

Emerging Trends for Ocean Service Contract Bid Season

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Beneficial cargo owners have faced well-reported challenges in recent bid seasons. Two plus years of global pandemic unleashed supply and capacity interruption, carrier lane divergence, and an explosion in rates as well as inland dwell fee and demurrage costs. The bookend for those early headwinds is now a kinetic war in Europe with yet-unforeseen boundaries and consequence. Change remains in the air as shippers and their carriers alike grapple with this new reality. Fortunately, identifiable trends are emerging that can help professionals on both sides of the table manage planning and execution this year and beyond.

The Historic Approach to Ocean Carriage Bid Seasons

The exercise and approach of each bid season was always a carefully planned, high-dollar, intense, and heavily negotiated affair. Ocean transportation procurement teams historically spent great efforts in the winter and early spring to understand and anticipate the challenges facing lanes, volumes, and specialized service requirements for the forthcoming bid season. Those enterprises that go to market with bespoke service contract templates would dust them off during this period and update them for any changes in law or operational requirements, and in response to lessons learned from the prior season. Steamship lines would likewise issue lane and service-specific quotes based upon the shipper's required lanes and services. Negotiating rates and legal terms would pick up in the second quarter with interest in wrapping up the new season's contracts in May or June, when the prior contracts would often expire. If new terms were not negotiated in time, then amendments to extend prior terms, or signing the prior terms for the new season with only commercial updates, would be required in order to avoid service under spot market rates.

The Present-State Bid Season Influences and Challenges

The present bid season is showing hallmarks of wear and tear from current events. Volatility was once the principal enemy, with eastbound PRC-USA traffic escalating 1,000% in year-over-year spot rates followed by refused containers and blank sailings. In many ways, complexity has only grown. This year, shippers and carriers have contended with backlogged ports and significant delays that have yielded exponential increases in drayage costs, detention, demurrage, port congestion fees, and the like. As the West Coast ports prepare for dockworker negotiations, which have caused slowdowns and strikes as in years past, shippers importing and exporting through the West Coast are increasingly unsettled as the market is experiencing a demand for carriage that is overwhelming the available carrier capacity. West Coast ports are also reeling from the imposition of Marine Terminal Operator dwell fees directly on importers of record rather than carriers, some of which were launched with little notice to change inbound cargo flows. Challenges extend well beyond North

America; for example, those shippers who sought other methods of traffic such as PRC-EU rail service for hub out of Western Europe are now back to the drawing board due to the Ukraine invasion.

This bid season is also different because of continued winds of oversight in the United States. Should President Biden sign the Ocean Shipping Reform Act (OSRA) into law, U.S. importing and exporting shippers will have additional protections of the Federal Maritime Commission (FMC). For example, OSRA would prohibit carriers from unreasonably declining U.S. exports (with a reasonableness standard that is determined by the FMC), which the FMC would control by requiring carriers to file quarterly reports with the agency detailing the total import/export tonnage and 20-foot equivalent units (FEU) per vessel that have made port in the U.S. Further and for the first time, OSRA would also establish minimum service standards for carriers and shift the burden of proof regarding “reasonableness” of detention and demurrage charges from the beneficial cargo owners to the carriers. The FMC would have broader authority under OSRA through its Bureau of Enforcement (BOE) to investigate potential Shipping Act violations and initiate formal proceedings, which include carriers’ operational practices and related charges. Finally, carriers and marine terminal operators would need to certify that detention and demurrage charges comply with FMC regulations or risk incurring penalties.

Ocean Carriage Service Contract Trends

In the face of increasing uncertainty in this ever-changing bid season, shippers and carriers alike will look to reexamine their expectations and approaches for contracting and negotiating their ocean contracts. Four of the trends that appear to be emerging from our vantage point are: (1) focusing on visibility and collaboration, (2) close examination of the inland leg, (3) new takes on common contract terms, and (4) repackaged service offerings. Each of these early trends is outlined below.

1) Focus on Visibility and Collaboration. The pandemic years laid bare the risk to shipper and carrier alike from inflexibility when confronting dramatic change in cargoes, lanes, and cost. The theme we are seeing take hold is a continued and growing interest in working together to better communicate about forecasted volumes and capacity. This can involve a regular cadence of reporting, defined “meet and confer” periods to align on each party’s needs, or even close attention to the sequence of events if and when a container is refused for any reason. On the purely financial side of the equation, we are seeing increased interest in index-linked rates here as well as with other modalities. Most reasonable parties appear to understand that inflationary pressures are here to stay, together with higher operating costs, and, as a result, recognize the value in aligning on whether and to what extent future adjustments in price will be managed.

2) Examination of the Inland Leg. Some enterprise shippers are executing on strategies for essentially sole source procurement on the entirety of door-to-door traffic. In our experience others are taking the exact opposite approach of fragmenting throughput in the interest of gaining greater visibility and service on the inland leg. The value of doing so is a potential for a response to the gridlock at ports and container yards through direct contracting with dray operators and sources for intermodal equipment. The designation of “nominated truckers” often impacts service contract terms as well, since there is joint interest in understanding how steamship lines will interact with inland carriers for maximum throughput and shipper benefit.

3) New Takes on Common Terms.

Certain terms that were not all that interesting a few years ago are now front and center for strategic analysis. The terms themselves, which were historically often only one year, are now frequently much lengthier, and extending them to three or more years not uncommon. Doing so necessitates serious consideration of future rating, which lends itself to the topic of indexing to address inflationary pressures on input costs and the like. Extended terms can also yield a long-term shift in bid season itself, with many large enterprise shippers having gone to market as early as fourth quarter in an effort to gain early clarity on their capacity needs. Another point of interest is MQC, where at least a few approaches conceptually migrate from traditional MQC and liquidated damages structures, although much of the leniency under these approaches is arguably for carrier benefit. Some shippers have preferred instead to focus on the concept of dead freight. The new takes on common terms are attempts at what amount to essentially dynamic pricing and capacity terms, which is an interesting approach to find middle ground between the hard-coded world of historic contracting and the volatility of the spot market.

4) Repackaged Service Offerings. Finally, we have seen certain novel takes on traditional service contracts. The apparent increase in interest for at least considering the technology intermediary operating, such as the New York Shipping Exchange (NYSHEX), is one such example. This private party provides connectivity between shipper and carrier, contract and tender management, and a mandatory dispute resolution council. We have also encountered new ideas in bilateral shipper-carrier contracting (without involvement of a third-party enterprise such as NYSHEX). Those often involve the unique features described in Section 3 above together with a new sales-oriented pitch construing the package as unified and beneficial to all parties.

The future of global influences on ocean trade, and industry reactions to the same, of course remains to be seen. We nonetheless remain optimistic, observing that shipper and carrier alike are endeavoring to navigate uncertainty so that end-to-end supply chains remain moving as best as possible. If there is a silver lining, it is perhaps that once-hypothetical events are no longer academic, and we all have benefit from the experience. We have had at least two once-in-a-lifetime black swan events within the past two years. The net effect is sure to be improvements in the supply chain, including ocean carrier procurement practices, commercial models, contract terms, and day-to-day interactions between shippers and carriers.

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