Commodities

January 2012

COMMODITIES BULLETIN

An uncertain future for the EU sugar regime

The existing EU sugar regime is due to expire in 2015 and there is some controversy over what will replace it. The current regime is based on radical reforms to the European Common Market Organisation for sugar ("CMO") which were introduced on 1 July 2006 and phased in over a four-year transition period, to allow the European sugar industry and the market to adapt. The reforms represented the EU's response to a ruling by the World Trade Organisation, following a complaint by Australia, Brazil and Thailand, which criticised the EU's payment of subsidies to European sugar producers.

The aim of the reforms was to ensure a long-term sustainable future for sugar production in the EU and to enhance competition in the market. Measures implemented included a reduction in quotas for sugar production, a substantial cut in the subsidised sugar price, the end of intervention buying of surplus production and incentives for less competitive sugar producers to leave the industry.

A key element of the reforms was the opening up of the EU market to sugar imports from developing countries, under preferential arrangements. Up until 30 September 2015 (and within automatic safeguard ceilings), there will be duty-free, quota-free access to the EU sugar market for sugar from the Least Developed Countries ("LDCs") under an Everything But Arms ("EBA") initiative. Similar arrangements will apply to sugar from African Caribbean Pacific ("ACP") countries which have signed an Economic Partnership Agreement ("EPA"). Under both the EBA and EPA initiatives, importers will pay a guaranteed minimum price up until 30 September 2012.

Since the reforms were introduced, there have been significant changes in the balance of supply and demand in the world sugar market, leading to extreme price volatility. There has also been growth in world ethanol consumption. The EU has moved from being the world's

second largest exporter of sugar to being one of its leading importers, with demand outstripping supply by around 3 million tonnes per annum. Although the reforms have improved efficiency in beet production and a bumper crop is predicted for 2011-12, the market deficit has not so far been met by imports as anticipated and in the first half of 2011, there were concerns about a European sugar shortage. Levels of cane imports from developing countries, where bad weather has affected crops, have been disappointing.

In March 2011, the EU introduced a series of "exceptional measures" to boost supplies, including releasing out-of-quota sugar on to the European market. It expressed its willingness to adopt similar exceptional measures for the next year should the need arise.

Arrangements for the CMO after the existing regime expires in 2015 will form part of the ongoing Common Agricultural Policy negotiations. Initial suggestions were that the European Commission might prolong the current sugar quota system, but they recently announced a proposal to abolish all quotas on the domestic production of sugar when the existing regime ends. Member States are divided over the issue, with some backing the plan, while others are calling for the quota regime to be extended until 2020. Observers are watching with interest to see what transpires; a decision is unlikely to be made before mid-2012.

Against this uncertain backdrop, it is important for all those entering into arrangements for sugar sale and purchase, particularly on a long-term basis, to appreciate that the situation is in flux. It would be prudent, before making commitments in such a climate, to check what the latest position is so that decisions can be taken and risks assessed with the benefit of current information.

For more information, please contact Judith Prior (pictured below), Associate, on +44 (0)20 7264 8531, or judith.prior@hfw.com, or your usual contact at HFW.

"Against this uncertain backdrop, it is important for all those entering into arrangements for sugar sale and purchase, particularly on a long-term basis, to appreciate that the situation is in flux."

Moves towards protectionism: the impact on commodities

The economic downturn has led many states to defend their economies, in some cases introducing protectionist measures to support specific industry sectors. Contemplated Indian legislation to protect domestic shipping companies is illustrative of this trend. If given effect, the measures could have a profound effect on prices of Indian commodities, and interfere with existing contracts.

The Indian Shipping Minister recently asked the Indian government to enact legislation reserving at least one-third of seaborne cargo for Indian-flagged vessels. The request came after the state-owned Shipping Corp. of India (SCI) suffered large losses in 2011.

Indian-flagged vessels currently carry less than 9% of India's imports and exports. SCI is unsurprisingly seeking a larger share of this market. SCI also wants Indian ships to be given contracts of five to seven years to carry crude oil, petroleum products, thermal coal, coking coal, fertilizer and iron ore. In the case of LNG, SCI is demanding 25-year contracts.

It is not clear whether the Indian government will respond favourably to the Shipping Minister's request. If the request is taken up, there is plainly the potential for non-Indian shipowners to be excluded in favour of SCI, which would cause serious disruption to medium-term and long-term contracts for the sale and purchase of commodities to and from India. Some English law contracts might even be discharged by frustration.

One of the standard tests for frustration under English law is whether performance of the contract is fundamentally different from that anticipated. The need to put in place alternative shipping arrangements would not necessarily change the fundamental nature of sale and purchase contracts, but there are likely to be many contracts which contain detailed and specific stipulations with regard to performing vessels.

India could also attract sovereign liability for such measures. It is a party to over 30 bilateral investment treaties, by which India promises to treat foreign investors in accordance with international legal standards relating to fair and equitable treatment and prohibiting discrimination. These obligations can be enforced against the sovereign state by investors through international arbitration. The definition of "investor" is wide and potentially includes producers and businesses with a commercial presence in the country.

Additionally, the measures could be found to be contrary to WTO rules, as a disguised subsidy in favour of the Indian market. Breaches of WTO law can be raised before its arbitral panels in Geneva, at the request of other states, behind which stand aggrieved foreign counterparts. Alternatively, competing sovereign states may be entitled to apply countervailing duties to nullify the effects of the subsidy.

Traders, producers and suppliers of commodities should monitor any measures of the kind proposed in India, given their potential to affect contractual relationships and create liability for sovereign states. Any form of industrial policy that favours the domestic sector over international ones may trigger liability at multiple levels.

For more information, please contact Matthew Parish (pictured below), Partner on +41 22 322 4814, or matthew.parish@hfw.com, or your usual contact at HFW.

"Traders, producers and suppliers of commodities should monitor any measures of the kind proposed in India, given their potential to affect contractual relationships and create liability for sovereign states."

HFW assists in setting up European Bulk Oil Traders' Association

The European Bulk Oil Traders' Association ("EBOTA") has been launched this month. EBOTA is a group of leading oil trading companies, comprising BP, Chevron, ConocoPhillips, Hetco, JP Morgan, Litasco, Mercuria, Morgan Stanley, Noble, Petrochina, RWE, Trafigura and Vitol. EBOTA will represent the interests of its members on various issues such as REACH, regulation of biofuel trading, and rules and procedures for trading platforms and price reporting agencies. HFW has been closely involved in the establishment of EBOTA, drafting its constitutional documents, advising on competition law and intellectual property issues, and providing EBOTA's secretariat. The HFW team working for EBOTA includes Alistair Feeney, Anthony Woolich, Nick Hutton, Judith Prior, Philip Thomas and Eleanor Midwinter. More information can be found at www.ebota.eu.

Conferences & Events

Blending on board: legal and practical issues
HFW Geneva
(10 January 2012)
Jeremy Davies

Intercem Shipping Conference
InterContinental Hotel Hamburg
(24-25 January 2012)
Rory Gogarty

LMA Time & Voyage Charterparties
Madinat Jumeirah Resort, Dubai
(29-31 January 2012)
Simon Cartwright, Nejat Tahsin, Yaman Al Hawamdeh and Sam Wakerley

Lawyers for international commerce

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888

© 2012 Holman Fenwick Willan LLP. All rights reserved

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice.

Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please contact Craig Martin on +44 (0)20 7264 8109 or email craig.martin@hfw.com

hfw.com