GSF Secretariat Policy Briefing

The Costs of the Suez Canal Closure

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The Closure Incident
On 26 March, the 22,000 TEU capacity, Evergreen-operated vessel *Ever Given* went aground in the Suez Canal, blocking it to navigation by other vessels and effectively halting trade through one of the busiest shipping lanes in the world.

The vessel was re-floated on 29 March and towed to the Great Bitter Lake where it has been detained by the Suez Canal Authority pending settlement of a claim for losses made on the vessel's owner for $916 million. General Average was declared on *Ever Given's* cargo by the vessel owner on 1 April.

Meanwhile, the 400 or so vessels that were queuing to enter the Canal have now transited and traffic flows have returned to normal. The resulting surge of delayed and diverted vessels can be expected to reach their destination ports later in April and are likely to create added pressure on already congested facilities. Shipping lines have warned that port calls will be amended at short notice to minimize disruption and speed turnaround times. They also warned the six-day closure meant vessels are out of position and have disrupted the return of empty containers to the exporting countries. Some lines have already predicted that these factors will result in higher spot rates and additional surcharges.

The Costs of Closure to International Trade
There have been several estimates made of the costs of the disruption to international trade. These have focussed on the total amount of goods stranded at sea or diverted. GSF believes these values represent an estimate of the 'Value of Trade at Risk' during the closure, rather than the actual incurred costs. Significantly, no vessels or cargo were actually lost during the incident (although *Ever Given* and her cargoes remain confiscated by Egyptian authorities), and for reasons set out below much of the cargo would have already been 'sold' and probably paid for. So whilst the <u>potential</u> damage is indeed a big number the <u>actual</u> costs to international trade should only be the sum of the individual costs and receipts incurred by the parties directly involved, most of which will (or should) be internalised within the shipping industry.

The GSF Secretariat's view is that these are a one-off costs that the market should absorb. Canal transits are already back to normal and although there will be a period while vessels and equipment are out of position, these should not be a basis for an enduring increase in costs or rates, at least not in a normal competitive market. Moreover, any increases should not be signalled in advance by the shipping lines that would benefit from them. GSF has prepared the following analysis of the different parties involved or affected by the incident:

- **Shippers**
  First, distinguish between the costs incurred by the importer of the goods on board affected vessels and those incurred by the exporter of those goods. Which party is affected will depend on the terms of sale (i.e. the Incoterm). Most of the containerised cargoes on northbound vessels at Suez will be consumer goods sold on FOB or FCA terms by Far East and ISC manufacturers to European and North American importers (most likely retailers). This means the goods will have been 'delivered' at the port of loading, at which point the invoice for sale or Letter of Credit becomes payable to the exporter. So, the actual sale for these transactions is intact even though the goods are still at sea, and there will be no loss to 'world trade', as such. The transaction should register in national trade statistics for that period

  Under FCA and FOB terms, the costs of delay and of subsequent recovery of affected containers will fall to the importer. At a trading level, there may be lost sales opportunities because of stock shortages but most consumers will buy substitutes anyway or defer the spending. There may be additional logistics costs of collecting a container from a different port than expected. (e.g. Rotterdam instead of Felixstowe) and the shipping line may have to absorb the costs of relocating containers to the destination stated on the Bill of Lading. Some may attempt to demand a surcharge from the importer to recover this cost.

Owners of cargo on board the *Ever Given* face the costs of meeting the General Average levy that has been declared (unless they have taken out cargo insurance).

Goods sold on 'Delivered' terms or under CIF (some commodities and raw materials for example) will impact on the exporter if delayed, but only in so far as they were at sea for longer than expected and invoices or Letters of Credit could not be settled until arrival at the port of unloading or inland destination (CIF, DPU, DDP). So, again, the effect will be a cash-flow impact rather than an actual loss of revenue. The General Average levy on *Ever Given* cargoes will fall on exporters under these terms.

Shipping lines invariably try to recover their on-costs (port congestion, diversion, etc.) through surcharges levied on the party contracting for carriage, as shown on the Bill of Lading. This will be the importer on FOB/FCA and Exporter under CIF and 'Delivered' terms. At several hundred dollars per TEU these costs will be real and significant cash transfers. They apply to all cargoes over a period so may last for several weeks and beyond the duration of the responsible event. Many European and North American importers will offset these against contract commitments or negotiate them away. Lines may then seek recovery from exporting countries by imposing the surcharge through local agents, even though there is no commercial relationship with the exporter. This practice is currently widespread in West African states.

Surcharges are not trivial costs on international trade, as governments have started to realise: it is now a legal requirement that shipping lines and forwarders quote only all-inclusive shipping rates to Sri Lankan exporters, and similar legislation is now before the Indian legislature. Last month, Peru passed regulations mandating that all shipping charges must be shown on the Bill of Lading, which then makes them payable by the exporter and not the Peruvian importer (who mostly buy on CIF terms). GSF is supporting several African shipper associations in managing excessive surcharging in their ports. Surcharges remain a serious burden on trade for emerging and developing economies, normally levied in US Dollars with release or collection of cargo conditional on their payment.

- ***Ever Given* Owner**
  Costs include salvage and re-floating & repair of the vessel and claims for consequential loss from SCA. These will be settled through arbitration and paid by either insurers, or the sale of a sea- worthy 22,000TEU, 3-year old container vessel. This may bankrupt the company. In any event these will become a cost to the shareholders (through lost dividends or liquidation). However, there may be a contribution coming from shippers and insurers obtained by the declaration of General Average on the *Ever Given* cargoes. The legality of this is likely to be challenged as the 'losses' to be averaged across all cargo owners will presumably include the compensation deal struck with the SCA. When 'averaged' this could exceed the value of many of the cargoes, in which case they will be abandoned and forfeited to the vessel owner.

- **Suez Canal Authority**
  Costs include reinstatement of the Canal embankment and losses of revenue from diverted traffic. But all delayed traffic will still pay their transit fees, just a few days later than was expected. So, this should be a cash-flow effect not a permanent accounting loss and will be shown as the enduring accounting effect and shown as lower receipts for the current period. The costs of reinstatement are likely to recovered (at least partially) through claims against the vessel owner, secured against release of the vessel from the Canal.

- **Owners/operators of delayed vessels**
  It is questionable whether the costs of delay are significant. The value of the traded goods is intact, as most cargoes will have been paid for or will be once delivered. The costs incurred by owners of queuing vessels are crew, charter and port re-scheduling costs less the fuel not burned whilst at anchor. But these are fixed overheads so would be paid for anyway. The accounting effect will be the number of lost

revenue-earning days for each vessel in the queue (i.e. it picked up its next load later than expected and so these earning-days are displaced from the current financial period to the next one). But then many services have been running several days late recently anyway and in overall the Suez delay costs are just 'noise' in the continuing Covid disruption. Some shipping lines stopped accepting short-term spot bookings for about seven days, which could back-up some shipments, some of which may be lost altogether (so a missed trade opportunity) but most will likely just be moved forward to later in the Q2 reporting period.

- **Diverted vessels**
  The costs of diversion will include additional fuel burn plus crew time (accounted for as 5-10 lost revenue-earning days to offset the fixed overhead). The time cost depends on where the vessel was when diverted. There will be port rescheduling costs but also a saving in SCA fees not incurred. A good proxy for the diversion costs (to the vessel operator) will be the SCA fee tariff itself, which is presumably fixed at a level that makes Canal transit a slightly less costly option than a diversion via CoGH. But these costs should be disregarded from world trade effects as the diversion decision was an expedient made at vessel owners' risk. There may be attempts to recover these costs through surcharges, but these would be levied more in hope than real expectation of recovery.

- **Insurers**
  Insurance underwriters will probably be the biggest losers, encountering claims for re-floating of the vessel and damage to the Canal (hull insurers) and claims for detained cargo arising from General Average (cargo insurers). Goods in Transit policies do not normally cover costs due to delays. These costs will ultimately be recovered by slightly higher premiums being quoted but will not be significant given the overall market's size and competitiveness.

- **Lawyers**
  The legal profession will almost certainly be the biggest winners from this incident, because no one will concede any of the above costs until they have to. The costs to litigants will be accounted for as internal company overheads (Professional Fees) and although invisible and internal to the sector could, in total, be comparable to some of the other costs mentioned above.

GSF does not have the means of estimating or calculating these costs, and most of them will be commercially confidential to the companies involved so are unlikely to be disclosed. However, the following assessment of the net position is offered:

- Transfers of funds from insurers to the vessel owner and on to the Canal Authority to cover the direct costs of the incident and closure (booked as a loss to the insurance underwriters, with the balance shown as an extraordinary cost to the shipowner, which may or may result in insolvency).
- In the event of liquidation of the vessel owner, a loss to its shareholders and creditors (booked as losses to the individuals or institutions affected).
- Litigation fees paid to lawyers and courts of arbitration, internalised to the parties directly involved.
- a rise in Canal transit fees to cover costs of proposed additional tug provision and possibly escorting of the biggest vessels to reduce the risk of repeat incidents (passed on by shipping lines in higher rates)
- one-off adjustment costs to shipping lines in recovering from the disruptive effects of closure (partially recovered as surcharges on shippers or booked as lower than expected revenue for the period)
- possibly higher shipping rates generally due to yet further tightening of capacity attributed to displaced vessels and equipment shortages.

So, the costs should be largely internalised to the shipping industry, which seems appropriate as it is a mess of its own making. The external effects on the wider market may emerge as some short-term surcharges and possibly higher spot rates. If these higher rates are sustained then their aggregate effect on future shipments will be the real visible cost to world trade arising from the closure of the Suez Canal.

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