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Ocean Carrier Bankruptcies

Federal Agencies Have a Limited Role in Addressing the Effects on Cargo

Accessible Version

Objectives, Scope, and Methodology

This briefing describes stakeholder's and federal agencies accounts of: 1) the effects of Hanjin's bankruptcy on the movement of cargo; 2) federal agency actions taken at the time of Hanjin's bankruptcy; and 3) federal agency and industry actions taken since then to help mitigate the effects of any future bankruptcies.

To address these objectives we reviewed bankruptcy-proceeding documents and relevant documents from FMC and the Department of Commerce (Commerce). We interviewed 15 industry stakeholders representing 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, and one association representing agricultural cargo owners. The selected stakeholders encompass a range of views and roles from the supply chain. While the findings from these interviews are not generalizable to all industry stakeholders, they provide important perspectives. We also interviewed officials with FMC and Commerce.

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Introduction

Ocean shipping is an important part of the U.S. economy, supporting the trade of cargo into and out of the United States from all over the world. The Federal Maritime Commission (FMC) oversees ocean common carriers in the liner trade that provide service to and from the United States and works to ensure a competitive and reliable ocean transportation supply system.[1] According to FMC, more than $1 trillion in U.S. exports and imports are moved by ocean vessels annually.[2]

In August 2016, South Korea's Hanjin Shipping (Hanjin) filed for bankruptcy protection after 4 consecutive years of financial losses. Hanjin—at the time the seventh largest ocean carrier in the world—subsequently halted the movement of its vessels and failed to meet many of its cargo delivery and payment obligations.[3] These actions affected the movement of cargo into and out of the United States.

In recent years, the ocean common container carrier industry has consolidated and the largest 10 international ocean container carriers—none of which are U.S. companies—now carry about 90 percent of global container traffic.[4] This consolidation may enable carriers to be more financially viable and therefore less likely to file for bankruptcy protection. Should one of these larger, consolidated carriers file for bankruptcy protection and ultimately cease operations, however, the effects on the movement of cargo could be even more significant than they were when Hanjin filed for bankruptcy protection.

The Frank LoBiondo Coast Guard Authorization Act of 2018 included a provision that GAO review the effects of a major ocean carrier bankruptcy on the movement of cargo.[5] The most recent major ocean carrier bankruptcy was that of Hanjin Shipping initiated in August 2016.

[1] In general, an ocean common carrier operates, for all or part of its service, vessels on the high seas or the Great Lakes between a port in the United States and a port in a foreign country, providing transportation by water of passengers or cargo for compensation to the general public. 46 C.F.R. § 535.104(f), (u). Much of this ocean cargo is transported in containers, which are large steel boxes that can be transferred from vessels to other transportation modes such as railcars and trucks.

[2] FMC, *Fiscal Year 2020 Budget Justification* (March 2019).

[3] According to FMC officials, Hanjin's financial difficulties were widely known and the surprise was the precipitousness of the withdrawl of financial support for Hanjin by a Korean state-sponsored bank.

[4] See United Nations Conference on Trade and Development, *Review of Maritime Transport 2019*.

[5] Pub. L. No. 115-282, § 713, 132 Stat. 4192, 4298-99.

Background

Hanjin's bankruptcy occurred at a time when the industry was undergoing a number of changes, as shown below.

Changes to the Ocean Carrier Industry during the Time of Hanjin's Bankruptcy

Bigger vessels:

Over the past decade, ocean carriers have ordered larger sized container vessels to meet expected demand, capture economies of scale, and maintain market share.

Financial challenges and carrier losses:

The global shipping industry invested in new vessels prior to the 2007 to 2009 recession. However, the growth in demand for shipping services after the recession was less than projected, resulting in an imbalance between capacity and the demand for these services; the volume of trade and shipping rates were lower than expected and the ocean carrier industry experienced considerable financial pressures.

Carrier alliances:

Ocean carriers have merged and formed alliances and other vessel and slot-sharing agreements over the past several years to address their financial difficulties by, for example, containing costs through operational efficiencies. In particular, the alliances allow for cargo booked with one carrier to be transported on another alliance carrier's vessel. While helping to improve capacity utilization, these relationships can result in any one carrier's containers being on vessels of many other carriers.

Source: GAO analysis of industry documents and interviews with industry stakeholders. | GAO-20-353R

Overview of Hanjin's Bankruptcy Process

Hanjin filed for bankruptcy protection in South Korea, the United States, and reportedly in a number of other countries.[6] In effect, the Bankruptcy Court for the District of New Jersey had primary jurisdiction over Hanjin-related bankruptcy proceedings in the U.S. court system and authorized steps that affected cargo in the United States. (See fig. 1.) With respect to Hanjin's assets within the territorial jurisdiction of the United States, the court issued an order on September 6, 2016, that imposed a temporary freeze on creditor actions seeking to collect amounts owed by Hanjin. This freeze enabled Hanjin vessels to come into U.S. ports without fear of being subject to creditor actions to arrest Hanjin assets.[7]

Figure 1: Key Dates in Hanjin Shipping's Bankruptcy

Aug. 31, 2016: Hanjin Shipping (Hanjin) files for bankruptcy protection in South Korea (the main foreign bankruptcy proceeding).

Sept. 2, 2016: Hanjin files for Chapter 15 bankruptcy protection in the United States Bankruptcy Court for the District of New Jersey (U.S. Bankruptcy Court) seeking bankruptcy protection of Hanjin assets in U.S. territorial jurisdiction and U.S. Bankruptcy Court recognition of the main foreign bankruptcy proceeding in South Korea.[a]

Sept. 6, 2016: U.S. Bankruptcy Court issues an interim provisional order (pending a final order) that recognizes the South Korea proceeding to which the U.S. proceedings will generally be secondary and grants bankruptcy relief on a temporary basis, preventing creditor actions against Hanjin's assets, such as actions to arrest vessels in U.S. territorial jurisdiction.

Sept. 9, 2016: After additional consideration of the issues, the U.S. Bankruptcy Court issues an order, still provisional, that recognizes the South Korea proceeding, maintains the previously granted bankruptcy relief pending a final order, and approves a protocol whereby cargo owners can enter into agreements with terminals, carriers, or other third parties to obtain their cargo in U.S. territorial jurisdiction.

Dec. 14, 2016: U.S. Bankruptcy Court issues an order that finalizes the previously granted bankruptcy relief and recognizes the South Korea proceeding to which the U.S. proceedings will generally be secondary.

Dec. 2016 –Feb. 17, 2017: U.S. Bankruptcy Court takes various actions relating to Hanjin assets, such as a protective order, as well as an order recognizing and enforcing an order by the South Korean court approving the sale of specified Hanjin assets.

Feb. 17, 2017: South Korean court declares Hanjin bankrupt and ready for liquidation.

February 21, 2017 – Jan. 2019: U.S. Bankruptcy Court takes actions including enforcing sale orders of the South Korean court approving the sale of specified Hanjin assets in U.S. territorial jurisdiction to facilitate liquidation.

Source: GAO analysis of bankruptcy documents. | GAO-20-353R

[a] The purpose of Chapter 15 is to provide effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country.

[6] Hanjin filed for bankruptcy protection under Chapter 15 of the United States Bankruptcy Code. Chapter 15 is based upon the policy that countries other than the home country of the debtor, where a main bankruptcy proceeding would be brought, should usually act in support of the home country main proceedings.

[7] Arrest prevents a vessel's further movement and can occur under many scenarios such as when the vessel's owner has not met its contractual obligations to a creditor with a maritime security lien on the vessel.

Ocean Shipping Is Part of a Larger Supply Chain with Many Industry Parties

The process of moving containerized cargo from a point of origin through the supply chain to the final destination involves many parties, most of which are private sector companies.

Ocean carriers transport containers over established ocean routes. Carriers berth their vessels at port facilities known as terminals to load and unload cargo, where services are generally provided by laborers with specific skills.

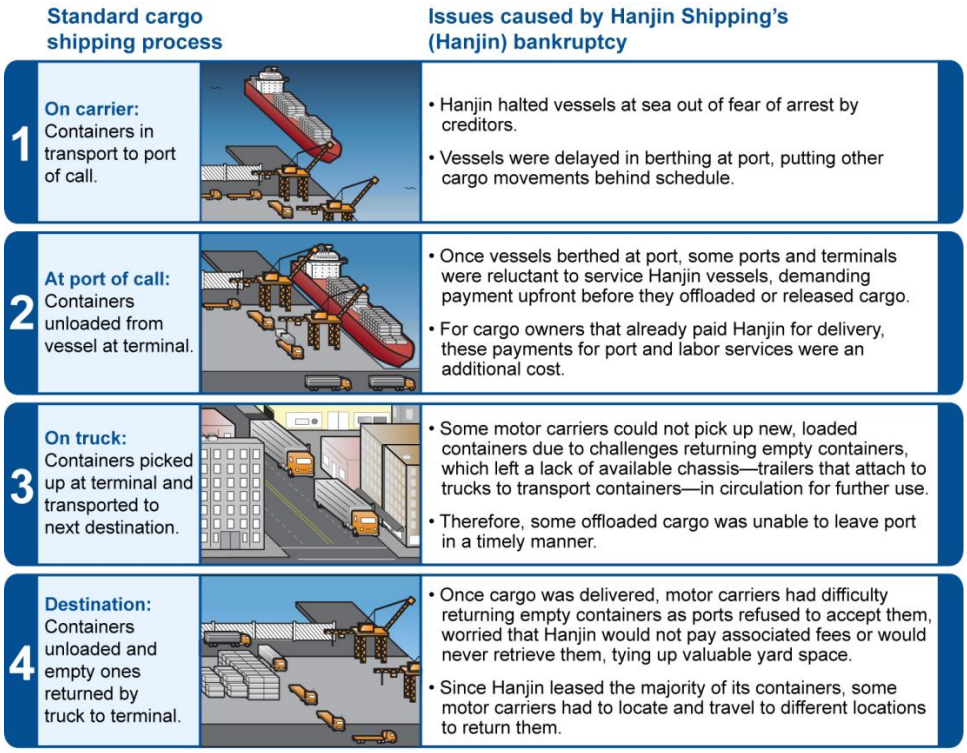
Other transportation providers such as railroads or motor carriers provide transportation of cargo between two locations—for example, from a port to a distribution center for imports, or from a factory to a port in the case of exports. Motor carriers use container chassis—trailers that attach to trucks for land transport—to carry loaded and empty containers from and to port.

While historically ocean carriers owned chassis, they now typically lease them. In some cases, terminals also operate shared chassis pools that multiple carriers may use.

According to Industry Stakeholders, Hanjin's Bankruptcy Had Short-Term Effects on Cargo Movements and Brought Additional Costs to Some Cargo Owners

Stakeholders we interviewed said that Hanjin's bankruptcy affected the movement of both exports and imports. However, they could not quantify the effects and primarily noted the effects on the movement of imports. (See fig. 2.)

Figure 2: Primary Effects of Hanjin's Bankruptcy on the Movement of Imported Cargo



Source: GAO analysis of stakeholder interviews. | GAO-20-353R

No stakeholders we spoke with cited any data or analysis regarding the overall economic effects of Hanjin's bankruptcy. However, stakeholders were able to describe two primary effects:

- **Cargo delays.** Because some cargo did not arrive or was not offloaded at the intended ports when scheduled, it did not reach its final destination on time.
- **Additional costs.** Some cargo owners or other industry stakeholders paid unexpected additional fees to obtain cargo that was not being released, or incurred other fees as described below.

According to most stakeholders, while some of the bankruptcy's effects on the movement of cargo were resolved in weeks, others took longer:

- Cargo delays were resolved and detained or delayed containers were moved off port within a few weeks, generally between 4 to 8.
- Lingering issues regarding empty containers and chassis shortages at ports were resolved within 6 weeks to 3 months.

Supply Chain Parties (con't)

Cargo owners, which include retail and manufacturing companies importing cargo and manufacturers and farmers exporting cargo, contract with ocean carriers and other parties to facilitate the movement of their cargo.

In some cases, cargo owners contract with an ocean carrier which then arranges all aspects of transportation, including trucking from a terminal to a distribution center or from a factory to a port for export.

In other cases, cargo owners contract with the ocean carrier only for port-to-port shipping, and then contract separately with other providers for necessary transportation to the final destination or to the port for carriage for exports.

Some cargo owners contract with freight forwarders to handle the organization of all aspects of transportation for their cargo from origin to destination.

Effects on Movement of Cargo (continued)

After Hanjin filed for bankruptcy protections in 2016, there were immediate effects on the movement of cargo, according to stakeholders we interviewed. When Hanjin filed for bankruptcy protections in South Korea on August 31, it halted some vessels at sea due to fear of arrest of such vessels on behalf of creditors, while other vessels were forcibly stopped by creditors at ports or in canals. On September 6, in response to Hanjin also filing for bankruptcy protection in the United States, the U.S. bankruptcy court took action to protect Hanjin assets in United States territorial jurisdiction, enabling vessels to come into port.

According to industry stakeholders, for U.S.-bound cargo still at sea, movement was better able to proceed once the U.S. bankruptcy court approved protocols on September 9, which provided a framework for cargo owners and others to handle payment for services to release containers within United States territorial jurisdiction. However, according to stakeholders we interviewed, effects on the movement of cargo on land continued, including:

- Initially, some cargo owners were unaware of the location of their cargo or when they could retrieve it. This situation was due in part to vessel-sharing agreements between carriers, which meant that some cargo owners may not have known that they had cargo on a Hanjin vessel.
- Once vessels berthed at ports, some terminal operators were reluctant to provide services to Hanjin vessels, refusing to offload or release cargo until they received payment. These actions further contributed to congestion and delays. Some ports instituted cash-only policies to cover fees and the labor costs of handling containers or demanded payment upfront before releasing cargo. For cargo owners that already paid Hanjin for the delivery of their cargo—which could have included payment for these port fees and labor services—these additional payments were an unexpected added cost.
- Some Hanjin containers intended for a particular port were offloaded at the vessel's first port of call. Accordingly, some cargo owners had to arrange for additional transportation for the cargo to reach its intended location.
- Some cargo owners had exports booked for transport on Hanjin vessels that had not yet been shipped. In these cases, exporters retrieved their cargo and arranged for other means of transportation, incurring additional costs as well as delays that may have led to spoilage of perishable goods.
- As some ports refused to accept empty containers—worried that Hanjin would not pay the associated fees or would never retrieve them, tying up valuable yard space—motor carriers struggled to discharge the empty containers to free up chassis for loaded containers. Additionally, since Hanjin leased the majority of its containers, some motor carriers had to locate and travel to different locations to return them. This inability to offload empty Hanjin containers contributed to congestion and delays in the movement of cargo, and in some cases resulted in extra fees for chassis usage when motor carriers held containers for long periods of time.

FMC and Commerce's Roles in Ocean Shipping

FMC's authorities under the Shipping Act of 1984, as amended (Shipping Act), include specific tools to enhance competition and prohibit discriminatory practices of ocean carriers in the foreign commerce of the United States.[8] FMC also shares relevant industry information with industry stakeholders and other agencies. For example, FMC reviews and approves agreements between carriers to share vessels, among other things, and requires ocean carriers to publish their shipping rates.

According to Commerce officials, it does not have regulatory authority over the ocean carrier industry. However, its statutory authority provides the Secretary with the authority to foster, develop, and promote domestic and foreign commerce and to assist exporters in their dealings with foreign governments and enterprises owned by foreign governments. For example, it works closely with carriers, ports, terminals, and cargo owners to help them identify and address impediments to the flow of cargo, increased stakeholder costs, and the effects on national trade.

Commerce's Advisory Committee on Supply Chain Competitiveness was established in 2011 to increase the private sector's involvement in providing the Secretary of Commerce with advice on freight policy to support U.S. trade and issues affecting the competitiveness of supply chains.

FMC and Commerce Had Limited Roles in the 2016 Ocean Carrier Bankruptcy

Outside of the U.S. Court process, FMC and Commerce were the primary federal agencies that addressed cargo-related issues.[9]

According to FMC officials, FMC took the following actions:

- FMC monitored transactions for unreasonable practices that would violate the Shipping Act.[10] Officials said, however, that FMC did not find sufficient evidence to take action in any such cases.
- Through the Office of Consumer Affairs and Dispute Resolution Services (CADRS), FMC offered mediation services to industry parties experiencing challenges or disputes. For example, if a cargo owner felt that it was charged unreasonable fees to retrieve its cargo, CADRS would offer mediation services to resolve the dispute if both parties were willing to participate. CADRS handled approximately 66 complaints related to the bankruptcy, mainly from cargo owners. According to FMC officials, this was a higher than average volume.
- FMC officials, including the Chairman, held regular meetings and calls with cargo owners, ocean carriers, terminals, and other industry stakeholders regarding problems they faced. FMC staff also attended bankruptcy court proceedings and shared relevant information, such as court actions, with key stakeholders.

According to Commerce officials, Commerce took the following actions:

- Immediately following the bankruptcy, Commerce convened officials from relevant federal agencies and industry stakeholders, including representatives from port authorities and retail and trade associations, to share information. This information included updates on port congestion, cargo owners' questions about the location of containers, and status updates on court proceedings.
- In coordination with the White House and the Department of State, Commerce engaged with South Korean government officials to emphasize the importance of keeping cargo moving and to secure emergency funding to facilitate continued cargo movement.[11]
- Commerce reached out to embassy officials from countries where Hanjin vessels had been arrested pursuant to creditor actions en route to U.S. ports in an effort to keep cargo moving.

[8] Pub. L. No. 98-237, 98 Stat. 67 (codified as amended at 46 U.S.C. §§ 40101-41309).

[9] Several other federal agencies, including the Maritime Administration, Department of Treasury, and Department of Labor took actions as a result of the Hanjin bankruptcy. For example, the Maritime Administration conducted outreach to ports affected by Hanjin's bankruptcy. This engagement focuses on Commerce and FMC as their actions were most focused on addressing the movement of cargo.

[10] Under the Shipping Act, common carriers, marine terminal operators, or ocean transportation intermediaries may not fail to establish, observe, and enforce just and reasonable regulations and practices relating to or connected with receiving, handling, storing, or delivering property. 46 U.S.C. § 41102(c).

[11] According to FMC officials, Hanjin's largest shareholder provided emergency funding, helping enable vessels to come into port and be offloaded by, for example, paying fees.

Industry Actions

According to stakeholders we interviewed, some industry parties have taken steps to reduce the risk of being negatively affected by any future ocean carrier bankruptcies. For example:

- Some cargo owners have diversified their shipping contracts with carriers to, for example, limit the percentage of their containers that are being shipped with any one carrier or on any one vessel to reduce their exposure to risk.
- Cargo owners are more likely to review the financial stability of ocean carriers and book cargo with carriers that are more financially stable.
- One of the major carrier alliances created a contingency fund designed to provide funds to keep cargo moving should a member of that alliance go bankrupt. While the other two major alliances did not take such action, one has marketed the financial stability of its carriers.

FMC and Commerce See Limited Role in Addressing Effects of Any Future Ocean Carrier Bankruptcies

Officials with both agencies suggested that the legal and market response to Hanjin's bankruptcy resolved the effects on cargo movements in a timely and effective manner, and that therefore, taking actions to address the specific aspects of a future bankruptcy may be unnecessary at this time. Both also noted that the agencies have limited authority to take additional regulatory action to address the effects of future bankruptcies on cargo movements.

When asked, many of the industry stakeholders we interviewed had no additional actions to propose that FMC or Commerce could take at this time to mitigate the effects on the movement of cargo of any future ocean carrier bankruptcies. However:

- Two suggested that FMC require ocean carriers be licensed and bonded, as it requires of some other providers.[12] FMC officials, however, said that FMC does not have the legal authority to impose such a requirement on ocean carriers. They said FMC requires other entities to be licensed and bonded as instructed by statute.
- Two suggested that FMC conduct additional financial analyses to assess the financial health of ocean carriers and the extent to which they are at risk of going bankrupt. However, FMC officials said it may not be appropriate for FMC as a government entity to publicly speculate on the potential viability of a private entity.[13]

Additionally, Commerce's Advisory Committee on Supply Chain Competitiveness recommended in 2017, in response to Hanjin's bankruptcy, that Commerce use various financial criteria to assess the risk of future ocean carrier bankruptcies.[14] According to Commerce, department analysts use such criteria for internal industry assessments. Commerce also noted that if analysts were to find a high risk of a future bankruptcy, it would coordinate with other federal agencies, carriers, and supply chain stakeholders to take appropriate action.

The Advisory Committee on Supply Chain Competitiveness also recommended that Commerce establish a committee to coordinate an interagency response to any future bankruptcies. Commerce has not implemented this recommendation because, according to officials, the threat of future ocean carrier bankruptcies appears minimal at this time and it does not see the need to create a new committee that would have little responsibility or work during periods of stability in the carrier industry.

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[12] FMC requires freight forwarders—also known as Ocean Transportation Intermediaries—to obtain a license from FMC in order to operate. FMC also requires them to submit proof of having a bond so that cargo owners that are their customers are protected if the provider does not comply with FMC rules or does not fulfill its duties. See, 46 U.S.C. §§ 40901, 40902.

[13] Some private sector companies conduct and publish financial analyses of carriers. In addition, some large ocean carriers receive significant financial backing from their national governments and are not publicly traded companies. As a result, complete financial information for those carriers may be unavailable.

[14] Advisory Committee on Supply Chain Competiveness *Maritime Carrier Bankruptcy Risk Assessment Framework* (April 2017). The committee also recommended that cargo owners conduct such analysis.