

FEDERAL MARITIME COMMISSION

46 CFR PART 581

[DOCKET NO. 88-7]

SERVICE CONTRACTS - "MOST-FAVORED-SHIPPER" PROVISIONS

AGENCY: Federal Maritime Commission.

ACTION: Final Rule.

SUMMARY: The Federal Maritime Commission is adopting a Final Rule that prohibits a rate contained in a service contract to be changed during the course of the contract on the basis of unpublished offers made to any shipper of the commodity covered by the contract. However, changes to service contract rates based on published rates of the contract carrier or other carriers, whether in tariffs or service contracts, will continue to be allowed.

DATE: Effective 30 days after publication in the Federal Register.

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SUPPLEMENTARY INFORMATION:

The Commission initiated this proceeding in response to a Petition for Rulemaking ("Petition") filed by the International Council of Containership Operators ("ICCO"),

an association of several containership operators.¹ The Petition requested that the Commission issue a rule prohibiting: (1) so-called "most-favored-shipper" ("MFS") clauses² in service contracts, and (2) the use of de minimis liquidated damages provisions in service contracts for a shipper breach of its volume commitment.³ The Commission published the Petition in the Federal Register and invited

¹ The following were members of ICCO at the time the Petition was filed: American President Lines, Ltd.; Atlantic Container Line Services Ltd.; The Australian National Line; Ben Line Containers Ltd.; Blue Star Line Ltd.; Compagnie Generale Maritime, CMB S.A.; Crowley Maritime Corporation; The East Asiatic Company Ltd. A/S; Evergreen International Corporation; Societa Finanziari Marittima (Firmare); Hamburg-Sudamerikanische Dampfschiffahrts-Gesellschaft Eggert & Amsinck; Hapag-Lloyd AG; Lykes Bros. Steamship Co., Inc.; A.P. Moller (Maersk Line); Mitsui O.S.K. Lines, Ltd.; Koninklijke Nedlloyd Groep N.V.; Neptune Orient Lines, Ltd.; Nippon Yusen Kaisha; Orient Overseas Container Line Ltd.; Overseas Containers Limited; Sea-Land Service, Inc.; South African Marine Corporation, Limited; Transatlantic Shipping Company, Limited; Trans Freight Lines, Inc.; Transportacion Maritima Mexicana, S.A. de C.V.; United Arab Shipping Company (S.A.G.); United States Lines, Inc.; and Wilh. Wilhelmsen.

² ICCO identified two distinct types of MFS clauses. Under the first, if the contract carrier or conference offers to any other shipper (by service contract or by tariff) a lower rate for that commodity for that service than is offered to the contract shipper under the service contract, the contract shipper will prospectively receive the lower rate. The second type is referred to by ICCO as a "Crazy Eddie" clause. Under this arrangement, if, during the contract term, the contract carrier or any other carrier offers the contract shipper or any other shipper (by service contract, by tariff, or by other means), a lower rate for that commodity for that service than is provided to the contract shipper under the service contract, the contract shipper will prospectively receive that lower rate from the contract carrier.

³ ICCO would classify as "de minimis," damages for cargo shortfall that are less than seventy-five percent of the contract rate.

comments.

After consideration of the forty-one comments received, the Commission published a Proposed Rule prohibiting MFS clauses in service contracts (53 FR 8775, March 17, 1988).

The Proposed Rule defined a "most-favored-shipper clause" as:

. . . a service contract provision that allows a service contract rate or rate schedule(s), or any other essential term(s), to be changed to adopt (by direct match, formula or by any other means) any provision offered to the contracting shipper or another shipper, by tariff filing, other service contract, or any other offering, by any other carrier or conference.

However, the Proposed Rule would have permitted adjustments in service contract rates based upon charges in a carrier's or conference's own tariffs or service contracts.

Accordingly, proposed section 581.5(a)(4) stated that the essential terms of a service contract:

May incorporate by reference additional charges, surcharges, allowances, or adjustment factors as set forth in the service contract carrier's or conference's tariff of general applicability or service contract essential terms publication in the same trade in effect on the date of execution of the service contract. The reference must be made by specific FMC tariff or essential terms publication number to an active publication. The service contract may also provide for adjustments in such charges as effected by adjustments in the carrier's or conference's tariff of general applicability or essential terms publication. Each service contract shall describe any restriction(s) or limitation(s) which apply to such adjustments.

The Commission declined to propose any regulations dealing with the issue of the level of liquidated damages. Although the Commission determined that it had the legal authority to issue rules in this area, it concluded that such action was not warranted at the time.

Comments on the Proposed Rule were received from thirty-eight interested parties. These comments can be divided into two categories: (1) shippers, shippers' associations and other shipper groups ("Shipper Comments"),⁴ and (2) carriers, conferences and other associations ("Carrier Comments").⁵ Comments were also received from two members of Congress - the Honorable John B. Breaux, Chairman of the Merchant Marine Subcommittee of the Senate Committee on Commerce, Science, and Transportation and the Honorable

⁴ Shipper Comments were submitted by: (1) American Paper Institute, Inc.; (2) Wine and Spirits Shippers Association, Inc.; (3) First International Shippers Association; (4) National Industrial Transportation League; (5) E.I Du Pont de Nemours and Company; (6) American Institute for Shippers' Associations, Inc.; (7) Chemical Manufacturers Association; and (8) Subaru of America.

⁵ Carrier Comments were submitted by: (1) Associated Container Transportation (Australia) Ltd.; (2) Trans-Pacific Freight Conference of Japan and Japan-Atlantic and Gulf Freight Conference; (3) Inter-American Freight Conference; (4) Gulf-Europe Freight Association, North Europe-U.S. Gulf Freight Association, U.S. Atlantic-North Europe Conference, North Europe-U.S. Atlantic Conference; (5) Mitsui O.S.K. Lines, Ltd.; (6) Nippon Yusen Kaisha; (7) Blue Star Line, Ltd.; (8) Transpacific Westbound Rate Agreement; (9) Asia North America Eastbound Rate Agreement, Israel Eastbound Conference, Mediterranean North Pacific Coast Freight Conference, and South Europe/U.S.A. Freight Conference; (10) Seafarers International Union of North America, AFL-CIO; (11) EAC Lines Transpacific Service, Ltd.; (12) Transportation Institute; (13) United Shipowners of America; (14) Maritime Institute for Research and Industrial Development; (15) Council of European and Japanese National Shipowners' Associations; (16) National Customs Brokers & Forwarders Association of America, Inc.; (17) Atlantic & Gulf/West Coast of South America Conference, United States Atlantic & Gulf/Ecuador Conference, United States Atlantic & Gulf Hispaniola Steamship Freight Association, United States Atlantic & Gulf/Southeastern Caribbean Conference, and United States/Colombia Conference; (18) ICCO; and (19) New York Foreign Freight Forwarders and Brokers Association.

Walter B. Jones, Chairman of the House Committee on Merchant Marine and Fisheries.⁶

SUMMARY OF COMMENTS

In light of the number of submissions and the fact that many of the commenters make the same arguments, the position taken by each and every commenter will not be individually summarized. Instead, comments of certain parties representative of the basic carrier or shipper positions will be presented and addressed. Unique comments of the remaining parties will also be noted.

A. Carrier Comments

ICCO recognizes that the Proposed Rule would prohibit that type of MFS clause it characterizes as the "Crazy Eddie" clause, i.e., one that references another carrier's tariffs, service contracts, or other offers. It further recognizes that the Commission has indicated that service contracts containing de minimis liquidated damages for breach of a shipper volume commitment violate the proscriptions of the Shipping Act of 1984 ("1984 Act" or "Act"), 46 U.S.C. app. 1701-1720. Nonetheless, ICCO continues to argue that all MFS clauses should be prohibited (including those that reference a carrier's own tariffs or

⁶ On April 29, 1988, the Commission served notice that it had completed an environmental assessment of this proceeding and had determined that it would not constitute a major Federal action significantly affecting the quality of the human environment within the meaning of the National Environmental Policy Act of 1969, 42 U.S.C. 4321 et seq.

service contracts) and that the Commission should by rule set the limits on acceptable liquidated damages provisions.

ICCO submits that "Crazy Eddie" clauses are contrary to section 10(b)(1) of the 1984 Act, which prohibits a carrier or conference from charging different compensation than the rates and charges that are shown in "its" tariffs or service contracts.⁷ ICCO also contends that, to the extent the legislative history of the 1984 Act indicates that Congress contemplated a carrier incorporating by reference material in its service contract, it did not contemplate reference to any other entity's rates, charges, or allowances. ICCO argues that Congress intended to apply longstanding tariff policy and tariff rate filing requirements to service contracts. Among these requirements are those prohibiting a carrier's tariff from referencing rates in other tariffs, either of another carrier or the same carrier. This leads ICCO to conclude that Congress likewise intended that service contracts not reference rates in other service contracts or tariffs. As a result, ICCO contends that all

⁷ Section 10(b) states, in part, that:

No common carrier, either alone or in conjunction with any other person, directly or indirectly, may -

(1) charge, demand, collect, or receive greater, less, or different compensation for the transportation of property or for any service in connection therewith than the rates and charges that are shown in its tariffs or service contracts
.....

46 U.S.C. app. 1709(b)(1).

MFS clauses, not simply what it refers to as "Crazy Eddie" clauses, should be prohibited.

ICCO further notes the requirement in section 10(b)(1) that rates be "shown" in tariffs or service contracts. It argues, however, that the rates to be charged under an MFS clause (whatever variety) are, at the time the contract is filed, unknown and, therefore, not "shown."

ICCO also asserts that MFS clauses, as a class, are contrary to section 3(21) of the 1984 Act, because they result in service contracts that do not contain a "certain" rate.⁸ ICCO refers to several statements in the legislative history to the 1984 Act that it argues demonstrates a Congressional intent that service contracts include specific numerical rates or rate formulas. In addition, ICCO contends that the Commission's proposal to allow reference to a carrier's own tariff rates or service contract rates results from a misinterpretation of certain language in a Report of the Senate Committee on Commerce, Science, and

⁸ Section 3(21) states:

"service contract" means a contract between a shipper and an ocean common carrier or conference in which the shipper makes a commitment to provide a certain minimum quantity of cargo over a fixed time period, and the ocean common carrier or conference commits to a certain rate or rate schedule as well as a defined service level - such as, assured space, transit time, port rotation, or similar service features; the contract may also specify provisions in the event of nonperformance on the part of either party.

Transportation that accompanied S. 504, a predecessor to the 1984 Act.⁹ ICCO submits that this discussion only contemplates reference to a carrier's "additional charges" or "allowances," and not to the base rate for a commodity. In this regard, ICCO notes that the Commission's service contract rules distinguish between "rates" and "charges and allowances," citing 46 CFR 581.5(a)(3)(iii).

ICCO notes that MFS clauses were never mentioned - by a shipper or a member of Congress - in the legislative history to the 1984 Act. Moreover, ICCO considers a prohibition of MFS clauses to be a modest step, in that service contracts with staged rates for staged volumes would still remain as options. ICCO believes that MFS clauses decrease rate stability and could frustrate the system of common carriage by undercutting the requirement that service contracts be made available to similarly situated shippers. ICCO claims that, at the point when a rate reduction is triggered under

⁹ The discussion at issue reads:

The "line-haul rate," referred to in paragraph (4) includes all compensation to be paid and must also be disclosed. Many service contracts may provide for charges or allowances for transporting or handling the goods involved that may be different from those published in the otherwise applicable general tariff and, accordingly, any such variance must be identified in the line-haul rate disclosure. To the extent any contract charge or allowance is the same as that in the carrier's or conference's general public tariff, incorporation by reference will suffice.

S. Rep. No. 3, 98th Cong., 1st Sess. 31-32 (1983) ("Senate Report").

a contract, otherwise similarly situated shippers may have shipped different quantities of cargo and will, therefore, receive different rate treatment.

As a technical matter, ICCO suggests that the last six words of proposed section 581.1(f) could be construed as prohibiting only reference to another ocean common carrier's rates and might, therefore, allow reference to rates offered by tramps, non-vessel operating common carriers ("NVOCCs") or other entities. ICCO would strike the words and substitute in their place: "by any other carrier, conference, or other person or entity."

ICCO also states that even though the Commission intended to prohibit only "Crazy Eddie" clauses, the wording of proposed section 581.5(a)(4) would appear to proscribe all MFS clauses, consistent with ICCO's position. ICCO, therefore, suggests that the word "only" be inserted before the word "additional" in section 581.5(a)(4).

Finally, ICCO reaffirms its position that de minimis liquidated damages clauses should be prohibited by rule. ICCO recognizes that the Commission declined to address the issue of liquidated damages by rule partly because a staff survey indicated that 6% of the contracts in a sample provided liquidated damages of \$100 or less. ICCO questions whether \$100 per container is an appropriate threshold for declaring damages to be de minimis, especially with regard to high rated commodities. In any event, ICCO believes that 6% is a sufficiently high number of service contracts to

warrant rulemaking in this area. ICCO further argues that when the level of damages in a service contract for shipper breach is very low, or nothing, the stability which service contracts are intended to provide is lost. De minimis liquidated damages provisions also allegedly provide an incentive for unscrupulous shippers to engage in deceptive practices.

ICCO believes that a rule regarding de minimis liquidated damages would be more effective than adjudication on a case-by-case basis. It suggests that, at a minimum, such a rule should state that:

service contracts including clauses specifying damages for cargo shortfall which the Commission finds to be de minimis will be rejected.

However, ICCO also supports a more specific rule that would create a rebuttable presumption that, if a contract set less than a specified percentage of freight charges, the parties would have to explain to the Commission why the level is a valid attempt to approximate damages. ICCO indicates that it could accept a percentage of less than 75%, but also notes that the appropriate percentage should be determined after notice and opportunity for comment.

Most of the other Carrier Comments support the Proposed Rule but also urge that it be expanded to include all MFS clauses. In addition, most request that the Commission reconsider its decision to treat the level of liquidated damages on a case-by-case basis and propose instead a rule of general applicability in this area. In support of this

position, most of the Carrier Comments raise the same or similar arguments as those presented by ICCO and they will not, therefore, be repeated here. Others, however, offer additional insights which warrant specific mention.

Some conferences note that the Commission's service contract rules require that if a service contract does not provide damages for termination or breach, all cargo moving under the contract must be rerated at the otherwise applicable tariff rate - 46 CFR 581.7(b)(2). They further point out that this provision was intended to prevent collusive action by the parties to avoid contract commitments. They argue, however, that de minimis liquidated damages undercut the purpose of this rule.

The Inter-American Freight Conference requests that if the Commission decides not to prohibit MFS clauses entirely, it should at least require such provisions to state the specific carriers or conferences whose rates may affect the service contract rates and that the rates involved must cover shipments of exactly the same commodity in the same volume as that specified in the service contract.

The New York Foreign Freight Forwarders and Brokers Association ("NYFFBA") questions whether the Commission, as a procedural matter, properly disposed of ICCO's Petition. It contends that ICCO petitioned for a rule prohibiting all MFS clauses, and not for the rule the Commission proposed which would allow certain MFS clauses.

NYFFBA also contends that the Proposed Rule is contrary to section 2 of the 1984 Act,¹⁰ in that it would allow large shippers to enjoy an advantage over small shippers.

Moreover, NYFFBA submits that, if MFS clauses are allowed, more shippers will choose to use service contracts, thereby eroding the common carriage system and perhaps reducing the effectiveness of the conference system.

B. Shipper Comments

Commenters representing shippers, shippers' associations and related organizations generally support the Commission's decision not to propose rules regarding liquidated damages. They also support that aspect of the Proposed Rule which would allow service contracts to reference a contracting carrier's tariff rates or other service contract rates. However, they oppose any limitation on a service contract referencing other carriers' tariff rates or service contracts.

The National Industrial Transportation League ("NITL") claims that contracts that protect both parties from adverse price consequences based on changing market conditions are an accepted business and contractual practice. Unrestricted

¹⁰ Section 2 states, in part:

The purposes of this Act are -

(1) to establish a nondiscriminatory regulatory process for the common carriage of goods by water in the foreign commerce of the United States with a minimum of government intervention and regulatory costs

46 U.S.C. app. 1701(1).

"meeting competition" clauses (MFS clauses) are said to allow similarly situated shippers to compete without changing carriers when a foreign competitor can lower its transportation costs from another carrier. NITL argues that such clauses also allow the contracting carrier the choice of claiming the business if it elects to continue at the reduced rate, consistent with normal business practices.

First International Shippers Association believes that all of the matters included in ICCO's Petition are commercial matters subject to negotiation and that the market should not be disrupted to create additional unfair advantages for carriers. It basically contends that carriers will not agree to MFS clauses unless it is to their commercial advantage and that carriers and shippers should have the "right" to negotiate these matters.

The Wine and Spirits Shippers Association ("WSSA") contends that Congress did not intend for the Commission to regulate the commercial form and aspects of contract carriage. WSSA also argues that inclusion of MFS clauses will put carriers on notice of the consequences of predatory rate reductions, thereby limiting their use and enhancing revenues for all carriers. Lastly, WSSA asserts that shippers' associations are unique, in that they do not own cargo and cannot compel their members to ship exclusively through them. If a non-contracting carrier or conference undercuts the contract rate, members of the association will allegedly be induced to use those lower rates. WSSA

believes that the net effect would be that the association could not meet its commitment, through no fault of its own.

The American Institute for Shippers' Associations ("AISA") advises that it represents two types of shippers' associations - (1) "full service" associations, which, it explains, handle all aspects of the freight movement as cooperatives, and (2) "rate negotiator" associations, which are said to enter into rate arrangements on behalf of their collective memberships. AISA contends that the Commission lacks jurisdiction to regulate the form and substantive content of service contracts, but particularly the pricing terms. AISA believes that the Commission's interpretation of the 1984 Act's initial policy goal, as a general policy exhortation only, is incorrect. It claims that Congress specifically identified service contracts as requiring a minimum of government regulatory interference, citing S. Rep. No. 3, 98th Cong., 1st Sess. 18 (1983). It also avers that the level of rates charged shippers was another area specifically identified as being outside the Commission's jurisdiction. Id. at 16, 18. This governmental non-intervention policy is allegedly further underscored by the fact that the exclusive remedy for breach of a service contract is an action in court, unless otherwise agreed. 46 U.S.C. app. 1707(c).

AISA questions the Commission's determination that service contracts are "special" contracts subject to regulation. It argues that the essential terms set forth in

section 8(c) of the 1984 Act are not mandatory, but merely examples of terms that may be agreed to.¹¹ AISA further contends that a pricing term is not mandatory and that both the common law and the Uniform Commercial Code recognize contracts which do not have specific pricing terms.

AISA also takes issue with the conclusion that the words "certain rate or rate schedule" in sections 3(21) and 8(c) of the Act indicate a requirement that service contract

¹¹ Section 8(c) states:

SERVICE CONTRACTS.--An ocean common carrier or conference may enter into a service contract with a shipper or shippers' association subject to the requirements of this Act. Except for service contracts dealing with bulk cargo, forest products, recycled metal scrap, waste paper, or paper waste, each contract entered into under this subsection shall be filed confidentially with the Commission, and at the same time, a concise statement of its essential terms shall be filed with the Commission and made available to the general public in tariff format, and those essential terms shall be available to all shippers similarly situated. The essential terms shall include--

- (1) the origin and destination port ranges in the case of port-to-port movements, and the origin and destination geographic areas in the case of through intermodal movements;
- (2) the commodity or commodities involved;
- (3) the minimum volume;
- (4) the line-haul rate;
- (5) the duration;
- (6) service commitments; and
- (7) the liquidated damages for nonperformance, if any.

The exclusive remedy for a breach of a contract entered into under this subsection shall be an action in an appropriate court, unless the parties otherwise agree.

46 U.S.C. app. 1707(c).

rates be an established, numerical value rate. It argues that "certain" is not limited to previously existing events, but includes items "in law, capable of being identified or made known, without liability to mistake or ambiguity, from data already given." Black's Law Dictionary 204 (5th ed. 1979). This definition is said to be consistent with an alternative definition for "certain" in Webster's New Collegiate Dictionary 182 (1975). AISA argues that under these definitions, MFS clauses contain certain rates, because the rate can be determined from data which is specified in the contract. This interpretation is allegedly consistent with statements in the Senate Report implying that service contracts need contain no provision concerning prices, on the condition that they provide meaningful commercial disclosure. S. Rep. No. 3, 98th Cong., 1st Sess. 32 (1983).

AISA also submits that the policy of allowing a carrier to reference its own published rates but not the rates of its competitors is arbitrary. If the Commission is attempting to achieve rate certainty in service contracts, AISA claims that it must either uniformly prohibit or uniformly allow all MFS clauses.

Further, AISA believes that the Commission's prohibition against cross-referencing of tariffs should not be applied to service contracts. AISA states that the policy against cross-referencing tariffs to reduce the burden on shippers does not apply in the case of a service

contract, where the shipper negotiates an MFS clause and voluntarily assumes the burden of ascertaining the market rate. The 1984 Act is said to consistently treat tariff rates and service contracts as distinct systems.

To the extent that rate instability is one of the reasons for prohibiting MFS clauses, AISA contends that no cause and effect relationship has been established. Because AISA views complaints against MFS clauses as complaints with the statute itself, it suggests that these issues await the results of the Commission's section 18(a) study. See 46 U.S.C. app. 1717(a).

AISA advises that the Department of Justice prohibits shippers' associations from requiring their members to ship exclusively through the association. As a result, shippers' associations and particularly "rate negotiator" associations are said to be susceptible to having their members raided by a contracting carrier or conference or by competing carriers.

AISA suggests that the Proposed Rule may inhibit the use of service contracts for intermodal transportation. This allegedly may occur because inland transportation contracts do allow MFS clauses. AISA explains that if a shipper can obtain an MFS clause for the domestic portion of its transportation movement but is unable to do so for the foreign portion, it may have no choice but to use a carrier's tariff rates for the ocean transportation rather than enter into an intermodal service contract. This result

is argued to be contrary to the policy of the 1984 Act to develop and promote intermodal services.

AISA also maintains that the Proposed Rule is vague and does not clearly permit that which the Commission intended to permit. AISA states, for example, that while proposed section 581.5(a)(4) permits cross-referencing of a contracting carrier's "additional charges, surcharges, allowances, or adjustment factors . . .," this language does not make it clear that "rates" may be cross-referenced. AISA also believes that the Proposed Rule is broader than that requested by ICCO, in that it prohibits incorporation by reference of any essential term, not simply a rate term. It suggests, therefore, that the phrase "or any other essential term(s)" be deleted. Lastly, AISA takes issue with certain other wording of the Proposed Rule, in particular the meaning of the phrases "allow to be changed to adopt," "direct match, formula or by any other means," and "any other offering."

The Chemical Manufacturers Association ("CMA") states that the Commission has overstepped its proper statutory role under section 8(c) of protecting the rights of similarly situated shippers and involved itself in second-guessing the business judgments of contracting parties to protect carriers and/or their competitors. It believes that certain statements by the Commission in Docket No. 86-6, Service Contracts, 52 F.R. 23989 (June 26, 1987), delineate its proper role in this regard, and are consistent with the

legislative history of the 1984 Act. The requirement in the Commission's rules that similarly situated shippers be notified of a change in essential terms due to the operation of a contingency clause (e.g. an MFS clause) is said to be adequate to implement section 8(c) of the 1984 Act.

CMA further contends that the Commission has failed to explain why existing rules will not ensure compliance with section 10(b)(1) of the 1984 Act, which prohibits a carrier from charging a different rate from that shown in its tariff or service contract. It argues that a carrier that adjusts a service contract rate in accordance with the terms of its contract is charging a rate as shown in its service contract for purposes of section 10(b)(1).

CMA views the Proposed Rule as designed to protect either the contracting carrier from its own folly or a contracting carrier's competitors from that carrier's competition. Under either case, the rule is alleged to reflect "administrative paternalism." Moreover, to the extent the Proposed Rule is intended to limit competition and stabilize rates, it allegedly could be considered as a form of price support for ocean carriers. CMA notes that

section 4(a)(7) of the 1984 Act¹² gives conferences the ability to prohibit or regulate their members' use of service contracts to limit competition, and CMA contends that the Commission should not assume this role.

CMA notes the Commission's statement that, as a practical matter, a carrier signatory to a service contract could meet the rate of a competitor by simply adjusting its own tariff rates. It argues, however, that such an approach would make service contracts more restrictive than general tariffs and would discourage the use of service contracts.

The American Paper Institute, Inc. ("API") points out that the Transpacific Westbound Rate Agreement ("TWRA") no longer enters into any service contracts and suggests that this alone is reason enough to deny the Petition. It also questions how MFS clauses can be upsetting any balance between shipper and carrier interests. API claims that carrier opposition to the concept of service contracts was rejected by Congress in enacting the 1984 Act and submits that the Commission should not now "second-guess" Congress.

¹² Section 4 states, in part:

(a) Ocean Common Carriers -- This Act applies to agreements by or among ocean common carriers to -

* * *

(7) regulate or prohibit their use of service contracts.

46 U.S.C. app. 1703(a)(7).

API further questions the Commission's reliance on a Report of the House Committee on Merchant Marine and Fisheries ("House Report")¹³ for the proposition that Congress intended that the Commission take an active role in regulating service contracts. API suggests, rather, that the controlling legislative history is the Conference Report¹⁴ and then the Senate Report. It reads the Conference Report as indicating that service contracts can be employed in a discriminatory fashion and are not, therefore, constrained in any way by common carriage concepts.

API takes issue with the Commission's interpretation of the statement - "to the extent any contract charge or allowance is the same as that in the carrier's or conference's general public tariff, incorporation by reference will suffice." Senate Report at 32. This language is allegedly not meant ". . . to tie the referenced tariff to any particular carrier or conference's rate, but rather to emphasize that incorporation by reference will be allowed for a 'general public tariff.'" After citing additional language in the Senate Report, API concludes that the concern of Congress was not whose rates are referenced, but rather that publicly available rates be referenced.

¹³ H.R. Rep. No. 53, 98th Cong., 1st Sess. (1983).

¹⁴ H.R. Conf. Rep. No. 600, 98th Cong., 2nd Sess. (1984) ("Conference Report").

API further suggests that the Commission's reliance on precedent under section 18(b)(3) of the Shipping Act, 1916, 46 U.S.C. 817(b)(3) (repealed 1984), is inapposite to service contracts, which are entirely new under the 1984 Act and are intended to provide certain preferences.

Du Pont claims that the definition set forth in proposed section 581.1(f) is not a "most-favored-shipper" clause, but rather a "meeting competition" clause. It submits that valid "meeting competition" clauses do not result in a lack of mutuality of consideration. To the contrary, Du Pont suggests that the common law recognizes contracts that provide relief from adverse price consequences based on changing market conditions as valid. Du Pont also questions ICCO's references to a lack of balance or the overwhelming market power of shippers over carriers, especially in light of the fact that the TWRA has no service contracts, with or without "meeting competition" clauses.

Du Pont further proposes that the Proposed Rule be modified so that shippers could use only written offers from comparable carriers that are firmly committed, in writing, to provide the service, either under a tariff or under a service contract, if the contract carrier elects not to continue to carry the cargo. Moreover, Du Pont proposes to preserve the statutory rights of similarly situated shippers by treating a carrier's decision to meet competition as a new, limited service contract, thereby affording a 30-day

period for similarly situated shippers to exercise their "me-too" rights.

Subaru fully supports the Proposed Rule as a fair and equitable solution to the concerns raised by ICCO's Petition. It believes that if carriers are free to adjust rates in a service contract upward (by reference to a general rate increase), they should also be free to allow reductions, when market conditions dictate. In addition, Subaru notes that the proper time for a carrier to address an MFS clause is at the time the contract is negotiated, because such a provision need not be included if a carrier does not desire it.

The National Customs Brokers and Forwarders Association of America, Inc. ("NCBFAA") likewise supports the Proposed Rule. It notes that, historically, after a shipper executes a service contract, conferences have adjusted rates downward to a point where a non-signatory shipper has a lower rate than a competing signatory. In addition, NCBFAA asserts that after a shipper tenders cargo for a period of time and establishes its ability to generate a certain volume of cargo, carriers may approach the shipper and seek to deal directly with it by offering a lower than contract rate. The Proposed Rule is seen as preventing this conduct.

C. Other Commenters

Senator Breaux advises that service contracts were not intended to replace the system of common carriage in ocean transportation. He states that they were intended to

provide greater stability to ocean freight rates and to enable both shippers and carriers to make mutual commitments which would add greater predictability to rates, volume and service. Senator Breaux further states that the essence of service contracts is the long nature of these commitments as opposed to the unpredictable tendering of cargo under tariff rates that may fluctuate.

Congressman Jones expresses support for the standards in the Proposed Rule that define, by exclusion, what may be considered an acceptable service contract. He also notes the importance of the Commission's reiteration of its policy to require meaningful rate and service commitments for shippers and meaningful service commitments for carriers. Congressman Jones views the Proposed Rule as reducing the burden on the Commission if MSF clauses were allowed and numerous contract amendments were filed with it.

DISCUSSION

MFS clauses are provisions in service contracts that permit the contract rate to vary based on some external activity or event. There are essentially three different types of MFS clauses. The first allows a service contract to meet or adopt any rate offered by the contracting carrier or conference in its tariffs or service contracts. The second allows the contract to meet the rates of other carriers or conferences, whether in tariffs or service contracts. The last category permits changes to the contract rate based on unpublished offers of other carriers.

ICCO originally petitioned the Commission for a rule that would prohibit all three forms of MFS clauses. ICCO also requested a rule establishing a minimally acceptable level for liquidated damages provisions in service contracts for a shipper breach of its volume commitment.

The Proposed Rule would have allowed a carrier's service contract rate to be adjusted based on its own tariff rates or service contract rates. Reference to other carriers' rates or offers would have been prohibited. However, the Commission also suggested that a basis might exist to distinguish and permit MFS clauses referencing other carriers' rates. In addition, the Commission declined to issue a rule addressing the acceptable level of liquidated damages, but instead indicated that it would deal with that issue on a case-by-case basis.

After consideration of all the comments to the Proposed Rule, the Commission has determined to prohibit only those MFS clauses that allow a service contract rate to meet unpublished offers of carriers or conferences. In addition, the Commission notes that the issue of de minimis liquidated damages was outside the scope of the Proposed Rule. Nonetheless, because this issue was reargued by some commenters, the Commission will take this opportunity to reaffirm its earlier decision. The reasons for these determinations follow, with the latter subject treated first.

Liquidated damages are sums a party to a contract agrees to pay to the other party in the event a promise is breached, and are good faith efforts to estimate the actual damages which might ensue, taking into account the difficulties in proving actual damages. See Black's Law Dictionary 353 (5th ed. 1979). The appropriateness of any given liquidated damages provision is generally judged on its own unique circumstances. In the area of service contracts for ocean transportation, liquidated damages are most often included to address the situation of a shipper failing to meet its volume commitment. However, given the shipper, carrier, commodity, and trade characteristics that influence the determination of liquidated damages, it may be particularly difficult to quantify in a universally applicable rule, what might be an acceptable level of liquidated damages.

The Commission has never stated, however, that it lacks authority to issue regulations concerning de minimis liquidated damages. In fact, in the Supplemental Information to the Proposed Rule, the Commission stated that, although it

. . . lacks the authority to directly regulate the use of liquidated damages provisions [this] does not necessarily mean that the Commission is without authority to preclude service contract liquidated damages provisions which may permit evasion of the otherwise applicable tariff rate contrary to the 1984 Act and the policies underlying it, regardless of whether both parties to the contract willingly or unwillingly agree to those provisions.

Proposed Rule at 28, 29. In this regard, the Commission noted that it would be extremely difficult to devise "an efficient and appropriate regulatory requirement" and that it would only consider such a course of action if there were a showing that "the use of de minimis liquidated damages clauses is widespread and presents a serious problem that threatens the viability of the overall legislative scheme of the 1984 Act."

Although the Commission recognized that there is a potential for illusory contracting through the use of de minimis liquidated damages clauses and that such contracting may on occasion have occurred, it did not find such contracting to have been shown to be of sufficient magnitude to warrant the significant restrictions on service contracting that effective regulation would entail.

Proposed Rule at 30. In this connection, the Commission also noted a random survey of service contracts by its staff that indicated that only 6% of the contracts reviewed had liquidated damages provisions at less than a level that might be considered clearly de minimis. The Commission nevertheless advised that it would closely scrutinize filed service contracts and reject any with potentially low levels

of liquidated damages.¹⁵

No new facts or arguments have been presented that persuade the Commission to alter its earlier determination. Moreover, more recent Commission staff surveys reveal only about seven to nine percent of the service contracts reviewed having provisions for deadfreight at a level that might be considered clearly de minimis. The Commission therefore will treat such matters on a case-by-case basis. The Commission intends to be particularly vigilant in this regard, and intends to require parties to any service contract containing suspect levels of liquidated damages to justify their provisions. It is the Commission's belief that under certain circumstances liquidated damages of an extremely minimal amount could violate section 10(a)(1) of the 1984 Act and may also indicate a failure of consideration on the part of the shipper, calling into question whether the arrangement is indeed a "contract."

¹⁵ As the Commission noted:

. . . it is the stated policy of the Commission to require meaningful rate and volume commitments on the part of the shipper and meaningful service commitments on the part of the carrier in all service contracts entered into under the authority of section 8(c) of the 1984 Act. The Commission will scrutinize contracts carefully at the time of filing to ensure that they contain such commitments, pursuant to the requirements of 46 CFR 581.1(n). Failure to comply with the requirements of 46 CFR 581.1(n), as herein interpreted, will result in the rejection of the contract pursuant to 46 CFR 581.8 or other appropriate Commission action.

Proposed Rule at 27.

ICCO's Petition indicated that MFS clauses may, in certain instances, be triggered not only by some rate offer contained in a tariff or service contract, but also by other means, including telephone quotes. The Commission concluded, in issuing the Proposed Rule, that this type of MFS clause appeared to be contrary to section 8(c) of the 1984 Act. The Commission explained that tying a service contract rate to an unpublished, nonbinding rate "offer," that cannot be readily ascertained by interested third parties, did not appear to provide the "meaningful commercial disclosure" contemplated by Congress. Proposed Rule at 22 and 27.

The only two commenters that directly addressed this type of MFS clause represented shipper interests. Notwithstanding their predilection in favor of MFS clauses generally, these commenters concede that clauses tied to unpublished offers might be legally prohibited by the Commission. Thus, API states that, to the extent an MFS clause references an unpublished and unknown rate which is not thereafter filed with the Commission, prohibition would constitute a "viable enforcement action designed to provide meaningful commercial disclosure." Likewise, AISA indicates that it could support a regulation prohibiting reference to unpublished offers as being within the Commission's jurisdiction to require rate certainty.

The Commission concludes that service contract provisions that allow a contract rate to match a vague,

unwritten and unpublished offer of some other carrier are unlawful and should be, therefore, prohibited. These types of provisions do not provide any commercial disclosure to other interested parties, let alone the meaningful commercial disclosure required by section 8(c) of the Act. Accordingly, the Proposed Rule has been modified to clarify that this type of MFS clause will no longer be countenanced. Specific language will be added to 46 CFR 581.5(a)(3)(iii) to indicate that the "contract rate" essential term may not be changed based on rate offers of other carriers not published in a tariff or service contract.¹⁶

As for the remaining two types of MFS clauses, there is little or no practical difference between them. A service contract that references a carrier's own tariff or service contracts and a contract that references rates contained in other carriers' tariffs or service contracts both operate in a similar manner. The only question is whether the kinds of materials to which they refer (i.e., one's own rates versus the rates of others) have been somehow distinguished by statute or by Congressional intent.

Upon review of the comments and further consideration of the relevant language, the Commission does not believe that the Senate Report can serve as a sufficient basis to

¹⁶ The Final Rule thus amends existing paragraph (a)(3) of section 581.5, rather than adding several new paragraphs to Part 581, as had originally been proposed.

distinguish between these two types of MFS clauses.¹⁷ The language in this Report discussing incorporation by reference to a carrier's general public tariff makes reference only to a carrier's additional "charges" or "allowances" and not the base rate for the commodity covered by the contract. Therefore, because the Senate Report does not distinguish between MFS clauses referencing a carrier's own rates and those referencing other carriers' rates, both types of clauses must be assessed together against other possible restrictions contained in the 1984 Act.

ICCO has argued that service contracts containing MFS clauses do not contain "certain" rates for purposes of section 3(21) of the 1984 Act. The Commission disagrees. As we noted in the Proposed Rule, a contract must be drafted so as to permit a person to ascertain the agreed upon rate from the face of the document or a specified rate schedule. The initial rate to be charged under a contract containing an MFS clause is a specific, numerical rate and is,

¹⁷ The pertinent section of the Senate Report states:

The "line-haul rate," referred to in paragraph (4) includes all compensation to be paid and must also be disclosed. Many service contracts may provide for charges or allowances for transporting and handling the goods involved that may be different from those published in the otherwise applicable general tariff and, accordingly, any such variance must be identified in the line-haul rate disclosure. To the extent any contract charge or allowance is the same as that in the carrier's or conference's general public tariff, incorporation by reference will suffice.

Senate Report at 31, 32.

therefore, "certain" for section 3(21) purposes. Moreover, to the extent that that rate is subsequently adjusted based upon circumstances specifically set forth in the MFS clause, that "adjusted" rate is capable of being ascertained from objective data, although published elsewhere. In fact, when such a contingency is invoked, the Commission's rules already require that this fact must be brought to the Commission's attention. 46 CFR 581.3(a)(3)(viii) and 581.5(b)(1). At all times, the applicable rate under a contract with an MFS clause will be ascertainable and known to the Commission.

ICCO has also argued that MFS clauses that reference other carriers' rates violate section 10(b)(1) of the 1984 Act. The Commission again disagrees, after full consideration of all the comments and reexamination of the applicable statutory language. A carrier that adjusts a service contract rate in accordance with an MFS clause referencing other carriers' rates is charging a rate "shown in its service contract." Although the rate ultimately charged may be affected by another carrier's rates, the method of determining the service contract rate is stated in the contracting carrier's service contract. And, as indicated above, that rate is ascertainable from objective data. The Commission does not therefore believe that section 10(b)(1) can be used to distinguish between acceptable MFS clauses.

One further issue raised in the Supplemental Information to the Proposed Rule is whether MFS clauses are in any way inconsistent with the Commission's past policy and precedent which precluded a carrier's tariff from referencing rates published in any other carrier's tariff.¹⁸ The Commission noted that this policy was designed to lessen the burden on shippers to refer to other carriers' tariffs to determine applicable freight rates. However, given the "greater commercial freedoms service contracts appear to have been intended to provide," the Commission specifically recognized that "a direct application of tariff case law and policy to service contracts may be inappropriate." Proposed Rule at 28. For the reasons stated below, the Commission finds the tariff, no-cross-referencing policy to be not directly applicable to service contracts.

In the process leading up to enactment of the 1984 Act, the issue of whether to require tariff filing at all was thoroughly debated. Ultimately, Congress decided to continue the system of tariff filing and with it the Commission's prior interpretation and rules. However, there is no clear indication that Congress at any time intended

¹⁸ Although the Commission raised the question of the applicability of tariff rules and precedent in the context of MFS clauses that reference other carriers' rates, several commenters have suggested that these arguments apply with equal force to MFS clauses that reference a carrier's own rates. The relevant tariff rules, 46 CFR 580.6(k)(2), 580.5(g), and 580.13(b), allegedly reflect a longstanding Commission policy of prohibiting a carrier from incorporating by reference any rates, even its own.

that the Commission's practices vis-a-vis service contracts were to track its existing tariff filing practices.¹⁹

Moreover, Congress specifically distinguished service contracts from rates in tariffs. The Conference Report notes that section 8(a) of the Act ". . . does not require service contracts to be filed in tariffs." Conference Report at 29. As a result, conferences are not required to permit their members a right of independent action on service contracts pursuant to section 5(b)(8). Id. Tariff rates are open to all and must be employed in a non-discriminatory manner. However, service contracts may favor certain shippers and are expressly exempted from certain statutory prohibitions against discrimination. See e.g. 46 U.S.C. app. 1709(b)(6) and (11).

Further support for not applying the tariff, "no cross-referencing" policy to service contracts can be drawn from the policy underlying the rule itself. As the Commission noted in the Supplementary Information, the reason the tariff policy was adopted was to lessen the burden on a shipper to ascertain the applicable rate. However, in the case of an MFS clause, as noted in shipper comments, it is

¹⁹ There is language in the Senate Report to the effect that ". . . a service contract must be filed and is subject to the tariff filing requirements and common carrier obligations of the bill." Senate Report at 21. However, the "tariff filing requirements . . . of the bill" to which the Report refers appear to be any requirement that a statement of the essential terms of a service contract be "made available to the general public in tariff format." See Section 8(c).

the shipper who negotiates the clause and voluntarily assumes the burden of becoming aware of other rates that might trigger the clause.

Based on the foregoing, the Commission cannot find that MFS clauses that reference published rates of the same or other carriers are per se contrary to the Shipping Act of 1984 or otherwise warrant regulation. The Commission will not, therefore, adopt any rules that would prohibit such clauses. The Commission further concludes, however, that MFS clauses referencing unpublished offers are contrary to section 8(c) of the 1984 Act, and will modify its service contract regulations to preclude such provisions.

The Federal Maritime Commission has determined that this rule is not a "major rule" as defined in Executive Order 12291, 46 FR 12193, February 27, 1981, because it will not result in: (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effect on competition, employment,

investment, productivity, innovations, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

The Chairman of the Commission certifies pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq., that this Rule will not have a significant economic impact on a substantial number of small organizational units, and small governmental jurisdictions.

List of subjects in 46 CFR Part 581:

Administrative practice and procedure; Contracts; Maritime carriers; Rates and fares.

Therefore, pursuant to 5 U.S.C. 553 and sections 3, 8, and 17 of the Shipping Act of 1984, Title 46, Code of Federal Regulations, is amended as follows:

1. The Authority Citation to Part 581 continues to read:

Authority: 5 U.S.C. 553; 46 U.S.C. app. 1702, 1706, 1707, 1709, 1712, 1714-1716 and 1718.

2. In section 581.5, paragraph (a)(3)(iii) is amended to read as follows:

(a) * * * * *

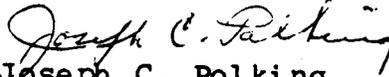
(3) Shall include the following:

* * *

(iii) The contract, rates or rate schedule(s), including any additional or other charges [i.e., general rate increases, surcharges, terminal handling charges, etc.] that apply, and any and all conditions and terms of service or operation or concessions which in any way affect such rates or charges; Provided, however, that a contract may not permit the contract rate to be changed to meet a rate offer of another carrier or conference not published in a tariff or set forth in a service contract on file with the Commission.

* * * * *

By the Commission.


Joseph C. Polking
Secretary