

Submission In Response To FMC Requests For Comments

John D. McCown is pleased to make this submission related to the recent requests for comments. This is made in my individual capacity as someone with four decades of operating and investing experience in container shipping, including twenty years as CEO of a container carrier I co-founded and five years heading shipping and transportation investments at a major hedge fund. My current subject matter expertise is highlighted in part by widely read and quoted monthly reports analyzing US container volume and quarterly reports analyzing the financial results of the container shipping industry.

In an August 2 posting on its website, the FMC said it would be seeking public comments on a plan for gathering import and export information from vessel-operating common carriers. An August 8 notice in the Federal Register establishing a 60 day comment period ending on October 7 followed. In an August 11 posting on its website, the FMC said it is seeking public comments on whether supply chain congestion has created conditions warranting the issuance of an emergency order requiring carriers and marine terminal operators to share key information. That was followed by an August 15 notice in the Federal Register establishing a 30 day comment period ending on September 14. The first request for comments did not refer to a formal docket while the second was described as a request for information under formal docket number 22-19. While the first request covers a broader area of information, the second request is more narrowly focused and primarily concerns whether respondents believe an emergency situation exists, if an emergency order will be effective and what the scope of such order should be.

This respondent has comments primarily relating to gathering import and export information from vessel carriers. However, because he believes an emergency situation exists and he is aware of the additional authority available to the FMC in such situations, his comments overlap and relate to both of the recent requests for comments by the FMC. Respondent wants his suggestions to be included as part of the official record and makes this submission under formal docket 22-19. His comments will demonstrate why an emergency situation exists, the information from carriers that will be helpful in alleviating that emergency situation and why requiring that information fits within and is allowed by the Ocean Shipping Reform Act (OSRA).

An emergency situation does in fact exist that can be measured by any one of a number of factual benchmarks. These comments, however, are focused on one particular benchmark resulting from supply chain congestion that is now at its highest and therefore most disruptive point. That benchmark is a tangible confirmation that an emergency exists and it also can serve as a measure to track the progress in alleviating the emergency situation. As the benchmark indicates the situation resulting from the supply chain congestion is now at its most disruptive point, this condition warrants the FMC taking action now that result in information that can play a role in rectifying that condition.

The benchmark that justifies taking emergency action is the significant inflation in the aggregate cost of shipping products into the US in containers now compared to before the pandemic. As respondent will detail, that aggregate shipping cost for the most recent quarter (2Q22) is 3.404 times what it was two and one half years ago during the last quarter unaffected by the pandemic (4Q19). The annualized cost difference is \$88.0 billion based on an aggregate shipping cost equivalent of \$124.6 billion in 2Q22 compared to \$36.6 billion in 4Q19.

The aggregate shipping cost numbers were both calculated using volume of 25,303,087 TEU's, which is total inbound volume at the Top 10 US ports for the twelve months ending June 2022. The average aggregate shipping cost was \$4,922/TEU in 2Q22 compared to \$1,446/TEU in 4Q19. The \$1,446 amount was equal to the 4Q19 average of the Drewry Shanghai to Los Angeles spot rate that is viewed as a reasonable approximation of all inbound spot container rates to the US during that quarter. As spot and contract rates were broadly in equilibrium during that quarter, it also represents the average aggregate rate for all inbound containers to the US. The \$4,922 amount results from applying the 3.404 factor to the starting amount and it is the difference between the two that drives the inflationary impact. That factor was determined based on dividing the latest aggregate pricing index for Asia to North America for 2Q22 disclosed by Ocean Network Express (ONE), the consortium of three Japanese carriers, by the same index in the 4Q19 prior to the pandemic. The ONE aggregate pricing index is more relevant for our purposes than the Container Trades Statistics (CTS) Global Pricing Index, which is an average based on all lanes worldwide. However, because the Asia-North America lane represents some 25% of global container miles, the two indices move in the same direction and the ONE index increased only slightly more over the period. Calibrated just like the CTS Global Pricing Index where actual aggregate pricing in

2008 is equal to 100, the ONE index for 2Q22 was 354 while the index for 4Q19 was 104. In contrast, the CTS Global Pricing Index increased by a factor of 3.030, standing at 200 in 2Q22 compared to 66 in 4Q19.

The CTS volume and pricing data results from information provided to it by all the top global container shipping companies who are affiliated with it. The pricing indices maintained by CTS are based on all the loads that actually move on vessels, both those moving under contract rates and those moving at spot rates. The large majority of loads, particularly those in US trades, move under contracts that typically have a one year term. Spot rates in my view are given much more attention than they deserve, both because they impact only a minority of loads and are based on surveys that are not always based on loads actually moving. Indices based on aggregate pricing like those provided by CTS and ONE are much more factual measures of the level and trend of container pricing and give more insight into near term pricing given the significant representation of contract rates.

The \$88.0 billion annualized cost impact of higher container shipping costs on inbound loads to the US has been absorbed into the economy where it has a noteworthy inflationary impact. For instance, when compared to the goods portion of our latest GDP, it is equivalent to a 1.60% cost burden that didn't exist prior to the pandemic.

The inflationary impact number is actually conservative in that it includes only the inbound loads to the Top 10 ports. While they represent the large majority of activity, the 20 or so smaller container ports in the US would collectively add an estimated 13.4% to total inbound volume. Using that estimate and assuming the same relative change in aggregate pricing, the total annualized cost impact expands to \$99.8 billion, which is equivalent to 1.82% of the goods portion of GDP. A further indirect economic impact from increases in container shipping pricing is related to the 9,451,340 TEU's of outbound volume at the Top 10 ports for the twelve months ending June 2022. While that doesn't directly affect inflation as they are goods that are exported and I don't have precise figures on outbound pricing changes, it is reasonable to conclude that they involve a further adverse economic impact in the billions per year.

The numbers demonstrate that an emergency situation exists. My view is that a key contributing factor to that situation (ie, aggregate shipping costs 3.404 times what they were prior to the pandemic) is the opacity in actual shipping costs in container shipping. The best way to cure that is to

inoculate the problem with additional factual information obtained via emergency orders. Such orders should play a constructive role in improving the situation but noticeable improvement will take more than 60 days, which is why emergency order is used here in its plural form. Because the selected benchmark offers a precise manner in which to measure progress, my suggestion is that the initial 60 day emergency order be made with the full understanding that it will be unanimously renewed for additional 60 day periods until a goal is reached. For instance, stating that the additional factual information will be required until the aggregate increase in shipping costs compared to 4Q19 is no more than half of what it was in 2Q22 is one such possibility.

While the technical information suggested in many of the comments on this docket can clearly play a role in increasing fluidity that in turn should improve the pricing situation, my view from detailed analysis is that nothing offers as much of an opportunity to accomplish that as greater factual transparency related to both volume and pricing. I envision a framework that starts with what is specifically required under OSRA and then refines how and when that information is disseminated. When that is done, that volume information becomes a more useful measure of demand and vessel capacity utilization trends. In addition, it results in several useful measures of port activity and utilization. Armed with this factual macro information, shippers are in a position to make more informed decisions as they have access to historical data that gives them more of a window into the future. It is in the area of information related to factual historical pricing, however that offers the most promise in terms of more informed decisions. I recognize there will be resistance to this. However, between the information that is already disclosed by carriers in different venues and its historical nature that reveals no confidential data, I believe an emergency order whose scope fits within OSRA can be developed.

A fundamental issue related to pricing in the container shipping sector is that the most followed measures – spot indices – represent just a relatively small sliver of the market and more often than not reflect neither the level nor trend in actual overall pricing that is driven by contracts. In many cases as in the recent past, they are actually showing different trend lines. While spot indices are everything in the tanker and bulker shipping segments and are comprised of actual transactions, that is not at all the case in container shipping where no real natural market exists for spot rates. Any shipper with consistent volume wants to lock down on its shipping cost as a needed input into pricing its own product. The one time shipper moving household

goods is one of a limited number of examples of a natural candidate for spot rates. It is primarily select intermediaries who have no cargo of their own and who are unwilling or unable to make a minimum volume commitment that were why spot rates developed in container shipping.

The CTS Global Pricing Index and other measures of aggregate pricing in specific lanes are in fact the only real measure of the overall level and trend of actual pricing in the sector. Those measures by definition include the effect of both contract and spot rates. When the relative change in those measures compared to spot indices from any given point are graphed and analyzed, a trend line for just contract rates can be developed. The level and trend of contract rates will vary based on the assumption of the incidence of each, but that exercise itself assists in developing a reasonable estimate in the actual split between the two.

Based on many analyzes like the one above, I've developed a strong view that container spot rates are neither as prevalent nor as credible as most think. Related to the former, they could represent as little as 10% of loads while anything more than 20% begins to strain creditability. In most cases, analysis of the data shows that above 20% would require a gap in both the level and trend of contract versus spot rates that makes little sense. So spot rates simply aren't as prevalent as most think and certainly can't be as high as some figures referenced in media. At those higher levels, the math just doesn't work as any solution showing contract rates little changed or going down doesn't make sense. Related to the latter view of spot rates and indices not being credible, that too is informed by analyzing the data with a focus on the relationship between changes in spot indices and aggregate indices such as the CTS. Speaking in the classic definitional sense, spot rates are generally thought of as the market rate on any given day and the difference with contract rates is just timing. That is how I suspect most think of spot rates in container shipping and why they've come to be viewed with such prominence. That isn't the case in container shipping and there isn't the linkage between the two you would expect. Just looking at a graph showing aggregate indices like CTS compared to spot and contract trend lines demonstrates that the majority of contract rates aren't being reset at the spot rate when the typical one year contract term comes up for renewal. Given the typical one year contract term, if they were there would be a narrowing of the gap between the two instead of the widening evident for much of the more than two year period of rising prices.

One reason for the misunderstanding of pricing is that both contract rates and spot rates involve a range that has likely been widened during the pandemic. That range is wider in both categories than most think and lends itself to anecdotal stories that may be accurate but are not at all indicative of the typical pricing level. To understand the actual level and trends in pricing, narrative is no substitute for analysis that needs to be focused on the overall averages. The aggregate pricing indices such as CTS and ONE are hard understandable numbers based on the universe of containers actually moving. The spot indices on the other hand are much softer and driven by surveys that don't always represent actual movements and don't even reflect all containers moving under spot rates. They are more akin to anecdotal accounts, albeit ones that still have some information content.

So with spot rates being neither prevalent nor credible, why do shippers and others give them the attention that they do? Because they generally view them as much more prevalent and credible than they actually are. That view has resulted in those spot rates and indices playing a key role in many contract renewal discussions between shippers and carriers. With those being the only pricing metrics many shippers are aware of, there can be little doubt that there were countless situations where shippers believed they were receiving favorable treatment relative to spot rates when in fact their renewal was above what recent contracts had been renewed at. In the unprecedented ramp up in pricing during the pandemic, shippers were at a very decided disadvantage in terms of factual information. The FMC can play a key role in returning more balance to that situation with actual historical information that fits within OSRA and does not reveal proprietary or customer specific data.

A comparison of the percent increases in various average indices from 4Q19 to 2Q22 is illustrative. Over that two and one half year period, the CTS Global Pricing Index rose each quarter and in the latest quarter was 203.0% higher than it was in 4Q19. The oldest and most followed spot index, the Shanghai Containerized Freight Index (SCFI), was 410.2% higher. Even though the SCFI had risen more than twice as much as the aggregate index, it has been trending down since the beginning of the year and the 2Q22 average was 13.4% below the 1Q22 average. By definition, the contract rates embedded in the aggregate CTS index had to have increased by a smaller percentage than the overall measure. If you peg spot rates at making up 10% of total loads, the average increase in contract rates is 180.0%, meaning that spot rates are still up by a 2.3 times factor. If you peg spot rates at 20%, that solves for contract rates being up just 151.2%, translating

into a 2.7 times factor for spot rates. The wider the gap, the less credible these spot rates are in terms of acting the way they are supposed to act. The focus should be on the actual numbers and what they are saying in terms of the actual level and trend of pricing.

The various spot rate indices have continued to move down after the end of the second quarter. However, the CTS Global Pricing Index was still marginally up in July from June when an adjustment is made to net out the impact of fuel surcharges which should be a wash. A benchmarking service has noted that contract rates it follows were up more than 4% in August compared to July. Despite near breathless accounts in the media that spot rates are declining fast, there is no factual confirmation that the more important contract rates are doing anything other than increasing, even if by more modest amounts. Furthermore, media reports that spot rates are now less than contract rates is not borne out by any of the actual data. I suspect that relates to the wide range of both types of rates where there will often be an example of something fitting an anecdotal story. While it is true, it's also an example of narrative triumphing over analysis that rarely leads to good results.

Let me preface my specific suggestions by indicating that I view the Securities and Exchange Commission (SEC) as an exceptional model of an efficient and effective federal government regulatory agency. They don't judge or render an opinion on the efficacy of any investment, but they act as a clearinghouse for the filing of detailed and comprehensive factual information that allows investors to make their own judgment.

The federal regulatory agency most involved with container shipping is the FMC. I strongly believe that, as much as possible, the FMC should have as a goal of becoming a clearinghouse for detailed factual information that is readily available on its website for shippers and the public at large. In that regard, the SEC and other federal agencies that provide important historical factual information should be looked at as role models.

One such agency is the Energy Information Administration (EIA) which was established to collect and disseminate factual information on a key sector affecting the economy. Imagine the confusion and chaos that would result if there was no credible source like the EIA on the average actual price of what gasoline was selling for and the available information was based on anecdotal narrative or surveys of what a small segment of purchasers may be

willing to pay. That in effect is the pricing opacity that currently exists in the container shipping market.

However, there is factual information that is presently available to the FMC and additional information that the OSRA empowers it to obtain that can be collected and disseminated to improve factual transparency. This enhanced disclosure will allow shippers to make more informed judgments of their own and will provide other governmental entities with useful macro economic data that enhances their ability to fulfill their own mission.

There is way too much opaqueness related to historical macro economic data in the container shipping sector that in many cases is already publicly available and that in all cases doesn't disclose any customer specific data. FMC would do well to marshal as much of this factual information as they can and make it readily available. That overriding view informs my suggestions which relate to both refining newly enacted disclosure requirements and charting a path towards additional disclosure requirements.

The OSRA signed into law on June 16, 2022 includes a provision that already requires additional disclosure by carriers. That disclosure will be in the form of a quarterly report by published by the FMC on its website that will show total import and export tonnage and the total loaded and empty TEU's per vessel making port calls in the US. That quarterly report will be a significant amount of detailed factual information that will be useful in many ways.

However, given that this information is already required under OSRA, the FMC should seek to get it from the carriers on a rolling monthly basis. In addition to the detailed by ship information, FMC should require the carriers to provide key summaries of that data in a form that could be made publicly available immediately. Included in the information in the monthly summaries should be total loaded inbound and outbound TEU's by coastal range, total capacity deployed by coastal range and resulting overall vessel capacity utilization. The latter factual information is in effect obtainable from the information already required by OSRA, but getting the carriers to provide their own calculation of vessel utilization and to provide on a timely useful basis will be particularly useful. Among other things, by tracking monthly vessel capacity, shippers will be able to see the impact of blanking sailings or other changes in deployed capacity.

The potential impact from blanking sailings is meaningful enough that the FMC should give some consideration of requiring some sort of notice of any plans to change capacity beyond a threshold amount be included in the monthly information carriers provide. It is now abundantly clear that capacity constraints and supply contraction predominantly drove the favorable supply/demand dynamic (for carriers) that developed during the pandemic. Over the same ten quarter period that the CTS Global Pricing Index increased 203.0%, worldwide TEU volume grew only 5.2%.

The corresponding monthly volume data that FMC should require from each port is volume off and on vessels, TEU's residing in terminals and volume out and in terminals. That port data should allow a reconciliation of all activity and a snapshot of where the port is in terms of effective capacity utilization.

The value of information like this is directly related to its timeliness and granularity. In that sense, monthly information is geometrically more informative than quarterly information. Monthly historical information lends itself much more to discerning the actual underlying trends at work on whatever is covered by the data. The carriers already maintain such information on a monthly basis, so that is a known frequency. It may even make it easier by being consistent with their normal cycle and avoiding a new project of accumulating such information on a quarterly basis. Most shipping companies produce detailed internal monthly financial statements with related statistics within ten days following the end of each month. Based on that, it doesn't seem unreasonable to require the summary volume information referenced above from both the carriers and the ports be provided for the preceding month by the 15th of each month.

In terms of new disclosure requirements, the focus should be on the same type of monthly aggregate volume and pricing data provided by CTS. High level volume data along with the global pricing index, both of which are an aggregation of data from all the carriers, are available for free on the CTS website. But for a relatively modest fee, additional aggregated volume and pricing data by trade lane are available. All of this monthly data is generally available 35 days after the end of the month. Presumably there is a process where CTS receives all of the same data from the individual carriers at some earlier point and then aggregates it to show overall industry volume and pricing data by trade lane. Note that all that pricing data is presented in index form with 2008 as the base set at 100. That same process could be followed as it relates to trade lanes involving the US. To the extent the

carriers may object to providing that data to the FMC for its aggregation, I suspect that process could be performed for a relatively modest fee by CTS which should be funded by the carriers.

By providing their detailed actual monthly volume and pricing data to CTS where they know it will be aggregated to show overall industry data that is made publicly available, the carriers have already acknowledged that such historical industry data is not confidential or proprietary. As such, it seems like an acceptable framework can be found to provide all of the aggregate industry data that is now available, including the more granular trade lane data, on the same monthly basis to FMC.

In addition to the aggregate industry wide volume and pricing data, for the same reasons it is not unreasonable to move towards requiring each of the carriers to provide their portion of the same data. In this case, there is no need for aggregation and each carrier can provide its own overall pricing index and pricing index by major trade lane. First and foremost, this actual information is their overall volume and pricing and discloses no customer specific data. It is the same information they now provide to CTS so it is imposing no additional burden on them. It is factual information on what has already happened. The same pricing format using a relative index with 2008 set at 100 can be used to preclude carrier concerns that actual average pricing per TEU is giving competitors information. For the container shipping companies that are publicly listed, this information is similar and often less invasive than what they provide during quarterly earnings calls. Based on all of these facts, its difficult for them to say this aggregate historical information is confidential.

With aggregate actual overall pricing per trade lane, a shipper can and will be in a position to make a more informed decision. That would be even more so if the shipper had access to the same information on the carrier they are considering. Having those facts on the relative level and trend of actual overall pricing is beneficial information, particularly when it can serve to inoculate the significant misinformation that appears to be embodied in container spot rates. It is useful as a benchmark by itself. The overall pricing data can also be compared to trade lane spot rates in an effort to see what it says about the relative level and trend of contract rates in an analysis similar to the above.

The bottom line is that readily available factual data that doesn't reveal any customer specific or confidential information should be required to be filed

on a timely basis with the FMC which will then make it publicly available on its website. It will replace pricing opaqueness with more clarity by providing shippers and others with factual information they deserve to see.

No discussion of additional information in the maritime sector would be complete without a nod to the efficacy of sharing digital information and the need to make such sharing a priority. FMC should consistently support and promote initiatives that result in more digital efficiency throughout the maritime sector.

Conclusion

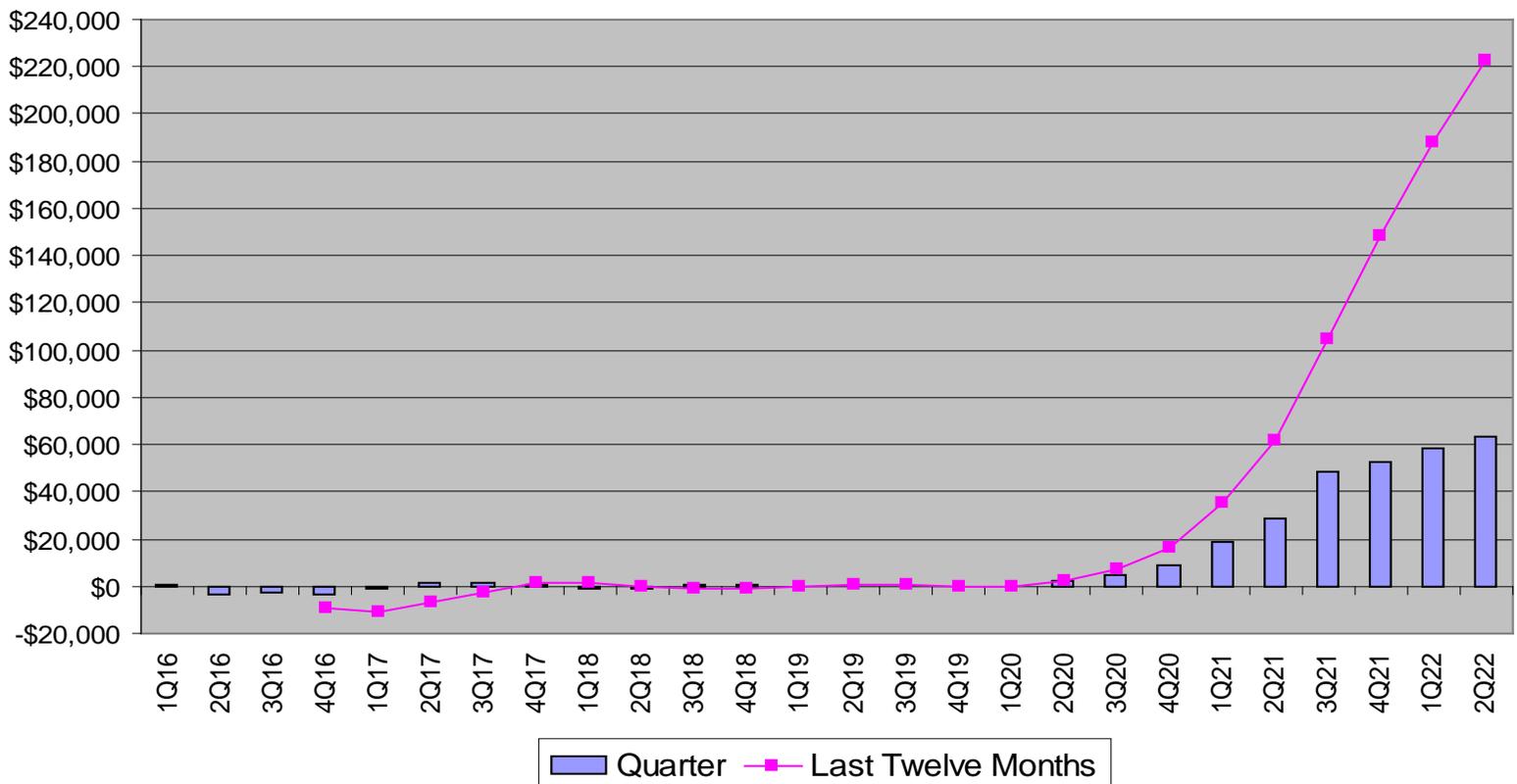
Spot rates are the bright shiny objects in container shipping. Perhaps because there is such a dearth of easily available pricing information, they are constantly and sometimes breathlessly focused on. But as this submission has shown, they provide little clarity on what is actually happening related to pricing levels and trends in the container shipping sector. In many cases they can actually distract from what is really occurring related to pricing. The focus should be more on broader pricing metrics that embody all of the loads actually moving. Narrative is almost always trumped by analysis when it comes to economic decision making.

In most business situations where there are spot and contract rates, the main difference is simply timing. When a contract ends, if it is renewed, it will be renewed at the spot rate if that rate is the meaningful metric it purports to be. It is patently obvious that has not been the situation in container shipping. Enough time has elapsed where almost all contracts prior to the sharp increase in spot rates have expired, yet just looking at the charts it is clear that they haven't been renewed anywhere near the then current spot rate. That fact is another strong indictment related to the efficacy of spot rates in the container shipping sector.

The continuing uptick in the financial results of the container shipping industry since the 3Q21 peak in the Drewry World Container Index (WCI) belies the impact of spot rates. In 2Q22, the Drewry WCI was 20.8% lower than it was three quarters earlier. Despite that spot pricing decline, industry net income was 32.4% higher. Put simply, sharply higher net income at the same time that spot rates are down significantly underscores that spot rates aren't a particularly relevant factor.

Below is a graph of actual container shipping industry net income by quarter from 2016. The industry went from being an extreme under-performer to performing at never anticipated levels as a result of consistent increases in aggregate pricing.

Container Shipping Industry Net Income By Quarter From 2016 (USD Millions)



Container shipping industry net income for 2Q22 was a staggering \$63.7 billion, an increase of \$35.1 billion and a 123% improvement from the \$28.6 billion profit in the year ago quarter. Compared sequentially to 1Q22, net income was \$5.0 billion or 8.5% higher. Remarkably, that year ago profit was the highest quarterly net income ever for the industry at the time, just as the three quarters before it were also. With stair step increases over the last two years, this is the seventh straight quarter of record earnings. Net income as a percent of revenue was 46.1% in 2Q22 versus 31.8% in the year ago quarter and 44.9% compared sequentially to 1Q22. The Drewry WCI peaked in the 3Q21, a quarter where net income was \$48.1 billion and the net income to revenue margin was 42.7%. When the Drewry WCI declines 20.8%, but net income increases 32.4% and the margin grows from 42.7% to 46.1%, its fair to question the relevancy of spot rates to what is going on.