BUILD IT, BUT WILL THEY COME?

Port Development as a Harbinger of Growth in Shipping and the Gamble Ports are Making

By Alfred J. Kuffler[1], Montgomery McCracken Walker & Rhoads

For a very long time, now, the news unrelentingly reports financial disasters – plunging freight rates, collapsing vessel values, failing companies, laid up vessels by the hundreds, and the demise of numerous shipping ventures.

But, though cold comfort to those who have seen the recent economic cycle destroy their fortunes, for the longer term, port development projects already under way and those in the planning stage are based on forecasts of increased trade and therefore substantial growth in ocean transportation.

At least in the United States, a sure sign of long-term growth may be found in port development projects concentrating on container traffic. This segment of the industry accounts for about one third of the waterborne export and imports in the US Deutsche Bank's RREEF division produced a study in April 2009 cataloguing major port expansion projects in Hampton Roads, Virginia, Savannah, Georgia, Miami, Florida, New Orleans, Houston, Oakland, Tacoma, and Seattle as well as Prince Rupert and Vancouver, British Columbia. The same paper reported industry projections that U.S. west coast container shipments would triple in twenty years. Likewise, the Port of New York and New Jersey is projecting a doubling of container volume by 2020. The writer can add that the Delaware River is witnessing similar development under the aegis of the Philadelphia Regional Port Authority which is overseeing $600 million of development on the Philadelphia side of the river while New Jersey is developing a facility from scratch in Paulsboro.

The US Department of Transportation's January 2011 study "America's Container Ports: Linking Markets at Home and Abroad"[2] recognized that container traffic is recovering from the lows of 2008, that between 1995 and 2009 the number of loaded TEUs moving through US ports went from 13 million to 25 million and concluded that "if the current rebound follows the pattern experienced after 2001, long term growth is likely to resume after the US and global economics recover" (RITA, p. 15).

However, the prospect of growing demand for vessels should not end inquiry into the impact port development will have on the industry. More and larger ships carrying greater quantities of cargo, augmented with expanded terminals to handle the growing movement of the boxes, tells only a part of the story. Effective, competitive, and efficient transportation requires dredging to deepen the channels so they will accommodate the larger vessels coming on line, as well as improvement and expansion of intermodal transport including highways, rail, and perhaps domestic water transport. Remediation of obsolete local infrastructure also poses issues. All these separate but related infrastructure projects require financing and coordinated completion within reasonable time frames.

Both the RREEF and RITA studies state that funding for port development today is likely to come from a mix of public and private financing. This mix in and of itself poses considerable difficulties. Public funding must inevitably negotiate the political process in order to reach fruition. Whether the proposed investments are attractive enough to generate private sector commitments remains to be seen, notwithstanding pre 2008 investments in terminals by Macquarie Infrastructure Partners, AIG, RREEF, Goldman Sachs, the Ontario Teachers Pension Plan, and Morgan Stanley (RREEF p. 37). Then there is the impact that development of dedicated terminals by the individual container shipping lines may have.

The scope, and hence by implication importance, of the public effort at least at the federal level may be found in the Summer 2011 issue of "Seaports Magazine." This publication of the American Association of Port Authorities' reports introduction of bills in Congress such as: (1) S.936, The American Infrastructure Investment Fund Act of 2011, a $5 billion fund to support transportation infrastructure; (2) S.942, The Transportation Infrastructure Grants and Economic Reinvestment Act which would likewise provide funding for transportation projects; (3) S.652, The Building and Upgrading Infrastructure for Long Term Development Act, more commonly known as the act to establish an infrastructure bank. In the current political climate, though, where austerity is king, it remains to be seen whether any of this legislation, or for that matter state legislation, can be enacted and the programs publicly funded.

Also, from the investment standpoint, public funding will take into account not only return on investment, but also the ability of any given project to produce jobs and tax revenues. This latter consideration may affect investor interest.

Local conditions, such as increasing the clearance under the Bayonne Bridge in the Port of New York and New Jersey, reportedly requiring up to $2 billion for this single effort, must also be considered in appraising the timing and likely success of any venture (RREEF p. 29).

Timing impacts success in other related areas as well. Dredging projects are underway in the Delaware River, New York, and Savannah, while Miami includes channel widening and deepening in its plans (RREEF pp. 26-29). But, funding for dredging in the United States is subject to the vagaries of the Congress and its willingness to appropriate the necessary monies.

New and larger ships will be delivered; the widened Panama Canal will open in barely three years, but infrastructure development in the United States can be subject to considerable delay. Indeed, it takes an average of ten years to bring new marine terminals alone from the conceptual stage to being operational. (RITA, p.31)

The growth in shipping will require not only more port facilities, but facilities which can accommodate the newer and much larger vessels because the average size of container ships is escalating. The EMMA MAERSK class of vessels which are in the range of 13,000 TEUs are already trading; Mediterranean Shipping Company announced in November 2011 an order for six vessels reportedly in the 16,000 TEU range while Maersk is building monster 18,000 TEU vessels. (TradeWinds, 18 November 2011). Ports will be under great pressure to provide facilities capable of servicing these behemoths. We need only recall the pressure the Port of New York and New Jersey came under to provide a terminal suitable for the EMMA MAERSK herself when that vessel began trading. Whether a number of ports will undertake the necessary investment given the prospect for interport competition subject to the Darwinian selection process aided and abetted by the possibility of "gateways" or spoke and hub patterns (RITA, pp. 12,18; RREEF, p.25) with the economic consequences to be visited those falling by the evolutionary wayside and their investors also remains to be seen.

As to interport competition,, RREEF reports that both Mexican ports and Vancouver, Canada are investing heavily in part at least to position themselves as alternatives to US west coast ports. Likewise, the sheer number of development projects on the US East Coast suggests continuing competition among North Atlantic ports although some of the development seems to represent positioning for all water routes from Asia as the Panama Canal widening approaches completion. This, of course, would come at the expense of the West Coast ports. (RREEF, p.25)[3]

In summary, then, new and bigger ships are being delivered; the Panama Canal widening will be completed in two years. But the supporting port development projects are in various stages of planning and construction; necessary dredging projects are subject at least to the questionable availability of funding; funding itself for both the projects and needs peculiar to the locale may be uncertain. There is also concern that even as the business expands, ports will compete for a share of the pie, and some may fail in the effort. It seems that the overall effect of these competitive possibilities and disconnects in timing must be appraised in the context of investment opportunity.

CONCLUSION

While the lawyer's role does not include analysis of investment opportunities or risks, the knowledge of liens, restructurings, and bankruptcies garnered during past downturns in the shipping cycle and the consequent need to plan within the context of the law business forces some reflection on the "bigger picture," its effect on the broader industry, and the opportunities for growth within the profession.

While presumably port developers have proceeded on the basis of feasibility studies, economic models and business plans, the reality for investors is that, even assuming the projected increases in trade materialize, still, the impact of larger vessels, the widened Panama Canal, intermodal bottlenecks and disruptions, disconnects between completion of infrastructure projects and the coming on line of the ships and the possibility of changing trading patterns all combine to raise serious questions.

Thus, the question – If they build it, will they come? And, even if they do, will there be a profit at the end of the day, and for whom?

[1] *Partner and Chair of the Maritime and Transportation Group, Montgomery McCracken Walker & Rhoads, LLP. Philadelphia and New York*

[2] *U.S. Dept. of Transportation, Research and Innovative Technology Administration, Bureau of Transportation Statistics, Wash. D.C. 2011 ("RITA")*

[3] *We are perhaps already witnessing the bypassing of the West Coast ports. Using the volume of loaded inbound containers coming into Los Angeles-Long Beach with holiday goods, The Wall Street Journal on October 13, 2011 forecast a gloomy Christmas retail season. But the post Thanksgiving sales on "Black Friday" and "Cyber Monday" which mark the beginning of the holiday retail season reached record heights, thus belying the foregoing forecasts. Moreover, increased container volumes during the relevant pre-shopping period in Charleston, the Virginia ports, New Orleans, and Savannah (based on ports for which statistics were obtained) can be read to suggest that holiday shopping volumes would not disappoint. Retailers, though, were never as gloomy as the West Coast port representatives. See New York Times," A Contradiction in the Cargo" October 12, 2011.*