HFW

COMMODITIES BULLETIN
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Welcome to the October 2022 edition of the HFW Commodities bulletin.

Welcome to the HFW Commodities bulletin. In this extended edition, a number of our partners from across the globe have taken time to reflect on the profound impact of the Russian invasion of Ukraine on the commodities sector. It includes contributions from our offices in Australia, Geneva, London and Singapore, with articles on energy and food security, sanctions, insolvency, regulation, the energy transition and force majeure.

On the back page, you will find details of the latest news and where you can meet the team next.

Lastly, we are delighted to have maintained our Tier 1 ranking for Commodities disputes in this year's Legal 500 and are grateful to the many clients who provided such positive feedback about the team.

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THE RUSSIA – UKRAINE CONFLICT: IMPACT ON ENERGY SECURITY IN ASIA

It can be difficult to imagine how strongly events in Russia and Ukraine could impact on energy markets in Asia. The reality, however, is that the world's energy markets are so globalised and regionally interlinked that even mildly significant changes in one region can have a huge effect in another.

Context

A number of background factors come into play here. Many countries – including in Asia - have sought recently to move away from burning low net calorific value energy coal as the core of their national energy supply. This is for a number of reasons, including better air quality experienced during COVID lockdowns; the weight of nationally determined contributions for greenhouse gas emissions reductions under the Paris Agreement; and the challenges now associated with seeking regulatory approvals or financing for coal production projects.

Under its One Belt, One Road project, the PRC had been incredibly active in constructing coal-fired power stations along the land belt, in nations such as Pakistan and Bangladesh. However, some of those states began to turn their backs on the new power stations almost immediately. Pakistan and Bangladesh recently vowed to join other Asian nations such as Japan, Korea and Taiwan in moving away from coal as a core energy source and to increase their use of alternative energy sources such as liquefied natural gas (LNG). As a result, the PRC changed tack and indicated last year that it would not construct any further coal-fired power stations abroad, representing a significant departure from its previous long-term strategy.

Whilst also a hydrocarbon fossil fuel which is certainly responsible for the generation of greenhouse gases in its production, transportation, storage and consumption. LNG is nonetheless significantly less environmentally unfriendly than older generation fuels such as coal or oil. In addition, recent technological developments (particularly in respect of floating storage and regasification units, or FSRUs) have considerably reduced the cost of installing technically complex LNG receiving terminal infrastructure. These factors have led to LNG becoming the 'interim' fuel of choice for energy transition purposes in Asia, and beyond.

It is now widely anticipated that LNG will continue to bridge the gap between 'dirty' hydrocarbons and 'clean' energy sources that are not yet sufficiently advanced to meet global energy requirements. This transitional role looks likely to last – by design or by necessity - for many years to come, as borne out in practice by many Asian nations including Pakistan, Thailand, Sri Lanka and the Philippines looking to construct new complex and expensive LNG receiving facilities to alter their national energy mix going forward. This can only reasonably be viewed as a medium to long term investment strategy, given that such facilities cost hundreds of millions to billions of dollars to construct or assemble.

Impact of the Russia-Ukraine conflict

Against this backdrop, there are many ways in which the Russia-Ukraine conflict has had a significant impact on energy security challenges in Asia. We consider a few below.

- Russia was widely anticipated to be one of the world's largest future sources of production and supply of LNG. Global sanctions imposed on Russia have had a significant effect on its technical and financial ability to proceed with the construction and implementation of scheduled gas liquefaction projects.
- While many Asian states have not necessarily implemented energy sanctions against Russia themselves, many other states, or blocks such as the EU, have. This has had a significant impact on parties' ability to either produce or lift LNG cargoes in Russia,

as well as on the construction of liquefaction facilities. Such processes are complex and may well require the involvement of third parties that are subject to sanctions, including international survey companies; vessel owners and operators; and banks necessary for the establishment of the high value security instruments commonly used in international LNG sale and purchase. As such, even where Asian parties are legally free and clear from applicable sanctions and want to lift Russian cargoes, doing so is not necessarily that simple.

- Some Asian market participants are struggling with the potential reputational impact of continuing to purchase Russian LNG, or of participating in Russian upstream LNG projects. The impact on those projects of the Russia – Ukraine conflict is still playing out but as a minimum, intended purchasers from them, or parties retaining equity stakes in them, may be subject to significant scrutiny from the international community and risk a potential reputational impact or, worse, international counterparty boycotts, or sanctions breaches. It is still too early to assess the full effects of this situation; time will tell.
- Europe is now diversifying its own energy mix and moving away from what has been shown to be a significant overdependence on Russian pipeline gas. This is likely to involve the construction of new LNG receiving terminals (including many FSRUs) across coastal Europe, capable of receiving LNG shipments from North Africa, the USA, the Middle East, or further afield.

In simple terms, all this (and more) has led to a scramble for LNG. This is most obviously reflected in the market price of LNG, which has rocketed, with spot prices rising more than 1,800% in the last 18 months. Asian states that were previously heavily reliant on coal and oil are looking to sign up to long term LNG sale and purchase arrangements. Europe is looking to do the same. There is potential for a major energy security issue to arise for many Asian states, in circumstances where global analysts had anticipated an oversupply of LNG for the next few years or even decades. We have seen the brutal reversal of that assumption in a tremendously short period of time. (Against this backdrop of sudden and surging demand for LNG and growing energy security concerns, it is interesting to note that despite its announcement last year, the PRC has in fact continued to build overseas coal-fired power stations.)

Other, broader LNG market developments have added to the legal complexity of some trades and shipments. These include the move away from traditional 'tram line' production facility to end buyer trade routes, and the influx of proprietary traders in the LNG space. It is now not uncommon for an individual LNG cargo to be traded multiple times on the water. The LNG space has become a fertile one for disputes, as borne out by the significant range of issues on which we have, increasingly, assisted our clients over the last few months and years.

From a legal perspective, aside from the sanctions issues which will undoubtedly remain relevant for some time, the consequence of all this is that significant disputes are now emerging in the global LNG markets. These may relate to participation in upstream production projects; shortfalls in supply; or non-performance of individual cargoes. The exponential growth in the value of individual LNG cargoes means that such disputes are too big for parties not to contest them. In the same way, pricing disputes under long-term LNG sale and purchase agreements are set to increase in both volume and value, with many more of these likely to be submitted to price review arbitration globally.

The Russia – Ukraine conflict has significantly exacerbated existing issues with the result that increasing energy security concerns and challenges in Asia will give rise to greater complexity and more disputes in the LNG space going forward.

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SEISMIC SHIFT IN OVERSIGHT OF COMMODITY TRADERS OFFERS OPPORTUNITY FOR THE INDUSTRY

Commodity traders and the energy markets have got the world's attention. The Russian invasion of Ukraine has sparked the beginning of what is likely to be a seismic shift in the oversight, regulation and enforcement of the commodity trading industry. This offers a unique opportunity for commodity traders to help shape that shift and to ready their businesses for what is coming, in turn increasing their competitive advantage.

In the UK, we have seen a Bank of England liquidity fund of £40 billion for energy suppliers and a package of £100 billion to deal with surging energy prices. Top of the EU's agenda is an attempt to reach consensus on what to do about intervention in the energy market. In the meantime, hikes in energy prices have created raging inflation in Europe, foreshadowing a European - if not global - recession.

Energy market price increases have been likened to a "Lehman moment" for the energy sector and have sparked a UK government review described as being intended to "*undertake fundamental reforms to the structure and regulation of energy market through recommendations from a new review of the UK energy regulation.*"

The UK review mirrors a global concern and review of the energy and other commodity markets.

The Financial Stability Board, an international body that monitors and makes recommendations about the global financial system, is looking at three areas in relation to commodity markets under the umbrella of its snappily titled "non bank intermediation sector" work. First, it is looking into "*linkages between commodity markets and the rest of the financial system. … second, … commodity market volatility [which] has led to large margin calls for commodities derivatives, that seem to have placed strains on a number of market participants. Third, [gaining]…. a more comprehensive picture of leverage in the financial system and possible amplifiers in the event of market stress, including through banks' prime brokerage businesses.*". A report is due next month.

When explaining the problem in the aftermath of Lehman, Mary Schapiro, then SEC Chairwoman, referred to "*the proliferation of complex financial products, including derivatives, with illiquidity and other risk characteristics that were not fully transparent or understood.*"

The comparison to the Lehman moment is likely a good one. Commodity traders have long been under the radar and their business not well understood. Central banks have this year spoken of the opacity of commodity trading. For example, physically settled transactions that are not reportable create potentially huge unknown exposures. The LME nickel market meltdown earlier this year is a stark reminder of and wake-up call to the problems which can ensue.

While the catalysts for Lehman and the global financial crisis may be different, governments have identified the importance of commodity traders to global financial stability.

Against that backdrop, more government oversight, scrutiny and enforcement is inevitable. Indeed, enforcement in the commodity sector had been gaining momentum even without the energy crisis.

Glencore recently pleaded guilty in the US and UK and agreed to pay over US$1.1 billion in respect of bribery and market manipulation violations relating to the Platts oil benchmark. (The UK sentencing is slated for later this year). Just over a year and a half ago, Vitol entered into a US$135 million settlement with the US Department of Justice for bribery violations under the Foreign Corrupt Practices Act, and a related settlement with the US Commodity Futures Trading Commission in respect of manipulation of the Platts oil benchmark. There is reported to be an ongoing investigation into manipulation of the Platts oil benchmark involving a cooperating witness.

Against this backdrop, what should commodity businesses do?

First, in the context of the general review into the industry and global financial stability, we recommend commodity businesses work to ensure that their compliance house is in order and that existing policies and procedures are demonstrably fit for purpose.

HFW has a team of experts helping clients with their compliance programmes using a two-phase approach: first, a series of checks to understand what exactly is actually going on in a business from a compliance perspective and second, to enable change where necessary.

Second, it is likely that commodity business leaders will be called upon to explain the industry and the work they do in it as part of the global reviews of the industry being undertaken.

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"Indeed, enforcement in the commodity sector had been gaining momentum even without the energy crisis."

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THE RUSSIA-UKRAINE CONFLICT: IMPACT ON THE RENEWABLE ENERGY TRANSITION

This article considers some of the possible short and long term impacts of the conflict in Ukraine on the renewable energy transition and how these might influence net-zero commitments and geopolitical strategy going forward.

History clearly demonstrates the close connection between civil unrest and energy resources. The oil wars of the 1970s highlighted a global overreliance on oil from the Middle East and prompted consideration of energy alternatives. Now, the war in Ukraine has demonstrated Europe's overreliance on Russian gas, with subsequent shockwaves being felt around the world in terms of both prices and policies.

War in Ukraine has made energy transition even more critical because of its potential to provide greater energy security and thereby change the future of geopolitics by decentralising supply of – and power over - energy commodities.

Against this background, we are now seeing increased nationalism and the formation of strategic partnerships to ensure energy security through energy transition at the forefront of many government agendas. However, the short-term reality also seems to be that any ongoing conflict in Ukraine will force governments to prioritise investment in immediate fossil fuel energy supply - so as to ensure energy security - over meeting decarbonisation goals through energy transition.

Energy crisis in Europe, a crisis of conscience

From an energy perspective, Europe's reliance on Russian fuels has seen it most directly affected by the war in Ukraine. Of the EU member countries, Germany is most reliant on Russian gas and, in the wake of the Russian invasion of Ukraine, it committed to divesting of all reliance on Russian gas by 2024. As Russia has retaliated to threats of price caps by cutting supply, this sharp pivot to alternative energy sources is not without consequence. In efforts to alleviate immediate pressures on energy supply, Germany will now keep unpopular nuclear plants, previously destined for closure, in operation. Similarly, Germany and the United Kingdom have also resorted to stalling the planned closures of coal-fired plants.

In order to secure energy supplies, particularly for the coming winter, Germany is also looking to Asia and the Middle East for gas and LNG, requiring unanticipated investment in fossil fuel technologies, including the leasing of storage facilities and construction of regassification infrastructure in German ports. However, conscious of its climate commitments, Germany has partnered with Qatar not only to provide much-needed gas, but also to establish a trade deal for green hydrogen. Many pundits remain hopeful that the hastened retreat from Russian gas may in fact result in an accelerated energy transition in Europe by increasing focus on renewable projects including the North Sea Wind Power Hub, which is planned to be jointly owned and operated by various European countries.

Critical minerals, critical supply

Although no single nation has power over the sun or wind, the same cannot be said for the critical minerals required for solar, wind and other renewable technologies. The war in Ukraine has already had a significant impact on critical mineral markets, including the extraordinary price volatility in the nickel markets earlier this year.

Russia is among the world's highest producers of a number of key critical minerals, including nickel, aluminium, titanium, scandium and palladium, the latter of which is crucial to the automotive and semiconductor industries and of which, Russia is responsible for close to 37% of global production[1]. Ukraine is a key producer and manufacturer of titanium and titanium products. Investments in critical mineral projects in Russia and Ukraine are now uncertain, with the war obstructing both production and supply.

“War in Ukraine has made energy transition even more critical because of its potential to provide greater energy security and thereby change the future of geopolitics by decentralising supply of – and power over - energy commodities.”

As a result, the need for secure supply chains of critical minerals for energy transition has become even more acute. However, attempting to diversify supply is far from straightforward, partly due to the long lead times for exploration, mining and production, but also because the world’s best-known deposits of critical minerals are located in nations beset by geopolitical instability and poor ESG standards. It is estimated that 75% of the most in-demand critical minerals is produced by just three countries, including China and the Democratic Republic of Congo.[2]

The complexities of the critical mineral supply chain and the potential volatility of the markets for these commodities are now influencing government agendas and policy.

There has been an increase in nationalism, particularly in the United States and Australia, with the Australian government funding domestic exploration and development of critical mineral mining as well as announcing plans to produce batteries domestically. Elsewhere, the UK government published its first ever Critical Minerals Strategy to ensure that the UK remains “in the game”.

However, at the same time, multinational trade and finance partnerships are also being established among like-minded nations, to enhance value chains and increase energy security. One recent example is the US-led Minerals Security Partnership whose members include the US, Australia, Canada, Finland, France, Germany, Japan, the Republic of Korea, Sweden, the UK and the European Commission. In September, Ursula von der Leyen announced plans for an EU Critical Raw Materials Act, aimed at avoiding the risk of becoming dependant on other countries by identifying strategic projects along the supply chain and building up strategic reserves.

Conclusion

There is no doubt that the short-term impact of the war in Ukraine has been increased investment in fossil fuel technologies.

However, the war has certainly increased the impetus for diversification of both fuel and critical minerals supply chains, which is bound to have positive long-term consequences for the energy transition. The formation of strategic, trade partnerships for creating secure supply chains has been accelerated which will in turn, perhaps, fast-track the energy transition’s progress. These partnerships will underpin an increased desire to invest in critical mineral mining projects in stable countries with high ESG standards, such as Australia.

Ultimately, the impetus towards energy independence, born out of the energy transition, could bring about a new era in geopolitics, with reason to hope this may minimise the scope for, and duration of, future conflicts and any resultant energy crises.

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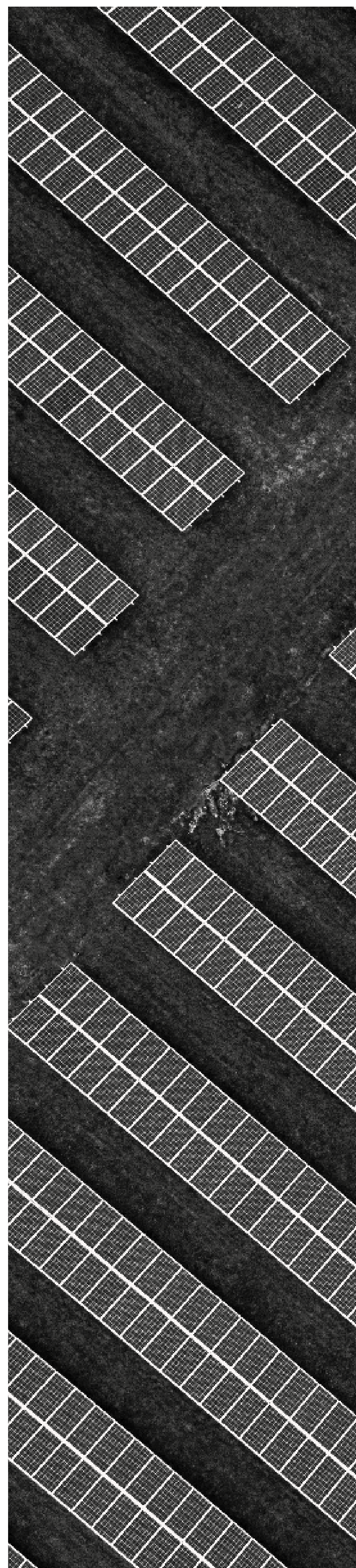
Footnotes:

1. Columbia | SIPA Center on Global Energy Policy | Supply of Critical Minerals Amid the Russia-Ukraine Crisis and Possible Sanctions
2. The state of play – The Role of Critical Minerals in Clean Energy Transitions – Analysis - IEA



THE RUSSIA-UKRAINE CONFLICT: LATEST DEVELOPMENTS IN SANCTIONS

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Following Russia's invasion of Ukraine, an unprecedented series of sanctions was imposed that were almost bewildering in their speed and extent. The impact on the commodities sector was profound. In this article, we set out the latest developments in EU sanctions and our assessment of the situation, both to bring readers up to date and by way of illustration of the range and complexity of issues to which the sector has been exposed.

7th package of EU sanctions relating to Russia

This was announced by the EU on 21 July 2022 in further amendments to EU Council Regulation 833 of 2014 (the "EU Regulation") as amended.

Oil

Amongst the main changes introduced was the amendment of article 5aa, which prohibits engaging in transactions directly or indirectly with entities listed in Annex XIX (including Rosneft, Gazprom Neft and Transneft). Whereas the original provision included an exception for "*transactions which are strictly necessary for the direct or indirect purchase, import or transport of Russian natural gas, oil, titanium, aluminium, copper, nickel, palladium and iron ore into the Union, a country member of the European Economic Area, Switzerland, or the Western Balkans*", it now differentiates oil from these other commodities. Transactions with entities listed in Annex XIX with respect to commodities other than oil remain prohibited unless the commodity is being imported "into the Union…", but transactions with these entities as far as Russian oil is concerned are now permitted, regardless of whether the oil is being transported into the Union or not.

Accordingly, all transactions with entities listed in Annex XIX are now permitted with respect to Russian oil, as long as they are "*strictly necessary*" for the purchase, import or transport of that oil, and in so far as the transaction is not prohibited by article 3m (prohibition on Russian oil purchase, import and transfer/ transport into the EU and related services) or article 3n (prohibition on services relating to the transport of Russian oil outside the EU). To date, the EU has not provided any guidance on what "*strictly necessary*" means.

Whilst not entirely clear from the language of the provision, the EU has stated that article 3m is only engaged when Russian oil is being imported into the EU[1]. Accordingly, under article 3m it is prohibited directly or indirectly to purchase, import or transfer crude oil or petroleum products, as listed in Annex XXV, if they originate in Russia or are exported from Russia and to provide certain types of services, including brokering services and insurance, if the oil is coming into the EU. However, that prohibition is subject to various exceptions, including a wind-down period for spot contracts until 5 December 2022 for CN 2709 00 oil (crude) and 5 February 2023 for CN 2710 oil (products).

Under article 3n, it is prohibited to provide certain services, including brokering services and insurance related to the transport of Russian oil outside the EU. This is subject to a wind down period for pre-existing contracts (sales contracts and brokering contracts concluded before 4 June 2022) provided that they are executed before 5 December 2022.

Gold

Article 3o of the EU Regulation now prohibits the purchase, import, or transfer/transport, directly or indirectly, of gold, as listed in Annex XXVI, if it originates in Russia and it has been exported from Russia into the Union or to any third country after 22 July 2022. It also prohibits the provision of certain types of services in that respect, including brokering services and insurance. This ban was imposed with immediate effect, with no wind down period. There are exceptions, which relate specifically to diplomatic or cultural purposes and products which are not intended for sale. Switzerland mirrored this change on 3 August 2022.

“Given that the FAQs are non-binding in character, the question remains whether EU operators can safely rely on them.”

What is the impact?

It is now permitted to trade with an Annex XIX entity, i.e. to lift Rosneft/ Transneft pipeline crude, where it is bound for a destination outside the EU.

If coming into the EU, it is permitted to lift oil products from Annex XIX entities until 5 December 2022 for CN 2709 00 oil (crude) and 5 February 2023 for CN 2710 oil (products). It is also permitted to provide brokering services and insurance with respect to the trading of Russian oil coming into the EU until 5 December 2022 for CN 2709 00 oil and 5 February 2023 for CN 2710 oil.

Pre-existing brokering or insurance contracts (concluded before 4 June 2022) related to the transport of Russian oil outside the EU are permitted, as long as they are executed by 5 December 2022. This would include paying out all claims under an insurance policy (unless the EU Regulation or FAQs are updated on that issue). However, new brokering services or insurance related to the transport of Russian oil outside the EU remain prohibited, notwithstanding the relaxation of the restrictions on trading with Annex XIX entities.

All of the above are subject to the “*strictly necessary*” criteria in article 5aa of the EU Regulation, described above.

Interaction with UK sanctions

Under the Russia (Sanctions) (EU Exit) Regulations 2019 (as amended) (the "UK sanctions"), it is currently permitted to provide brokering services and insurance with respect to the trading of Russian oil. However, from 31 December 2022, it will be prohibited to do so under the UK sanctions if the oil is being imported into the UK (or the intention is that it comes into the UK). It is important to remember that if Russian oil is coming into the EU, EU sanctions would be applicable by reason of article 13(e) of the EU Regulation, even if the company involved is based in the UK with no EU nexus whatsoever.

Latest guidance

The EU updated its FAQs on the import, purchase and transfer of some listed goods on 10 August and 19 September 2022. These FAQs provided guidance on articles 3g (iron and steel products), 3i (goods which generate significant revenues for Russia) and 3j (coal) of the EU Regulation.

The update on 10 August made clear that the prohibition on the goods listed in Annexes XVII, XXI and XXII apply even when the goods are not destined for the EU. However, on 19 September, the Commission introduced an exception to these prohibitions, for the transfer/transport outside the EU of some goods listed in Annex XXI (some fertilizers, certain hydrocarbons, certain animal feed and some essential goods including wood and cement products) and all the goods listed in Annex XXII (coal and related products) and related financing or financial assistance, in order to combat food and energy insecurity and avoid negative consequences of sanctions preventing the transfer of those goods to third countries.

Given that the FAQs are non-binding in character, the question remains whether EU operators can safely rely on them.

HFW comment

The position on sanctions continues to change frequently and the only way to be sure that your understanding is up-to-date is to exercise due diligence by checking that new contracts remain lawful in all jurisdictions applicable to your situation, both in terms of suppliers and related parties' listing status and sectoral sanctions.

Given the multi-jurisdictional nature of international trade, the situation is set to remain challenging for owners, traders, charterers, insurers and banks for at least the rest of this year and likely into 2023. However, our view is that the situation is stabilising as world trade adjusts to the new patterns of 2022.

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HOW DEEP DO YOU NEED TO DIVE TO MITIGATE AGAINST A FM EVENT?

The Russian invasion of Ukraine has turned the spotlight onto two particular types of clause in commodities contracts: sanctions and force majeure ("FM"). The avalanche of global sanctions imposed in response to the invasion created huge challenges for commercial parties and many found themselves having to put sanctions related contractual wording to the test as a result.

In addition, a large number of affected commercial parties triggered the FM clauses in their contracts. Doing so always involves risk: it is difficult successfully to argue that contractual performance has been prevented or delayed by FM, in part because English courts and arbitration tribunals will interpret such clauses strictly and narrowly, against the party seeking to rely on them.

Given all this, a recent decision of the Commercial Court[1] (unrelated to the Ukraine war) has attracted particular interest because it required first the arbitral tribunal and then the Commercial Court to interpret a FM provision in light of the application of sanctions.

Background

In June 2016, MUR Shipping BV ("Owners") concluded a Contract of Affreightment ("COA") with RTI Ltd ("Charterers") for the carriage of bauxite over several shipments.

The COA provided for payment of the freight in US dollars. It also included a FM clause, which stated, amongst other things, that the FM event could not be "*overcome by reasonable endeavours from the Party affected.*"

In April 2018, the US Department of the Treasury's Office of Foreign Assets Control applied sanctions to Charterers' parent company. Owners invoked the FM clause and issued a notice which stated that:

- it would be a breach of sanctions to load any further cargoes under the COA.
- the sanctions would prevent dollar payments, which were required under the COA.

Charterers responded that sanctions would not interfere with cargo operations and that payment could be made in euros instead. Owners argued that freight had to be paid in US dollars and the FM event did impact cargo operations, as they could not be expected to load and discharge cargo without receiving payment in accordance with the COA.

Charterers found alternative tonnage and brought a claim for the additional costs incurred by way of arbitration under the terms of the COA.

Tribunal's Decision

The Tribunal held that payment in US dollars would fall foul of sanctions, as any US dollar payments would very likely have to pass through a US intermediary bank, which would stop the transfer based on Charterers' status as a blocked party in order to investigate further. It held that "*common sense indicates that any US bank would exercise extreme caution before making a payment that could conceivably fall foul of sanctions legislation.*"

The Tribunal found that Owners' case on FM would have succeeded, but for the "reasonable endeavours" provision in the FM clause. It held that this required Owners to accept payment in euros rather than in US dollars. As Charterers had indicated they would bear any additional costs or exchange rate losses incurred, Owners would have suffered no detriment. Owners appealed.

Commercial Court Decision

Two issues of particular interest came before the Court. First, Owners argued that the exercise of reasonable endeavours did not require an affected party to agree to vary the terms of the contract, or to agree to a non-contractual performance. Second, Charterers contended that the Tribunal's award should be upheld on additional grounds, because of a problem with causation, namely that the imposition of sanctions and difficulties with payment did not interfere with cargo operations.

Reasonable endeavours

On this point, the Court overturned the Tribunal's decision, finding in favour of Owners. It confirmed that the COA required payment to be in US dollars only:

"*If there was a contractual right to payment in US$, and a contractual obligation to pay in that currency, then this was a right and obligation which formed part of the parties' bargain. The exercise of reasonable endeavours required endeavours towards the performance of that bargain; not towards the performance directed towards achieving a different result which formed no part of the parties' agreement.*"

A payment in euros that would be converted to US dollars was still a non-contractual payment. Charterers' offer to cover any costs incurred as a result only highlighted that the alternative method of payment was non-contractual, as it required workarounds to be inserted so that Owners could receive fair payment under the COA.

Causation

Here, the Court disagreed with Charterers' contention that the Tribunal had been wrong to find that the imposition of sanctions caused a delay to cargo operations. It held that:

"*It [was not] possible to discern any error of law in the Tribunal's conclusion that (reasonable endeavours apart) the Owners' case on FM succeeded in all other respects.*"

Consequences for mitigation

In English law, a party affected by a FM event generally has an obligation to mitigate the effect of that event. Where the obligation begins and ends, however, has proved difficult to judge for commercial parties.

This decision, although in the context of a specific requirement to use reasonable endeavours, does offer some guidance. It suggests that although a party affected by a FM event is always required to mitigate, it need only do so in line with the contractual bargain and is not required to accept performance outside of the original contract terms.

For the many commercial parties affected by the invasion of Ukraine and ensuing sanctions who may be invoking FM provisions, that guidance will be helpful.

The decision is currently being appealed.

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Footnotes:

1. MUR Shipping BV v RTI Ltd [2022] EWHC 467 (Comm)

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FOOD SECURITY IN THE WAKE OF THE RUSSIA-UKRAINE CONFLICT

In addition to upending global recovery in the post-pandemic world, the Russia-Ukraine conflict has put the agri-commodities sector under enormous strain. Food security has become one of the most pressing concerns for many nations worldwide, resulting in the adoption of a series of defensive measures at national level to manage the global food crisis.

How has the war impacted food security?

As one of the world's "breadbaskets", Ukraine is a leading producer of cereal crops. It enjoyed record-breaking grain and oilseed harvests in 2021-22. However, from the time of invasion, Russia blockaded maritime access to the Black Sea ports in Ukraine. As a key point of export for Ukraine's agri-commodities, this had a significant impact on the industry globally, pushing up prices and raising major concerns about food shortages in several parts of the world.

Russia itself is one of the world's top wheat exporters and its 2021-22 harvest was also plentiful. However, it introduced temporary export bans on wheat, meslin, rye, barley and corn for several months this year. In addition, the effect of global sanctions has been to create practical challenges for those seeking to trade with Russia in terms of obtaining finance and insurance, making payments, arranging transport and dealing with service providers. Aside from all these practical issues, many companies are giving careful pause for thought before trading with Russia.

Add into the mix soaring fertiliser prices and rising energy costs.

What has been the result?

The result has been spiking prices, exacerbating concerns over food security. This was against a backdrop of reduced crop yield in some areas due to drought – and there are concerns that the lack of rainfall will affect next year's harvest, too. Developing nations have been hit the hardest.

A number of countries responded by seeking to ensure food security for their own people. Hungary, Egypt and Serbia banned exports of various types of grains and other soft commodities. India banned the export of milling wheat and Indonesia banned exports of palm oil in an attempt to manage escalating prices. Whilst many of these measures have since been repealed, they added to an already volatile international problem.

How have traders been impacted by the war?

We have seen an increase in the number of cancellations and force majeure declarations in grain contracts. For instance, Egypt cancelled contracts for a total of 240,000 tonnes of Ukrainian wheat that had been agreed by its state grains buyer earlier in the year.

However, not all of these force majeure declarations were successful, as grain was still being transported via rail and road from Ukraine, albeit at a considerably reduced rate and to fewer countries.

Black Sea Grain Initiative

In July 2022, with the aid of the UN and Turkey, Russia and Ukraine agreed a deal to minimise the impact of the war on food security around the world. The Black Sea Grain Initiative has seen the resumption of shipments of grain from Ukrainian ports.

The first vessel loaded with corn sailed from Ukraine on 1 August 2022 and as at 1 September 2022, more than 100 grain-carrying vessels had left Ukraine. The effect was almost immediately to push down global prices. However, it will take some time for exports to reach anywhere near pre-war levels and the return of prices to equilibrium is far from guaranteed.

It is also not certain that the initiative represents a clear end to force majeure claims being made under sale contracts, as traders compete for a limited number of cargoes, many of which have already been committed to specific customers or destinations.

“If the initiative does not continue, it has the potential to reverse the decrease in prices and may also signal a fresh wave of force majeure declarations.”

Russia has since criticised the deal, claiming that much of the grain leaving Ukrainian ports reaches the EU rather than the developing countries most in need of the grain. It has claimed that the defective terms of the deal are to blame for the ongoing global grain crisis and is considering limiting the export of grain along the EU route. It is therefore far from clear that the corridor will be extended at the end of its initial term, which is due to expire in mid-November.

If the initiative does not continue, it has the potential to reverse the decrease in prices and may also signal a fresh wave of force majeure declarations. Any price increases could trigger further protectionist measures in the form of export bans as part of national defence strategies against food insecurity and rising prices.

It is also clear that the Ukrainian farming, harvest and export programme will be significantly disrupted for some time and the destruction of critical infrastructure is likely to delay any resumption of exports. In Russia, the partial mobilisation announced recently could have a direct impact on next year’s harvest because Vladimir Putin has confirmed that agricultural workers are included within the mobilisation. The impact of the war on agri-commodities looks set to continue and the situation is finely balanced.

Going forward, how can traders manage the situation?

Grain traders will need to monitor the situation closely to determine the feasibility of performance of any contracts which may be affected. For buyers, certainty of performance during uncertain times can be managed with flexible contractual arrangements which provide for optionality as to origin and load ports. On the other hand, sellers who have limited supply options will likely prefer much tighter provisions and less optionality such that their performance may be excused if their intended source of supply falls through.

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THE RUSSIA-UKRAINE CONFLICT: INSOLVENCY RISK IN ENERGY MARKETS

The war in Ukraine has caused significant disruption to the supply of commodities globally, particularly in the energy sector. In Europe, governments are proposing the implementation of measures to combat an increase in insolvencies triggered by the rising cost of power and gas. In Australia, participants in the energy sector are also mindful of insolvency concerns, having regard to increased gas costs, a looming deficit in gas supply, and the overall impact of the global economy on power and gas prices and supply.

Europe

European governments have taken vital steps to protect energy companies from the consequences of price volatility occasioned by the Russia-Ukraine conflict. Primarily, this is because European importers compelled to procure gas on the spot market have been unable to pass on the higher prices to their customers, as many receive their gas under long-term contracts that are not open to renegotiation.

For example, in July the German government proposed emergency amendments to energy legislation allowing it to "*take stakes in companies impacted by the rising cost of imported gas as tensions with Russia threaten to plunge the country's power sector into crisis.*"[1] The amended law was intended to "*allow importers to pass on the higher costs of the gas they are procuring on spot markets to all their customers, and so avoid insolvency.*" In September, the German government took the drastic step of nationalising Uniper (its biggest gas importer) in order to prevent energy shortages. This followed a EUR15 billion bailout of the company in July.

Also in September 2022, Finland and Sweden announced plans to offer similar bailouts in the form of liquidity guarantees to power companies following Russia's Gazprom shutdown of the Nord Stream 1 gas pipeline in early September. Finland's Prime Minister Sanna Marin described the government's intervention as a "*last-resort financing option for companies that would otherwise be threatened with insolvency*".[2]

Australia

The effects of the conflict are not limited to Europe. Australia's electricity and gas prices have reached record highs as a result of the European energy crisis. The Australian Energy Regulator has warned that "*expectations are for high prices to continue in coming years*" – illustrating the need for Australian market participants to remain proactive and take stock of the evolving situation in Europe. The Regulator is also being vigilant in awarding electricity retail licences, requiring businesses to demonstrate a strong balance sheet and the ability to cope with market swings.

High wholesale market energy prices and caps on customer pricing have resulted in several large retail insolvencies in Australia. The dire situation has also made it difficult for other small retailers to operate. With price increases, disruptions to supplies and rising inflation, and assuming that there is no government intervention similar to that in Europe, businesses should ensure appropriate risk-mitigation strategies are implemented and reassessed periodically as the energy crisis unfolds.

What can businesses do to protect themselves?

Businesses in the energy sector - and those which are heavily dependant on the energy sector - should be particularly vigilant because of the increased risk of insolvencies. By addressing potential insolvency concerns at the outset, market participants will be in a better financial position in the long-term.

In order to ensure that counterparties are solvent, reputable and, importantly, not impacted by global sanctions, it would be prudent to carry out thorough due diligence and credit checks on contractual counterparties. In

addition, businesses should consider securing back up-supply options and employing other risk mitigation strategies. These strategies are likely to differ depending on where the business sits within the supply chain but may include:

- Negotiating tighter trading terms to control volatile market conditions – including pre-payment or shorter term trading terms where possible.
- Consideration of “fair market price” in the context of price arbitration clauses in long term contracts or alternatively, negotiation of appropriate terms (price escalation / force majeure / hardship) in new longer-term contracts.
- Monitoring market changes and sanctions and obtaining regularly updated, relevant advice from trusted advisors.
- In Australia, entering into a Retention of Title agreement and registering the security interest under the *Personal Property Security Act 2009* (Cth) (“PPSA”) – where delivery of commodities is made before payment is received, parties should ensure a valid security interest is created and perfected on the Personal Property Securities Register (“PPSR”).

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Footnotes:

1. Germany draws up law to take stakes in struggling gas importers | Financial Times (ft.com); Russia-Ukraine war: Germany set to pass law to bail out struggling gas importers, including Uniper, after Gazprom reduced flows (afr.com)
2. Russia-Ukraine war: After Nord Stream 1 shut down, Sweden, Finland forced to avert crisis for energy companies (smh.com.au)
3. The Australian, Power, gas price pain to last years: Australian Energy Regulator, 6 September 2022

Where you can meet the team next

- HFW is a proud gold sponsor of Asia ADR Week 2022, which will feature discussions on best practices, innovative approaches to Alternative Dispute Resolution and legal developments. Find out more and see the full programme here.
- Damian Honey and the HFW commodities team presents our Autumn Breakfast Seminar Series (18 October, 3 November and 16 November 2022). Click here to register. Topics include future regulation for the commodities markets, LNG boom, digitalisation of trading documentation, latest compliance developments for commodity traders and more. If you have any queries, please contact events@hfw.com.
- HFW will be a seminar sponsor at this year's INSOL BVI Seminar (17 November 2022). Rick Brown, Simon Jerrum and Scott Cruickshank will be attending.

For more information on upcoming HFW events, click here.

Other Team News

HFW has once again been recognised as a leading firm in the 2022-23 edition of The Legal 500 UK, a guide to the world's best lawyers and law firms.

We achieved 21 practice rankings in the 2022-23 guide, covering a wide range of areas including aerospace, commodities, construction, energy and resources, insurance, shipping, disputes and finance. Click here for more information.

HFW regulatory defence and investigations partners Barry Vitou and Anne-Marie Ottaway have been recommended and recognised as 'global leaders' by Who's Who Legal for investigations, business crime defence - corporates, and business crime defence - individuals.

Barry and Anne-Marie advise corporations and individuals on all aspects of economic crime, including compliance, pre-investigations, investigations, and prosecutions relating to fraud, bribery and corruption, insider dealing, market abuse and money laundering. The team advise on regulatory investigations all over the world, and frequently represent clients under investigation by law enforcement agencies and prosecutors. To find out more, speak to Barry or Anne-Marie.

We are pleased to announce that HFW's Helen Chen has been elected to The Law Society's Council for 2022-23 representing Women Lawyers along with four other female solicitors.

Helen transferred from HFW's BVI office to the Commodities Disputes team in London in July 2022. Helen has offshore experience in fraud and insolvency work and is now broadening her practice to include commodities and energy trading, shipbuilding and yacht-related disputes both in court proceedings and arbitration.

Best Law Firm 2022 in Environmental Finance Awards

HFW has won Best Law Firm in Environmental Finance's Voluntary Carbon Market Rankings 2022. The Rankings are Environmental Finance's annual poll of the market, in which market participants vote for the leading companies and initiatives that exhibit best practice and innovation. This recognition reflects the work and strong profile of Peter Zaman, Jo Garland and their teams.

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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