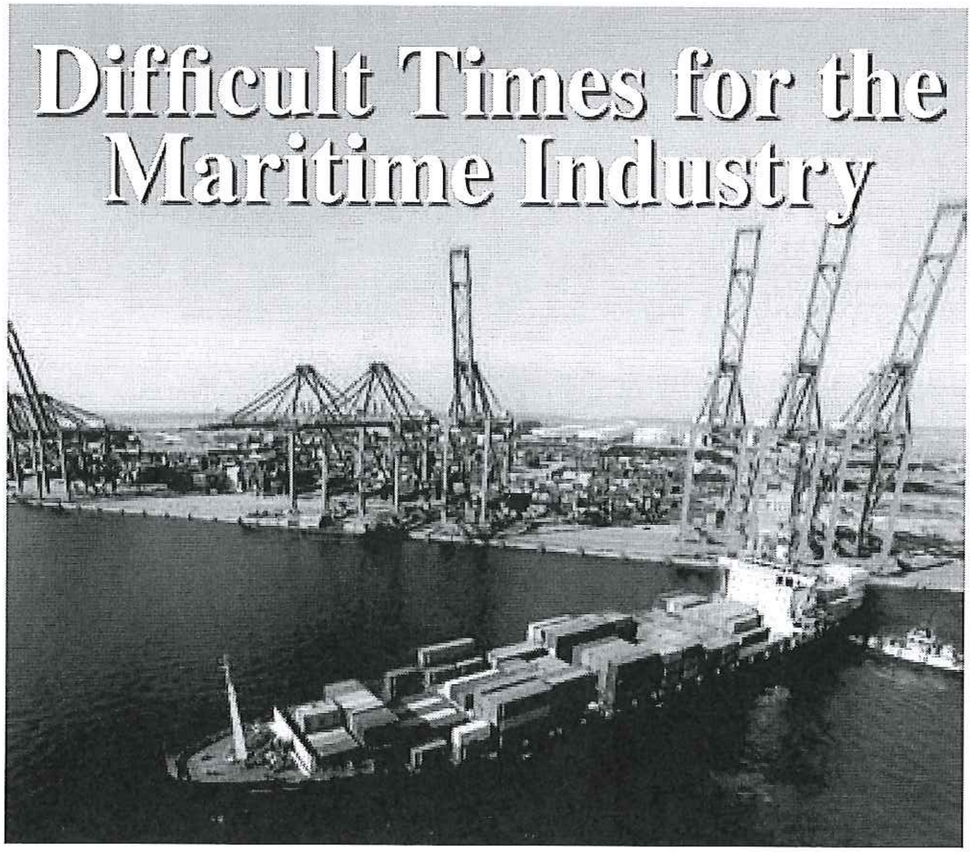
Difficult Times for the Maritime Industry



Overcapacity in liner fleets, the bankruptcy of one of the world's top ten carriers, sluggish global trade growth and increased rates are just a few factors resulting in 2016 being an exceedingly rough year for the global maritime industry. Don Pisano, chairman of the GCA's Traffic and Warehouse Committee, reviews the challenges of 2016 and the lingering effects, and offers an outlook on expected issues facing the industry and subsequent supply chains in 2017.

By Don Pisano

Last year – 2016 – will long be remembered as one of the most challenging years for the shipping industry. It began with significant over-capacity in the world's liner fleet and saw the additional delivery of ultra large vessels continuing to outpace the growth in global demand. To ease carriers' burden of excess capacity, the scrapping of vessels reached an all time high including the scrapping of a seven-year old vessel, which is unheard of. Many of the vessels operated under charter were returned to their owners as their lease periods expired, which has caused charter rates to plummet with a significant number of modern container ships available for charter at rock bottom rates.

Then on 31 August 2016, Hanjin Shipping, the world's ninth largest carrier in container capacity with its primary focus in the Asian trade lanes, filed for bankruptcy upending all perceived notions of top-level carriers being too big to fail, even those closely aligned with government interests and national pride. Hanjin's collapse caused tremendous upheaval at the nation's ports with confusion and frustration among terminals, cargo owners and their draymen. As the legal ramifications were sorted out, there were significant costs absorbed and disputed among all parties. Other carriers in the Far East trade were not willing to let a good crisis go to waste and immediately announced general rate increases of up to 50 percent of their previous base rate levels. While the existing significant idle capacity could have easily filled the void left by Hanjin's quick exit from the market, their competitors deployed few additional vessels being content to book only the highest paying freight and squeeze the rest of their customers for additional revenue above the previously agreed and contracted rates.

Still, the carrier industry continued to struggle with the top 20 carriers estimated to have lost a combined USD $5 billion in calendar year 2016. Perhaps all the turmoil of 2016 has set the ▷

stage for an eventual stabilization of the ocean-borne containerized trade. But with global trade growth at a still sluggish pace and slowed but continued growth in new ship deliveries, freight rate increases should be tempered through 2017.

ULV Supply Exceeds Demand

Over the last decade, the container lines engaged in the aggressive buying of Ultra Large Vessels (ULV) years in advance of their delivery. With the expectations of high demand for capacity and the need for cost and fuel-efficient operations, deploying ULVs in key routes carrying significantly greater quantities of containers per voyage would reduce their cost per container handled. Their desire to differentiate themselves and increase market share did not extend to any significant changes in the way they did business such as innovative pricing mechanisms like index linked contracts which were introduced but met with only a tepid response. Their great fear was having their service becoming a commodity. Yet the acquiring of such ULVs and increased capacity far beyond the increases in global trade has forced carriers into mergers, acquisitions and joining their competitors in forming Vessel Sharing Alliances (VSA) in order to fill the ships to levels required to make the voyages profitable. Thus, carriers have very much achieved what they were trying desperately to avoid, commoditizing their industry.

While shippers may be enjoying low freight rates due to the current over-capacity in the container market, the increased direct costs being expended on the land side of the supply chain along with the required allocation of human resources has been absorbing much of the freight savings. Furthermore, our expectations are looking fairly grim due to:

- Fewer carrier choices resulting from M&As within the industry lessen the choices of shippers and their ability to negotiate freight rates and service requirements including free time and detention privileges;
- Significant reduction in direct port pairs with an increase in "hub and spoke" operations;
- Ships carrying higher volumes of containers laden by multiple carriers, will continue to cause congestion and delays at the marine terminals;
- Carriers on board VSA partner ships that will be required to communicate and coordinate with Marine Terminal Operators (MTO) with which they had no previous experience;
- The expectation that MTOs and carriers will look to reduce the free time allowed at the terminals in order to ease congestion, and possibly further increase demurrage rates to penalize shippers for not removing their freight quickly enough, even though often times the delays are caused by the congestion at the marine terminals themselves and not the fault of the shippers;

Hanjin Shipping, the ninth largest carrier in the world, filed for bankruptcy in 2016.

- The increase of chassis imbalances due to VSA partners maintaining commitments with different terminals within the ports;
- The continued rise of chassis rental fees at rates far exceeding inflation, which already more than doubled since 2009 when Maersk first announced they would discontinue providing chassis for shipper drayed containers;
- Container displacements that require draymen to reposition empty containers to alternate terminal

yards with little if any compensation; and

- Long term, the need for carriers to comply with an International Maritime Organization (IMO) mandate to burn Ultra Low Sulphur Fuel with a maximum 0.5 percent sulphur content by 2020. This will greatly increase fuel costs which of course will be passed along to their customers.

At this point in time, shippers find it quite difficult to discern any true benefit from this evolution of container ship sizing which the carriers have imposed upon themselves and their customers.

What Challenges Will 2017 Bring?

Most American taxpayers are likely not aware and would be concerned to learn that billions of dollars of federal and local funding have been spent to dredge ports and waterways, raise bridges and invest in other targeted infrastructure projects to accommodate these behemoths, all owned and controlled by foreign carriers, yielding mostly negative impacts on their local industries.

What has been lacking is sufficient investments on the land side of terminal properties to improve gate operations, on-terminal turn times, waiting time outside the terminal entry gates, grey chassis pools and chassis roadability. It is also quite evident that public road projects, which would improve port and terminal access for commercial vehicles has been woefully inadequate. Such investments would yield immediate benefits to local shippers, truckers, warehouses and distribution centres while greatly enhancing air quality for the local populations.

It is quite clear to most logistics professionals that the current low rates cannot support a healthy ocean carrier industry and we have already seen a somewhat forced turnaround in rate levels with capacity being better managed. But it will take several years before achieving a sustainable balance in supply and demand. In the meantime, shippers would be wise to focus on a number of key issues and potential developments.

There needs to be shipper engagement with carrier representatives ensuring the terminals their ships are calling at are providing the shippers and draymen with the efficient handling of the containers on the land side of the operations as well as the water side.

Shippers can initiate discussions with VSA member carriers about the need to provide safeguards against the potential financial failure of their alliance partners in some form of a mutually assured performance guarantee.

Labour negotiations between carrier representatives and the stevedoring unions are

The outcome of labour negotiations between carrier reps and stevedoring unions is uncertain.

expected to commence early but we may see some union muscle flexing to shore up their positions.

International Longshoremen's Association (ILA) and US Maritime Alliance (USMX) contract covering the US East Coast and Gulf is scheduled to expire 30 September 2018. International Longshore and Warehouse Union (ILWU) and the Pacific Maritime Association (PMA) covering the US West Coast is scheduled to expire 31 July 2019.

The Alliance for Fair Port Practices filed a petition for rulemaking on fair practices for demurrage and detention charges with the US Federal Maritime Commission (FMC). The FMC accepted the petition and offered a comment period which expired on 28 February 2017. A total of 92 comments were filed, most of which came from shippers, brokers and trade associations expressing support. The comments from port authorities and carrier interests including the World Shipping Council expressed harsh criticism of the effort.

The new FMC chairman, Michael Khouri, has expressed the need for commercial interests to work out their own issues. However, shippers generally do not maintain commercial relationships with the Marine Terminal Operators who focus on serving the carriers as their customers even though it is ultimately the cargo that pays the bills. It is now up to the FMC to consider the comments filed and to decide whether or not to proceed on this petition.

This year – 2017 – is shaping up to be another significant year in the maritime trade with immediate and long term impacts felt throughout the supply chain. Shippers will need to remain alert to any and all developments within the maritime arena as each will impact the variable costs of transactions as well as the human resources required to ensure a smooth and efficient supply chain.

Don Pisano is president of American Coffee Corporation of Jersey City, New Jersey and chairman of the Green Coffee Association's Traffic and Warehouse Committee.