Test the Waters: The Trickling Effects of COVID on Ocean Carrier Service Contracts in 2021

By Dewey M. Golkin, Esq.

According to the Federal Maritime Commission statistics (SERVCON), there have been approximately 60,000 contract filings and 275,000 amended contract filings as of June 1, 2021. Whenever a contract (also referred to as a "service contract") involves transportation of goods via ocean, all parties must file their contract with the Federal Maritime Commission. The FMC is the regulatory body which is authorized to establish certain requirements for these agreements and authorized to review them to ensure compliance with the governing sections. Often, these contracts are formed between a carrier and a freight forwarder or other contracting party in order to provide its customers with the logistics needed. FMC explicitly states that "the act favors greater freedom in allowing parties to form their commercial arrangements." But what happens when the service contract is breached?

When Covid first occurred, global restrictions were implemented to slow the spread of the virus. Such measures caused the governments to lock down cities, which meant that workers were unable to report to factories or ports. These labor shortages resulted in product shortages as well as the decrease in the number of cargo ships to the U.S. Moreover, the shortages caused a tremendous backlog in cargo movements and has been nothing short of a nightmare for forwarders, shippers, and other contracting parties with ocean carriers. In response, carriers limited pre-negotiated service contracts by only allowing contracting parties to a portion of their agreed upon volume commitment.

To exemplify the circumstance described above, consider the following example: a freight forwarder and a carrier contract may agree to various terms including the access to 10,000 containers or another amount to the freight forwarder over a period of one year. Based upon that representation, the freight forwarder would then be able to sell the committed volume to its shipper clients. As a matter of policy, if the freight forwarder does not fill 10,000 containers within the year stipulated under the deadfreight clause, there is a penalty that the freight forwarder will pay per container. But what is happening in reality is that carriers are not honoring the volume commitment initially agreed upon. Freight forwarders often are able to sell their business because of their relationships with carriers that the shippers do not otherwise have. When this happens, what can be done and what burden of proof must be met?

The Shipping Act of 1984 governs all transportation of goods by ocean carriers. The Act provides in part, the requirements of agreements between parties and when a service contract is required to be filed with the FMC. If any section of this Act is violated, "[a]ny person may file with the commission a sworn complaint alleging a violation of this act…and may seek reparation for any injury caused to the complainant by that violation." This complainant may give rise to an investigation by the commission. Regardless, both the plaintiff and respondent are enabled to engage in both discovery and request hearings. Based upon a finding that a section of the Shipping Act has been violated, the FMC may award damages for actual losses, penalties or legal fees. If the plaintiff is successful on this claim, it may then seek to enforce the order in U.S. District Court. It should be noted that antitrust laws such as the Clayton Act and Sherman Act, which may carry additional civil and criminal penalties, may not be brought when the Shipping Act expressly prohibits certain conduct.

Section 10(d)(1) of the Shipping Act of 1984 states in pertinent part that "[n]o common carrier…may fail to establish…just and reasonable regulations and practices relating to or connected with receiving, handling, storing or delivering property." Both the Code of Federal Regulations and an Interpretative Rule by FMC issued on May 18, 2020 set forth further guidance on ocean carriers responsibility to procure just and reasonable regulations and practices. The interpretation arose out of issues where carriers were creating policies of detention and demurrage that were forcing contracting parties to pay penalties without just cause. However, the same interpretative rule may be applied to a new issue, the issue of breaching dishonored service contracts by refusing to provide the container space that was set forth in writing. This interpretative rule states the elements that a complainant must establish to prove that reparation is warranted in a given case. The main element that the complainant must demonstrate is that the respondent engaged in conduct in violation of the Shipping Act of 1984, which was "normal, customary, and continuous basis."

The issue has not gone unnoticed. On May 19th, 2021, the National Industrial Transportation League (NITL) wrote a letter to Congress to amend The Shipping Act of 1984 to, among other aspects, "prohibit…unfair business practices and clarify the obligations of common carriers." NITL has published a summary of the letter here. As of this writing, Congress has not acted on this letter.

As attorneys, we know that there is, of course, a cost-benefit analysis to be considered when pursuing such a lawsuit. Shippers and freight forwarders may not want to complain about the carriers because they rely on good relationships to secure the space for the imports. There is no doubt that these matters are ripe for litigation and any complainant who is brave enough to test the waters (*no pun intended*) may succeed on a claim for reparation. Certainly, there are numerous mechanisms to recover actual losses for damages suffered. But the consequences of bringing such a lawsuit may be dire for long-term business relationships and place them in deeper waters than intended.

[Source documents and citations available from author.]