deteriorated below what other world markets yield. More instability in our mind with the carriers.

The impact as stated earlier would put the control of the freight away from the exporter and to the overseas buyer. If we think we have no control with the ocean carriers now and we have contracts with them, what do you think it will be like without having the contracts?

Ultimately reduce competition and drive up costs.

Too early to say for sure

A financial market should have no impact on the physical market.

I don't believe anyone can answer this accurately without speculation

Conclusion

The AgTC is grateful to the Commission for undertaking this ambitious Inquiry. As is evident by the sampling of representative responses submitted to the Commission herein, indexes, either for their own sake, or as the foundation for hedging instruments, are of extreme interest to the agriculture export community, as well as great uncertainty. It is our hope that the Commission will find these representative responses to be useful, even if far from definitive. The U.S. agriculture and forest products community is broad and diverse, and extremely competitive. It is not surprising, therefore, that the responses to this Inquiry reflect this diversity.

Respectfully Submitted on Behalf of the Agriculture Transportation Coalition
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