HFW

COMMODITIES BULLETIN

SEPTEMBER 2021

Welcome to the September edition of our Commodities bulletin.

I am delighted to introduce the bulletin from HFW's Geneva office, as we celebrate our tenth anniversary. Fittingly, several Geneva lawyers feature in this edition. We open with an article from Jason Marett and Natalie Lake on the role of sustainable financing in the move towards sustainable commodities. Next, Michael Buisset writes on the opportunities and challenges for hydrogen in the green industrial revolution. We then turn to focus on insolvency with an article by Simon Jerrum, Rick Brown and Joshua Prest, examining the return of director liability to the spotlight. We close with a piece by Daniel Martin reflecting on ten years of the UK's Bribery Act. Please also see our schedule of upcoming events for details of where you can meet the team next.

Last but not least, congratulations go to our newly qualified solicitors, Natalie Lake and Joshua Prest, both of whom feature in this bulletin! Joshua has qualified into the London office and Natalie is moving to Geneva; we are looking forward to introducing them to many of you.

This bulletin has your business in mind – please let us know if there is anything you would like us to cover in the next edition. Don't hesitate to email me to be included on the monthly invitations to HFW's Swiss seminar series - now live - for networking throughout Switzerland.

Sarah Hunt, Partner

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"Banks involved in trade finance are under growing pressure from their stakeholders, including institutional investors, employees and activist shareholders, as well as regulators, to make sustainability commitments and disclosures."

TOWARDS SUSTAINABLE COMMODITIES: THE GROWING IMPACT OF SUSTAINABLE FINANCE

The focus on environmental, social and governance (ESG) issues and on 'sustainable finance' – the integration of ESG measures into financial investments – has intensified over recent months.

The commodity sector is in a particularly challenging position; according to S&P Global's Sector Risk Atlas, six of the top ten sectors most exposed to ESG risks are commodities-focused[1]. Those risks include environmental threats from pollution, water use and greenhouse gas emissions, as well as human rights, health and safety and other social risks for workers and local communities affected by the extraction, processing or transportation of commodities. This challenging position, combined with the high global demand for commodities and the focus of investors and end consumers on ESG issues, means that sustainable commodity trade finance has a key role to play in the move towards a more sustainable commodity sector.

A number of challenges have been holding back investors and the market. Sustainably sourced and produced commodities are typically more costly to produce: health and safety measures, risk assessments and environmental due diligence all come at a cost, as do efforts to assess, verify and certify the sustainability of commodities. For an inherently cross-border sector like commodity trading, the lack of global standardisation is also costly and inefficient from a compliance and risk perspective. The plethora of voluntary sustainability frameworks makes it difficult for market participants to know which standard to follow and for investors to compare sustainability risks even within the same sector.

Nevertheless, the costs for society if sustainability risks are not addressed – the so-called externalities such as the costs to the environment, to communities affected by human rights failures and to future generations if we fail to tackle climate change – are increasingly outweighing the challenges.

More coherent regulation might help the market "price" these costs and push market participants in the direction of more sustainable commodities. Regulators are certainly increasingly requiring companies to take sustainability risks into account in their decision-making and disclosures.

Banks involved in trade finance are under growing pressure from their stakeholders, including institutional investors, employees and activist shareholders, as well as regulators, to make sustainability commitments and disclosures. This is driving a surge in banks offering their customers 'green' and sustainable finance products and making it harder for companies without sustainability ratings to access funding. Green and sustainability-linked loans are one such product which the commodities sector is embracing. The HFW Geneva trade finance team recently advised Sucafina, a multinational coffee trader, on their flagship trade finance facility, a USD 500 million sustainability-linked loan with KPIs related to farmer "fair trade" certification, carbon emissions and deforestation monitoring in East Africa and other coffee producing regions.

Other products that might help the banks to meet their sustainability commitments are also being developed. One example is sustainable supply chain finance (SCF). A sustainable SCF arrangement takes the standard SCF structure and adds a sustainability requirement. Typically, a buyer would require its suppliers to meet certain sustainability criteria before they can gain access to the SCF programme. This allows a large buyer to better manage the sustainability risks in its supply chains and to offer favourable terms to suppliers that can demonstrate sustainability commitments.

Letters of credit, one of the oldest and most fundamental instruments in international trade, could also have a role to play. Under a pilot project run by the Banking Environment

1 https://www.spglobal.com/ratings/en/research/articles/200722-environmental-social-and-governance-the-esg-risk-atlas-sector-and-regional-rationales-and-scores-11582800

Initiative, a Sustainable Shipment Letter of Credit (SSLC) has been trialled, under which the seller of goods must meet internationally recognised sustainability standards before it can be paid by the bank[2]. So far, only palm oil with an RSPO (Roundtable on Sustainable Palm Oil) certificate is eligible but if SSLCs catch on, it is possible the programme could be expanded to include other commodities.

More tools are now available to help trade finance banks set meaningful sustainability targets for their customers and to manage their own sustainability risks. For example, the World Bank hosts the GMAP tool which provides freely available data on the environmental and social risks of agri-commodities and maps sustainability certificates . These tools also enable investors to benefit from better tracking of sustainability data in commodity supply chains.

The really big news would be if global regulators are persuaded to offer capital relief for sustainable trade finance assets. The International Chamber of Commerce (ICC) is working on a paper examining the case for incentives like capital relief. If this became a reality, then sustainable trade finance as an asset class could really take off. For this to happen, regulators would need to be convinced that the risks of holding these assets really are lower than for their non-sustainable counterparts. If banks face lower capital costs for holding sustainable trade finance assets, then they will have more room to pass on the benefits to commodity traders and producers.

With COP26 around the corner, the global momentum towards sustainable commodities is building and it is unlikely that any of the challenges faced will slow it for long. Sustainable finance is integral to that momentum and we expect to see new developments in the year ahead.

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2 https://www.cisl.cam.ac.uk/resources/sustainable-finance-publications/sustainable-shipment-letter-of-credit

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"The majority of countries rely on their existing gas regulations to regulate hydrogen. Due to its distinct characteristics, these frameworks are not always appropriate and countries are actively working on new legislation to regulate the origin, quality, safety, transportation, storage and supply of hydrogen on a large scale."

GREEN HYDROGEN'S ROLE IN THE WORLD'S GREEN INDUSTRIAL REVOLUTION

In 2020, the world faced unprecedented disruption to economies and commodities trade flows. The price of and demand for oil collapsed temporarily at the height of the lockdowns. At the same time, there has been a stronger than ever push for the decarbonisation of our societies. The COVID-19 crisis has coincided with a political, social and economic move to transition our economies from industrial to low carbon.

This transformation is potentially the biggest we have seen in our lifetimes. Just as the advent of coal and oil reshaped the world, the move towards clean energy will do the same. Here we focus on one new commodity which is likely to be pivotal in this transformation: hydrogen.

The context: irreversible momentum towards renewable energy

Countries are setting strict sustainability goals and are moving away from carbon. We expect to see that trend continue and accelerate for a number of reasons, including:

- In the Paris Agreement reached at the UN Climate Change Conference ("COP21") in 2016, 196 countries committed to effect a net reduction of at least 50% of their carbon emissions by 2030.
- The next conference, COP26, is due to take place in Glasgow in November. Its first stated goal is to "secure global net zero by mid-century," with a specific call on countries to accelerate the phase-out of coal and encourage investment in renewables.
- In light of this, as governments focus on economic recovery in the wake of the pandemic, many are taking the view that spending should be directed towards creating a greener economy.
- The increased focus on sustainability in the finance sector has boosted investment in renewable energies.
- The traditional oil and gas majors are adapting by diversifying their energy offerings.

The technology: the hydrogen rainbow

It is expected that hydrogen will play a vital role in the transition to a low carbon economy.

Hydrogen is classified according to the way it is produced and categorised by colour. The cheapest forms of hydrogen are grey and brown but fossil fuels are used to power the machines that separate the gas from water in the production process, offsetting the environmental benefits of its end use.

Blue hydrogen is extracted from natural gas with a carbon capture and storage technology. This method of production is cleaner, but is not carbon neutral.

Green hydrogen is produced using exclusively renewable energy sources such as wind, solar, hydro or household waste, making the entire process effectively carbon free. A number of pilot projects have been developed globally but for the moment, the high cost of the energy intensive electrolysis is a significant barrier to widespread production.

Despite the commercial challenges, hydrogen is perceived as offering the greatest hope of achieving low carbon targets, with the backing of local and national policies promoting its use. The EU and the UK are two examples of this.

The EU announced a hydrogen strategy in July 2020, to "explore how producing and using renewable hydrogen can help decarbonise the EU economy in a cost-effective way, in line with the European Green Deal (and also helping the post-COVID-19 economic recovery)". The European Commission is currently preparing legislative proposals for a new hydrogen and gas markets decarbonisation package. These are expected before the end of 2021.

The UK's 10 point plan for a green industrial revolution published in November 2020 included at point 2, "Driving the growth of low carbon hydrogen." This was followed on 17 August 2021 by the UK government announcing a plan to build a world-leading hydrogen economy, unlocking GBP 4 billion investment by 2030, potentially rising to GBP13 billion by 2050. Government analysis

suggests that up to one third of the UK's energy consumption by 2050 could be hydrogen based.

In both cases, challenges are emerging created by the high cost of producing green hydrogen amidst concerns that blue hydrogen, whilst more commercially viable, is not sufficiently low carbon to enable countries to reach their targets.

With so much investment in and focus on hydrogen production, we expect a depreciation in the cost of hydrogen technologies in the current decade, just as the prices of solar and wind technology have depreciated in recent years.

The commodity: hydrogen's unique characteristics and challenges

Each new technology has its own characteristics and this is also true for hydrogen. It would be a mistake to treat it like any other energy source for the purposes of legal, regulatory, logistical or financial frameworks.

Hydrogen is a colourless, odourless and flammable gas and its large-scale use has commonly been perceived as risky because of how easily it may leak and ignite at relatively low temperatures. Most hydrogen is produced and consumed on the same site or transported over short distances by road or pipeline. Transporting hydrogen over long distances is restricted because its flammable characteristics require extreme care when handling. The particular challenges in hydrogen production, handling and transport will inform the contractual and regulatory frameworks in which it is produced and traded.

The rapid development of hydrogen projects has meant that legislative frameworks have not always kept up with the speed of the advancing projects. The majority of countries rely on their existing gas regulations to regulate hydrogen. Due to its distinct characteristics, these frameworks are not always appropriate and countries are actively working on new legislation to regulate the origin, quality, safety, transportation, storage and supply of hydrogen on a large scale.

As an industry focused law firm, HFW is used to advising clients on the development of new technologies and rapidly changing industry environments. We look forward to supporting our clients as they navigate the green industrial revolution and the commercial development of green hydrogen.

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DIRECTOR LIABILITY BACK IN THE SPOTLIGHT

It is now almost 18 months since the UK government implemented an array of measures designed to mitigate the financial consequences for companies of the COVID-19 pandemic. Some of these were temporary and are now coming to an end.

One such measure, the suspension of liability for wrongful trading, ended on 30 June 2021. Whilst this may have briefly turned attention away from the threat of liability for directors who allow a company to continue trading in circumstances where the company is unlikely to avoid insolvency, the end of this suspension, as well as the findings in the recent Privy Council case of *Byers v Chen Ningning* [2021] UKPC 4, mean that director liability is firmly back on the agenda.

The end to the suspension of wrongful trading

The Corporate Insolvency and Governance Act 2020 came into force in June 2020 and introduced a number of changes to UK insolvency law. Some of these changes were permanent, while others were temporary and specifically designed to mitigate the expected consequences of the COVID-19 pandemic. One such measure was to suspend the liability of directors for wrongful trading. A director can be liable for wrongful trading where they allow a company to continue trading in circumstances where there is no reasonable prospect of that company avoiding insolvency. The suspension was introduced to give directors confidence to trade and minimise losses to creditors during the pandemic, without the fear of potential wrongful trading claims from any future liquidator or administrator.

The wrongful trading suspension initially ended on 30 September 2020. However, the suspension was renewed in November 2020, and (following an extension) ended on 30 June 2021. Directors can therefore now (once again) be personally liable if they allow a company to continue trading whilst it is insolvent.

Byers v Chen Ningning – breach through inactivity

In the recent judgment of the Privy Council in *Byers v Chen Ningning*, it was held that a director can breach their fiduciary duties through inactivity. In this case, the breach occurred when the director failed to stop funds leaving the company at a time when the company was known to be insolvent.

The Respondent, Miss Chen, was the ultimate beneficial owner of Pioneer Freight Futures Ltd (**PFF**), a BVI company involved in the trading of forward freight agreements (**FFAs**). PFF got into financial difficulties in 2008 following a collapse in the freight market. It subsequently ceased trading FFAs and attempted to negotiate settlements with creditors and minimise its losses.

In May 2009, PFF entered into a loan agreement with Zenato Investments Ltd (**Zenato**) through which US$13 million was advanced to PFF. In October 2009, PFF lost an action in unrelated proceedings in the High Court in London. During these proceedings, PFF conceded that it was commercially insolvent.

In the weeks following the High Court proceedings, PFF used funds to repay Zenato in full, despite the loan not being due for repayment for another year. Miss Chen did not authorise the repayments herself, but she was aware of them and did not object to them being made by one of her employees. PFF subsequently went into liquidation in the BVI.

In 2014, the liquidators of PFF brought a claim against Miss Chen in relation to the Zenato repayments. The liquidators alleged that Miss Chen had breached her duties as a director of PFF. That claim failed in the lower courts.

The Privy Council, allowing the appeal, held that Miss Chen did still owe fiduciary duties to PFF at the time of the Zenato repayments. However, the case is of most interest because the Privy Council then proceeded to find that Miss Chen had breached her fiduciary duties to PFF simply by not preventing the Zenato repayments from being made. Miss

Chen, as the person who was the sole signatory of the company's trading account, had a fiduciary duty to PFF to take all reasonable steps to prevent payments being made from that account for an improper purpose. As Miss Chen was aware of the early repayments to Zenato and had not objected to them being made by one of her employees, the Privy Council concluded that her inaction amounted to a breach of her fiduciary duties to PFF. The Privy Council also noted that the Zenato repayments were *"undoubtedly improper"*.

Conclusion

Whilst directors had some breathing space during the COVID-19 pandemic as a result of the suspension of wrongful trading liability, the liability of directors is now back in the crosshairs of insolvency practitioners. Directors should therefore be mindful of their duties, particularly when a company is in the twilight zone of insolvency, and should tread carefully when the company cannot reasonably avoid insolvency.

HFW acted for the successful liquidators in Byers v Chen Ningning.

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"Both supporters and detractors would agree that while the Act sought to tackle those who pay bribes (the "supply side"), it does nothing to address the question of why bribes are demanded in the first place."

UK BRIBERY ACT 10 YEARS ON: HAS ANYTHING CHANGED?

On 1 July 2011 the UK Bribery Act (the Act) came into force. It garnered a huge amount of attention both in the UK and globally and there were high hopes that it would signal a sea change in attitudes and significantly reduce both public and private sector corruption.

Ten years later and the spotlight is once again on corruption, in light of the recent guilty plea entered by a former oil trader over his part in a scheme to bribe government officials in Nigeria in return for lucrative oil contracts. So, what has changed in the past 10 years and has the reality lived up to expectations?

The Act's supporters would say that it was effective in putting the issue on the agenda and triggering an immediate focus on preventing corruption. Many companies rolled out more detailed policies and increased engagement at board level. There was recognition of the importance of a strong corporate culture and the need to ensure that employees were aware of increased efforts to stamp out corruption.

According to the Act's detractors it is unclear whether (and to what extent) the Act has actually had any impact on corporate behaviour and attitudes. They would argue that more enforcement and greater fines are necessary to bring about real change. Advocates for more aggressive enforcement say that it penalises those who engage in corrupt activities, sends a message to potential offenders and also makes it easier for early adopters to get board room approval for the time and cost involved in building a robust compliance programme and ensuring transparency.

Both supporters and detractors would agree that while the Act sought to tackle those who pay bribes (the "supply side"), it does nothing to address the question of why bribes are demanded in the first place.

Some would defend the Act, on the basis that this is outside the scope of legislation but others would argue that there was a significant missed opportunity, in that the Act did not do enough to encourage collective action.

Collective action includes the efforts of organisations like the Maritime Anti-Corruption Network (MACN), a global business network working towards the vision of a maritime industry free of corruption that enables fair trade to the benefit of society at large. Its members include many of the world's leading commodity traders, as well as shipowners, flag states and service providers.

One of MACN's key objectives is to tackle the demand side: to drive a significantly improved compliance environment in the countries targeted by MACN's collective action strategy.

So, 10 years on, bribery is still very much in the line of fire – but there is a long way to go and the collective action of MACN and others is vital to drive real change.

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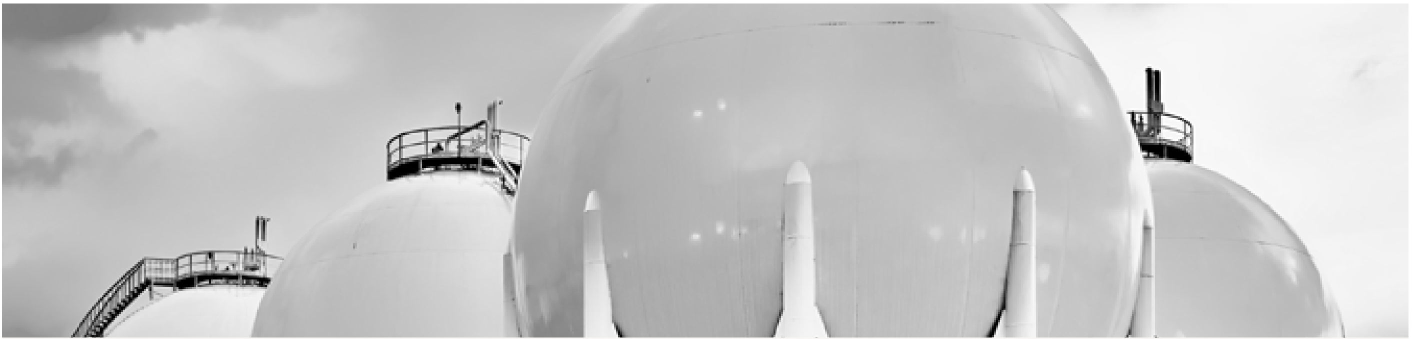

WHERE YOU CAN MEET THE TEAM NEXT

7 October 2021
HFW Webinar: Painting the future of Arbitration in Asia: Key Changes to Arbitral Rules
Moderator: Dan Perera
Speakers: Jo Delaney, Nick Longley, Ben Mellors

12 October and 15 November 2021
HFW Commodities webinar series
Sessions 2 and 3 – details tbc

14 October 2021
HFW and Zug Commodities Association Seminar: Commercial Court procedure, sanctions and trade finance
Speakers: Michael Buisset, Sarah Hunt, Jason Marett, Kathryn Martin, Patrick Myers, Anne-Marie Pearce, Alix Bosson

21 October 2021
HFW panel event: Latest Developments and Next Trends in Swiss International Trade: Where Does CH Go From Here
Moderator: Georges Racine

25 October 2021
HFW panel event: Hong Kong Arbitration Week: Staying on track for a successful arbitration process. Enforcement in sight – all clear or trouble ahead?
Moderator: Ben Bury
Speaker: Peter Murphy
(with other outside guests)

1 November 2021
HFW Presentation to the Geneva Trade Credit Market
Speakers: John Barlow, Nigel Wick, Shane Gibbons

9 November 2021
GAFTA webinar: Recent court judgments of interest to GAFTA members
Speakers: Brian Perrott and Stephen Thompson

24 November 2021
GAFTA webinar – The Corporate and Insolvency Governance Act 2020 (CIGA)
Speaker: Simon Jerrum

OTHER TEAM NEWS

Karen Cheung

Our Hong Kong office is delighted to welcome Partner **Karen Cheung**, who handles a broad range of commercial litigation and arbitration. Karen is a fellow of both the Chartered Institute of Arbitrators and the Hong Kong Institute of Arbitrators as well as being an accredited mediator. She joins with Associate **Fantasia Liang**.

Joshua Prest

Natalie Lake

Congratulations to the newly qualified solicitors who have completed their training at the firm and joined the Commodities team, Joshua Prest in London and Natalie Lake in Geneva.

Congratulations to our Geneva office, which is marking and celebrating 10 years of HFW in Geneva.

HFW has over 600 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our commodities capabilities, please visit hfw.com/Commodities

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