



WHAT IS A CARRIER? WHAT IS A SHIPPER?

Legal Corner By David Street, IHSA Legal Counsel

Perhaps you have heard the phrase “regulated industry” before. You may have even heard that the ocean shipping industry is a regulated industry. A regulated industry is an industry subject to government regulation usually overseen by a specialized agency created for that purpose. Thus, the ocean shipping industry is subject to the regulation of the government by the Shipping Act of 1984 (and several other, less important, Acts), which is overseen by the Federal Maritime Commission (“FMC”). But do you really know what it means to be a regulated industry? In the ocean shipping industry, one of the things it means is that the government determines the basic qualifications of parties eligible to enter into that most basic of commercial instruments, the contract. Furthermore, the government even defines who those parties are.

The subject here is service contracts, which are the basic mechanism by which private parties form their agreements for the transportation of millions of containers of cargo worth billions of dollars to and from the United States each year. If you want to contract with somebody in your local community to haul your garbage, all you need to do is call them up and work out an agreement covering pricing, times and place of pick up, which types of garbage are acceptable and the other subjects that the two of you want to cover in your agreement. This right of you and your garbage hauling company to reach such agreements is loosely called the “freedom to contract.” While your garbage hauler may need to be licensed by your local community, neither of you need meet particular definition in order to sign your contract. It’s enough that you need the service and your garbage hauler provides it.

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Service contracts, however, are a completely different story. Only certain types of people are permitted to enter into service contracts. These types of people are “ocean carriers,” on the one hand, and “shippers” on the other. If you are not one or the other of these types of people, entering into a service contract will lead to significant potential penalties of as much as \$30,000 per shipment. That’s a pretty big price to pay for not being the right type of person. Further, the U.S. government has been careful to define each of these types of persons in very specific ways. Let’s first examine what an “ocean common carrier” is. The Shipping Act definition of this term states that it “means a vessel-operating common carrier.” Simple, you think? Not so fast.

If you look carefully, you will see that the definition encompasses two concepts. The first is “vessel-operating.” The second is “common carrier.” Each of these concepts has produced difficulties when the FMC has examined them in various proceedings over the years. For example, what does it mean to be a “vessel operator”? Some cases are easy and obvious. A company that owns a vessel, hires the captain and crew, and furnishes the vessel with oil, food and other essentials is clearly a vessel operator. However, what about a company that only charters a vessel and does not pay for the crew? What if the charter is only for a single voyage rather than for a period of time? What if the charter is only a space charter and not for the full reach of the vessel? All of these, sometimes difficult, questions are necessary for the FMC to decide because the ocean shipping industry is a regulated industry.

In fact, the FMC has pretty much reached a determination over the years that a vessel operating common carrier (assuming that it is a “common carrier” - - see discussion below) is, for purposes of the Shipping Act, a carrier that operates the full reach of the vessel, whether owned or chartered. The FMC has also determined that a company that operates a single vessel in one U.S. trade will be considered a vessel operating common carrier in all of its operations in U.S. trades. Once a person successfully crosses the threshold of operating one vessel in one U.S. trade, it remains a vessel operator even if it simply charters space from other vessel operators in the remaining trades. For various reasons, these definitional decisions by the FMC are probably correct interpretations of the Shipping Act. The fact, however, that an agency of the United States must

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spend its time - - and the taxpayer's money - - on making these decisions is a significant commentary on what a regulated industry really is.

Issues have also arisen regarding the "common carrier" part of the ocean common carrier definition. The Shipping Act, in fact, contains a separate definition for common carrier. This definition focuses on three separate activities. Thus, a "common carrier":

- (1) holds itself out to the general public to provide transportation by water of passengers or cargo between the United States and a foreign country for compensation;
- (2) assumes responsibility for the transportation from the port or point of receipt to the port or point of destination; and
- (3) uses a vessel operating on the high seas or the Great Lakes between a port in the United States and a port in a foreign country.

Of these three activities, the second has proven relatively easy to define. Generally, a person "assumes responsibility for the transportation" by issuing a bill of lading. The third activity, "using a vessel", has also been relatively easy to pin down, although it took a decision by a United States Court of Appeals to decide it. That case involved a carrier that accepted goods for transportation in the Chicago area, but actually put them on a vessel in Montreal for carriage to Europe. While the FMC had found this company to be a common carrier subject to U.S. jurisdiction, the Court of Appeals focused on a phrase "between a port in the United States and a port in a foreign country" and found that the use of the port of Montreal for the export took the carrier outside of U.S. jurisdiction. That is why you don't even need a service contract when the carrier you use puts your goods on a vessel at a port in Canada or Mexico.

The activity causing the most problems is the "holding out" to the general public. Cases involving this activity are still being decided by the FMC based on their specific facts. The factors the FMC looks at in determining whether there has been a sufficient "holding out" for common carrier status include the number of shippers on the vessel, whether the carrier's vessels sail regular routes on a scheduled basis, whether bills of lading or other documentation is issued, whether the carrier

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advertises its services, the type of cargo and the method of charging rates. As you can see, it's a complicated project to determine who is eligible to enter into a service contract on the carrier side.

It is only slightly less complicated on the shipper side of the equation. Congress has helpfully provided a definition of "shipper" in the Shipping Act. This definition includes a number of pretty clear concepts. For example, a "cargo owner" is a shipper. Although it would be possible to debate who actually owns cargo at any given time in a world where some types of cargo are bought and sold more than once during an ocean voyage and buyers and sellers enter into purchase agreements containing a variety of trading terms (e.g. "FOB", "DDU", etc.) which define the responsibilities of the parties for risk of loss or damages to the goods, in practice, this issue has risen very infrequently at the FMC. The definition of shipper also includes "the person to whom delivery is to be made." This has generally always meant the consignee on the vessel operator's bill of lading.

Two other entities defined as "shippers" are shippers' associations and non-vessel-operating common carriers ("NVOCC"), which are usually clear. The FMC has wrestled, however, on several occasions with defining what an NVOCC is. It has determined that a company operating as an unlicensed NVOCC still qualifies as a NVOCC for Shipping Act and service contract purposes. It has also addressed the question of whether an NVOCC qualifies for service contracts in a situation where a number of separate companies created a corporation that qualified as a NVOCC. The NVOCC corporation, however, had no assets and no independent life of its own. All of the substantive activity regarding the NVOCC's operations was carried out by the shareholding companies. The FMC found that this NVOCC was a "sham" that could not enter into service contracts.

The final entity defined as a "shipper" in the Shipping Act has caused problems in the service contract arena. This entity is the "person for whose account the ocean transportation for cargo is provided." Apparently, Congress meant to designate some type of persons who did not fall within the other categories of the shipper definition. Therefore, a person for whose account the transportation is provided might, on some occasions, be neither the shipper nor the consignee. The use of the phrase "for whose account" suggests that the term refers to the person with the legal duty to pay the

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transportation charges. Thus, the term could conceivably mean the “bill to” party that sometimes shows up on carrier’s bills of lading or invoices. The FMC has also suggested that ocean freight forwarders might fit within this category in certain circumstances. Normally, ocean freight forwarders would not be regarded as “shippers” because they act as agents for shippers. On certain occasions, however, freight forwarders assert that they are delegated complete responsibility for making all of the transportation decisions on behalf their customers, and, in addition, directly pay the carrier for the transportation. In such cases, ocean freight forwarders contend, they should qualify as persons for whose account the ocean transportation is provided. The FMC has not rejected this contention but has not accepted it either. The FMC’s position is that, while theoretically an ocean freight forwarder may qualify as a shipper for a given service contract, these decisions must be made on a case-by-case basis. Thus far, there have not been any publically reported cases involving this issue so the ocean freight forwarder’s right to be a “shipper” for service contract purposes is still left unresolved.

Thus, as you can see, questions about who is eligible to enter into a service contract are not necessarily clear or easy under the Shipping Act of 1984. This is one of the prices we pay for having a regulated ocean shipping industry. The ultimate justification for regulating any industry is to protect the public. Does restricting the “freedom to contract” in the ocean shipping industry serve the public’s interests? This is an old and contentious debate, the ultimate resolution of which must be made by the United States Congress. But the discussion of the pros and cons of this debate must wait, at least for purposes of this newsletter, for another day.

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