Commodities

January 2014

COMMODITIES BULLETIN

Court of Appeal upholds GAFTA arbitrators' decisions on prohibition and default clauses

Last year we reported two decisions of the London Commercial Court, upholding GAFTA Board of Appeal Awards about the meaning of the standard GAFTA prohibition and default clauses (*Bunge SA v Nidera BV* in the February 2013 Commodities Bulletin and *Seagrain v Glencore BV* in the May 2013 Commodities Bulletin). Those decisions have now been confirmed by the Court of Appeal.

The outcome in both cases has confirmed the limits of the extent to which sellers can rely on the GAFTA prohibition clause to excuse them from shipping goods.

Both decisions concern the shipment of wheat from the Black Sea. The Contracts incorporated the same standard GAFTA prohibition clause which provides as follows:

"In case of prohibition of export, blockade or hostilities or in case of any executive or legislative act done by or on behalf of the government of the country of origin of the goods, or the country from which the goods are to be shipped, 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 an unfulfilled portion thereof shall be cancelled …".

In *Bunge v Nidera*, the issue concerned the timing of Sellers' reliance on the prohibition clause and the broader point of whether it was necessary for Sellers to show merely that an export ban was in place, or not only that there was a ban in place, but also that they were actually prevented from performing their obligations under the contract by that ban.

holman fenwick willan hfw

The contract was on FOB Novorossiysk terms and incorporated the terms of GAFTA 49. The contractual delivery period was 23 to 30 August 2010. On 5 August 2010, the Russian government issued a resolution prohibiting the export of wheat between 15 August and 31 August 2010 (therefore covering the entirety of the contractual delivery period). On 9 August 2010, Sellers purported to declare the contract automatically cancelled under the prohibition clause – even though there were 21 days before the end of the contractual delivery period still to run. Buyers accepted Sellers' message of 9 August 2010 as a wrongful repudiation of the contract and claimed damages.

The Court of Appeal confirmed the decisions of the Commercial Court and the GAFTA Board of Appeal in favour of Buyers.

Lord Justice Moore-Bick said that the words *"restricting export"* lie *"at the heart of the clause"*. He said that those words describe *"the practical effect on the seller's ability to perform the contract, particularly since the various events covered by the clause are likely to be of uncertain duration and effect. That appears most clearly in the case of blockades and hostilities"*.

The Court found that it was necessary for Sellers to show that their performance was actually prevented before they could rely on the clause. Sellers' purported cancellation of the contract on 9 August was, therefore, premature and amounted to a wrongful repudiation of the contract.

In *Seagrain v Glencore*, the Court considered the meaning of the same GAFTA prohibition clause and, in particular, the meaning of the wording *"any executive act … restricting export"*.

In this case, Sellers contracted to sell 3,000 MT feed wheat of Ukrainian or Russian origin C&F Israel. The shipment period was 15 to 31 August 2010 at Sellers' option. The contract incorporated the terms of GAFTA 48. It was common ground that Russian wheat was subject to an export ban at the material time so that the contract had to be fulfilled by Ukrainian wheat.

Unlike the Russian government, the Ukrainian government had not issued an express export ban. However, the 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 made a mandatory requirement of customs clearance that the authorities had cleared the laboratory results of the samples. On 2 August 2010, it was decided that only samples tested at the Kyiv Research Forensic Institute would be accepted.

On 2 September 2010, Sellers informed Buyers that they were unable to execute the contract because Ukrainian ports were *"fully blocked by local government for any kind of grains"*. Buyers terminated the contract and claimed damages.

Sellers argued that they were entitled to rely on the GAFTA prohibition clause. Buyers disagreed and argued that there had been no executive or legislative act restricting export for the purposes of the clause.

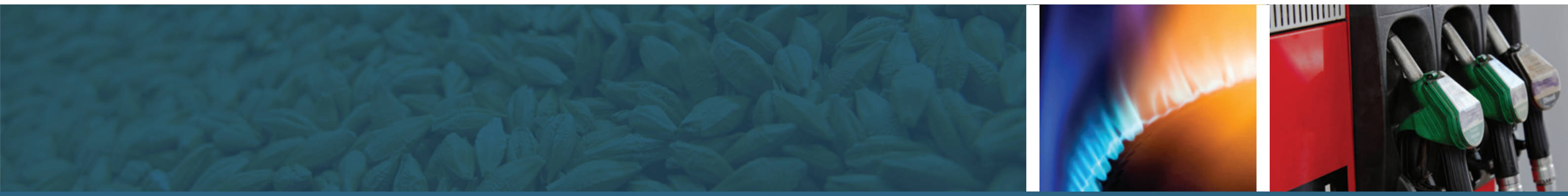
The Court of Appeal confirmed the Commercial Court Judge's finding that *"any executive … act"* had to be construed in context and meant *"an act done by or on behalf of the government which is in the nature of a formal restriction on exports…it could not be construed as extending to every action by an official body which has the effect of restricting exports"*.

Sellers wishing to rely on the GAFTA prohibition clause must therefore exercise caution to ensure that the prohibition event on which they seek to rely is an event which falls within the meaning of the clause, and that it has the practical effect of preventing their performance for the whole of the contractual delivery/shipment period.

In *Bunge v Nidera*, the Court of Appeal also confirmed the Commercial Court's construction of the GAFTA Default clause by holding that the clause is effective to exclude the common law principles established in the *"Golden Victory"* case that damages are intended to be compensatory.

The Court found that it was necessary for Sellers to show that their performance was actually prevented before they could rely on the clause. Sellers' purported cancellation of the contract on 9 August was, therefore, premature and amounted to a wrongful repudiation of the contract.

JOHN ROLLASON



Sellers wishing to rely on the GAFTA prohibition clause must therefore exercise caution to ensure that the prohibition event on which they seek to rely is an event which falls within the meaning of the clause, and that it has the practical effect of preventing their performance for the whole of the contractual delivery/shipment period.

Nidera argued that, since the Russian government export ban in fact remained in force throughout the contractual delivery period, Sellers would have been unable to perform the contract even if they had not terminated it prematurely and that, therefore, the Buyers suffered no loss as a result of the Sellers' failure to ship the goods.

The arbitrators and the Court rejected this submission.

The relevant provisions of the Default clause provide:

"Default – In default of fulfilment of contract by either party, the following provisions shall apply:

(a) The party other than the defaulter shall, at their discretion have the right, after serving notice on the defaulter, to sell or purchase, as the case may be, against the defaulter, and such sale or purchase shall establish the default price.

(b) If either party be dissatisfied with such default price or if the right at (a) is not exercised and damages cannot be mutually agreed, then the assessment of damages shall be settled by arbitration.

(c) The damages payable shall be based on, but not limited to, the difference between the contract price and either the default price established under (a) above or the actual or estimated value of the goods on the date of default and established under (b) above …"

Lord Justice Moore-Bick said that:

"The Default clause is intended to be easily understood and readily applied by traders and trade arbitrators alike in a variety of cases whose only common feature is that the contract has not been performed. It is worded in clear terms, is based on recognised principles and provides the commercial certainty that the trade requires".

Buyers were therefore correctly awarded damages on the basis of the difference between the contract price and the market price on 11 August 2010 when they accepted Sellers' repudiatory breach of contract. There was no requirement to go beyond the clear wording of the Default clause and investigate whether performance of Sellers' obligations would have been possible.

For further information, please contact John Rollason, Senior Associate, on +44 (0)20 7264 8345 or john.rollason@hfw.com, or your usual contact at HFW.

hfw Damages for late delivery of fuel oil to be based on spread of days of Platts' prices

The English Commercial Court's recent decision in *Galaxy Energy International Ltd v Murco Petroleum Ltd (27 November 2013)* will be of interest to commodities traders because of the way the Court ruled damages should be assessed.

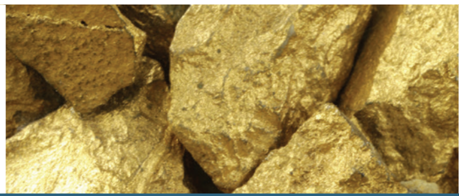
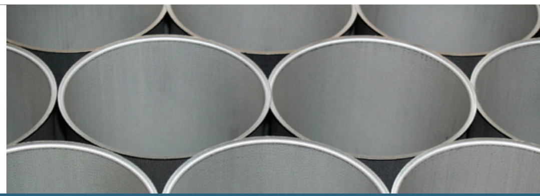
The claimant oil trader, Galaxy, claimed damages for alleged late delivery by the defendant oil refiner, Murco, of 35,000 MT of fuel oil, sold on an FOB basis.

The parties were familiar with each other's terms of business from previous dealings. On 4 January 2012, their brokers discussed terms for a sale of fuel oil for loading during the period 15–17 January on the same terms agreed in previous deals. However, Murco's confirmation email contained slightly different terms, including a change to the delivery provision to permit an extension to the delivery period required by Murco in order to effect or complete delivery. Galaxy responded on 11 January to the effect that the additional delivery wording should be deleted. Following a delay in berthing Galaxy's nominated vessel, the vessel began loading on 20 January and sailed on 21 January, outside the contractual loading period. Galaxy claimed damages.

Murco argued that:

1 Galaxy's conduct amounted to an acceptance of the additional delivery term.

2 The relevant delivery provision was in fact a laytime provision which contained no latest permitted date of delivery.

3 Any damages ought to be assessed by reference to prices given by the market information provider Platt's on a spread of days, as opposed to the Platt's price for the single day on which a breach occurred.

The Court found in Galaxy's favour, but awarded damages on the basis suggested by Murco:

1 There was an "agreement if not a final contract" in the 4 January conversation. The extension wording had not been incorporated into the parties' agreement and Murco was aware it had not been accepted. Galaxy's conduct at no point amounted to an acceptance of the new provision.

2 The delivery provision was not a laytime provision. Had the contract provided for an extended period of delivery within which a shorter, specified laycan was required to be agreed, the position may have been different.

3 In assessing damages, the Court was required to determine the market price at the date of the seller's breach. Platts was the best available measure of prices and it was common practice for prices in oil deals to be based on a spread of Platts' days. Trades in the market on the relevant day would be much more likely to be priced on a spread of Platts' days than on the quoted figure for that day. That spread of prices is closer to the market value for real deals on the day than the single day's Platts figure, which is not the same as a quoted price on an exchange. In order to determine the market value at the date of the breach, the Court's basis should be a spread of days of Platts' prices. Although this approach was more complicated, it was fairer.

This decision demonstrates the commercial awareness of the English Court. It is also worth noting that Murco's attempt to run two unpleaded arguments at trial was thwarted by the judge, who commented that given the amount in issue was relatively small and given the need for proportionality over costs, *"the parties should know what issues they have to face and not be met with surprises"*.

For further information, please contact Lucinda Rutter, Associate, on +44 (0) 20 7264 8226, or lucinda.rutter@hfw.com, or your usual contact at HFW.

In order to determine the market value at the date of the breach, the Court's basis should be a spread of days of Platts' prices. Although this approach was more complicated, it was fairer.

LUCINDA RUTTER

EU MiFID II/MiFIR agreed – major implications for commodities

On 14 January, the European Parliament and Council, with the Commission, reached political agreement on a package of updated rules governing markets in financial instruments. The package is commonly referred to as "MiFID II", but will comprise a rewritten Markets in Financial Instruments Directive (MiFID II) and a regulation (MiFIR).

It contains a wide range of reforms, including provisions that substantially broaden the scope of commodities regulation. The reforms particularly relevant to commodities firms include:

- Market structure – a new broadly defined category of Organised Trading Facility (OTF) will be introduced for non-equity products (bonds and derivatives).
- Commodity derivatives definition – extended to cover physically settled contracts traded on OTFs, except for wholesale power and gas covered by the EU Regulation on Energy Market Integrity and Transparency (REMIT). This in effect also broadens the scope of EMIR (the European Market Infrastructure Regulation) but "physically settled" oil and coal contracts will have a lengthy grace period from certain EMIR obligations.
- Authorisation – existing exemptions for commodity firms are deleted or restricted in scope, so more commodity firms will require authorisation and thereby become "financial counterparties" under EMIR.

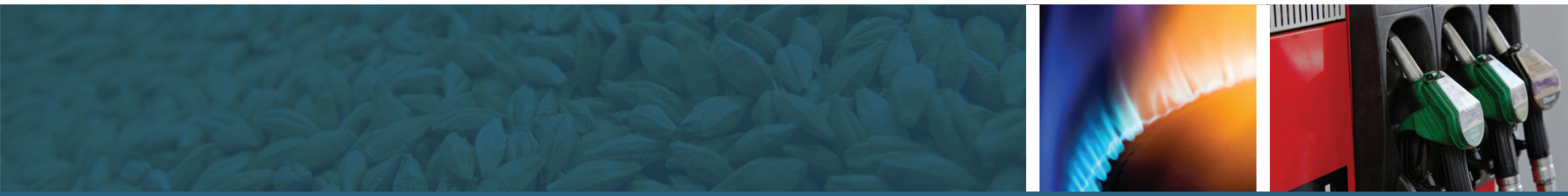
- Mandatory trading on an organised venue – may be applied to sufficiently liquid derivatives that are subject to mandatory clearing under EMIR.
- Position limits – will apply at group level to net positions in any commodity derivatives except for hedge positions of non-financial entities. National regulators will determine limits, applying a methodology set by ESMA.
- Third country access – Non-EU firms registering with the European Securities and Markets Authority (ESMA) will have access to EU "professional clients" and "eligible counterparties" if their home jurisdiction has been assessed as equivalent. Otherwise national regimes will apply to such firms.

MiFID II must be implemented by member states but MiFIR will apply directly. However, detailed "Level 2" regulations must first be made by the Commission on the advice of ESMA, so the measures are unlikely to take effect until at least late 2016.

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

MiFID II must be implemented by member states but MiFIR will apply directly. However, detailed "Level 2" regulations must first be made by the Commission on the advice of ESMA, so the measures are unlikely to take effect until at least late 2016.

ROBERT FINNEY



News

Revised EU & US sanctions
Following last November's preliminary agreement between the so-called P5+1 nations and Iran, the US and EU have relaxed certain sanctions with effect from 20 January 2014. For further information, please contact Daniel Martin, Partner, on +44 (0)20 7264 8189, or daniel.martin@hfw.com.

Conferences and events

Investing in African Mining Indaba
Cape Town, South Africa
3–6 February 2014
Attending: Brian Gordon, Nick Hutton and James Lewis

10th Kingsman Dubai Sugar Conference
Dubai
8–11 February 2014
Presenting: Simon Cartwright, Judith Prior and Jemma Hill

EU commodity derivatives regulation and how it affects traders in Switzerland
HFW Geneva
13 February 2014
Presenting: Robert Finney and William Hold

International Petroleum Week Dinner
London
19 February 2014
Attending: Alistair Feeney, Damian Honey, Steven Paull, Brian Perrott, Chris Swart, Sarah Taylor, Robert Wilson, Judith Prior and Eleanor Midwinter

IECA IP Week Dinner
London
20 February 2014
Attending: Janet Butterworth, Robert Finney, Damian Honey, Chris Swart and Robert Wilson

2nd Annual Dubai International Arbitration Summit
Dubai
25 February 2014
Presenting: Damian Honey
Attending: Hugh Brown

Commodities Breakfast Seminars
Our Spring series of breakfast seminars, covering current issues affecting commodities trading, will take place on 4 and 18 March and 1 April 2014. Anyone with an interest in the sector is welcome to attend. The seminars will be held at HFW's London office. For further information or to register your interest in attending the seminars, please contact Sarah Clayton on +44 (0)20 7264 8324 or events@hfw.com.

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
United Kingdom
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888

Lawyers for international commerce   hfw.com