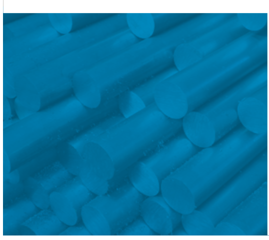
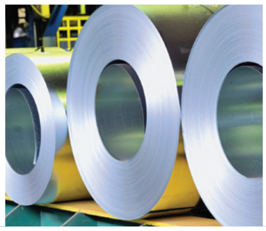
Commodities

February
2015

COMMODITIES BULLETIN





Welcome to the February edition of our Commodities Bulletin.

On 31 December 2014, BP launched their new GTCs for crude oil and petroleum products. In our first article, Partner Damian Honey and Associate Mike Buffham, who worked on the project with BP, identify ten things you need to know about the new GTCs.

The alleged metals warehousing fraud in Qingdao, China, has spawned multiple claims. Associate Nick Moon reviews a recent decision of the English Court in one such claim which is an indicator of the hard fought, complex and long-running claims that lie ahead, in which jurisdictional issues are likely to feature prominently. It also illustrates the high threshold an applicant must meet in order to obtain a final anti-suit injunction in support of an exclusive jurisdiction clause from the English Court.

Lastly, Partner Robert Finney provides the third in his series of regulatory updates for commodities. This month, he focuses on MiFID II and ESMA.

Should you require any further information or assistance with any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

Katie Pritchard, Partner, katie.pritchard@hfw.com
Amanda Rathbone, Professional Support Lawyer, amanda.rathbone@hfw.com

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Ten things you need to know about the BP General Terms & Conditions for Sales and Purchases of Crude Oil and Petroleum Products, 2015 Edition

On 31 December 2014, BP published the new General Terms & Conditions for Sales and Purchases of Crude Oil and Petroleum Products, 2015 Edition (the 2015 GTCs). In this note, Damian Honey, Partner, and Michael Buffham, Associate, explore the top ten things you need to know about the 2015 GTCs.

The 2015 GTCs now include a separate time bar provision in Section 67... The wording is substantially the same in the 2015 GTCs. However, it is crucial to note that the relevant time bar has been reduced from two years to one year.

DAMIAN HONEY, PARTNER

1. Structure

The General Terms & Conditions for Sales and Purchases of Crude Oil 2007 (the 2007 Oil GTCs) and General Terms & Conditions for Sales and Purchases of Petroleum Products 2007 (the 2007 Products GTCs), have been merged into one amalgamated document, the new 2015 GTCs. There have been a number of structural changes in the document with some reordering of the sections. The document therefore refers to crude and products at the same time, but there are a number of sections specifically only dealing with crude (for example Section 23.5, Section 34, Schedule I).

2. New parts

In the 2007 GTCs, the "Ex Ship" section was contained in a number of short paragraphs in part two, which also concerned CFR and CIF deliveries. In the 2015 GTCs, "Ex Ship" deliveries are now governed by separate provisions in a new part three. Although the term "Ex Ship" has been replaced in Incoterms 2010 by "DAP", the phrase "Ex Ship" is still commonly used in commercial practice. For this reason, the 2015 GTCs continue to refer to "Ex Ship" deliveries, although Section 17.1 does specify that *"references to Ex Ship herein shall also refer to DAP"*.

Separate parts have also been introduced dealing with road tanker and rail tank car deliveries. It is largely because of the introduction of these new parts that the 2015 GTCs are now 116 pages long.

3. Deeming provisions

The FOB sections (but not CFR/CIF sections) of the 2007 Oil GTCs and 2007 Products GTCs both make reference to Section 20A of the Sale of Goods Act 1979 (SGA 1979), which relates to the transfer of property where the relevant goods are part of an unascertained bulk. Section 20A of SGA 1979 provides that property in an unascertained bulk cannot pass until payment has been received. The 2007 GTCs expressly provide that, if the goods form part of an unascertained bulk, for the purposes of Section 20A and solely to enable property to pass to the buyer, payment is deemed to be made as the goods are being loaded.

The 2015 GTCs no longer expressly refer to Section 20A, which is consistent with the approach taken in the general terms and conditions of some other oil majors. The effect is that, if the goods form part of an unascertained bulk, property does not pass to the buyer upon loading unless payment has already been made. This has the benefit of relying on statute

and common law and not attempting to codify an area of law which is difficult. However, parties should be aware that, as a result of the operation of Section 20A, there are potential risks where the buyer is purchasing part of an unascertained bulk and has not yet paid for the goods. For example, in the event of insolvency of the seller, the goods would remain in the insolvent seller's estate; on-sales may be invalid; and title may end up passing in the territorial waters of another jurisdiction, which could give rise to licensing or tax issues.

4. Shifting, lightering and vessel-to-vessel transfers

In the 2015 GTCs, shifting and lightering have been split into different subsections. There is also a separate section for floating storage and vessel-to-vessel transfers. The main changes are structural amendments to these provisions. The scope has also been slightly expanded, for example, either party may now request the vessel to be loaded or discharged (as the context of the delivery term requires) from lighters/floating storage.

5. Default events

The 2015 GTCs include a new and expanded set of default events in Section 68. Upon the occurrence of a default event (details of which are listed in Section 68.1) under Section 68.2 the non-defaulting party may terminate the agreement, suspend delivery if it is the seller, terminate an individual cargo in the case of an agreement for multiple cargoes or set-off monies payable by the non-defaulting party against the liabilities of the defaulting party.

6. Time bar

The 2015 GTCs now include a separate time bar provision in Section 67, which in the 2007 GTCs is a sub-section of the Section 32 limitation of liabilities provisions. The wording is substantially the same in the 2015 GTCs. However, it is crucial to note that the relevant time bar has been reduced from two years to one year.

7. Limitation of liabilities

In the 2015 GTCs (Section 66), "hedging or other derivative losses", which were excluded from the liability of the parties in Section 33.1 of the 2007 GTCs, are no longer expressly excluded. This reflects the fact that hedging is now more commonly used to manage risk in commodities contracts. In the light of recent developments in English law, hedging losses are now in principle recoverable, subject to the usual rules regarding causation, remoteness and mitigation. However, in practice hedging losses can be very difficult to prove.

8. REACH

Section 60, which concerns health, safety and the environment, has been comprehensively updated in the 2015 GTCs to take account of new SDS requirements that have been introduced since the publication of the 2007 GTCs, and in light of REACH and other provisions. Section 60 now covers REACH, CLP and ADN, as well as setting out the seller's and buyer's responsibilities with respect to the SDS.

9. Sanctions and boycotts

The 2015 GTCs include an updated and modernised set of provisions dealing with sanctions and boycotts (Section 71). Further provisions are now included excusing the parties from performing any obligation (including to (i) perform, deliver, accept, sell, purchase, pay or receive monies to, from or through a person or entity; or (ii) engage in any other acts) that would violate any EU, UN or US trade sanctions, foreign exchange controls, non-proliferation, anti-terrorism and similar laws.

10. Payment provisions

The 2015 GTCs now include in Section 63.1 a standalone provision requiring payment to be made by the Buyer to the seller without any discount, deduction, withholding, offset or counterclaim on or before the due date. A number of other amendments have been made to the payment provisions, including in Section 63.12 a new section on credit support, in Section 63.15 a new section on advance payment, in Section 63.16 a new section on purchase confirmation, and in Section 63.17 a new section on currency of payment.

For more information, please contact Damian Honey, Partner, on +44 (0)20 7264 8354, or damian.honey@hfw.com, or Michael Buffham, Associate, on +44 (0)20 7264 8429, or michael.buffham@hfw.com, or your usual contact at HFW.


Qingdao: an English Court decision

In the summer of 2014, alleged large-scale fraud involving metals warehoused in Qingdao, China, was discovered. This has spawned multiple claims in different jurisdictions involving traders, banks and warehouses. *Impala Warehousing and Logistics (Shanghai) Co Ltd v Wanxiang Resources (Singapore) PTE Ltd* (15 January 2015) is a decision from one of several cases set to be heard in the English High Court.

Its progress is an indicator of the hard fought, complex and long-running claims which lie ahead, in which jurisdictional issues are likely to feature prominently. It also illustrates the high threshold an applicant must meet in order to obtain a final anti-suit injunction in support of an exclusive jurisdiction clause from the English Court.

Background

Wanxiang claims to be the owner of a quantity of aluminium stored in a warehouse in Qingdao. Warehouse certificates in respect of the aluminium were issued by Impala to Rabobank International, to whom the goods had been pledged as security. The sums advanced by Rabobank were paid off and, it is said, the warehouse certificates were endorsed to Wanxiang. Wanxiang commenced proceedings against Impala in China seeking delivery of the aluminium. Impala have not delivered the goods to Wanxiang, apparently because of the Chinese proceedings against them.

In September 2014, Impala successfully sought an interim anti-suit injunction from the English Court, restraining Wanxiang from continuing the Chinese proceedings on the basis that the warehouse certificates upon which Wanxiang were suing in China contained an exclusive jurisdiction clause in favour of the English Courts. After discovering that the Chinese proceedings would be advanced by the Chinese court even if Wanxiang complied with the anti-suit injunction, Impala applied for a final anti-suit injunction with a mandatory injunction ordering Wanxiang to discontinue the Chinese proceedings. Alternatively, an interim mandatory injunction to the same effect was sought.

Applications

The basis of these applications was that the proceedings in China were (i) vexatious and (ii) in breach of the exclusive jurisdiction clause.

Wanxiang claims to be the owner of a quantity of aluminium stored in a warehouse in Qingdao. Warehouse certificates in respect of the aluminium were issued by Impala to Rabobank International, to whom the goods had been pledged as security. The sums advanced by Rabobank were paid off and, it is said, the warehouse certificates were endorsed to Wanxiang.

Wanxiang submitted:

- It did have a claim in China against Impala, even though no evidence in support had been presented.
- The warehouse certificates did not contain an exclusive jurisdiction clause in favour of England. The *governing* jurisdiction clause was in fact contained in a Collateral Management Agreement (CMA), even though Impala was not a party to the CMA.

Impala contested this:

- No evidence had been adduced by a Chinese lawyer explaining the basis of the claim in China.
- Wanxiang had not challenged the English Court's jurisdiction at a previous hearing in September 2014.
- The proceedings in China were vexatious because Wanxiang argued before the English Court that its claims against Impala were under the CMA, but its Chinese claims were brought under the warehouse certificates.

Whilst the Court found Impala's arguments had undoubted force, it held that from an English law perspective, Wanxiang did have a claim against Impala on the terms of the warehouse certificates, in bailment. There was no evidence that Chinese law was different in this respect from English law and the way in which Wanxiang's Chinese claim was expressed was consistent with the English law position. Therefore, the English Court dismissed the argument that the Chinese proceedings were vexatious.

As to whether the warehouse certificates contained an exclusive jurisdiction clause, the English Court considered that there was a *"simple and cogent argument that they do."* The exclusive jurisdiction clause was contained in a set



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of standard terms on Impala's website which had been validly incorporated, making a specific reference to dispute resolution.

However, Wanxiang submitted that it would be wrong to determine the application without evidence as to all the facts regarding the making of the relevant agreement, the knowledge which Impala had of the relevant agreement and its appreciation, when issuing the warehouse certificates, that it was doing so as agent for Impala UK pursuant to the terms of the relevant agreement.

The Court decided that it had little, if any, evidence on these matters and could not fairly or properly determine the principal issue between the parties without a clear understanding of them. Referring to the fact that the Court can only issue a mandatory injunction if it has a "high degree of assurance" that the basis on which it does so is correct, it dismissed Impala's application.

Interestingly, the Court also commented on Wanxiang's argument that it would suffer prejudice if it had to litigate in England because any judgment of the English Court would not be enforceable in China as there is no reciprocal enforcement arrangement between England and China. It noted that an inability to enforce a judgment is a form of prejudice specifically mentioned in a previous case, concluding that this would be a strong reason for not giving effect to the exclusive jurisdiction clause.

A full hearing regarding the English Court's jurisdiction is scheduled to take place in March 2015.

Conclusion

This decision illustrates the difficulty an applicant faces in obtaining a final anti-suit injunction where there are outstanding legal or factual issues to be determined. Even though the Court agreed in principle with a number of Impala's arguments, there was not sufficient evidence to grant the final anti-suit injunction sought. It appears that applications on the basis of an exclusive jurisdiction clause can also be successfully resisted where no reciprocal enforcement arrangement is in place.

It is certainly an indication of the complexity of claims relating to the alleged warehousing fraud in Qingdao and the potential difficulties for claimants in relation to both jurisdiction and enforcement. It is likely to be a considerable time before they reach their conclusion.

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 Regulatory update for commodities: MiFID II and ESMA

From 3 January 2017, the MiFID II regulatory package will impose major new obligations on businesses dealing in energy, commodities, freight and emissions. Many will need to become authorised for the first time, and therefore comply with EU's investment services regime (which MiFID II reforms), and even non-authorised firms may be affected by new restrictions on the size of commodity positions. As the detailed rules become clearer, understanding how the changes will affect your firm becomes increasingly important. A lot of planning and execution is required before the rules take effect.

This article looks at the recent European Securities and Markets Authority (ESMA) consultation on MiFID II and focuses on some of actions to be taken now.

ESMA consultation

On 19 December 2014, ESMA published recommendations to assist the European Commission in developing regulations under MiFID II. ESMA's recommendations are non-binding and take the form of a final technical advice sent to the Commission and a consultation paper (with annexed draft regulations) to which responses may be submitted until 2 March 2015. ESMA will review these before finalising the draft regulations and submitting them to the Commission later in the year.

ESMA's technical advice covers a range of important definitions, including "financial instruments", "systematic internaliser" and the meaning of

"must be physically settled" in respect of commodity derivatives. It also addresses numerous investor protection issues and the reporting and management of commodity positions.

The consultation paper also covers investor protection, including access by third country firms, but is more focussed on transparency, liquidity and other issues of market structure and operation – including the mandatory trading of derivatives on organised venues, algorithmic and high frequency trading and direct electronic access. On commodities, it addresses two key issues: the criteria for the ancillary activity exemption for commodities and emissions business, and commodity position limits.

Key changes for commodities

Some of the most significant changes in MiFID II are those which will require many more commodity market participants to become authorised, especially as a result of the curtailment of existing exemptions widely used by them. For example, the exemption for own-account commodity dealers is being removed entirely and the ancillary exemption severely restricted.

The amended ancillary exemption will apply to activities in commodity derivatives, emissions allowances and derivatives on emissions allowances. It will be available only to firms which:

- Deal on own account in those instruments (except when executing client orders).
- Provide investment services (but not dealing on their own account) in respect of those instruments to the customers or suppliers of their main business.

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ROBERT FINNEY, PARTNER

These elements are subject to further conditions including that the activity is an "ancillary" activity to the main business at a group level in the EU.

MiFID II will introduce strict quantitative parameters, based on accounting capital employed and trading activity, to determine what is "ancillary". These will be critical to firms and groups determining whether they qualify for an exemption. ESMA is currently consulting on what these parameters should be.

Firm relying on this exemption will need to notify the relevant regulator annually and may be required to provide supporting evidence.

MiFID II also introduces, for the first time in the EU, mandatory legal restrictions on the scale of commercial trading in commodity derivatives traded on an EU venue and 'equivalent' OTC contracts.

Daily position reporting and weekly publication of venues' aggregate positions will also be required.

In calculating position limits, certain hedges may be excluded where positions are held by, or on behalf of, non-financial entities. Loss of this facility is therefore a significant factor to take into account when considering authorisation under MiFID II.

Act now

While the precise formulation of many MiFID II rules will not be finalised until 2016, steps should be taken now to assess how MiFID II might apply to your firm, what the impact could be, and what steps you should take.

Firms currently exempt from MiFID, including those outside the EU that have EU business, should consider the need to restrict or restructure trading to maintain their exempt or

other status and to manage the need for authorisation individually or across a group. This entails a detailed legal, financial and market analysis.

Whether or not authorisation will be required may depend upon future trading figures which will determine whether the firm needs to be authorised come 3 January 2017. How this will operate in practice is not yet clear - at present, no transitional arrangements are proposed to phase in authorisation requirements.

Notwithstanding these uncertainties, firms need to engage actively now to avoid business disruption in 2017.

For further information, please contact Robert Finney, Partner, on +44 (0)20 7264 8343 or robert.finney@hfw.com, or Orla Isaacson, Associate, on + 44 (0)20 7264 8101, or orla.isaacson@hfw.com, or your usual contact at HFW.

hfw Conferences and events

Global Law Summit
London
23–25 February 2015
We are gold sponsors of this Summit and will be hosting a panel session on global trends in international trade and the laws that underpin them. Richard Crump and Damian Honey will be attending, among other HFW partners.

Commodity Financing Seminar: Post-Qingdao – A New World Order?
Lausanne
26 February 2015
Presenting: Sarah Taylor and Spencer Gold

globalCOAL Atlantic Futures Event
HFW London
26 February 2015
Presenting: Robert Finney
Attending: Damian Honey

HFW Commodity Breakfast Seminars
HFW London
5 and 19 March 2015
Presenting: Sarah Taylor, Robert Finney and Damian Honey

Compliance Event with Zug Commodity Association
Zug
3 March 2015
Presenting: Robert Finney and Sarah Hunt

Collateral Management Agreements Conference
Lugano
5 March 2015
Presenting: William Hold

AGIC Asia
Singapore
9 March 2015
Presenting: Stephen Thompson

Global Grain Asia
Singapore
10–12 March 2015
Presenting: Chris Swart
Attending: Katie Pritchard

Cereals Europe Conference
Geneva
14–26 March 2015
Attending: Michael Buisset, Dragan Zeljic and Kathryn Martin

HFW International Trade and Commodities Seminar
Hong Kong
23 March 2015
Presenting: Peter Murphy, Andrew M Johnstone, Guy Hardaker and Anthony Woolich

WA Power and Gas Conference
Perth
30 March 2015
Presenting: Simon Adams

FT Commodities Conference
Lausanne
31 March – 2 April 2015
Attending: Jeremy Davies

Argus Biomass Conference
London
14–16 April 2015
Attending: Chris Swart, Rory Gogarty and Andrew Williams

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