INCREASE IN SHIPPING RATES AND LEGAL ISSUES FACING SHIPPERS

The knock-on effects of the Covid-19 pandemic are continuing to impact the global shipping market, with a shortage of containers coupled with a rebound in demand for goods driving freight costs to unprecedented levels. In this article we consider the root causes of the increase in freight rates and some of the legal issues that shippers are now having to adjust to.

What's behind increasing freight rates?

By the end of January, the global average freight rates for a 40' container (FEU) reached $4,089, up almost 75% since the end of November 2020.[1] This increase is even more striking in respect of rates between East Asia and Northern Europe, which have more than tripled in the same period to almost $8,000/FEU.

The primary driver behind this increase in freight rates has been a shortage of containers at origin ports in Asia and, in particular, Shanghai (the world's busiest container port). This shortage is a hangover from the disruption caused in the shipping market during the first wave of the pandemic, when a high volume of empty containers were left stranded at ports across Europe and the US rather than returning to East Asia in the first half of the year.

This issue was only further exacerbated by the bulk purchase of PPE and other medical equipment – in the UK, the government was initially forced to stockpile PPE in containers at ports or other temporary facilities for weeks at a time until warehousing space became available. Similarly, due to the restrictions imposed because of the pandemic, many ports have been forced to lower their capacity, which coupled with social distancing and quarantining restrictions has forced turnaround times at ports to be slower.

While demand for containers was low, the relocation of shipping containers and disruptions at ports did not pose such a problem to the industry. However, the second half of 2020 saw a surge in demand, primarily driven by the continuing growth in e-commerce and consumer demand for goods, resulting in the demand for containers increasing by approximately 5 million TEU compared to the first half of the year.[2]

Carriers have, in fact, increased capacity and have chartered more vessels compared to 2019. However, despite these efforts, demand has outstripped supply for both containers and space onboard vessels, and this is what has caused freight rates to rise so significantly.

Shippers – Between a rock and a hard place?

Volatility in container shipping rates is certainly not novel, and both carriers and shippers have weathered significant fluctuations in the market in recent memory, particularly during the global recession at the start of the last decade and the subsequent rebound in 2011. However, the sudden rise in spot rates has left many businesses facing freight costs that all but wipe-out any profit margin on lower value goods. Nonetheless, given that the only alternative is cancel shipments in the hope that the rates level-off in the short-term, businesses are being left with little choice but to agree to higher rates (and these costs will inevitably trickle down to the consumer).

Even the largest shippers, who have sufficient buying power to enter into longer-term volume contracts with the shipping lines, are not immune to the current volatility. There have already been reports of carriers prioritising shipments at higher spot rates or even reneging on previously-agreed fixed rates altogether. Blue-chip retailers may have even encountered the same issues as smaller shippers and been forced to accept higher rates than those contractually agreed to avoid delays in shipments. In these circumstances, the only real recourse for shippers would be to threaten or bring a claim for breach of contract against the carrier (though this will not have assisted shippers in enforcing fixed rates in the short term).

A return to index-linked contracts?

If freight rates do not stabilise in the near future, it is likely that these higher rates will be baked in to any annual contracts that shippers enter with carriers in the coming months, particularly on the Asia-to-Europe trade lane. This could lead to shippers eventually paying fixed rates that are above market if freight rates start to fall later in 2021.

One option larger shippers could consider would be to link any longer-term volume contract with an online container index (such as the Freightos Baltic Index) rather than agreeing fixed rates per container. Where the rates under a contract are index-linked, the shipper and carrier may look to agree minimum / maximum rates to avoid either party being exposed to major movements in freight rates either way.

Another possibility would be for shippers to use a digital contracting platform such as the NYSHEX (which was founded by the New York Shipping Exchange in 2015). These platforms typically offer parties a standardised freight contract, so that shippers have better visibility and certainty when it comes to the enforceability of freight rates and carriers have better enforceability of shippers delivering on volume commitments (NYSHEX recently said that it has 98.4% compliance under its contracts).

Predictions

There are hopes that the factory closures in China over the Lunar New Year in February will help carriers to clear the backlog, reposition empty containers and will allow supply and demand to stabilise. Whilst this may ease pressures in the short term, so long as shippers are still faced with challenges in forecasting volumes, with constant question marks over how governments around the world will respond to issues such as new variants of COVID-19 and growing levels of inoculation, it is difficult to predict when and to what extent freight markets will return to normal.

As in 2020, the logistics industry, as we all are, is still very much in the hands of the pandemic.

For more information, please contact the author of this article:

MATTHEW GORE
Partner
T +44 (0)20 7264 8259
M +44 (0)7810 320275
E matthew.gore@hfw.com

Additional research conducted by Trainee Solicitor Joshua Prest.

1 Freightos Baltic Index: https://fbx.freightos.com/

2 Lloyd's List, "Volume surge, not blankings, behind supply chain problems": https://lloydslist.maritimeintelligence.informa.com/LL1135437/Volume-surge-not-blankings-behind-supply-chain-problems

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