WFW Competition and Regulatory Group

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Scheme 810 in outline

This outline provides a skeleton description of WFW's *Scheme 810*. It is sub-divided as follows:

- *Scheme 810*'s structure and operation as a full function joint venture ("FFJV") (**Section A**);
- the legal rationale underlying a switch from traditional pools to FFJVs (**Section B**);
- a description of some of the specific requirements for the creation of a legitimate FFJV (**Section C**); and
- the pros and cons of *Scheme 810* (**Section D**).

Maritime transport services are currently characterised by extensive co-operation between competing carriers. The repeal of Council Regulation 4056/86/EEC containing the liner conference block exemption and the tramp shipping exclusion, means carriers operating services to and/or from ports in the European Union must now cease all co-operative activity that is contrary to Article 81 of the EC Treaty. All pooling agreements between competing carriers must now be assessed for their compliance with competition rules, and, most likely, be restructured to some degree to ensure their legality given the changed regulatory climate.

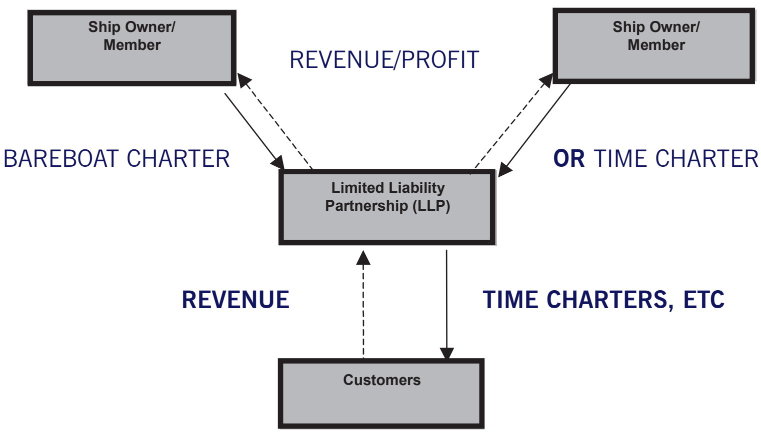
Scheme 810 is WFW's fully tested "maritime transport" version of a FFJV which provides 100% compliance with European competition rules whilst allowing most of the benefits of standard pool arrangements. In order to provide flexibility and fiscal efficiency, the FFJV is structured around a Limited Liability Partnership ("LLP") or equivalent.

The outline description set out below is for information purposes only. For further information please do not hesitate to contact either Stephen Tupper or Andy Bailey of WFW's Competition and Regulatory Group.

A - Structure and operation

Competing shipping entities looking to enter into arrangements that would allow them jointly to fix rates and other conditions of carriage can do so in compliance with the EU's new regulatory regime by entering into a FFJV structured around an LLP.

A.1 - Structure



The above diagram portrays the basic structure. Several variations around the basic theme are possible. These can take account of the parties' preference concerning geographical location, income streams, taxation issues, etc.

A.2 - Operation

Each partner/member contributes the use of its owned/controlled vessels to the LLP for an agreed minimum period of time. This can be via a time or bareboat charter of the vessels into the LLP. Vessels may even be sold to the LLP (although this may entail a tax consequence). The vessels are then managed by the LLP, which is responsible for all day-to-day operations including chartering, commercial operations and procurement (i.e., a role similar to that of "pool manager"). The LLP receives revenue for the vessels' operation from customers and this revenue is in turn distributed among the LLP partners in the manner agreed to in the LLP agreement. The method of profit distribution is flexible and could be done via the charter arrangement payments, the partnership distributions, etc. Technical management of the vessels can be left to the vessel owners/operators if necessary.

The basis of the *Scheme 810* structure relies on the LLP being a single, independent and long-lasting economic entity. LLP partners must enter into a legitimate FFJV or risk losing the immunity benefits. The basic requirements to ensure a legitimate FFJV are set out in **Section C**.

B - Legal rationale

- Restructuring a co-operative pool agreement into a FFJV provides carriers with an absolute defence to European competition rules, and partners/members will obtain full immunity from regulatory intervention.

- A FFJV involves a concentration of competitors (which is legitimate) rather than co-operation by competitors (like a pool agreement) which now has questionable legality.

- Note that if entry into a FFJV by a number of carriers exceeds certain regulatory thresholds (usually relating to annual turnover by participating party) the establishment of the FFJV may require notification to competition regulators. Assessment of the FFJV pursuant to a notification will involve an analysis of the market and the position of the parties in it but this is done on a non-adversarial and a comparatively non-intrusive basis.

- Once a FFJV is approved, or cleared, by competition regulators it is effectively certified and as long as it continues to function in the same way, it can operate freely with no regulatory risk going forward.

In addition to these factors *Scheme 810* retains many of the basic features and flexibilities, both legal and commercial, associated with traditional pools (see below).

C - Requirements for a full function joint venture

The following is required to satisfy the definitional criteria for a FFJV:

C.1 - Joint control

Each LLP partner must have the ability to exercise decisive influence over the joint venture. This includes **equality of voting rights**. This means that all participants must have veto rights over some key strategic decisions, such as:

- budget;

- business plan (or any deviation from the budget or business plan);

- major investments;

- appointment of senior management; and

- market specific decisions (such as launching of new products or services).

Arrangements can be put in place to deal with any voting impasses that may occur.

C.2 - Structural change

The LLP must bring about a lasting change to the structure of the market. To do so it will need some or all of the following:

- verifiable independence from its parent companies (i.e. a distinct legal entity);

- separate senior management dedicated to its day-to-day operations (which can be seconded from the LLP parent companies);

- separate business premises and IT network;

- ability to enter into its own contracts with unrelated third parties;

- access to sufficient resources to conduct its business on a lasting basis (finance, staff, assets, licenses, and premises);

- its own separate marketing and sales activities; and

- the LLP must file its own accounts.

C.3 - Permanency

The LLP must be capable of existing on a lasting basis. If the LLP has a short, finite duration, it will not be considered to operate on a lasting basis. To satisfy permanence, the LLP must have the necessary resources to function as an autonomous economic entity (see above). When entering into the LLP agreement, **a safe initial term is, optimally, no less than three years.** The longer the term, the more defensible the arrangement.

C.4 - Withdrawal and new entry

Agreements establishing the LLP may provide for withdrawal of one or more partners, or the early dissolution, on a "catastrophe" basis, of the joint venture. Provisions such as these will not adversely affect the quality of permanency. Flexibility can be drafted into the agreement creating the LLP. A vessel, however, must be withdrawn subject to the rights of the LLP. For instance, should a LLP partner wish to sell a particular vessel, the vessel will either need to be replaced with a suitable substitute, or sold subject to the rights of the LLP for the remaining duration of the LLP agreement.

Not all the vessels or LLP partners must enter the LLP structure at the same time. LLP partners, or new vessels, may enter in stages. Depending on the number of vessels entering and the timing, as with the creation of the LLP itself, new entry may require further notification to relevant merger control authorities if applicable thresholds are exceeded.

Please note that variations on all the above themes are possible and acceptable, so long as the overall effect of "full functionality" is achieved. We are confident that many of the most frequently voiced concerns can be mitigated via appropriate contractual mechanisms.

D - Pros and cons

D.1 - Pros

- Scheme 810 is the closest thing to an existing pool that is fully compliant with the law.
- It is a simple corporate structure which is no more difficult or costly to negotiate than a pool.
- The structure is geographically flexible and tax efficient and has been designed with the maritime transport sector in mind.

D.2 - Cons

- Withdrawal of vessels from the FFJV will necessarily be subject to limitations.
- Notification of the FFJV to competition regulators is required if thresholds are exceeded.
- Parents to the FFJV must vacate the market segment in which the FFJV operates.

We look forward to discussing *Scheme 810* with readers in more detail should the need arise.

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