



BREXIT: A COMMODITIES PERSPECTIVE

The challenge is by now familiar: the UK is set to leave the EU in March 2019 and the nature and impact of Brexit still remains unclear. Vast numbers of publications speculating on possible outcomes and implications have ensued.

This briefing adopts a different perspective: it identifies the certainties. Some characteristics of the commodities sector will allow for continuity and can act as anchor points for commodities businesses navigating the uncertain path ahead. It concludes by looking at ways in which those in the commodities sector can minimise the impact of Brexit on their business.

English law

The majority of commodities contracts are governed by English law. This includes both the standard terms of trade associations such as GAFTA, FOSFA, the International Cotton Association (ICA) and The Refined Sugar Association, and the standard terms of oil majors widely used in oil trading. There is no reason for this to change post Brexit.

Choosing English law to govern their contractual relationships gives commercial parties certainty as to what their contracts mean and how they will be interpreted in the event of a dispute, both before and after Brexit, based on a long and well respected history of case law. This includes the meaning of Incoterms such as FOB, CIF and DES and the interpretation of the UCP 600 in relation to letter of credit financing.

Trade sanctions

The practical impact of trade sanctions on commodities businesses is substantial and ensuring compliance with sanctions is a key issue for commodities businesses.

On 2 August 2017, the UK government published its plans for sanctions post-Brexit. As almost all UN and EU sanctions are currently adopted in the UK through directly applicable EU Regulations, the UK will need a new legal framework to enforce sanctions, whether they originate from the UK or the UN. This will be achieved through a new Act of Parliament and a Sanctions and Anti-money laundering bill is currently on its way through the House of Commons, with the second reading having taken place on 20 February 2018.

Most of the measures set out in the government's plans are familiar – travel bans and restrictions, asset freezes and financial and trading restrictions – and they will continue to be enforced in a similar way post-Brexit.

The key changes proposed are that (a) the role of the EU Council will be performed by the UK government and (b) rights of challenge will be to UK courts. The main risks for businesses will be that the UK regime will add another layer of complexity to international sanctions regimes and that the UK may act to impose or remove sanctions in a way which puts the UK out of alignment with the EU. The UK could adopt measures which are more closely aligned with the US, or adopt its own restrictions entirely.

UK government policy in respect of sanctions seems unlikely to change substantially however and the practical impact of any changes for commodities businesses is unlikely to be significant. This is for three main reasons:

- Many UK businesses are already affected by non-UK restrictions because of the nature of their business. This will not change after Brexit. EU restrictions, as well as those imposed by other states which impose sanctions, such as the US, Switzerland and Canada, will continue to apply to them as before.
- The UK has a commitment to maintain national legislation to give effect to UN sanctions, which make

up around half of the sanctions regimes currently in place in the UK.

- The balance of the sanctions regimes flow from the EU. Since current UK foreign policy is broadly aligned with EU policy, and the UK has driven the debate in respect of many of the sanctions which have been imposed, the UK seems likely, at least at first, to adopt restrictions in line with those adopted by the EU post-Brexit.

More details can be found in our briefing from September 2017¹.

Data Protection and Cyber

Data protection and cyber security are a current focus for many businesses. Those in the commodities sector are no exception.

The EU General Data Protection Regulation (GDPR) becomes effective across the European Economic Area (EEA), including in the UK, from 25 May 2018. It will also apply to a large number of businesses established outside of the EEA.

With large potential fines (up to 4% of global turnover or €20 million), and the risks of claims from individuals and reputational damage, businesses both inside and outside the EEA are (or should be) now actively making the necessary changes in order to be prepared when the GDPR 'goes live' in May 2018. These preparations should continue as planned, regardless of whether Brexit will happen.

Before Brexit, the GDPR will have direct effect in the UK and so businesses will need to be compliant from 25 May 2018. The UK government is proposing a new Data Protection Bill, currently in draft form, which sets the enforcement mechanisms in the UK for the GDPR, as well as a number of clarifications and exemptions. In fact, the Bill is intended to go beyond the GDPR. In the UK government's Statement of Intent published on 7 August 2017, the Minister of State for Digital, Matt Hancock MP, stated that the Bill would "allow the UK to continue to set the gold standard on data." After Brexit the GDPR is likely to remain law using the same mechanism by which a host of EU laws will remain applicable until repealed and replaced individually.

Given the GDPR's broad reach and the "gold standard" approach of the UK Data Protection Bill, preparations to be "GDPR-ready" can and should continue as planned.

The EU's Cybersecurity Directive, also known as the Network and Information Security Directive (NISD) entered into force on 8 August 2016 and EU member states have until May 2018 to implement it. It focuses on the protection of IT systems in the European critical national infrastructure. It imposes new reporting requirements on certain sectors - which relevantly for commodities include energy, transport and banking. In August 2017, the UK government published a consultation paper on its plans to implement the NISD into UK legislation. The consultation ended on 30 September 2017 and having received over 350 responses,

the UK government published its own response in January 2018 alongside detailed guidance from the National Cyber Security Centre. The response makes clear that the NISD is and will remain an important part of the government's five-year National Cyber Security Strategy launched in 2016.

Structured Commodities Trade Finance

There are many difficulties faced by those seeking to access liquidity for structured commodities trade finance, and indeed for those providing it, but in our view very few of these arise as a result of, or are impacted by, Brexit. As the latest digital trade technologies (such as distributed ledger technology, smart contracts and the Internet of Things, alongside digital currencies), continue to gather momentum into, and to disrupt, the trade finance sector, the progress being made will not be impeded by Brexit; the growth of fintech, regtech and tradetech companies promoting the new digital wave from their bases in London since the referendum is testament to this. Further, these digital technologies are inherently designed to operate globally through the internet, without undue deference to borders.

Although uncertainty of course deflates the availability of finance, the main issues hindering growth in trade finance lie more in the need to handle the avalanche of regulation which has fallen onto the sector in the years since the financial crisis, as opposed to laying the blame at the feet of Brexit. The main consideration for commodities trade finance may indeed be much more forensically defined, namely the impact on finance documents of the need to include bank bail-in language as a result of Article 55 of the Bank Recovery and Resolution Directive, which will require non-EU governed law finance contracts to include such language, where an EU in-scope institution is a party.

Accessibility to the UK financial services market

While trade in physical commodities faces concerns going both ways (UK to EU and vice versa), about tariff barriers, customs procedures, and sector specific issues (for example in power and gas, nuclear material, and goods covered by REACH), and UK financial institutions fret over future access to EU markets, EU firms will be free to continue to access UK markets.

As regards the wide range of commodity contracts covered as derivatives by UK financial services regulation, non-EU firms have long been able to rely on a safe harbour for "overseas persons" when dealing with UK counterparties and commercial/professional clients. EU firms can anticipate post-Brexit access on at least this basis. Of course, some UK firms may prove reluctant to deal with EU counterparties, even on an unsolicited basis, for fear of breaching EU rules.

Pollution

For oil traders, pollution is a key business risk. In the event of a pollution incident, the environmental obligations and potential liabilities of operators of land-

¹ <http://www.hfw.com/downloads/HFW-UK-Policy-on-Sanctions-Post-Brexit-September-2017.pdf>

based storage facilities, and the owners of products in those storage facilities, may change after Brexit, depending on the nature of the post-Brexit regime. Some aspects of environmental law will be unaffected however. The environmental obligations and potential liabilities placed on owners, charterers and cargo-owners in the event of an oil pollution incident in UK waters are governed by a number of international conventions ratified by the UK, which set out where claims should first be directed. Exit from the EU will not affect the application of the international convention regime to oil pollution in UK waters. In terms of other legislation, relevant EU directives, including the controversial Ship Source Pollution Directive 2005/35/EC, would as things stand pass into UK law by means of the Great Repeal Bill.

Dispute Resolution

There is potential for Brexit to have a significant impact on contracts which have opted for disputes to be decided in the English courts. These could be affected in a number of key areas, including service of proceedings and enforcement of judgments, which are likely to become more difficult, costly and time consuming following Brexit. These are discussed in more detail in our [Brexit considerations for Disputes](#)².

However, many commodities contracts will be unaffected by this uncertainty, because they opt for arbitration as a means of dispute resolution. These includes the standard terms of trade associations as provided for in GAFTA, FOSFA, cotton and sugar contracts, for example. Arbitration rules and proceedings are separate from and will remain unaffected by Brexit. Perhaps most importantly in terms of business certainty, the enforcement of arbitration awards will continue as before because this is governed by the New York Convention³ rather than by EU legislation.

Tariff-free movement of goods

The political debate in the UK has recently focused on whether to be in or out of a customs union after Brexit- and if in, whether that should be “the” customs union (of the 27 EU member states), or “a” customs union, the exact nature of which would have to be the subject of negotiation between the UK and EU.

If the customs union were to remain as it currently is post-Brexit, the position in relation to free movement of goods into and out of the UK to and from the EU would remain unchanged: there would be one external border for goods coming into the EU, at which tariffs would be imposed; then the ability to move goods tariff-free around all EU member states and the UK. A more limited customs union could take a number of forms, subject to the outcome of negotiations. The UK government’s position is that the UK will leave the customs union. However, since the Labour party’s announcement that it is in favour of a permanent customs union with the EU after Brexit, it is not clear that the government would have parliamentary support for its position.

Minimising the impact of Brexit

Despite all these continuities, some change will of course be inevitable. There are some steps that commodities businesses can take now to minimise the impact of Brexit:

- 1. Conduct a contractual audit to identify and resolve potential problems before they arise.** For example, consider the event of default clauses in your facility agreements. Commonly, the borrower represents and warrants that it has obtained all necessary authorisations and consents to enter into a loan document. If this representation and warranty is made applicable to both parties, then the financial institution (which may be relying on a consent/ authorisation granted pursuant to EU level financial services regulation) may no longer be authorised and therefore may potentially be in breach (or claim that its obligations under the facility would now be illegal for it to perform). You can address this by negotiation during the transition period.
- 2. Factor in Brexit when negotiating new contracts.** Consider how pricing, currency and duration could impact your business. Would a short term, US dollar contract offer more certainty than a long term contract paid in GBP?
- 3. Consider including a Brexit clause.** A well-drafted contract will include scope for the parties to resolve by negotiation any issues arising during the transition period.
- 4. Get involved.** Organisations such as the CBI and GAFTA actively encourage input from their members, offering a forum for interested parties to share concerns, identify common aims, participate in the debate and shape the future.

HFW also hosts regular events, for example in London, Geneva and Japan, including panel and round table discussions, to provide a forum for clients in the sectors in which it operates to raise concerns and seek solutions. For more information, contact events@hfw.com.

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² <http://www.hfw.com/Dispute-resolution-Brexit-considerations>

³ The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the “New York Convention”)

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