Commodities

September 2016

COMMODITIES BULLETIN

Welcome to the September edition of our Commodities Bulletin.

GAFTA launched amendments to its arbitration rules this month. Our first article comes from Partner Richard Merrylees and Senior Associate John Rollason, who consider the impact of the changes.

Partner Philip Prowse and Associate Laura Hingley then explain the significance of Article 55 of the Bank Recovery and Resolution Directive and its possible impact on trade finance contracts governed by English law, when the UK leaves the EU.

Thirdly, Associate Nick Moon reports on a recent arbitration award relevant to parties seeking to contract on the basis of amended FOB Sales Terms.

Lastly, Partner Daniel Martin provides an update on progress in trade with Iran following the easing of sanctions after Implementation Day in the Joint Comprehensive Plan of Action.

Finally, we report on the recent Commodities Roundtable Forum on Brexit, hosted at HFW's London office, and information about the launch of our new Commodities Case Update and the Autumn Commodities breakfast seminars.

Sarah Taylor, Partner, sarah.taylor@hfw.com
Amanda Rathbone, Professional Support Lawyer, amanda.rathbone@hfw.com

holman fenwick willan hfw

NEW GAFTA 125 RULES: give and take

A note on the changes to Gafta 125 Arbitration Rules

The new 125 Arbitration Rules (Rules) came into effect from 1 September 2016 and have been incorporated into all Gafta contracts from that date. The changes have been made to address a number of practical concerns raised by Gafta arbitration users since the last version was released in 2014.

For the most part the amendments tidy up the Rules. Some changes though are a breath of fresh air that demonstrate Gafta's often stated resolve to provide a leading commercial dispute resolution forum.

RICHARD MERRYLEES, PARTNER

For the most part the amendments tidy up the Rules. Some changes though are a breath of fresh air that demonstrate Gafta's often stated resolve to provide a leading commercial dispute resolution forum.

As well as some more minor amendments, there are three significant changes which we discuss below:

1. ***Give:*** the time limit for claiming arbitration in respect of a dispute relating to quality and condition has been increased from 21 days to one year (Rule 2.2).

This is arguably the most significant change and one that could bring about an increase in claims. The context is this: all too often quality/condition issues do not immediately present themselves and frequently they take some time to document. Lengthening the time limits from 21 days to one year provides some breathing space, which will be welcomed by buyers.

It also neatly streamlines with the general Gafta one year time limit for other types of dispute, which is especially helpful to users in cases where it is not clear whether the claim is one of general breach or one of quality/condition - a not infrequent occurrence.

Generally, one year is seen by most as an acceptable commercial time limit. For example, it is the same limit set by the Hague and Hague Visby Rules. All but the most unusual disputes will have arisen within that period and the Rules still provide for a discretionary further extension in certain circumstances.

2. ***Take:*** a time limit for a claimant paying a deposit has been introduced. If the deposit is not paid within 60 days of being called for, the arbitration shall be deemed to be waived and barred (Rule 4.1).

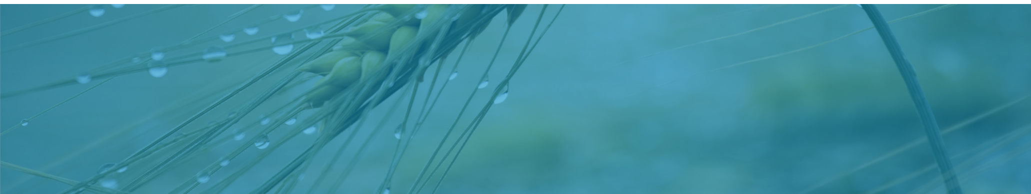
This no-nonsense approach will be welcomed by many. The intention plainly is to root out any frivolous arbitration claims at an early stage, rather than to permit them to linger in the books.

3. ***Give:*** arbitrators have been given greater flexibility to consolidate cases (Rule 7.1-7.2, 12.4).

In the age of long chains, this is a sensible provision - one Paranagua case alone that we are handling involves a chain of over 50 parties. Used appropriately by commercial arbitrators, this provision should cut through red tape, speed up the process and reduce costs, demonstrating Gafta's practical and commercial approach to resolving disputes.

In summary, Jonathan Waters, Gafta's General Counsel, says: "We believe that the amended Rules will be beneficial to all those who are involved in Gafta arbitration. Going forward, we will, through the Arbitration Committee in particular, keep the Rules under regular review and any member who has any comments is invited to contact me direct."

Please contact Richard Merrylees, Partner on +44 (0) 207 264 8408, or richard.merrylees@hfw.com, or John Rollason, Senior Associate, on +44 (0) 207 264 8345, or john.rollason@hfw.com, or your usual HFW contact should you wish to discuss further.



Trade finance: the challenges of the requirement for contractual recognition of bail-in

An issue that has seen an increase in interest following the Brexit vote in June is that of the BRRD's requirement for contractual recognition of bail-in.

What are the BRRD and "bail-in"?

The Banking and Recovery Resolution Directive (2014/59/EU) (BRRD) was passed in an effort by the EU to provide "adequate tools at EU level to deal effectively with unsound or failing credit institutions and investment firms"[1]. The 2008 global financial crisis had demonstrated that institutions which had previously been considered to be too big to fail could in fact do so. The BRRD has as one of its primary aims the preservation of systemically important functions when a bank fails, to allow a quicker return to stability.

The key features of the BRRD are as follows:

Preparation – this includes recovery and resolution planning and resolution assessments.

Early Intervention – this includes extensive regulatory powers to direct remedial action for an institution and the power to appoint a special manager.

Resolution – this includes a common set of resolution tools for the EU markets, harmonised objectives and triggers and a cross-border recognition framework. It also includes 'resolution stays' which are a limit on the right of counterparties of distressed institutions to exercise early termination rights.

In overview, bail-in is the process whereby the relevant authorities are permitted to write-down and/or convert certain of the bank's liabilities into equity, with the aim of the bank being able to continue, albeit perhaps fundamentally restructured.

Broadly speaking, the BRRD applies to EU incorporated banks, and large investment firms, their EU incorporated holding companies and any EU subsidiaries of such institutions.

For creditors, this is of some importance. Debt owed to them by such an institution can be converted, reduced or written off altogether.

Article 55

Article 55 states that from 1 January 2016, non-EU law governed contracts entered into by applicable institutions must include a clause recognising the effectiveness of actions permitted under the BRRD. The rationale is that objections to such actions are less likely to be successful if the party has explicitly agreed to the possibility of them occurring in the underlying contract. For EU law governed contracts, the BRRD will automatically apply and no explicit clause is required.

Whilst there is no specimen clause provided in the legislation, there is a list of elements which the clause must contain. ISDA and AFME, amongst others, have produced specimen bail-in clauses.

Whilst there are some exceptions for the requirement under Article 55, these are, at present, not clear.

The HFW view - impact on trade finance

Trade finance documentation presents some particularly complex issues for an Article 55 clause. For example, a letter of credit would be a relevant liability covered by the BRRD. However, it is very common for letters of credit not to specify any governing law. How then should it be determined whether the requirement is applicable?

The UK regulator[2] has recognised some of the challenges which market participants may face and has allowed an exception for UK entities caught by the BRRD where compliance with the Article 55 requirement would be impracticable. One example given was the creation of liabilities governed by an international protocol which the UK financial institution has in practice no power to amend. An obvious example of this is the UCP rules which are incorporated into almost all letters of credit.

The Brexit vote has brought renewed interest in this issue, as it could mean that when the UK leaves the EU, it would be classed as a third country and therefore any UK based relevant institutions entering into contracts creating a relevant liability with a counterparty based in the EU, but governed by English law would be required to incorporate an Article 55 clause. Such wording would already be required for contracts governed by, for example, New York or Swiss law.

However, with reports in the market of significant pushback from counterparties outside the EU who do not understand the need for such a clause, it remains to be seen how the banks will negotiate the challenges Article 55 presents for trade finance in particular.

Please contact Philip Prowse, Partner on +44 (0) 207 264 8587, or philip.prowse@hfw.com, or Laura Hingley, Associate, on +44 (0) 207 264 8816, or laura.hingley@hfw.com, or your usual HFW contact should you wish to discuss further.

1 Recital (1) to Directive 2014/59/EU

2 Prudential Regulatory Authority

Do the terms of a purchase contract affect the seller's obligations under an FOB sale?

A London arbitration tribunal has found that under a sale on FOB terms, a seller is obliged to load goods on board the vessel nominated by the buyer even where the terms of the purchase contract specify a date for the cargo to be "ready for shipment" only and do not require the buyer to nominate a vessel.

Introduction

We regularly see "hybrid" contracts, where parties contract on the basis of a sales term such as FOB or CIF but then seek to amend their respective rights and obligations using the particular terms of the agreement.

Under a classic FOB sale, a seller is obliged to load the goods "free on board" a vessel nominated by the buyer. This obligation exists whether or not it is expressly stated in the contract. The decision in this case is a reminder of what is required to affect those FOB obligations.

What happened?

The seller and the buyer entered into three contracts for the sale and purchase of steel bars. The contracts stated that the cargo was to be *"FOB stowed, lashed, secured and dunnaged [name of load port]"* and *"Delivery: Total cargo to be ready for shipment by 30 April"*.

Between 22 and 29 April, the seller delivered quantities of steel bars to its freight forwarder and was issued with forwarder's certificates of receipt.

The buyer nominated a vessel (Vessel A) to lift the cargo purchased under the first contract and another vessel (Vessel B) to lift the cargo purchased under the second and third contracts, for delivery to different receivers at a different destination.

The buyer alleged that:

(a) On arrival of Vessel A at discharge port there was a shortage of 68 bundles of steel bars.

(b) On arrival of Vessel B at discharge port there was an over-shipment of 66 bundles of steel bars.

As a result, the buyer incurred various losses which it sought to recover from the seller.

The seller disputed the alleged shortage and over-shipment. On the evidence the Tribunal found that there had been a shortage and over-shipment, despite contradictory figures stated in certain reports and surveys produced during the discharge operations of both vessels.

Key issue

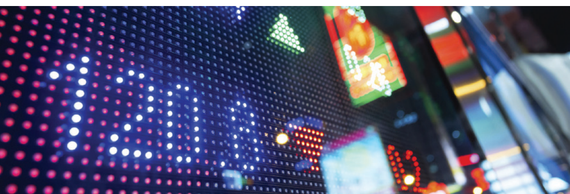
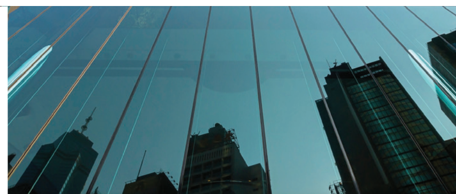
The key question then became whether the seller was in breach of the contracts because of the under and over-shipment and therefore liable to pay the buyer damages for its losses. The buyer submitted that because of the FOB nature of the contracts, the seller was obliged to place the correct quantity and quality of the cargo on the board the vessels nominated by the buyer.

Both parties agreed that under a classic FOB contract it was the obligation of the seller to load the goods on board the vessel nominated by the buyer and the obligation of the buyer to nominate a vessel in time. The issue in this case was whether the normal FOB obligations of the seller had been displaced by the particular terms of the contracts.

The seller relied on the delivery clause (see above) and submitted that its obligation was only to deliver the goods to the forwarding agent by 30 April, pointing out that the contracts did not include any obligation on the buyer to nominate a vessel or any date by which such a vessel was to be nominated.

The issue in this case was whether the normal FOB obligations of the seller had been displaced by the particular terms of the contracts.

NICK MOON, ASSOCIATE

The Tribunal disagreed. The delivery clause related only to timing and did not purport to define the extent of the seller's obligation. The fact that the contracts did not specifically require the buyer to nominate a vessel did not affect the seller's obligations under the contract. The fact that this was an FOB contract, under which the loadport and destination were specified, made it clear that the obligation was on the buyer to nominate the carrying vessels.

Accordingly, the seller was in breach of the contracts in relation to the cargo shipped on board both vessels and liable to the buyer in damages.

It is not yet known whether the award will be subject to an appeal before the High Court.

HFW perspective

Parties should always consider carefully which sales term (e.g. FOB, FAS, CIF, CFR or DES) is most appropriate to their contract, keeping in mind the rights and obligations each sales term imposes. If parties wish to replace or vary those rights or obligations, they should use clear and express wording in the contract to do so.

For more information, please contact Nick Moon, Associate, on +44 (0)20 7264 8219, or nick.moon@hfw.com, or your usual contact at HFW.

hfw Trade with Iran: any progress?

It has now been eight months since Implementation Day under the Joint Comprehensive Plan of Action (JCPOA), put in place to ensure that Iran's nuclear programme remains exclusively peaceful, as part of which sanctions against Iran have been relaxed. What progress has been made, and what issues still need to be overcome in order for businesses to trade with Iran?

There are certainly positive signs, including reports that Iran has been able to increase its sales of crude oil, shipping two million barrels of crude oil per day (bpd) in April, May and June 2016, up from 1.6m bpd in March 2016. There have been positive developments in other commodities, including gas, petrochemicals and metals. However, there is still a long way to go, with indications that, at least as of June 2016, Iran's main historic European crude oil buyers (Italy, Spain and Greece) were still a long way behind their pre-sanctions volumes.

So what is preventing Iran from getting back to pre-sanctions levels in crude oil, as well as other markets? The key issues are:

- Ensuring compliance with remaining sanctions.
- Dealing with the risk of sanctions snapping back into place.
- Getting banks and insurers back on board.

Compliance with remaining sanctions

Significant sanctions against Iran still remain in place and due diligence is required to ensure that any trade does not infringe any applicable sanctions. This will involve checking that no one involved in the trade remains on a sanctions list, and also that the cargo is no longer subject to any relevant restrictions.

There is still a long way to go, with indications that, at least as of June 2016, Iran's main historic European crude oil buyers (Italy, Spain and Greece) were still a long way behind their pre-sanctions volumes.

DANIEL MARTIN, PARTNER

As part of this process, businesses should check which sanctions apply, for example because the business is owned by US persons, or employs US nationals, or because payments need to be made in US Dollars.

The authorities in the US and the UK have made clear that they will continue to enforce the remaining sanctions. In the UK, the Office of Financial Sanctions Implementation (OFSI) was established on 31 March 2016 with an express mandate to "ensure that financial sanctions are properly understood, implemented and enforced" in the UK.

There is no amnesty for historic transactions which infringed those sanctions which were in place when the relevant activity took place. For example, in September 2016 PanAmerican Seed Company agreed a settlement with the US Office of Foreign Assets Control (OFAC), agreeing to pay US$4.3 million to settle allegations that the company had infringed US sanctions by supplying seeds (primarily of flowers) worth US$770,000 to Iran between 2009 and 2012. The potential fine for this activity was US$ 12 million, even though the exports were likely eligible for an OFAC licence, if one had been sought.

The risk of snap back

Because of the risk that sanctions might snap back into place if Iran fails to comply with its obligations pursuant to the JCPOA, parties should include sanctions clauses in their contracts. Those clauses should include not only warranties (and ideally indemnities) regarding the lawfulness of the trade, but also suspension and termination rights in the event that there is a breach of the warranties, or the sanctions snap back into place.

Banks and insurers

Banks and insurers remain extremely cautious about trade with Iran, because of the complexity of ensuring compliance with sanctions and because of the hugely damaging consequences, (both financial and reputational) of a breach. It may be that as time goes on, they will grow in confidence but for now, they are wary.

For more information, please contact Daniel Martin, Partner, on +44 (0)20 7264 8000, or daniel.martin@hfw.com, or your usual contact at HFW

hfw "Brexit and Beyond": Commodities Roundtable Forum

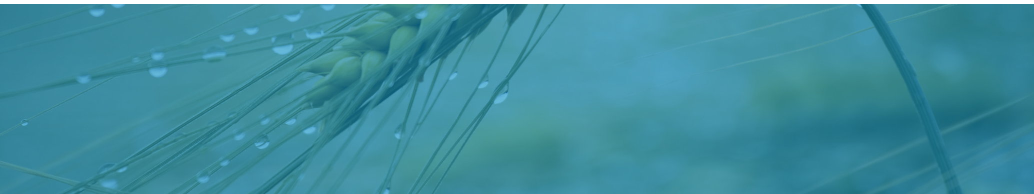
On 12 September 2016, HFW hosted a group of commodities clients and trade associations in its London office to consider some of the key issues likely to affect the commodities sector as a result of the UK's vote to leave the EU, and how to respond collectively.

A series of brief talks from HFW partners and associates, including Brian Perrott, Anthony Woolich, Robert Finney, Damian Honey and Emily Sweeney, covered topics including:

- "Japan's message to the UK and the EU" – issued by the Japanese government on 4 September 2016
- a brief analysis of the wording of Art 50(2) Lisbon Treaty
- the UK's relatively strong position – and a reminder that other countries and the EU face uncertainty as well (e.g. a referendum in Italy and upcoming elections in USA, Netherlands France and Germany)
- some of the models that could be adopted by the UK post-Brexit
- internal action (risk analysis and risk mitigation) and external action (lobbying) for companies to take in relation to the effect of Brexit on their business
- what has not changed as a result of Brexit – and in particular the strengths of English law
- the benefits of choosing arbitration as a means of dispute resolution so as to avoid current uncertainties in relation to jurisdiction and particularly enforcement.

Some of the key themes of interest to the attendees included migration issues, the significance or otherwise of trade agreements between countries, how to lobby, the notional possibility of "mandatory EU rules" being introduced and the breadth/depth of issues that the global market is facing.

HFW will continue to support its clients through Brexit by facilitating collaboration across the sector. Please contact marketing@hfw.com if you would like to be involved.



Commodities Case Update

Partner Damian Honey and Senior Associate Andrew Williams are launching a regular Commodities Case Update. This is designed to be a brief summary of 10 key recent cases affecting the commodities sector. It will be published 3 times a year. If you would like to receive a copy, please contact marketing@hfw.com.

Autumn Commodities breakfast seminars, HFW London

The Autumn series of our regular commodities breakfast seminars in the London office has begun. The second and third seminars will take place on 11 and 26 October 2016. If you would like to attend, please contact events@hfw.com.

Conferences and Events

Autumn Commodities breakfast seminars
HFW London
11 and 26 October 2016

Commodity Document Fraud Insurance Seminar
Geneva
11 October 2016
Presenting: John Barlow and Michael Buisset

Argus European Crude Conference 2016
Geneva
12 October 2016
Presenting: Sarah Hunt

GTR Lugano Trade Finance Conference
Lugano
25 October 2016
Presenting: Philip Prowse and Marc Weisberger
Attending: Michael Buisset, Damian Honey, Jameel Tarmohamed, Laura Hingley

4th Iran-Europe Annual Oil & Gas Summit and Expo
Berlin
1-3 November 2016
Presenting: Daniel Martin

International Trade and Commodities Seminar
Hong Kong
29 November 2016
Presenting: Peter Murphy, Sian Knight, Andrew M Johnstone, Guy Hardaker, Brendan Fyfe

Lawyers for international commerce hfw.com

© 2016 Holman Fenwick Willan LLP. All rights reserved

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice.

Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please contact Craig Martin on +44 (0)20 7264 8109 or email craig.martin@hfw.com

São Paulo London Paris Brussels Geneva Piraeus Beirut Riyadh Kuwait Dubai Singapore Hong Kong Shanghai Perth Melbourne Sydney