Commodities

December
2014

COMMODITIES BULLETIN

Welcome to the December edition of our Commodities Bulletin.

In our May 2013 Bulletin, Partner Sarah Taylor reported on a decision of the English Commercial Court in *Standard Chartered Bank v Dorchester LNG (2) Ltd*, relating to letters of credit. That decision was appealed and judgment was recently handed down by the Court of Appeal. In this edition, Sarah reflects on the effect of the Court of Appeal's findings.

Associate Nick Moon then reviews the recent decision of the English Commercial Court in *Toyota Tsusho Sugar Trading Ltd v Prolat Srl.* Not only does the decision reinforce the English courts' support for specialist trade arbitration bodies, it also acts as a useful illustration of the potential strategic importance of an application made under Section 32 of the Arbitration Act 1996 in staving off attempts to enforce any judgments obtained in parallel European court proceedings.

Finally, following on from his regulatory update in our previous edition, Partner Robert Finney provides a further update, this time in relation to market review, benchmarks and market abuse.

Should you require any further information or assistance with any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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Letters of Credit: a Court of Appeal decision

In our May 2013 Commodities Bulletin (http://www.hfw.com/Commodities-Bulletin-May-2013), we reported on the decision in *Standard Chartered Bank v Dorchester LNG (2) Limited* (18 April 2013). This decision was subsequently appealed and the Court of Appeal handed down its judgment on 22 October 2014. It has important implications for traders as beneficiaries under a letter of credit.

The Court of Appeal upheld the first instance judgment, which found in favour of SCB. However, it did so by means of a different interpretation as to the meaning and effect of Section 5 of COGSA, which identifies who is a bill of lading holder.

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Background

The underlying facts are complex and relate to the sale of two cargoes of gasoil from Gunvor International BV (Gunvor) to UIDC and to Cirrus Oil Services Ltd (Cirrus). Cirrus opened a letter of credit (LC) in UIDC's favour with Standard Chartered Bank (SCB) as the confirming bank. UIDC subsequently transferred the LC to Gunvor.

A dispute arose over the quality of the gasoil and Cirrus agreed with UIDC that it would accept only one cargo and at a reduced price. SCB refused to pay out on the documents as presented. In order to avoid further delays, UIDC issued a letter of indemnity to the carrier to enable discharge to take place without presentation of the bills of lading (which were held by SCB). A subsequent settlement between SCB and Gunvor, whereby SCB agreed to pay the full amount claimed by Gunvor, ended the dispute.

SCB then brought proceedings against the owners of the vessel, the defendants in these proceedings, for misdelivery of the cargo. SCB argued that it was the lawful holder of the bills of lading within the meaning of Section 5(2)(b) of the Carriage of Goods by Sea Act 1992 (COGSA).

The decision

The Court of Appeal upheld the first instance judgment, which found in favour of SCB. However, it did so by means of a different interpretation as to the meaning and effect of Section 5 of COGSA, which identifies who is a bill of lading holder.

The Court pointed to the difference between a "consignee" and "endorsee" under Section 5 COGSA. Whilst it was sufficient for a consignee to be in possession of the bills in order to become the holder, in the case of an endorsee, delivery is *"an essential element in a series of voluntary acts designed to give effect to the holder's intention to transfer the rights which it represents"*.

The Court of Appeal disagreed with the first instance finding that SCB had become holder of the bills upon presentation of the documents by Gunvor. Completion of an endorsement by delivery requires *"the voluntary and unconditional transfer of possession"* by the holder to the endorsee and *"an unconditional acceptance"* by the endorsee. By rejecting the presentation, SCB had rejected delivery, thereby preventing completion of the endorsement in its favour.

However, the Court of Appeal found that SCB became the lawful holder of the bills of lading on the date of the settlement agreement, once it had paid the sums due to Gunvor under the LC. All that was necessary was for Gunvor to make it clear that it was willing for SCB to accept the documents and therefore liability for payment. It was immaterial whether a fresh presentation was required.

Conclusion

The Court of Appeal conceded that it seems surprising that UIDC should have incurred a liability to indemnify the vessel's owners in respect of a misdelivery of the goods as a result of the actions of another party.

A seller, as the beneficiary under an LC, may be left with a dilemma when faced with wrongful rejection of documents. A claim in debt against the bank may only be brought upon transfer of the documents. By such transfer, however, the rights of the ultimate buyer to take delivery of the goods may interfere with the rights of the bank as holder of the bills of lading, as was the case here.

The alternative is just as problematic. A beneficiary under an LC could request that the bills be returned upon the bank's refusal to pay, thereby cancelling the endorsement, and present the bills to the vessel itself. However, this would leave the beneficiary with nothing more than a claim for damages against the bank and the challenge of paying for the cargo without financing in place.

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hfw Trade arbitrations: the strategic benefits of an application under Section 32 of the Arbitration Act 1996

The English Commercial Court's recent decision in *Toyota Tsusho Sugar Trading Ltd v Prolat Srl* (3 November 2014) should be welcomed as reinforcing its support for the jurisdiction of specialist trade arbitration bodies. It also serves as a useful illustration of the potential strategic importance of an application made under Section 32 of the Arbitration Act 1996 (the Act).

In July 2013, Toyota and Prolat reached an agreement for the sale and purchase of sugar. Toyota then sent a sale contract to a Mr Dibranco, to be signed and returned by Prolat. As is common practice in sugar trading, the sale contract contained an arbitration clause, specifying that arbitration would be in accordance with the rules of the Refined Sugar Association of London (RSA) and that English law governed the contract.

Disputes arose between the parties, and in January 2014, Prolat issued proceedings in the Italian court in Naples. Toyota, in reliance on the RSA arbitration clause in the sale contract, commenced London arbitration proceedings. Prolat objected to the jurisdiction of the RSA tribunal, claiming that there was no agreement to arbitrate, because Prolat did not sign the sale contract and Mr Dibranco was the appointed broker for Toyota and did not act for Prolat. There was no dispute that a contract for the sale of sugar had been agreed, rather the issue was whether the parties had concluded an agreement to arbitrate.

Toyota made an application to the RSA tribunal, seeking permission to apply to the English Court under Section 32(2) of the Act for a declaration that the tribunal had substantive jurisdiction to determine the dispute.

Under Section 32(2)(b), an application shall not be considered unless:

"(b) it is made with the permission of the tribunal and the court is satisfied

(i) that the determination of the question is likely to produce substantial savings in costs,

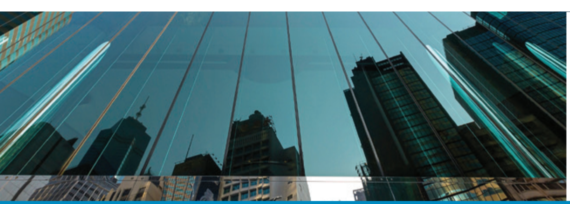
(ii) that the application was made without delay, and

(iii) that there is good reason why the matter should be decided by the court."

The tribunal granted Toyota permission to make the application. It ruled that there were factual issues which would need to be resolved in determining the jurisdictional dispute and an appeal might well follow a tribunal decision. The determination of the court would therefore produce substantial savings in costs.

The English Court agreed with the tribunal that the requirements of Section 32(2) were met, both as to costs and because the application had been made without delay. The involvement of the court in Naples was a further good reason why the English Court should decide the issues.

The first issue was whether the English Court had jurisdiction to determine matters relating to the arbitration, given that Prolat had commenced proceedings in Italy contending that it was not a party to any arbitration agreement. The English Court decided that it did have jurisdiction and was not being asked to interfere with the functions of the Italian court, as no



form of anti-suit injunction was being sought. With regard to the applicable law, the English Court referred to Article 10.1 of Rome I Regulation 583 of 2008, which provides that questions as to the existence and validity of a contract are to be determined by the law that would govern the contract if the contract were valid. On the evidence, the contract could only have been governed by English law. The arbitration clause in the sale contract (and repeated in various addenda) amounted to an express choice of English law.

The English Court then considered the terms agreed between the parties and the effect of the evidence put before it. It found that Mr Dibranco had both ostensible and actual authority to act for Prolat and in any event, Prolat by their own conduct in importing the sugar, had accepted the terms of the sale contract, including the arbitration agreement. Both the claims made by Toyota and the claims made by Prolat fell within the scope of the arbitration clause.

There was an agreement to arbitrate which was evidenced in writing by the sale contract and Toyota were entitled to the declaration sought. If the Italian proceedings were to continue to a judgment, Toyota should be able to rely on the declaration to prevent Prolat enforcing any Italian judgment against them in England.

Applications under Section 32 of the Act are relatively uncommon yet they offer a practical and cost effective solution in circumstances where it is clear that a tribunal's decision may be subject to appeal on the grounds of lack of jurisdiction. As this decision suggests, the Court will endeavour to uphold the jurisdiction of a tribunal when it accords with the terms agreed between the parties.

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Applications under Section 32 of the Arbitration Act are relatively uncommon yet they offer a practical and cost effective solution in circumstances where it is clear a tribunal's decision may be subject to appeal on the grounds of lack of jurisdiction.

Regulatory update: market review, benchmarks and market abuse

In our October edition, (http://www.hfw.com/Commodities-Bulletin-October-2014) we reported on recent developments in relation to MiFID and REMIT. In this issue, our regulatory update focuses on current initiatives aimed at addressing various market abuse issues.

Fair and Effective Markets Review

In the UK, there have been two significant developments in the "Fair and Effective Financial Markets Review" (FEMR). This is a joint review of wholesale fixed income, currency and commodity (FICC) markets (including derivatives and benchmarks), by HM Treasury, the Bank of England and the Financial Conduct Authority.

In October 2014, HM Treasury consulted on proposals to bring seven additional UK-based FICC benchmarks into the regulatory and criminal framework originally put in place to regulate LIBOR. As recommended by the FEMR, the proposed new benchmarks include the ICE Brent Futures contract, the London Gold Fix and the LBMA Silver Price as well as various interest rate and currency benchmarks. These proposals may be implemented by the end of December 2014.

On 27 October 2014, the FEMR launched a consultation examining what is required to reinforce market confidence and to assess:

- The areas where fairness and effectiveness are currently deficient.

In the UK, there have been two significant developments in the "Fair and Effective Financial Markets Review" (FEMR).

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- The extent to which regulatory, organisational and technological change, since the financial crisis and ongoing, is likely to address these deficiencies.
- What further steps are needed to help ensure fair and effective FICC markets (and what "fair and effective" means in those markets).

The consultation is open until 30 January 2015. The FEMR aims to make its recommendations by June 2015.

Benchmarks

There has been significant progress towards the adoption of the EU Benchmarks Regulation, proposed by the EU Commission in Autumn 2013.

The Regulation would regulate providers of benchmarks and, to a limited extent, contributors of data and users. It would affect benchmarks used in financial instruments/contracts traded on a trading venue and purely OTC-traded derivatives. It is possible that ultimately, purely OTC-traded derivatives will be excluded but that is not yet clear. The Regulation would apply to any index by which an amount payable under a financial instrument or financial contract (a loan, for example) is determined or by which the performance of an investment fund is valued.

Benchmark providers (administrators) established in the EU will require authorisation and the Commission proposed that users be permitted to use only regulated benchmarks or those subject to an equivalent non-EU regime. The proposed Regulation includes additional provisions for so called "critical benchmarks" (generally, this includes those benchmarks which reference financial instruments with a value of over €500 billion) and would impose mandatory contribution for "critical benchmarks" in the event of insufficient data inputs.

In early December 2014, the Italian Presidency of the Council pushed for agreement of a text based on recent discussions, but Member States objected on various grounds. Latvia takes up the Presidency in January 2015 and will continue negotiations to finalise a Member State position. Then, subject to the European Parliament having by then agreed its position, trilogue negotiations (among the Council, Parliament and Commission) to finalise the regulation can begin.

The European Parliament is considering the proposal from scratch. Its ECON Committee has focused on several controversial issues, including:

- Greater distinction between commodity and financial benchmarks – detailed requirements might be specified in subsequent, delegated regulations.
- Basing the "critical benchmarks" definition on qualitative as well as quantitative criteria.
- Proportionality in terms of the scope and substantive requirements of the Regulation, which might impose more stringent requirements on critical benchmarks.
- Alternatives to the strict third country equivalence regime proposed by the Commission (considered impractical given how few equivalent (or near equivalent) regimes have been adopted or proposed elsewhere).

Market abuse

The European Securities and Markets Authority (ESMA) is reviewing responses to two recently-closed consultations concerning implementation of the EU Market Abuse Regulation of April 2014 (MAR).

One consultation focused on proposed technical advice to the Commission on possible delegated acts: the topics included procedures to enable reporting of breaches (or suspected breaches) of MAR indicators and specification of indicators of market manipulation.

The other consultation sought feedback on draft technical standards developed by ESMA for adoption as regulations by the Commission. The areas addressed in this second consultation included:

- Accepted Market Practices (AMPs): MAR provides a safe harbour from its market manipulation prohibition orders in relation to transactions and conduct carried out for legitimate reasons in conformity with AMPs.
- Standards for the arrangements required by trading venues and regulated firms to prevent and detect abuse and to report suspicious orders and transactions.

ESMA is now expected to finalise the draft technical advice and standards for submission to the European Commission by March and July 2015 respectively.

In 2015, ESMA is expected to consult on proposed guidelines, including as to what constitutes inside information in the context of commodity derivatives.

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News

We are pleased to announce that HFW's commodity group was presented with the award for Legal Excellence at a gala reception for the Commodity Business Awards 2014 hosted by Commodities Now magazine on Wednesday 3 December. The awards recognise and reward talent and excellence throughout the commodity chain and we are delighted to have received this recognition from the industry. We would like to take this opportunity to thank our clients for their support in this endeavour.

HFW extends Season's Greetings to all of our readers with our best wishes for 2015.

Conferences and events

HKIAC/HFW International Trade & Commodities Seminar
Hong Kong
January 2015
Presenting: Andrew Johnstone and Fergus Saurin

HFW Commodities Seminar
Dubai
20 January 2015
Presenting: Sarah Hunt, Jeremy Davies and Simon Cartwright.

11th Annual Kingsman Sugar Conference
Dubai
31 January – 3 February 2015
Attending: Simon Cartwright and Judith Prior

IP Week: Strategies for raising capital for oil and gas projects and mitigating risk
London
12 February 2015
Presenting: John Barlow

Global Law Summit
London
23-25 February 2015
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