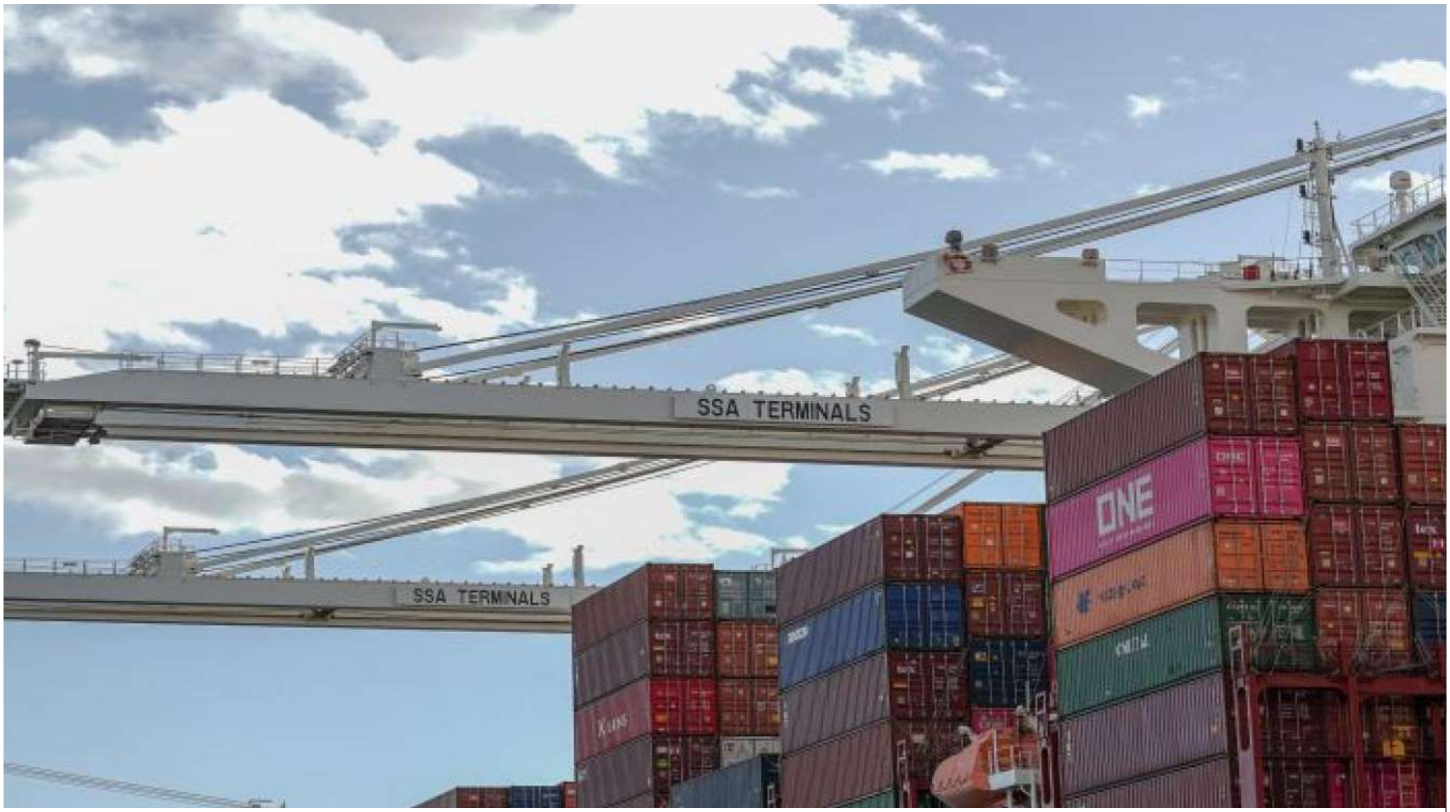
S&P Journal of Commerce

Carriers, shippers seek sweet spot in post-bull market service contract talks



Although negotiations began slowly this year, talks between shipping lines and the largest US retailers for the 2023-24 service contracts have picked up in intensity over the past two weeks. Photo credit: ferita Rahayuningsih / Shutterstock.com.

Maritime | Container shipping | Container lines | North American ports | Trans-Pacific

Bill Mongelluzzo, Senior Editor | Feb 14, 2023, 12:03 PM EST

Trans-Pacific container lines are fighting to dull the sharp decline in ocean freight rates by keeping their initial pricing offers above $2,000 per FEU for 2023-24 service contract rates even as the balance of power has flipped to importers.

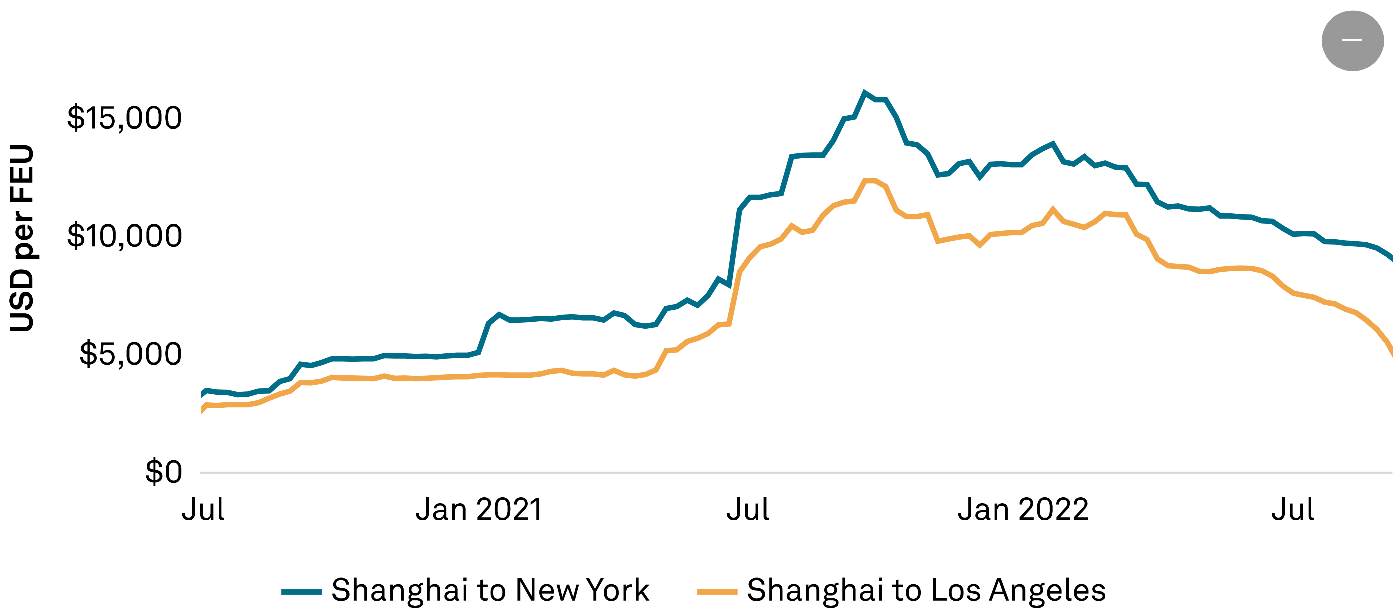
In the negotiations leading up to the annual service contracts that will take effect on May 1, container lines and importers are trying to find a new middle ground amid uncertainty as to how strong demand will be in the second half of the year. Shippers are trying to protect themselves from paying contract rates that could end up being too high if demand does not pick up in the summer-fall peak season. Carriers, meanwhile, do not want to price ocean freight too low in their contracts should the economy and consumer demand recover strongly later this year.

“BCOs [beneficial cargo owners] are asking for 2018 rate levels. Carriers are not prepared to offer those rates,” Larry Burns, president of Lawrence Burns Consulting and a former liner executive, told the *Journal of Commerce.*

In the current trans-Pacific environment in which spot rates and demand have fallen dramatically, retailers expect the ocean portion of their new service contract rates will be significantly below what they paid last year. That’s putting much of their focus on accessorial fees, such as detention charges for the late return of equipment, which can add hundreds of dollars to the total transportation cost. Importers want more free storage days at their congested warehouses. Container lines tell the *Journal of Commerce* they’re willing to be more flexible on detention if they receive compensatory ocean freight rates.

Asia-US spot rates near three-year low

Trans-Pacific eastbound spot rates as assessed by Drewry



Source: World Container Index assessed by Drewry

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Although negotiations began slowly this year, talks between shipping lines and the largest US retailers for the 2023-24 service contracts have picked up in intensity over the past two weeks. Carriers and importers told the *Journal of Commerce* the two sides are at least $500 per FEU apart in their initial rate quotes, with carriers reportedly quoting $2,000 to $2,250 to the West Coast and retailers asking about $1,700, or lower. Asia-East Coast rate quotes are $1,000 to $1,200 per FEU higher than the West Coast rates.

Last year, importers who signed early secured contract rates below $6,000 to the West Coast, but carriers' asking rates increased rapidly amid strong demand. Those who waited until April ended up signing contract rates between $6,000 to $8,000 per FEU.

Sources say that while a handful of smaller deals had been signed as of last week, no major contracts between a carrier and its largest customers that would set the trend for 2023-24 talks had been inked as yet.

"We're not doing rounds of negotiations yet like we used to do," a carrier executive

Far apart in talks

In conversations with three consultants, three non-vessel-operating common carriers (NVOs), four shippers, and four carriers, sources told the *Journal of Commerce* based on the dialogue that has taken place so far, it's obvious that carriers and their customers are far apart in their ocean rate quotes.

The largest retailers that set the service contract rate floor for the trans-Pacific trade are reportedly seeking rates that are "significantly below" $2,000 per FEU. Some large retailers are reportedly seeking service contract rates of $1,500 or lower.

But carriers say they can't drop prices below a certain level because their operational and administration costs increased significantly during the pandemic.

"Carriers would lose money at those rates," Burns said. "When all of their costs are added up, $1,400 is not going to do it for them."

Pre-COVID-19, carriers used to estimate that their per-unit costs in the eastbound trans-Pacific were about $1,400 per FEU. But several carriers told the *Journal of Commerce* that given the vessel backlogs and inland bottlenecks that add delays and costs to the supply chain, rising prices for bunker and diesel fuel, and administrative costs, their cost to carry a container from Asia to North America is now about $2,000 per FEU.

Rate quotes all over the map

Mid-size shippers said based on the discussions they have had with carriers in recent weeks, contract rate proposals vary widely from carrier to carrier. The logistics manager of an e-commerce shipper said one carrier asked for $2,200 per FEU to the West Coast, a second carrier quoted $2,100, and a third carrier weighed in at $1,744. The East Coast quotes ranged from $2,744 to $3,500 per FEU, the shipper said.

Still, the ocean freight rate is meaningless if "the other bells and whistles" including detention, demurrage, and peak-season surcharges are added on, the e-commerce shipper said. Those charges can easily push the total transportation cost to $3,000 per FEU or higher. "I can't run an efficient operation at $3,000," the source said.

Carrier managers say they are willing to be more flexible this year on allowing extra free storage time for containers and chassis that are detained at congested warehouses before charging detention fees. The e-commerce shipper said he is asking for extended free time for inbound container/chassis units at his warehouses. "I asked

Detention charges normally kick in after four or five days. Carriers' daily costs for chassis, which they generally lease from intermodal equipment providers, vary depending upon the contractual relationship they have with the equipment lessor. Other costs are more nebulous, such as the potential revenue that is lost when the equipment sits idle at a warehouse for days or weeks.

In contrast, carriers said they incur "real" costs for demurrage, which is charged by the terminals when shippers leave their inbound loaded containers on the docks for more than three or four days. Demurrage charges are included in the tariffs that port authorities sign with their terminal operators. The terminals normally charge demurrage to importers who leave their containers on the docks beyond the free storage time of three or four days.

Shipping lines, in the service contracts they sign with their customers, especially large retailers, oftentimes give the importers additional free time in order to win their business and will pay the demurrage costs involved to the terminal operators. But carriers this year say that with today's low freight rates, they can no longer absorb the demurrage charges on behalf of their customers.

"We'll extend the free time for detention, but not demurrage. That is a real cost that has to be paid," a carrier executive said.

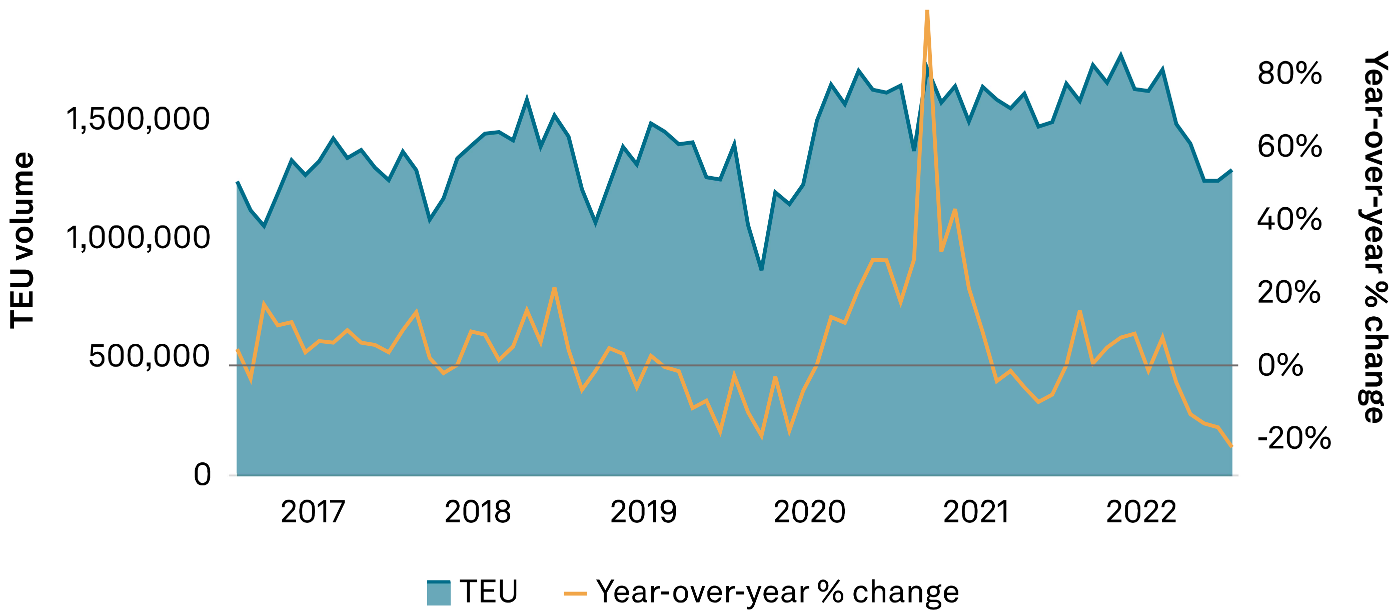
NVOs called upon more

Several forwarders told the *Journal of Commerce* that shippers and carriers are including more NVOs in the contract discussions this year. "Some importers are inviting multiple carriers, but they're also inviting NVOs as well. There is value in that," said Christian Sur, executive vice president for ocean freight contract logistics at Unique Logistics International.

Sur said shippers are devoting a high percentage of their freight to their core carriers in order to benefit from the lower contract rates they will pay this year, but those shippers also have contracts with NVOs. The NVOs can guarantee space for clients because they have contracts with a number of trans-Pacific carriers. If cargo volumes are weak during the summer-fall peak season and spot rates drop below contract rates, their clients will pay the lower spot rates. If the spot rates are higher than their contract rates, shippers will ship more with their core carriers under contract until they reach their minimum quantity commitment (MQC).

Asia imports to US remain near three-year low

Total monthly US imports from Asia with year-over-year change



Source: PIERS, S&P Global

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While sources who spoke with the *Journal of Commerce* said that this year, as every year, there will be some carriers and shippers who negotiate aggressively on every detail of the contract, most carriers and logistics managers know that the market in the trans-Pacific can change quickly, so neither party wants to threaten its business relationship with the other.

"The rates are what the rates are. Let's not be too aggressive because this may all change," said John Janson, senior director of global logistics at the apparel and accessories retailer SanMar.

Similar to some other shippers, Janson is telling SanMar's core carriers his main concern this year is for relief from accessorial fees, so he is focusing his contract discussions on those add-on costs. "We're in this for the long game," he said.

A carrier executive said that while some customers are saying it's payback time for shippers who endured exceptionally high freight rates last year, most customers are not demanding unreasonably low ocean rates this year.