Commodities

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COMMODITIES BULLETIN

Dawn raids: focus on commodities

In the wake of recent dawn raids conducted by the European Commission (the Commission) on oil majors, there is continued focus on competition law issues within the commodities sector. The Commission has revealed that up to 50 other companies could be implicated in its investigation and added as defendants in any prospective anti-trust action.

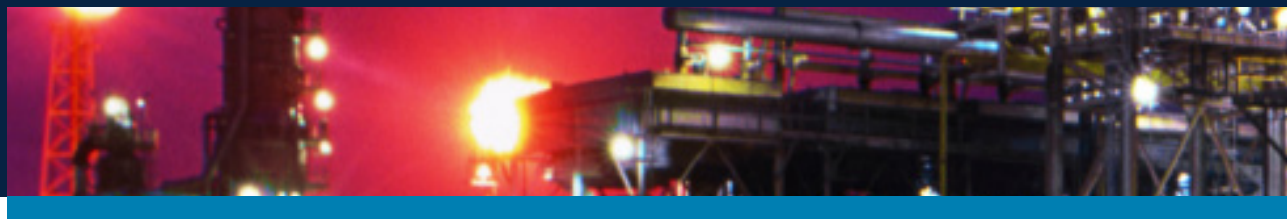
Various trading houses have already fallen under scrutiny and have reportedly received a formal request for information regarding the oil price fixing investigation.

The investigation of the oil majors related to suspected violations in the way that prices of crude oil, refined oil products and biofuels are assessed. The main concern is that these companies may have colluded in reporting distorted prices to Price Reporting Agencies, in order to manipulate the published prices for a range of oil products and biofuels. There were also concerns that other companies may have been prevented from participating in the price assessment process, with a view to distorting prices.

The key provision of the Treaty on the Functioning of the European Union (TFEU) in relation to this investigation is Article 101. This prohibits collusion between companies that has as either its object or effect the prevention, restriction or distortion of competition within the internal market. Fixing prices is one of the clearest examples of this. Article 102 of the TFEU, which prohibits unilateral behaviour by dominant companies, may also be relevant.

The investigation is ultimately likely to result in further regulatory action and a stricter oversight of both traders and price reporting agencies.

A number of factors have contributed to this focus on the commodities sector. The recent Libor manipulation scandal is likely to have been a significant trigger, particularly following the statement last month by one of Europe's largest trading groups, warning of "inaccurate pricing" in crude and oil products.



The sharp rise in commodity prices over the past few years and concerns over the effects of speculation and market volatility in this sector will also have been factors. Companies in the sector should be prepared for continued scrutiny from the Commission.

The Commission has extensive powers to investigate infringements under the TFEU, including the power to conduct "dawn raids" – surprise inspections of company premises - on the basis of an EU authorisation or decision. No judicial search warrant is required for this but if they obtain one, officials are also empowered to search the homes of directors and staff suspected of direct involvement.

It is important that companies provide the Commission with adequate cooperation, but without volunteering potentially incriminating information. Penalties for providing inaccurate, incomplete or misleading information can be severe. It is certainly not advisable to attempt to delete or destroy documents – investigators use advanced forensic IT software which is able to detect this activity and retrieve deleted data.

While conducting its investigation the Commission is entitled to review any data carriers and copy any documents deemed relevant in any form, provided they are not legally privileged. We recommend that companies engage external counsel to assist in any response to the competition authorities, and also in the management of any internal audit exercise. European qualified external counsel will enable the company to claim legal professional and legal advice privilege over any documents created for the purpose of obtaining competition law advice, protecting them from disclosure to the Commission.

A company's response to a dawn raid can have a significant impact on its defence. It is of vital importance that companies know what to expect, how to deal with a raid and what steps to take before, during and after the event. Commission investigations can also cause significant disruption to an organisation, not only during a raid but throughout the ongoing investigation, demanding extensive resources and time from senior management.

The competition and regulatory team at HFW has considerable expertise and experience in dealing with Commission competition investigations as well as investigations by National Competition Authorities. Members of our team have spent time working at the Commission in Brussels and our specialist competition lawyers have advised in relation to numerous cartel investigations. We have experience in responding to information requests from the Commission, managing dawn raids and making successful applications for leniency. Our team has particular expertise in the commodities sector and our regulatory lawyers are experts on related market conduct matters.

The HFW Dawn Raid emergency response team is able to offer support and effective legal advice throughout an investigation as well as an invaluable training service in order to fully prepare clients should a raid be carried out at their offices or should an antitrust investigation be initiated by the competition authorities.

For more information, please contact Eliza Petritsi, Partner, on +44 (0)20 7264 8772 or eliza.petritsi@hfw.com, or your usual contact at HFW.

Letters of credit: a cautionary tale

The recent decision in *Standard Chartered Bank v Dorchester LNG (2) Limited* (18 April 2013) acts as a warning to banks to ensure that firstly, they are identified as the endorsee on a bill of lading if they are to pay out under an associated letter of credit and secondly, that any amendments to letters of credit are made with the consent of all parties. The case also provides a useful summary of the application of the Carriage of Goods by Sea Act 1992 (COGSA 1992) to the transfer of rights under bills of lading.

The facts of the case are complicated. Gunvor International BV (Gunvor) shipped around 9,000 MT of gasoil on the vessel "Erin Schulte" (Vessel 1) and around another 9,000 MT of gasoil on the vessel "Maria E" (Vessel 2), both from Benin to Ghana. Gunvor sold both cargoes to UIDC who in turn

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sold them on to Cirrus Oil Services Ltd (Cirrus). Both sale contracts required that the respective buyers open letters of credit. Cirrus applied to its bank, United Bank of Africa (UBA), which opened a letter of credit in favour of UIDC as first beneficiary and later, added Gunvor as the second beneficiary, by way of a transfer letter of credit. SCB was the confirming bank.

On arrival at Takoradi, Ghana, samples of the gasoil on board Vessel 2 were found to be off spec. Cirrus offered to buy the off spec cargo at a reduced price and UIDC agreed. However, Cirrus rejected the cargo on Vessel 1. The letter of credit, which covered both cargoes for the original contract price, was amended to cover only the cargo on board Vessel 2 at the reduced price and not to cover the cargo on board Vessel 1. UIDC informed SCB that the letter of credit was to be amended. SCB sent the amendment to Gunvor, for Gunvor's consent.

Before receiving Gunvor's response, SCB informed UBA (Cirrus's bank) that UIDC had consented to the amendment. This left SCB exposed to the risk of being responsible to Gunvor for the difference between the price for both cargoes under the original letter of credit on the one hand and the reduced price for only one cargo under the amended letter of credit on the other. Unfortunately for SCB, this risk materialised. Gunvor did not accept the amendment and presented to SCB documents, which included the bill of lading, under the original letter of credit in relation to the cargo on board Vessel 1. SCB had to pay out over US$6 million to Gunvor.

On Gunvor's instruction, the shipowner discharged the cargo from Vessel 1 to two new buyers. The shipowner did so on the basis of letters of indemnity rather than on the production of bills of lading. The bills of lading, which had been delivered to SCB by Gunvor when it presented the documents, remained in SCB's possession and were endorsed to SCB.

SCB sued the shipowner for breach of contract. It is well established law that a shipowner will be in breach if he delivers cargo without the production of a bill of lading (even if he does so on the basis of a letter of indemnity) and that the bill of lading holder can sue the shipowner for misdelivery to a third party. The Court had to decide whether SCB was legally the bill of lading holder, and thus whether it had the right to sue the shipowner for breach of contract.

The Court had no difficulty in finding that, under section 5 of COGSA 1992, SCB was the holder of the bill of lading. This was for several reasons: SCB had possession of the bill of lading; SCB had taken delivery of the bill of lading by receiving it, scanning it and sending it to its production centre in India; and, crucially, SCB was the named endorsee on the bill of lading. The fact that SCB was the named endorsee sets this case apart from earlier cases concerned with whether financing banks in possession of bills of lading have or have not taken effective delivery on presentation of compliant documents. The rights under the bill of lading contract between shipowner and bill of lading holder had been effectively transferred to SCB by the endorsement and by the delivery of the bill to SCB by Gunvor.

It was fortunate for SCB that the bill of lading was specifically endorsed to it. Otherwise, it is likely that the case would have been decided differently, potentially leaving SCB unable to recoup over US$6 million paid out to Gunvor under the letter of credit.

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GAFTA prohibition clause: another new decision

Since the start of 2013, the English High Court has given a number of decisions on prohibition clauses, which have been covered in HFW's Commodities Bulletin. In *Bunge v Nidera* (29 January 2013), the Court held that it is necessary for a party relying on the GAFTA 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. A month later, in *Novasen v Alimenta* (27 February 2013) – which concerned the equivalent FOSFA clause – as well as confirming the approach to the assessment of damages established by *The Golden Victory* (2007), the Court held that a buyer's damages against a non-performing seller relying on the clause may vary considerably depending on whether or not it buys in replacement cargo against the loss.

In *Seagrain v Glencore Grain BV* (10 May 2013), the Court rejected a broad interpretation of the GAFTA Prohibition Clause, in particular of the wording *"any executive act.. restricting export"*, and held that proof that the restriction had in fact prevented performance was required before a seller could rely on it.

In July 2010, Seagrain LLC (the Sellers) contracted to sell Glencore Grain BV (the Buyers) 3,000 mt of feed wheat of Ukrainian or Russian origin, C&F, to Israel. The contract (GAFTA 48) incorporated the standard GAFTA Prohibition Clause, the relevant section of which reads:

"...in case of any executive or legislative act done by or on behalf of the government of the country of origin... 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 any unfulfilled portion thereof shall be cancelled."

Ukrainian customs authorities had recently introduced a requirement that samples of cargoes for export be taken and tested during loading. On 28 July 2010, it was made a mandatory requirement of customs clearance that the authorities had cleared the laboratory results of these samples and on 2 August 2010, it was decided that only samples tested at the Kyiv Research Forensic Institute would be accepted.

Sellers terminated the contract, relying on the Prohibition Clause. Buyers successfully claimed damages for wrongful repudiation at arbitration. Sellers appealed to the GAFTA Board of Appeal which upheld Buyers' claim, ruling that there had been no actual restriction on exports and that in order to obtain the protection of the Prohibition Clause, Sellers had to demonstrate clearly that they had made all reasonable efforts to either ship the goods or try to buy replacement goods in order to comply with their contractual obligations.

Sellers appealed to the English High Court, arguing that the GAFTA Board of Appeal should have asked itself whether the acts of Ukrainian customs – in particular the requirement that all samples must be tested at a single laboratory – had the *effect* of restricting the export of goods. They argued that it would have been impossible to export within the contractual window. There had been an "act restricting export" and the Board had set the bar too high.

Buyers submitted that delays in and disruption to the customs clearance regime did not constitute a restriction on export. There was no evidence that the export of cargoes would actually be prevented.

The Court upheld the Board's interpretation of the Prohibition Clause.

First, in order to rely on the Prohibition Clause, it was necessary to show that it had been impossible to perform the contract, not just that performance had been made harder.

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Second, Sellers could not rely on the Prohibition Clause merely because a prohibition had been imposed – the prohibition had to in fact prevent performance.

Third, in other cases, a full export ban had been in place, which was not the case here.

Finally, the term *"any executive... act"* had to be construed in context, and means *"an act done by or on behalf of the government which is in the nature of a formal restriction on exports... It cannot be construed as extending to every action by an official body which has the effect of restricting exports"*.

The Court held that whether the Prohibition Clause was triggered would depend on the particular facts of a case. Here, Sellers could not prove that they were restricted from exporting, only that they were delayed and inconvenienced. They were aware of the difficulties at the contract date and could not supply any evidence to show that they had attempted to do whatever it took to perform the contract.

Sellers' second argument was that the Board had erred in finding that they had to show that they had made all reasonable efforts to ship or buy replacement goods. The Court made no finding on this but observed that it raised the "causal connection" point considered in *Bunge v Nidera*, which is due to be heard by the Court of Appeal in November 2013.

This is currently a dynamic area of law and interested parties should watch developments closely over the coming year.

For more information, please contact John Rollason (pictured below), Senior Associate, on +44 (0)20 7264 8345, or john.rollason@hfw.com, or your usual contact at HFW. Research by Otto Rich, Trainee.

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Conferences & Events

Cargo Courses Seminars
HFW Sydney and Perth
(31 May and 10 June 2013)
Hazel Brasington

Oil and Gas Asia Dispute Resolution
Shangri-La Hotel, Jakarta
(5 June 2013)
Paul Aston

Demystifying China
HFW London
(13 June 2013)
Anthony Woolich,
Catherine Emsellem-Rope and
Matthew Gore

IECA European Conference
Antibes
(23-25 June 2013)
Robert Wilson

26th Annual Bills of Lading Conference
London
(26 June 2013)
Eleanor Midwinter and
Wagner Mesquita

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