Commodities

February 2016

COMMODITIES BULLETIN

Welcome to the February edition of our Commodities Bulletin

This month, we feature first an article from our new trade finance lawyers, Partner Philip Prowse and Associates Jameel Tarmohamed and Laura Hingley. They look at the reasons for the growing interest in club facilities, where a small group of banks combine to provide a facility to a borrower, in the last 12 months.

Next, Partner Brian Perrott and Associate Rachel Turner report on a recent English Commercial Court decision, *AvB, Queen's Bench Division (Commercial Court), No. 793*. This considers whether bespoke clauses protect against standard form terms. The case relates to a FOSFA standard form but has much wider implications.

Thirdly, Senior Associate Sarah Hunt from HFW's Geneva office provides an update on a case in which the parties have now been granted permission to appeal to the English Supreme Court, T*aurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq (SOMO)* (28 July 2015). This case will be one to watch for traders looking to enforce against state owned companies reluctant to pay long outstanding debts. The article considers in particular the Court of Appeal's ruling on whether in such circumstances, it would be possible to recover debts by arresting a letter of credit payable to the debtor.

Lastly, Senior Associate Rebecca Lindsey reports on a case relating to mitigation heard by the English Court of Appeal and significant for trading clients, *Fulton Shipping Inc. of Panama v Globalia Business Travel SAU* (21 December 2015). The Court of Appeal found that it must take into account benefits gained during the course of mitigation when assessing damages for breach of contract.

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.

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

hfw Trade finance in 2016: time to enrol in the club?

Club facilities, where a small group of banks combine to provide a facility to a borrower, had fallen out of favour in the commodities trade finance market. However, the last 12 months have seen a noticeable return to this form of financing.

Responses from the commodities industry to a survey carried out in 2015 by Commodities Now, the trade magazine and online resource for the global trade commodity markets, indicated that industry participants wished to see a return to closer, more responsive and more trade-related club relationships. This in itself is not particularly surprising given that club deals allow for more focused and efficient discussions between lenders and borrower as well as offering greater flexibility to a borrower, both in terms of covenants and (re)payment structures.

The industry response to the Commodities Now survey may have been driven by the significant growth in syndicated financing over recent years, perhaps without much consideration as to whether syndicated finance was appropriate for commodities trade. Borrowers may now view syndicated deals with a degree of apprehension for a number of reasons.

First, there is little or no emphasis on relationship banking with syndicated facilities. Large syndicates can be unmanageable from the outset, struggling to meet unanimity requirements (which are required for various key decisions such as extension of maturity) and losing track of business purpose. Banks also tend to sell down their participations in syndicated facilities to other entities, such as hedge funds, very quickly post-completion. This means both that a borrower may not be very, or at all, familiar with the parties actually involved in the deal and that those becoming part of the syndicate may not be specialist commodities lenders.

Next, most syndicated deals usually have a one year tranche and trade finance may often be needed for longer as some assets may be longer term investments which cannot be liquidated quickly if a demand for payment is made. One year maturities also require annual renewals, which in turn will trigger a yearly assessment of the borrower's credit risk by the syndicate members.

Further, syndicated deals usually make the whole amount of the facility available immediately and this may not be suitable for trade finance participants for whom a tranche structure would be more sensible. The tranche structure allows a borrower to plan projects and purchases when the next drawdown is available, rather than dealing with all funds immediately, and allows a lender to monitor usage and performance pre-drawdowns.

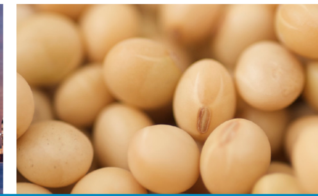
A number of club deals signed in 2015 were highlighted in the commodity finance press. These are indicative of a movement towards the favouring of club facilities to fill the gap between the types of financing available and the needs of borrowers in the commodities market.

Whilst a return to club financing is to be welcomed, caution should be exercised to ensure not only that club deal documentation is fit for purpose, but also that the problems associated with syndicated financing are not replicated in club deals. For instance, one club deal last year involved 19 international banks and another eight banks. It is not hard to imagine that club deals could replicate the problem of large syndicates becoming unmanageable in these circumstances.

As club deals are seemingly becoming more common, there is an argument that the documentation which currently exists for this type of financing should be updated for the modern club facility, in much the same way that the Loan Market Association (LMA) offers a suite of documentation for syndicated lending. However, to draw up such agreements from scratch, with no market consensus, would be both time consuming and costly. Whilst we would certainly not advocate completely standardised documents for club facilities - this would defeat the personal and bespoke nature of the club facility - there are large sections in a club facility which the industry should be able to agree on and standardise, including representations and warranties, general covenants, financial covenants and events of default. This would allow club deal documents to be produced more efficiently going forward. This process would replicate the standardisation of syndicated facility agreements carried out by the LMA, which led to considerable time and cost savings for industry participants.

As we progress into a new year it would be prudent to pick up where the commodities trade finance market left off in 2015 and consider the merits that club deals can offer.

For more information, please contact Philip Prowse, Partner on +44 (0)20 7264 8587 or philip.prowse@hfw.com, or Jameel Tarmohamed, Associate on +44 (0)20 7264 8588 or jameel.tarmohamed@hfw.com, or Laura Hingley, Associate, on +44 (0)20 7264 8816 or laura.hingley@hfw.com, or your usual contact at HFW.



Do your bespoke clauses protect you against unwanted standard form terms?

If your contract contains bespoke clauses designed to vary a set of incorporated standard terms, take care. The English Commercial Court has recently held that unless specifically negotiated clauses are so incompatible with the standard terms as to be *"repugnant"*, the standard term clauses will also be incorporated - with some surprising results.

In *A v B, Queen's Bench Division (Commercial Court), No.793*, one party believed that its customised contract excluded the FOSFA standard form "Scott v Avery" provision, which prohibits the parties from seeking pre-action injunctive relief from the court. The court disagreed.

Background

The parties contracted for the sale and purchase of two cargoes of soya beans. The contract for each cargo contained specific terms as to origin, specification, quantity, shipment, price, payment and so on.

The parties had also drafted a specific law and arbitration clause. This closely tracked the first paragraph of the FOSFA 23 arbitration clause, but deliberately omitted the whole second paragraph. It is the second paragraph which prevents the parties from bringing "any action or other legal proceedings" in respect of a dispute, until that dispute has first been determined by FOSFA. It is well established that this wording prohibits a party from seeking interim relief (including freezing injunctions to prevent the dissipation of assets) and it is common to seek to exclude its effect.

Despite the inclusion of bespoke law and arbitration clauses which specifically did not include the *Scott v Avery* wording, the court held that the *Scott v Avery* wording was nevertheless incorporated into the contracts by the general incorporation of the FOSFA form.

BRIAN PERROTT, PARTNER

Under the heading *"General Conditions"*, the contracts also incorporated *"All other terms, conditions and rules not in contradiction with the above contained in the form FOSFA number 23"*.

The buyer failed to perform under both contracts and, in the belief that the *Scott v Avery* provision had been excluded from both contracts, the seller sought and obtained freezing injunctions to prevent the dissipation of the buyer's assets. The buyer sought to set aside the orders.

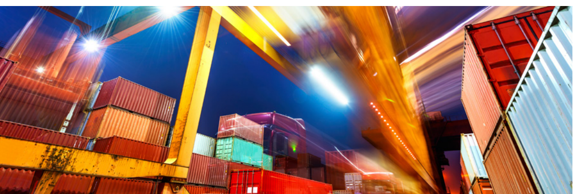
Judgment

Despite the inclusion of bespoke law and arbitration clauses which specifically did not include the *Scott v Avery* wording, the court held that the *Scott v Avery* wording was nevertheless incorporated into the contracts by the general incorporation of the FOSFA form. That was because, in the court's view, the FOSFA arbitration clause was an *"other"* term or condition, and was not *"in contradiction"* with the bespoke clause.

The court declined jurisdiction and the seller's freezing orders in respect of these contracts were discharged.

Key points

- Incorporated clauses are *"to be read harmoniously, so far as it is possible to do so, and are [only] given no effect where there is repugnancy with the specifically agreed special clauses"*.
- The seller submitted that the exclusion of the *Scott v Avery* wording in the bespoke clause was in contradiction to the inclusion of the wording in the FOSFA form, and that if the parties had wished the provision to apply they would have included it in their clause. The court disagreed. In its view an omission, without more, did not disclose any intention to exclude the clause and preserve the court's jurisdiction.
- In order to exclude the effect of a standard form clause, it is not enough to omit the unwanted wording from your specifically drafted clause. You must include an



express provision which is in direct conflict with the standard form clause.

HFW's perspective

The court's approach to incorporation is worthy of note in two main respects:

1. It seems to give little effect to the particular form of incorporating words used, namely only *"other"* terms were to be incorporated. The contract contained a bespoke law and arbitration clause and, therefore, the FOSFA arbitration clause was arguably not an "other" term. The effect, it could be said, is to give unwarranted primacy to the incorporated words, over the bespoke contract.
2. Although this judgment arises from a dispute over the *Scott v Avery* clause - which limits the interim remedies available to the parties and is therefore a sensitive provision – in our view the judgment is likely to have a wider application.

If your contracts incorporate standard forms, as many do, then we recommend a review of current and future contracts to ensure that all necessary bespoke provisions are not undermined or neutralised by standard form wording which has not been expressly excluded.

For more information, please contact Brian Perrott, Partner, on +44 (0)20 7264 8184 or brian.perrott@hfw.com, or Rachel Turner, Associate, on +44 (0)20 7264 8050 or rachel.turner@hfw.com, or your usual contact at HFW. We gratefully acknowledge the assistance of Stewart Buckingham of Quadrant Chambers in the production of this article.

Enforcing awards against a state owned entity and third party debt orders: Supreme Court grants permission to appeal

Not many cases make it to the English Supreme Court; most applications are rejected because they do not raise 'an arguable point of law of general public importance'. However, on 23 December 2015, the Supreme Court confirmed permission to appeal against the decision of the Court of Appeal in *Taurus Petroleum Limited (Taurus) v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq (SOMO)*[1].

The case raises important issues for those wishing to enforce against state owned traders that seek to hide behind a cloak of sovereign immunity to evade enforcement.

Taurus was awarded approximately US$9 million in an arbitral award which applied Iraqi law with Baghdad as the arbitral seat, while sitting in London. Taurus converted the final award into a English judgment pursuant to section 66(1) of the Arbitration Act 1966. Taurus then used an unusual mechanism to arrest a debt payable to SOMO: a third party debt order. Unlike a freezing order, a third party debt order may be used to arrest a sum payable to a debtor, rather than relying on locating the debtor's assets or bank accounts.

A without notice Commercial Court hearing was granted and it was ordered that the sums arrested (some US$9.4 million) be paid into the Commercial Court.

SOMO applied to set aside the third party debt order, on the grounds that it enjoys sovereign immunity and that its property is immune from execution.

The debt in question was owed under letters of credit payable to SOMO, with Credit Agricole promising to pay certain sums into the Central Bank of Iraq's account with the Federal Reserve of New York. The court held that the debt was owed jointly to the Central Bank of Iraq and to SOMO, so that the proceeds could not be arrested.

Importantly for enforcement against state owned traders, the court held that SOMO did not enjoy sovereign immunity and that London was the location of the debt, as the residence of the debtor bank.

Both Taurus and SOMO cross-appealed and both appeals were dismissed, with the Court of Appeal holding that the location of the debt was outside the jurisdiction so the receivership order could not be made. The Court of Appeal agreed that SOMO did not benefit from sovereign immunity but was split on the question of whether the owner of the debt under the letter of credit was SOMO alone, or SOMO and the Central Bank of Iraq.

The Supreme Court will now have to determine whether the debts constituted by Credit Agricole's promise to pay were owed to SOMO alone or to SOMO and the Central Bank of Iraq.

It will also address the interesting issue of whether the debts created by the letter of credit were sited in London, following the longstanding principle that a debt is sited in the place where the debtor resides, or New

1 28 July 2015

This appeal will be one to watch for traders looking to enforce against state owned companies reluctant to pay long outstanding debts.

SARAH HUNT, SENIOR ASSOCIATE

York, following the potentially newer principle[2] that the location of a debt created by a letter of credit is the place of payment. Leading commentators have pointed out that the disadvantage of the latter decision is that the debt could not be recovered where it was situated, since the paying bank was not located there. The question of the location of the debt created by a letter of credit is a matter of general importance.

This appeal will be one to watch for traders looking to enforce against state owned companies reluctant to pay long outstanding debts. It could establish a precedent that would make it easier to recover debts by arresting a letter of credit payable to the debtor.

HFW represent Taurus in this case.

For more information, please contact Sarah Hunt, Senior Associate, on +41 (0)22 322 4816 or sarah.hunt@hfw.com, or your usual contact at HFW.

2 *Power Curber v National Bank of Kuwait SAK* [1981] 1 WLR 1233.

All at sea: wading through the principles of mitigation – a Court of Appeal decision

When should a benefit arising from a breach of contract be taken into account in assessing a claimant's loss? The English Court of Appeal's decision in *Fulton Shipping Inc of Panama v Globalia Business Travel S.A.U.*[1] contains useful guidance on the relevant principles of mitigation.

The issue of mitigation, particularly in circumstances where there is no available market, can be complex. In this judgment, the Court of Appeal has taken a 'back to basics' approach.

The decision was in the context of a chartered vessel that was redelivered early and subsequently sold. However it is of wider interest to any potential claimant in light of the duty to take all reasonable steps to mitigate loss arising as a result of breach of contract.

The fundamental principles of recovering damages for breach of contract are:

- Damages for breach of contract are intended to put the innocent party (the claimant) in the same financial position as if the contract had been performed.
- A claimant must take all reasonable steps to mitigate their loss.
- If they do so, gains or losses arising from the mitigation should be taken into account when assessing damages.

The issue of mitigation, particularly in circumstances where there is no available market, can be complex. In this judgment, the Court of Appeal has taken a 'back to basics' approach.

REBECCA LINDSEY, SENIOR ASSOCIATE

Background

The parties agreed a charterparty between them until 2009 but the charterers asserted an intention to redeliver the vessel early in 2007. The owners treated this as an anticipatory breach of contract and terminated the charterparty. Following termination, and in circumstances where there was no available market for a replacement fixture, the owners sold the vessel for around US$23 million and commenced London arbitration proceedings against the charterers, seeking damages for the loss of profits that would have accumulated during the remainder of the charterparty.

At the arbitration, it was established that the value of the vessel at the agreed time for redelivery in 2009

1 21 December 2015

"if a claimant adopts by way of mitigation a measure which arises out of the consequences of the breach and is in the ordinary course of business and such measure benefits the claimant, that benefit is normally to be brought into account in assessing the claimant's loss unless the measure is wholly independent of the relationship of the claimant and the defendant. That should be a principle sufficient to guide the decision of the fact-finder in any particular case."

would only have been US$7 million, due to the collapse in the shipping market. The arbitrator found that the profit made by the owners by selling the vessel in 2007 arose from the charterers' breach, and that the difference between the higher sale price obtained in 2007 and the price that would have been achieved in 2009 should be taken into account when determining the owners' loss.

The owners appealed to the English Commercial Court which overturned the award in a complex judgment, following which the charterers were granted leave to appeal to the Court of Appeal.

The decision

Whilst noting that it was "notoriously difficult" to formulate clear and unwavering principles when it comes to mitigation, the Court of Appeal unanimously held that the benefit derived by the owners from selling the vessel in 2007 should properly be taken into account in assessing the owners' loss.

The key principle established was: *"if a claimant adopts by way of mitigation a measure which arises out of the consequences of the breach and is in the ordinary course of business and such measure benefits the claimant, that benefit is normally to be brought into account in assessing the claimant's loss unless the measure is wholly independent of the relationship of the claimant and the defendant. That should be a principle sufficient to guide the decision of the fact-finder in any particular case."*

The Court of Appeal went on to consider the application of this principle to cases where there is an available market and cases where there is not, coming to the following conclusions:

- Where there is an available market, the measure of loss is the difference between the contract price and the market price at the time of the breach. Where the claimant elects not to take advantage of the available market but instead takes speculative actions, any benefit (or loss) arising from such speculative actions will not affect the calculation of damages as they are considered to arise independently from the relevant breach.
- Where there is no available market, the position is different. In time charterparty cases, the basic measure of loss is the difference between the hire received and the owners' costs in earning that hire. However where owners are able to mitigate such loss by selling the vessel, this should be taken into account when calculating damages.

Conclusion

This judgment is a succinct and helpful clarification of when a benefit to an innocent party can be brought into account when measuring damages for breach of contract. The message from the Court of Appeal is that an extensive analysis of causation is not required. All that must be shown is that the benefit arose "out of the consequences" of the breach. In this case the fundamental factual finding of the arbitrator that the profit gained by the owners from selling the vessel arose from the consequences of the charterers' repudiation was pivotal to the decision to uphold the appeal.

For more information please contact Rebecca Lindsey, Senior Associate on +44 (0)20 7264 8252 or rebecca.lindsey@hfw.com or your usual contact at HFW. Research conducted by Matt Tozzi, Trainee Solicitor.

Conferences and events

HFW Hong Kong Commodities Seminar
Hong Kong
24 February 2016
Presenting: Peter Murphy, Andrew Johnstone, Caroline Thomas, Fergus Saurin, Philip Kelleher and Sian Knight

AGIC
Singapore
1 March 2016
Attending: Stephen Thompson

GAFTA Trading Course
Singapore
3-4 March 2016
Presenting: Chris Swart, Katie Pritchard and John Rollason

AGIC
China, Beijing
4 March 2016
Attending: Stephen Thompson

AGIC
China, Guangzhou
7 March 2016
Attending: Stephen Thompson

HFW London Commodities Seminars
HFW London
8 & 23 March 2016

HFW Geneva Commodities Seminar
Geneva, Switzerland
16 March 2016

Iranian Sanctions Seminar
Geneva, Switzerland
17 March 2016
Presenting: Sarah Hunt

Metals Minerals & Money
HFW Geneva, Switzerland
21 March 2016
Presenting: Michael Buisset, Sarah Taylor, Sarah Hunt and William Hold

Swiss Bourse
Geneva, Switzerland
22 March 2016
Attending: Michael Buisset, Sarah Taylor and Sarah Hunt

Global Energy
Geneva, Switzerland
23-26 March 2016
Attending: Michael Buissett and Patrick Myers

FT Commodities Global Summit
Lucerne, Switzerland
11-13 April 2016

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 Abu Dhabi Dubai
Singapore Hong Kong Shanghai Perth Melbourne Sydney