Commodities

July 2013

AUSTRALIA GRAINS INDUSTRY CONFERENCE 2013

HFW is pleased to be a sponsor of AGIC 2013, the premier conference for the grains industry. As part of our on-going commitment to the industry we have put together for this conference a Commodities Bulletin to highlight just some of the cases that have arisen over the past twelve months, or which we think will be of interest to many involved in logistics and the marketing of grain.

We look forward to seeing you in July, and you are welcome to drop by our stand in the Exhibition Hall or seek us out during Concurrent Session 2A on Wednesday 31 July, when we will be chairing a panel session that is seeking to make sense of arbitration.

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Decision on GAFTA Prohibition and Default Clauses

In Bunge S.A. v Nidera B.V. (29 January 2013), the English Commercial Court considered the interpretation of the standard GAFTA Prohibition and Default Clauses.

The case concerned a contract for the sale of 25,000 mt of Russian milling wheat on FOB Novorossyisk terms between Sellers (Bunge) and Buyers (Nidera). The terms, of GAFTA Contract No 49 were incorporated, Clause 13 of which sets out the standard GAFTA Prohibition Clause. This provides as follows: *"in case of prohibition of export, blockade or hostilities or in case of any executive or legislative act done by or on behalf of the government of the country of origin of the goods, or of the country from which the goods are to be shipped, restricting export, whether partially or otherwise, any such restriction shall be deemed by both parties to apply to this contract and to the extent of such total or partial restriction to prevent fulfilment whether by shipment or by any other means whatsoever and to that extent this contract or an unfulfilled portion thereof shall be cancelled..."*.

Clause 20 sets out the standard GAFTA Default Clause which provides a contractual scheme for establishing damages payable in the event of default by either party. The contractual delivery period was 23 to 30 August 2010. On 5 August 2010, the Russian government issued a resolution prohibiting the export of wheat between 15 August and 31 August 2010 (therefore covering the entirety of the contractual delivery period). On 9 August 2010, Sellers purported to declare the contract as automatically cancelled under the Prohibition Clause. Buyers rejected this and brought a damages claim against Sellers for wrongful repudiation.

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The principal issue considered by the Court (Mr Justice Hamblen) was the construction of the GAFTA Prohibition Clause. The GAFTA Board of Appeal had found that Sellers were required to prove that the prohibition prevented them from performing and decided that they could not do this at the time of termination because it was possible that before the end of the delivery period the ban might be revoked or modified so as to permit performance. The Court agreed with the Board and held that it is necessary for a party relying on the Prohibition Clause to establish a causal connection between the prohibition and the restriction of export of goods of the particular contractual description during the particular contractual shipment period.

In making this decision, the Court reviewed the commercial considerations underlying the competing interpretations of the Prohibition Clause, ultimately finding that the injustice of a ban being revoked before the end of the delivery period (in terms of the unnecessary financial detriment to one party and the unnecessary financial benefit to the other, depending on the movement of the market price) outweighed the certainty of automatic cancellation. The judge commented that automatic cancellation, on the mere announcement of a prohibition regardless of its likely or actual duration, or whether it had any impact on performance, was such a "crude re-allocation of risk" that it was most unlikely to have been intended by the parties.

The Court also had to consider the application of the standard GAFTA Default Clause. In accordance with the key principle of the Default Clause that damages are to be based on (but not limited to) the difference between the contract price and the actual or estimated value of the goods at the date of default, the Board of Appeal had awarded Buyers substantial damages. Sellers argued that, on the facts, the damages scheme in the Default Clause should have been overridden by the application of certain common law principles for the assessment of damages, which would have led to the conclusion that Buyers had suffered no loss. The Court rejected Sellers' argument, holding that the parties had agreed that their damages would be based upon the measure set out in the Default Clause and these rules could therefore not be displaced by other principles.

This case provides very clear guidance for parties trading on GAFTA terms, and who may be affected by export restrictions, that the Prohibition Clause must not be relied upon prematurely. We understand that Sellers have applied for leave to appeal to the Court of Appeal.

Challenging GAFTA jurisdiction: Court clarifies time limit

In a recent judgment, *PEC Limited v Asia Golden Rice Co Limited* (17 October 2012), the Commercial Court has clarified the time limit for challenging the decision of a first tier GAFTA tribunal that it has jurisdiction to hear a dispute.

Asia Golden Rice Co Limited (AGR) agreed a contract for the sale of 25,000mt of Thai Rice to PEC Limited (PEC). AGR alleged that PEC failed to perform and brought their claim before a GAFTA tribunal earlier this year.

In its award, the tribunal found that the contract of sale incorporated the GAFTA Arbitration Rules (GAFTA Rules) and so it had jurisdiction to hear the dispute. It found in favour of AGR and ordered PEC to pay damages in the sum of US$6,250,000.

PEC appealed the tribunal's findings on the merits to the GAFTA Board of Appeal. At the same time, PEC challenged the tribunal's jurisdiction. Under the GAFTA Rules, if a GAFTA tribunal decides it does not have jurisdiction to hear a dispute, a party can pursue an appeal against that decision to the GAFTA Board of Appeal. Where, as here, a tribunal rules that it does have jurisdiction, no appeal to the GAFTA Board is available.

However, under section 67 of the English Arbitration Act 1996 (the Act), any party to any arbitration can apply to the English Court to challenge a decision of an arbitral tribunal as to its own jurisdiction. The time limit for making such an application is 28 days, either from the date of the decision on jurisdiction, or from the date of exhaustion of *"...any available process of appeal or review"*.

PEC wanted to make an application under section 67 of the Act. The issue was whether they needed an extension of time to do so. PEC argued that they did not, on the basis that the 28 day time period would only start to run from the date of the GAFTA award on the appeal as to the merits – which was still underway. PEC placed emphasis on the reference to *"any available process of appeal or review"* in the Act and submitted that this had a wide enough meaning to include their outstanding appeal.

Although the parties had by then agreed that the Court should grant PEC an extension of time to make their application under section 67 of the Act, in a short judgment, the Court gave a reasoned decision against PEC's arguments.

The Court held that the GAFTA Rules are clear that a first tier tribunal's award that it has jurisdiction is *"conclusive and binding"*. As the only route to challenge such a decision is by way of section 67 application under the Act, the time limit for bringing such a challenge must be 28 days from date of the first tier award. Contrary to PEC's submissions, under the GAFTA Rules there is no available arbitral process of appeal or review where the first tier tribunal determines it has jurisdiction. PEC therefore required an extension of time (which they were granted in any event).

For GAFTA practitioners contemplating a section 67 application against a first tier award, the message is clear: time will start to run from the date of the first tier award, irrespective of whether there is an appeal on any other issue to the GAFTA Board of Appeal.

The consequences of delay in delivery for FOB contracts

Terms as to the time of performance, especially shipment periods, are usually conditions in a sale and purchase contract. Where a vessel is late in arriving under a FOB contract, the seller will typically be entitled to terminate the contract, in addition to any right to claim damages. Conversely, if the performing vessel arrives in time but cargo is not available, the buyer may wish to terminate the contract rather than claiming demurrage.

These are important considerations for the vast Australian export commodities trade, which relies heavily on FOB terms. Case law offers useful insights into how parties can protect themselves from the effects of costly delay.

The Luxmar (2007) highlights the importance of using appropriate terminology in sale contracts. Cargo was to be delivered FOB in the period 27-30 May 2004, with the Buyer to narrow the delivery period to a two-day "laycan". The Buyer duly narrowed the range to 29-30 May. When the vessel gave notice of readiness on 28 May, the Seller was experiencing production difficulties and was unable to load. On 3 June, the Buyer terminated the FOB sale contract. The contract stated that, "The laycan is an essential element of the contract in favour of the seller".

The English Court of Appeal found the Seller's late loading was a breach, but not a breach of condition. The Buyer was not entitled to terminate. The Buyer's only claim was for demurrage.

In T*he Luxmar*, the use of the concept of "laycan", which is appropriate in vessel charters, but should be used with caution in sale contracts, meant that the Buyer could present the vessel at any time up to the end of the laycan,

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failing which the Seller could terminate, but the Buyer could not terminate the contract if the Seller was not ready to load cargo within the laycan. By using the concept of "laycan" rather than a phrase such as "delivery period" or "delivery window", the parties had transformed the normal mutual obligations under a FOB contract.

Cereal Investment Co v ED&F Man (2007) shows that letter of credit terms may be affected by how a FOB sale contract specifies "shipment period". The sale contract stipulated, *"One vessel only presenting October 2006 shipment at buyer's option with ten days pre-advice of vessel's arrival..."*. The Buyer opened a letter of credit requiring presentation of a bill of lading dated no later than 31 October 2006. The Seller objected. The Buyer terminated the contract.

The Court held that while the contract specified the vessel had to present ready to load no later than 31 October 2006, it did not identify any fixed deadline for loading to complete, with the result that the letter of credit that the Buyer had opened was not adequate to cover its performance obligations under the contract. The Buyer's termination of the contract was therefore wrongful.

In *The Aragon* (1987), Phibro agreed to sell Coastal a cargo of Brent crude FOB Sullom Voe in one lot during February 1986, with Seller to advise Buyer of a three-day delivery range 15 days in advance. Phibro nominated 8-10 February 1986. Late on 10 February, Coastal terminated the contract on the grounds of Phibro's failure to deliver. At common law, Coastal would have been right, since time would have been of the essence of the loading provision. However, the contract incorporated BP's general terms and conditions, which limited the Seller's liability for delayed loading to demurrage. The Court of Appeal found that this meant the common law position did not apply. Coastal were not entitled to terminate.

The *Honam Jade* (1990) illustrates the benefit of clearly specifying when a requirement is a condition of a contract. Phibro sold crude oil to Nissho FOB Dubai for delivery in January 1986. Before a contract could be performed, Nissho's nominated vessel had to be given a loading slot in the terminal's lifting programme. Phibro proposed various loading ranges, none of which were acceptable. Nissho terminated the contract.

Under the contract, Nissho's vessel nomination depended on terminal acceptance, but Nissho was given some protection by a term obliging Phibro to accept or reject a nomination within five days. Phibro had not passed on Nissho's nomination to the terminal within the required five days. However, it was found that Phibro's obligation to obtain "terminal acceptance" was not a condition of the contract, breach of which would entitle Nissho to terminate. Nissho had to show that Phibro's breach was so serious that it undermined the whole contract. In the event, Nissho was able to show that its termination of the contract was justified by the consequences of Phibro's breach.

Conclusions

Parties should make clear, where possible, whether contractual stipulations as to time are conditions. Care should also be taken when selecting terminology, as the decision in *The Luxmar* shows, and when incorporating third party terms, such as terminal rules. Risks are usually mitigated by developing and ensuring the incorporation of general terms and conditions when selling, and careful consideration of counterparty terms and conditions when buying.

Australian Oil Pollution Penalties – update on increase in penalties

Legislative changes in December 2012 expanded the list of persons who may be charged with an offence in the event of a discharge of oil or oily mixture from a vessel into the sea to include "charterers" of the polluting vessel as well as the owner and master of the vessel (Protection of the Sea (Prevention of Pollution from Ships) Act 1983 (Cth)(PSPPSA):

On 28 December 2012, a new regulation came into force in Australia escalating the monetary value of financial penalties (which had not been adjusted since 1997) for applicable Federal offences committed on or after 28 December 2012. The changes affect fines calculated on penalty units, such as fines imposed under the PSPPSA. The value of a penalty unit increased from $110 to $170, which means that the previous maximum fines under the PSPPSA of AUD 2.2 million for an individual and AUD 11 million for a corporation are now AUD 3.4 million for an individual and AUD 17 million for a corporation.

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