



CARRIER SUES CUSTOMERS FOR LIQUIDATED DAMAGES FOR FAILURE TO MEET MINIMUM VOLUME COMMITMENT

Legal Corner

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The Containership Company (“TCC”), a small trans-pacific carrier that ceased operations last April, has sued multiple former customers for liquidated damages arising from their alleged failures to meet their minimum volume commitments in service contracts with TCC. These suits are a reminder to all shippers of the potential perils of failing to meet minimum volume commitments. It also highlights the need to give consideration to negotiating the liquidated damages provisions in service contracts.

There was a time, back in the early 1990s, when suits by carriers to collect liquidated damages for the shippers’ failure to meet minimum volume commitments was fairly common. The old trans-pacific conference, ANERA, in fact, frequently took defaulting shippers to arbitration in Hong Kong to collect liquidated damages. Several of these disputes led to litigation at the Federal Maritime Commission, which issued a series of decisions largely supporting the carriers. In recent times, however, such litigation has become rare. Most carriers will routinely amend their service contracts to accommodate shippers who have failed to meet their minimum volume commitments, calculating that it is better to maintain good commercial relationships with their customers rather than suing them. With that in mind, does TCC’s recent action constitute an anomaly or a new trend where failed - - or failing - - steamship lines that no longer care about maintaining relationships with their customers use their service contract boilerplate to make a grab for a final payday before disappearing?

TCC is - - or was - - a small Danish carrier that started operations in early 2010. TCC’s business plan was to employ medium-sized containerships in a “no-frills” service that was strictly port-to-port. At its beginning, the TCC operations were a simple shuttle service between Los Angeles and the Port of Taicang in China, close to Shanghai. Later, TCC added the Chinese Ports of Ningbo and Qingdao to its rotations. The service was clearly geared towards NVOCC customers, who signed the

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majority of TCC's service contracts. The operations apparently prospered during the first months of service and TCC added larger vessels to the service. As time went on, however, TCC's prospects faded. TCC itself reported that its cargo volumes to the United States were less than expected "due to increased competition in the trans pacific trade and an insignificant peak season" in 2010. TCC also blamed new entrants into the market who reduced prices, as well as greater than expected equipment acquisition and positioning costs, apparently for containers. On April 8, 2011, TCC abruptly terminated its services, leaving some customers scrambling to arrange for on-carriage of their containers that had been stuck on the TCC vessels.

This may have been the end of TCC's operations, but it was not the end of TCC. Within ten days of terminating its service, TCC sent letters to its former customers demanding payment of liquidated damages for failure to ship the minimum volumes under their service contracts. Based on news reports at the time, it appears that TCC made these demands on 83 of its former customers seeking a total recovery of \$23 million. Considering that TCC reported a net loss before taxes for 2010 of \$7.4 million, it seems apparent that the collection of dead freight penalties from its former customers struck TCC as a better business to be in than ocean shipping. TCC has reported that a few of its former customers have reached settlements by paying all or a portion of the liquidated damages claimed. Many of TCC's former customers, however, have decided to contest TCC's claims.

The legal fight between TCC and its former customers is currently taking place in the Bankruptcy Court for the Southern District of New York. When it ceased operations, TCC filed for bankruptcy in Denmark, its home country. It then filed in the Bankruptcy Court for the Southern District of New York seeking the protections of the U.S. bankruptcy laws pursuant to a procedure whereby foreign companies in bankruptcy can come to the United States to deal with U.S. issues. When TCC's petition to have its bankruptcy recognized in the United States was granted, a group of its former customers filed a motion with the Bankruptcy Court asking it to lift the automatic stay to permit these companies to sue TCC at the Federal Maritime Commission based on their claims that TCC's actions constitute violations of the Shipping Act of 1984.¹ TCC has opposed this motion and the parties are currently awaiting a decision from the bankruptcy judge.

¹ Whenever a bankruptcy occurs in the United States, the law provides for an automatic stay of all proceedings in other fora, including other courts and administrative agencies. The purpose of the automatic stay is to centralize all legal activity concerning a
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TCC is relying on the clause in its service contracts in which the shipper committed to paying liquidated damages of \$250 per TEU for failing to meet the minimum volume requirement. TCC's commitment in these service contracts to its customers, however, was significantly different. The typical contract provided as follows:

In the event that Carrier is unable to offer space on a particular vessel and Shipper has given sufficient notice as specified in Term 5 of this contract, the minimum quantity will be reduced by the quantity of cargo tendered but not carried on Carrier's vessel. . . .The reduction in the minimum quantity commitment herein shall be the Shipper's exclusive remedy for Carrier's failure to provide space or to comply with Terms 1 and 2 [of this Contract].

Upon analysis of this provision, it is clear that TCC made absolutely no commitments in its service contracts. Thus, if TCC decided not to carry a shipper's cargo (because the vessel was full or it had higher paying cargo) the only thing that would happen is that the shipper's minimum quantity commitment is reduced. Clearly, this is not a good thing for the Shipper, who contracted to have its cargo carried, not rolled. Moreover, this is not a penalty or a detriment to TCC because it obviously would have had other profitable things to do with the space. As a result, TCC's former customers have complained that the service contracts were "illusory," which means that one of the parties - - in this case, TCC - - assumed no real obligations to the other party. In addition, the former customers will be arguing that various of TCC's actions during the term of the contracts constitute violations of the Shipping Act.²

It will likely take several years for the litigation between TCC and its former customers to play out. In the meantime, are there any lessons from this situation for other shippers? One potential lesson is to carefully review the service commitment and liquidated damages provisions in your service contracts. If a carrier is not providing a real service commitment or refusing to assume a liquidated damages liability for its own service failures, you might wish to negotiate the language of this section of the contract. Or, if you wish, the liquidated damages section can be deleted in its entirety. This is because a liquidated damages provision is not required in a service contract; it is merely optional. This is made clear in the Shipping Act, which states that: "Each service contract shall include. . .the liquidated damages for nonperformance, if any." This final phrase, "if any," means

given bankruptcy in a single court. Thus, parties seeking to litigate issues in another forum must ask the bankruptcy court to lift the automatic stay to permit them to do so.

² Our firm represents some of the former customers of TCC in these actions.

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that the parties may decide to eliminate any provision calling for liquidated damages. If the liquidated damages provision is eliminated, the service contract will be similar to most other commercial contracts. That is, when there is a breach of the contract by the shipper or the carrier, the other party will have to sue the breaching party for damages arising from the breach. This means that, if a shipper fails to ship the minimum volume requirement in the service contract and there is no liquidated damages provision, the carrier will have to sue the shipper and will have the burden of proof to show what its actual damages were as a result of the shipper's failure. Depending upon the economic factors existing at the time, it may be that a carrier's losses as a result of not carrying the customer's cargo are far less than the typical liquidated damages provision provides.

The second lesson is to make sure you keep track of the progress you are making on your service contract minimum quantity commitments. As economic times get rougher, carriers may not be as willing to amend their MQCs down at the end of the contract term. Therefore, if you have not fulfilled the minimum volume commitment or made plans in advance to deal with that possibility, you could be in for a rude surprise when the contract term ends.

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