Commodities

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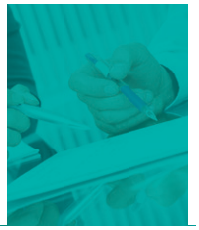
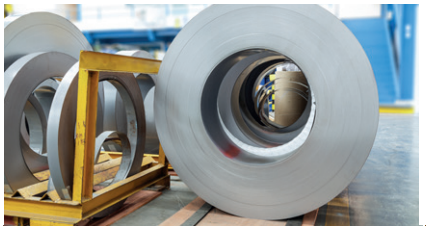
COMMODITIES BULLETIN




Welcome to the July edition of our Commodities Bulletin.

In the first article of this edition, we report on a recent significant UK Supreme Court decision on the GAFTA default clause and the application of the principle in the *GOLDEN VICTORY* to sale of goods contracts in *Bunge SA v Nidera BV (1 July 2015)*.

Next, Senior Associate Matthew Gore reports on new SOLAS regulations which will significantly impact traders shipping commodities in bulk. The new regulations come into force on 1 July 2016 and Matthew considers how those affected should prepare.

Next, Partner Brian Perrott and Associate Emily Sweeney review one of the first decisions arising out of the OW Bunker insolvency, *Swissmarine Corporation Ltd v OW Supply &Trading A/S*, in which HFW acted for Swissmarine. The case concerns the interpretation of the 2002 ISDA Master Agreement and issues of jurisdiction and injunctive relief.

Lastly, Partner Damian Honey and Senior Associate Andrew Williams consider a new electronic depositary for warehouse receipts recently announced by the LME.

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.

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Landmark Supreme Court decision on GAFTA default clause and damages in sale of goods contracts

In *Bunge SA v Nidera BV* (1 July 2015), the UK Supreme Court has given a key judgment on the GAFTA default clause and the application of the principle in the *GOLDEN VICTORY*[1] to sale of goods contracts.

Until now, there had been some doubt as to whether the *GOLDEN VICTORY* principle should apply both to one off and instalment contracts. The Supreme Court held it applied to both.

KATIE PRITCHARD, PARTNER

The Supreme Court determined how the GAFTA default clause works, finding it was not a complete code entitling a claimant to damages whether it suffered a loss or not. It upheld the principle established in the *GOLDEN VICTORY* and confirmed that when assessing damages, it is possible to consider subsequent events which show that a loss would not in fact have been incurred. It also held that this principle applies to sale of goods contracts just as to other contracts.

Background

The case concerned the effect of the default clause in the widely used GAFTA 49 form. Bunge (**the sellers**) contracted to sell to Nidera (**the buyers**) a cargo of Russian milling wheat FOB Novorossiysk. The contract incorporated the GAFTA 49 form, which included at clause 13 the then standard GAFTA prohibition clause and at clause 20, the standard GAFTA default clause which provides a contractual scheme for establishing damages payable in the event of default by either party.

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 all of the contractual delivery period). On 9 August 2010, sellers purported to declare the contract as cancelled under the prohibition clause. Buyers rejected this and brought a damages claim against sellers for wrongful repudiation. In the event, the prohibition was not lifted before the end of the delivery period and so shipment would not have been possible and buyers effectively suffered no loss as a result of sellers' wrongful early termination[2].

Issues

There were two issues for the Supreme Court to decide:

1. On the assumption that the *GOLDEN VICTORY* applied and buyers would be entitled only to recover nominal damages for sellers' default absent the GAFTA default clause, did that clause entitle buyers to recover damages in full?
2. If not, is the assumption valid?

Sellers argued that at common law, it was necessary to take account of events occurring after the breach which showed that the same loss would have been suffered even without the repudiation. Based on the *GOLDEN VICTORY*, buyers had suffered no loss as a result of sellers' termination of the contract and were entitled to no more than nominal damages – and clause 20 did not exclude the operation of those common law principles.

Buyers argued that because clause 20 applied, they were entitled to damages whether or not they would actually have suffered the loss for which they claimed based on the formula in clause 20.

Decision

The Supreme Court rejected criticism of the decision in *GOLDEN VICTORY* and confirmed its application in this case, so that sellers succeeded in their appeal.

1 *Golden Strait Corporation v Nippon Yusen Kubisha Kaisha (*The *GOLDEN VICTORY)* [2007] UKHL 12, [2007] 2 AC 353

2 It was no longer in issue before the Supreme Court that sellers' termination was wrongful.



It held that the fundamental principle of the common law of damages is the compensatory principle, which requires that the injured party is "*so far as money can do it to be placed in the same situation with respect to damages as if the contract had been performed*"[3]. In a contract of sale where there is an available market, this is usually achieved by comparing the contract price with the market price.

In the *GOLDEN VICTORY*, this compensatory principle was held to be overriding. Irrespective of the date as at which the market price was ascertained, it was necessary to take account of contingencies known at the date of assessment of damages, if their effect was to reduce the amount of the loss to be compensated.

Until now, there had been some doubt as to whether the *GOLDEN VICTORY* principle should apply both to one off and instalment contracts. The Supreme Court held it applied to both.

The Supreme Court also held that default clauses like GAFTA clause 20 are not necessarily to be regarded as complete codes on the assessment of damages or on mitigation and set out how the GAFTA clause operates:

- Clause 20 is concerned with non-performance. It does not matter whether the contract has not been performed because it was repudiated in advance of the time for performance, or because it was simply not performed when that time arrived.
- Clause 20(a) gives the injured party the option, at its discretion, of selling or buying (as the case may be) against the defaulter, in which case the sale or purchase price will be the "default price". Either party is at liberty to reject the default price, if there is one, as the basis for assessing damages. If either (i) there is no default price, because the injured party did not go into the market to buy or sell against the defaulter, or (ii) there is a default price but one of the parties is dissatisfied with it, then damages must go to arbitration under sub-clause (c).
- Clause 20(c) provides for two alternative bases of assessment. The first, which applies if a default price has been established but not accepted, is the difference between the default price and the contract price. The second is the difference between the contract price and the "actual or estimated value" of the contract goods at the date of default.

This decision should bring finality in the long-running debate over how the GAFTA default clause works and restore certainty for parties trading on GAFTA and other similar forms. The confirmation of the principle in the *GOLDEN VICTORY* and the scope of its application is significant too. It is likely to give rise to disputes as to whether subsequent events have impacted the level of damages to be awarded in sale of goods and other contracts.

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3 *Robinson v Harman* (1848) 1 Exch 850, 855 (Parke B).

A heavy weight to bear: challenges ahead for shippers of bulk commodities

Shippers of bulk commodities face fresh challenges as a result of the amendment to the Safety of Life at Sea (SOLAS) Regulation VI/2.

As the effective date for the amendment to SOLAS Regulation VI/2 fast approaches (1 July 2016), shippers will face increasing pressure to ensure that the correct systems and equipment are in place to comply with their new responsibilities to verify the gross mass of packed containers.

This article examines the obligations that the amendment will impose in particular on shippers of bulk commodities.

Background

As we have previously reported, the amendment to SOLAS makes shippers responsible for obtaining and documenting the verified gross mass of a packed container and reporting it to the owner or master of the vessel it is to be loaded on (i.e. the shipping line). Should the shipper fail to provide a verified gross mass, the cargo cannot be loaded. Moreover, if the verified gross mass proves to be incorrect, the shipper faces potential commercial and regulatory penalties, including summary conviction and/or a fine in the UK.

The regulations prescribe two possible methods by which a shipper may obtain the verified gross mass of a packed container:

Method 1: weighing the packed container using calibrated and certified weighing equipment (e.g. weighbridges or load cell sensing technologies).

Method 2: weighing all packages and cargo items, including the

mass of pallets, dunnage and other securing material to be packed in the container and adding the tare mass of the container to the sum of the single masses, using a certified method approved by the competent authority e.g. in the UK, the Maritime & Coastguard Agency (**MCA**), or its authorised body.

The IMO guidelines to the regulations expressly state that method 2 is an impractical and inappropriate means of verifying weight for shippers of bulk commodities. Therefore, shippers of bulk commodities must follow method 1 to verify the gross mass of cargo before the cargo can be loaded on board. Shippers are therefore responsible for physically weighing the bulk cargo - depending on the shipper's access to the required equipment, this is a potentially onerous obligation indeed. The recently published MCA guidance on UK implementation does however refer to establishing the weight of cargo under Method 2 for bulk products with the weight obtained from the production process, by metering through calibrated filling devices or again by physically weighing the product.

Weighing it all up

Shippers of bulk commodities will need to be sure that they either have their own, or have access to, "calibrated and certified equipment" to be able to physically weigh bulk cargo. In the UK, the MCA's guidelines on the regulations define "calibrated and certified equipment" as *"a scale, weighbridge, lifting equipment or any other device, capable of determining the actual gross mass of a packed container or of packages and cargo items, pallets, dunnage and other packing and securing material, that meets the accuracy standards and requirements of the State in which the equipment is being used"*[1]. If the equipment is being used in the UK, there are specific regulations that govern the standards of equipment. For example, the common standard for weighbridges is BSEN 45501[2].

Shippers of bulk commodities will need to be sure that they either have their own, or have access to, "calibrated and certified equipment" to be able to physically weigh bulk cargo.

MATTHEW GORE, SENIOR ASSOCIATE

Before 1 July 2016, shippers of bulk commodities will therefore need to check the standard of equipment already owned, or their access to suitable equipment. Shippers should note that it is the responsibility of the weighing instrument operator to ensure that the equipment has a documented procedure for maintenance, calibration and testing. Associated records must also be kept verifying the standards of the equipment. If the shipper is the weighing instrument operator, the shipper must make sure that these systems are in place.

Strategies for the future

The obligation on shippers of bulk commodities to verify the weight of the gross mass of containers of bulk cargo before they are loaded, and to communicate this information promptly to the shipping line or terminal operator, will be particularly onerous on those shippers that do not have access to adequate infrastructure, particularly those outside terminals. The Asian Shippers' Council has already recognised that many countries are not equipped for shippers to adapt to the changes in the regulations. It is therefore likely that in the coming years, the market's need for practical solutions will spark new technologies to deal with shippers' demands. The change in shippers' obligations may also lead to increased overall costs as shippers are forced comply with the regulations.

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1 Maritime & Coastguard Agency, Marine Guidance Note MGN 534 (M+F)

2 Ibid



hfw OW Bunkers and the 2002 ISDA Master Agreement: an English court decision

Last month, in *Swissmarine Corporation Ltd v OW Supply & Trading A/S*[1], the English Commercial Court denied Swissmarine Corporation Ltd (SwissMarine) injunctive relief against proceedings commenced by OW Supply & Trading A/S (OW) in Denmark.

OW was part of the OW Bunker group, the world's largest ship fuel supplier and Denmark's third largest company before its spectacular fall into bankruptcy and global collapse in November 2014. This judgment is one of the first English court decisions following those events.

For those with derivative contracts with OW (whether on OW's own general terms and conditions or on the ISDA form) payment obligations are subject to a condition precedent that no event of default has occurred and is continuing. An event of default includes a host of insolvency events and so, as at the date of OWs bankruptcy (and probably before), there was an event of default.

An event of default gave SwissMarine, as the "innocent" party, a right (but not an obligation) to close out their position under a derivatives agreement with OW on the 2002 ISDA Master Agreement form.

SwissMarine chose not to close out and instead relied on their English law right to "walk-away", a principle firmly established by the Court of Appeal in *Lomas and others v JFB Firth Rixson Inc and others*[2].

After SwissMarine had commenced proceedings in the English Commercial Court for declaratory relief that they did not have to pay according to English law, OW commenced proceedings in Lyngby in Denmark, claiming around US$2.5 million under Danish law on a forced close out.

With this clear potential for competing and conflicting judgments, and with OW claiming that the Danish proceedings were outside the Brussels Regulation, SwissMarine sought relief from the English court on two grounds:

1. The Lyngby action was a breach of the ISDA exclusive jurisdiction clause.
2. The Lyngby action was a breach of the ISDA English governing law clause.

Focusing most attention on the jurisdiction question, the court found that the ISDA jurisdiction clause, whilst wide in its remit, including within its scope non-contractual claims, did not apply to the dispute in the Danish court and in any event was not exclusive.

The ISDA jurisdiction clause, the court said, is only exclusive where the proceedings involve a "Convention Court" - a court *"which is bound to apply to the Proceedings either Article 17 of the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*[3] *or Article 17 of the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*[4]*"*.

Neither the Danish court nor the English court apply these conventions, both conventions having been superseded, and the judge found that the clause was not to be read as having been updated to refer to the new iterations.

At the time the ISDA 2002 form was drafted, the Danish court would have fallen within the definition, but not by the time the agreement was executed in 2014.

Today, the 1968 Brussels Convention applies only to certain dependent territories of EU Member States and the 1988 Lugano Convention applies only to judgments that pre-date the entry into force of the 2007 Lugano Convention. Given the extremely narrow (if not altogether defunct) definition of Convention Court, in effect the ISDA jurisdiction clause is not exclusive and parties are contractually free to bring as many parallel proceedings as they want.

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BRIAN PERROTT, PARTNER

1 [2015] EWHC 1571 (Comm)
2 [2012] EWCA Civ 419
3 The Brussels Convention
4 The Lugano Convention

Turning to a breach of the governing law clause, despite the fact that OW is seeking a money judgment in Denmark, the court found that on the balance of the evidence at an interlocutory standard *"the purpose of the Lyngby action is not to have decided by a foreign law the proper construction of the contract or the parties' rights or obligations under it. I do not accept that SwissMarine has shown a sufficient case that OW is breaking or disregarding the governing law agreement, or that it threatens to do so"*.

For many, this might seem rather an odd outcome. The parties agreed English law would govern their contract and non contractual obligations in relation to it and that in the event of an insolvency, payment obligations would be suspended. Further still, the parties had the option to elect for automatic early termination under their agreement but chose not to. OW brought proceedings for forced early termination under Danish law in a Danish court. Yet this was not found to be "disregard" of the governing law clause.

Whilst SwissMarine are free to pursue declaratory relief in the High Court to uphold their contractual bargain, there is no effective right in the English courts to prevent OW from seeking to undermine the English law agreement in the Danish courts.

Parties should therefore be aware that even though they may have chosen English law to determine disputes between them and English jurisdiction, a foreign party may have different ideas, may be able to sue in its own insolvency and civil courts, and the English court may decline to intervene.

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LME announces new warehouse receipt system

In the fourth quarter of this year, the London Metal Exchange (LME) is due to implement a new electronic depository system for warehouse receipts. It is a system distinct from LME Clear (the clearing and settlement service) directed at off-warrant metal. The objective is to streamline the process for the handling of warehouse receipts used in the over-the-counter metals market and make verification a much simpler and more secure process. In light of the recent scandal of alleged missing and over-pledged metal at various Chinese ports, in particular Qingdao, this is welcome news to commodity traders, warehouse operators and customers alike.

The new system, which is to be hosted on Sentinel (an electronic custody solution), is designed for the storage and financing of off-warrant metals. The service will provide a secure depository in which metal owners can lodge their warehouse receipts and according to its press release, will also offer "electronic transfer, pledging and administration functionality." The roll out of the electronic audit system is geared towards providing a more accountable and efficient system for the tracing and transferring of warrants.

It is clear from HFW's briefing on the Commercial Court's recent decision in *Mercuria v Citigroup* (http://www.hfw.com/Qingdao-judgment-in-Mercuria-v-Citigroup-May-2015) that safe storage of goods, consistent auditing of warehouse stocks and an accurate and transparent database of receipts are vital for facilitating commercial transactions in the metals market.

In that case, which concerned a commodity repurchase agreement of approximately US$270 million worth of metal, it was found that the tender of warehouse receipts (which under English law are not documents of title) to Mercuria without release instructions from Citi, who were reselling the metal, did not constitute a valid delivery of the metal. While the parties had agreed that for the purposes of the trial, Citi had title to and risk for the metal, the court did not rule out further litigation once the nature and extent of the alleged fraud, and the existence of the metal and relevant warehouse receipts, came to light. It is speculation whether or not the new depository system could have prevented or minimised the chance of such an occurrence, particularly as the metals were not stored at an LME approved warehouse. However, it does demonstrate the need for more comprehensive auditing mechanisms to be adopted in respect of non-LME stock.

The roll out of the electronic audit system is geared towards providing a more accountable and efficient system for the tracing and transferring of warrants.

DAMIAN HONEY, PARTNER



The new service, which is being developed in partnership with software-provider Kynetix, is being presented as a global warehouse receipt system that will accommodate both LME and non-LME stock. This announcement also appears to be part of LME's wider push to break into China, a significant market that remains closed to LME as it does not currently have permits to license warehouses. A slightly unexpected side effect of the ongoing investigation into alleged fraud at the port of Qingdao in China has been to highlight LME's reputation for only licensing warehouse firms with adequate capital security, appropriate insurance and strict auditing requirements. In fact, some banks who used metal as collateral to secure loans have requested that their clients shift metal stored at local warehouses in Qingdao to more regulated LME warehouses outside of China, including South Korea.

A more transparent system that improves warehouse storage, auditing and verification of warehouse receipts is a step in the right direction to creating commercial certainty. While further details of LME's new warehousing receipt system are required before its legal and commercial implications can be accurately assessed, it is hopeful that market players will adopt a system that increases transparency and certainty.

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hfw Conferences and events

AGIC Conference
Melbourne
27-29 July 2015
Presenting: Alistair Mackie
Attending: Stephen Thompson and Chris Lockwood

Energy in Western Australia
Perth
26-27 August 2015
Presenting: Alistair Mackie
Attending: Simon Adams and Caroline Brown

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