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Victoria Prussen Spears

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# Protecting the Supply Chain: U.S. Government Studies the Role of Federal Agencies in Ocean Carrier Bankruptcies

*By Rick Antonoff and Evan Jason Zucker\**

*The shipping industry plays an integral role in international trade and commerce. The immediate consequence of an ocean carrier bankruptcy will be substantial disruption in the supply chain. The authors of this article discuss the issue in the context of Hanjin's bankruptcy case and advise industry participants to take steps to insulate themselves from the potential bankruptcy of another participant in the supply chain.*

In December 2018, the Frank LoBiondo Coast Guard Authorization Act (the “LoBiondo Act”) was enacted to, among other things, improve and support the operation and administration of the Coast Guard and update maritime and environmental policy. Section 713 of the LoBiondo Act directs the Comptroller General of the United States to “conduct a study that examines the immediate aftermath of a major ocean carrier bankruptcy and its impact through the supply chain.”<sup>1</sup> In accordance with that mandate, in January 2020, the U.S. Government Accountability Office (“GAO”) published a report on the role of the Federal Maritime Commission (the “FMC”) and Department of Commerce (“Commerce”) in an ocean carrier’s bankruptcy case.<sup>2</sup>

The study was prompted by supply chain disruption at sea and at numerous ports caused by the bankruptcy of Hanjin Shipping Co., Ltd. in August 2016. At the time, Hanjin was one of the world’s largest integrated logistics and container shipping companies transporting cargo to and from ports throughout the world. The GAO concluded that the FMC and Commerce played an important monitoring function in the industry, but did not recommend any changes to either agency’s role in an ocean carrier bankruptcy. This is because the GAO found that industry participants have already taken steps to mitigate

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<sup>1</sup> Pub. L. No. 115–282, § 713, 132 Stat. 4192, 4298–99.

<sup>2</sup> “Ocean Carrier Bankruptcies: Federal Agencies Have a Limited Role in Addressing the Effects on Cargo,” [gao.gov/assets/710/704203.pdf](https://www.gao.gov/assets/710/704203.pdf).

the effects of another ocean carrier bankruptcy and current law does not authorize these agencies to have a more active role.

## THE OCEAN CARRIER INDUSTRY

The maritime transport industry is the backbone of globalized trade and the manufacturing supply chain. According to the United Nations Conference on Trade and Development's Review of Maritime Transport 2019, more than four-fifths of world merchandise trade by volume is carried by sea.<sup>3</sup> Annually, more than one trillion dollars in U.S. exports and imports are moved by ocean vessels. Prior to the current pandemic, the industry was already coping with low-freight rates, reduced earnings, and oversupply as a result of increased global tariffs, volatility in demand, and new environmental regulations. These market conditions have led to the continued consolidation of ocean carriers. "In February 2019, the [top] 10 deep-sea container-shipping lines represented 90 per cent of deployed capacity and dominated the major East-West trade routes through three alliances."<sup>4</sup> This consolidation in the industry increases the risk of disruption that the financial instability of any one shipping company can have on the global supply chain.

## SCOPE OF THE GAO STUDY

To address the objectives mandated in the LoBiondo Act, the GAO reviewed documents filed in Hanjin's bankruptcy case and documents provided by the FMC and Commerce. Additionally, the GAO interviewed 15 industry stakeholders representing various roles in the supply chain including representatives from four ports, two ocean carriers, one association representing carriers, one association representing freight forwarders and customs brokers, five associations or companies representing transportation and equipment providers, one association representing retailers, one association representing agricultural cargo owners, and officials with the FMC and Commerce.

## RESULTS OF THE GAO STUDY

### **Hanjin's Insolvency Proceedings and the FMC's Response**

After failing to reach a consensual restructuring agreement with its creditors outside of court, Hanjin commenced an insolvency proceeding in South Korea

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<sup>3</sup> UNCTAD/RMT/2019/Corr.1, [https://unctad.org/en/PublicationsLibrary/rmt2019\\_en.pdf](https://unctad.org/en/PublicationsLibrary/rmt2019_en.pdf).

<sup>4</sup> *Id.*

on August 31, 2016, and an ancillary insolvency proceeding in the United States under Chapter 15 of the United States Bankruptcy Code on September 2, 2016. These proceedings caused an immediate disruption to the movement of goods. In an effort to facilitate normal flow of goods notwithstanding the insolvency proceedings, the U.S. court issued an order in the Chapter 15 case prohibiting creditors from arresting Hanjin vessels in the United States, and from terminating or exercising other remedies under contracts solely because of Hanjin's insolvency proceedings. Additionally, after the South Korean proceeding was recognized in the United States, the U.S. court took various actions related to implementing Hanjin's liquidation, including recognizing and enforcing orders of the South Korean court approving sales of assets in the United States.

In response to Hanjin's insolvency proceeding, on September 1, 2016, the FMC issued initial guidance to U.S.-based shippers and cargo owners.<sup>5</sup> The guidance stated that the FMC had no jurisdiction to resolve bankruptcy claims and does not intercede in legal actions between third parties. The FMC would, however, "be vigilant in watching for, and quick to act on, any improper behavior by other carriers and regulated parties (such as marine terminal operators, non-vessel-operating-common-carriers, and freight forwarders) that would constitute violations of the Shipping Act."<sup>6</sup>

### **Bankruptcy Increases Cargo Costs and Has a Short-Term Effect on the Movement of Goods**

The immediate supply chain disruption caused by Hanjin's insolvency was significant. The insolvency proceeding created confusion around the world and uncertainty in the retail market. Cargo owners were unable to locate their cargo or know when their goods would arrive for delivery. This was exacerbated by vessel-sharing agreements between carriers, which meant that some cargo owners did not even know they had cargo on a Hanjin vessel. And worse, immediately after Hanjin commenced its insolvency proceeding, it halted some vessels at sea for fear of arrest, while other vessels were forcibly stopped by creditors at ports or in canals. Moreover, terminals refused to offload or release cargo until they received payment, and ports instituted cash-only policies to cover the fees and labor costs for handling containers. Ports refused to take empty Hanjin containers creating a backlog for motor carriers unable to remove the empty containers from their chassis to make room for full ones.

In addition to issuing orders staying creditor action against Hanjin, the U.S. court also approved protocols containing procedures for cargo owners to

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<sup>5</sup> [fmc.gov/statement-regarding-status-of-hanjin-shipping/](http://fmc.gov/statement-regarding-status-of-hanjin-shipping/).

<sup>6</sup> *Id.* See also, Shipping Act of 1984, 46 U.S.C. §§ 1701–1720 (the "Shipping Act").

negotiate with terminals, carriers, and other parties to release their cargo in the United States by paying the unloading and other costs and obtaining Hanjin's cooperation. Industry participants reported to the GAO that with respect to U.S.-bound cargo, once the U.S. court approved these protocols, it was easier for the cargo to resume moving through the supply chain. The protocol was approved by the U.S. court just seven days after Hanjin commenced the Chapter 15 case. While stakeholders found that some of the effects on the movement of cargo were resolved shortly after the commencement of the Chapter 15 case, other issues took longer to resolve. For example, it took between a month to three months to resolve issues such as detained containers that were moved off port and empty containers and chassis shortages at port.

The GAO did not quantify the overall economic effects of Hanjin's bankruptcy, but the report found two primary economic consequences.

First, costs were incurred from goods not arriving on time because of cargo delivered to or offloaded at a port that was not the intended port.

Second, even if goods arrived at the right port, cargo owners and other parties paid unexpected additional fees to release cargo and to arrange transportation to get their cargo to its destination on time.

#### **Federal Agencies Had Limited Role in Hanjin's Bankruptcy Case**

Under the Shipping Act, the FMC is charged with enhancing competition and prohibiting discriminatory practices of ocean carriers in the foreign commerce of the United States. It shares industry information with industry stakeholders and other agencies, and it reviews and approves agreements between carriers to share vessels and requires ocean carriers to publish their rates. According to the GAO report, FMC officials monitored the Chapter 15 case for unreasonable practices, but it did not find sufficient evidence to take any action in the case. The FMC, instead, conducted regular calls and meetings with industry participants to discuss the problems they faced and offered mediation services to industry participants through the Office of Consumer Affairs and Dispute Resolution Services.

With respect to Commerce, its statutory mandate is not to regulate the ocean carrier industry, but to foster, develop, and promote domestic and foreign commerce. Toward that end, it assists U.S. exporters in their dealings with foreign governments and entities owned or controlled by foreign governments. Commerce's primary function in Hanjin's insolvency case was to liaise with South Korean government officials to secure emergency funding to facilitate continued cargo movement. Furthermore, Commerce worked with embassy officials from countries where Hanjin vessels had been arrested en route to U.S. ports to assist in resolving outstanding issues so the cargo can ultimately reach its final destination.

Within Commerce, the Advisory Committee on Supply Chain Competitiveness (the "Advisory Committee") was established in 2011 to provide the secretary of Commerce with advice on national freight infrastructure and freight policy to support U.S. supply chain and export competitiveness.<sup>7</sup> In respect of Hanjin, the Advisory Committee recommended that Commerce use financial criteria to assess the risk of future ocean carrier bankruptcies and that Commerce establish a committee to coordinate an interagency response to any future bankruptcies. According to the GAO report, Commerce has not implemented these recommendations because it believes the threat of future ocean carrier bankruptcies "appears minimal at this time" so such a committee would have little to do during periods of stability in the carrier industry.

**Increased Participation by Federal Agencies is Unlikely, So the Industry Has Taken Steps to Mitigate Impact of Future Bankruptcies**

The FMC and Department of Commerce have suggested that they will continue to play only a limited role in any future bankruptcy case. Primarily, this is because, in their view, the legal and market response to previous bankruptcy cases resolved the effects on cargo movements timely and effectively. Second, both agencies have limited authority to take additional regulatory actions without the granting of further powers by an act of Congress.

The GAO identified the following suggestions by industry participants and the government's response:

<b>Industry Participant Suggested Changes</b>	<b>Agency Response</b>
The FMC should require ocean carriers to be licensed and bonded.	The FMC currently does not have the statutory and legal authority to impose such a requirement on ocean carriers.
Conduct financial analyses to assess the financial health of ocean carriers and the extent to which they are at risk of bankruptcy.	FMC officials said it is not appropriate for a government entity to publicly speculate on the potential viability of a private entity. According to Commerce, its financial analyses are for internal industry assessments only, but noted that if it found a high risk of a future bankruptcy, it would coordinate with other federal agencies, carriers, and other stakeholders to take appropriate action.

<sup>7</sup> See [trade.gov/acsc](http://trade.gov/acsc).

<p>The Advisory Committee recommended that Commerce establish a committee to coordinate an interagency response to any future bankruptcies.</p>	<p>Commerce has not implemented this recommendation because officials have suggested that the threat of future ocean carrier bankruptcies appear to be minimal.</p>
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While the federal government is not likely to implement any new regulatory changes to address future ocean carrier bankruptcies, industry participants have taken their own steps to mitigate risk in future insolvency proceedings. For example, global alliances have implemented different measures among their members to account for one of the member’s potential insolvency. These measures include the marketing of the financial stability of its members and the creation of a contingency fund designed to ensure that cargo keeps moving if one of its members files for bankruptcy. The purpose of this fund was to give reassurance to cargo owners, terminals, and other parties who want to engage in a contract with any of the alliance’s members. The fund would be used to pay the necessary fees and expenses to port and unload containers.

Moreover, other members would have the “option to make arrangements directly with entities providing vessels or space to the affected party that are used by the alliance, to make arrangements directly with agents or subcontractors of the affected party, or to take any other action to assure that the cargo that is on board the ships of the collapsed members can be discharged.”<sup>8</sup>

## CONCLUSION

The shipping industry plays an integral role in international trade and commerce. While Hanjin’s insolvency proceeding demonstrates that the legal system can quickly resolve disputes around the disruption in the movement of cargo, the fact remains that the immediate consequence of an ocean carrier bankruptcy will be substantial disruption in the supply chain. The GAO’s study was published just before the COVID-19 pandemic caused severe disruption in the supply chain. The shipping industry is expected to remain under pressure in 2020, as freight rates and profits in the container and dry bulk sectors slide.<sup>9</sup>

With declines in manufacturing, exports, and overall global commerce, the transportation and logistics network will be tested. Not only must industry participants take steps to insulate themselves from the potential bankruptcy of

<sup>8</sup> The Impact of Alliances in Container Shipping, International Transport Forum, [itf-oecd.org/impact-alliances-container-shipping](http://itf-oecd.org/impact-alliances-container-shipping) (November 2018).

<sup>9</sup> <https://www.scmp.com/topics/hong-kong-shipping-and-logistics>.

another participant in the supply chain, but federal agencies can also take a more active role in monitoring and, when necessary, supporting the supply chain. Given the existing strain on the supply chain, the market may not be able to quickly absorb the additional costs and disruption that results from the bankruptcy of an industry participant.