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## U.S. Authorities Weigh in on Emerging Derivatives Model for Global Transport Sector

On October 13, the FMC issued a proposed rule that would clarify and ease Agency regulation of service contracts and NVOCC service arrangements ("NSA"). Under the current regime, the terms of such contracts or NSAs either must be explicitly stated or must be "contained in a publication widely available to the public and well known within the industry."<sup>1</sup>

The proposed rule reflects a developing derivatives model for the international liner shipping industry. While derivatives have been used for many business sectors, including the purchase of bunker fuels by carriers, utilization of this financial instrument specifically for the containerized cargo industry is still in a nascent state. The FMC's action with respect to the proposed rule demonstrates the agency's interest in the use of derivatives and indices related to the purchase of cargo space by shippers (including NVO's) from carriers.

This "certainty of terms" standard has caused concern among carriers and shippers that have entered into contracts that link to subscriber-only freight rate indices that reflect changes in market conditions, such as the Transpacific Stabilization Agreement ("TSA") and the Shanghai Containerized Freight Index ("SCFI"). The most common reason for structuring a service contract this way is for carriers and shippers to embed market-based flexibility of pricing into a long-term contract.

Recognizing the importance of promoting innovation and flexibility in commercial arrangements, the FMC has proposed changing the rule to facilitate references to indices in service contracts while maintaining fidelity to the requirements of the Ocean Shipping Reform Act of 1998 ("Shipping Act").<sup>2</sup> Specifically, the FMC is proposing to replace the requirement that contractually-linked freight indices be "widely available to the public" with a requirement only that the indices that are referenced be filed with the Commission. The proposed change reads as follows:

- **CURRENT REGULATION:** Certainty of terms. The terms described in paragraph (b) of this section may not... [m]ake reference to terms not explicitly contained in the service contract itself *unless those terms are contained in a publication widely available to the public and well known within the industry* (emphasis added).<sup>3</sup>
- **PROPOSED LANGUAGE:** Certainty of terms. The terms described in paragraph (b) of this section may not... [m]ake reference to terms not explicitly contained in the service contract itself *unless those terms are readily available to the parties and the Commission*.<sup>4</sup>

The proposed rule has a comment period of forty (40) days (expiring November 28, 2011). During the comment period, the FMC noted its interest in receiving comment on two particular areas:

- Possible methods by which contracting parties could ensure that the information referred to in service contracts is readily available to the Commission
- Ways to reduce any impediments to small shippers having the option of index-linked service contracts

Venable is able to assist shippers, NVOCCs, shippers' associations, and vessel-operating common carriers in responding to and further understanding the implications of the FMC NSA proposed rule.

Interested parties are encouraged to consider drafting and submitting comments with respect to the proposed rule, as well as closely monitoring the FMC's further consideration and possible finalization of the new rule. This action is likely to take place over the next several months.

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1. 46 CFR 530.8(c)(2), 46 CFR 531.6(c)(2).

2. In its proposed rule, the FMC discusses the dual statutory requirements that a service contract must be a "written contract," and that it must be "filed with the Commission." See 76 FR 63581, available at <http://federalregister.gov/a/2011-26418>.
3. 46 CFR 530.8(c)(2).
4. The proposed change regarding NSAs is the same as for service contracts.

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