

## Rachel Dickon

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**From:** David Briggs [DBriggs@scoular.com]  
**Sent:** Wednesday, November 30, 2011 5:40 PM  
**To:** Secretary  
**Cc:** Lowry A. Crook; JMailhiot@scoular.com  
**Subject:** Index linked contracts.  
**Attachments:** SKMBT\_C28011113016380.pdf

Dear Karen,

Attached is a PDF of our comments regarding index linked ocean freight contracts.

Please feel free to contact me if you have questions.

Thank you

Dave Briggs  
TSC Container Freight  
[dbriggs@tsccontainerfreight.com](mailto:dbriggs@tsccontainerfreight.com)  
630-493-1401 tel  
630-493-1402 fax

**# 1. Referencing an index would be in writing committing to a rate that is based on published index values that would cover the time frame of the contract.**

**# 2. Using an index that is publically available is necessary. Currently the SCFI is published on their website. Historical data is available for purchase. This is standard in most markets (fertilizers, coal, ore, steel, etc). There is no reason that a third party can purchase that data and distribute it as they see fit.**

**# 3. Index linked contracts will provide more contracting options for shippers large and small. Shippers can continue to operate as they do today (on a spot basis) or they can fix rates by buying physical freight based on an index and hedging in the paper market, or they can use an NVOCC to provide that service.**

We are proponents of indexing rates. Indexing rates has even more value if there are hedging instruments settled against it, and the index is accessible by the public and that the inputs to the index are known (i.e. panel members are known and the methodology of the index calculation is clear). This provides for a more exact hedge as our physical rate would move in lock step with hedging mechanism. It is our understanding that most of the current indexed contracts have floors and ceilings, but the rate can change within those parameters. In this case the rate is still not fixed and the only certainty is that the rate has some downside and upside limit.

One area we would like to consider is pricing freight on backward looking basis, as this is how the existing hedging instruments would work. The swap contract settles at the end of every month and settlement value is determined by the average of the posted index values over the course of the contract month. At the beginning of every month you will not know what the physical rates will be, as the index values have yet to be published, but the rate is fixed through the hedging instrument. In this way the contract and hedge should have less "slip" (meaning divergence between the physical and paper contracts).

One could argue that the container market is primarily a spot market as most contracts allow for rates to change due to market conditions (both on the import and export side). Due to this uncertainty in forward rates MQC's are typically not enforced (If you don't what rate level you will receive, how can you reasonably be expected to commit volumes). Many other markets experience this same uncertainty on the physical side of the business (oil, grain, dry bulk vessel freight, etc). The tried and tested tool for managing this risk is a hedge based on some index, or price barometer, that tracks the physical market (the SCFI is a great example of this). Through the hedging mechanism is where the market will "fix" rates. Indexing rates should drive liquidity in the swap market as more participants seek to managing risk using the vehicles available in the paper markets.

The ability to manage forward price risk is the biggest challenge in the containerized ocean freight markets today (the export market should be much quicker to adopt a mechanism like this as many shippers already hedge their cargo exposure and freight rates represent a much larger portion of the delivered value of their goods so smaller price moves have a much larger impact on the delivered values). Indexing coupled with a hedge should make for a more efficient pricing mechanism in the containerized ocean freight market, and allow for better risk management practices.