HFW

COMMODITIES BULLETIN

Welcome to the Summer edition of our Commodities Bulletin.

This edition features articles on: help available from the English courts in enforcing judgments or awards in jurisdictions where that can be difficult; a recent case on letters of credit in which HFW has been acting; and an update on the MiFID II position limits and reporting regimes, which will directly impact commodity market participants both inside and outside the EU.

Should you require any further information or assistance on 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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LEGAL DIRECTOR

"The most direct way to enforce an award or judgment is to find an asset which belongs to the defendant and obtain a court order in the country where it is located. But if you cannot find an asset, or if you do find an asset but it is located in a country where obtaining an attachment order over it is very difficult, or at best slow and expensive, the London court can provide additional enforcement weapons."

Enforcement of awards and judgments in 'difficult' countries

Most commodities contracts are cross border, often with one or more parties located in a country where gaining access or cooperation to enforce an arbitration award or court judgment can be challenging.

If your counterparty is in a 'difficult' country, is there any point in incurring the time and cost of pursuing a claim in arbitration or litigation against them at all? Alternatively, do you already have awards or judgments against parties that you have not found a way to enforce? Are they worth any more than the paper they are written on?

The most direct way to enforce an award or judgment is to find an asset which belongs to the defendant and obtain a court order in the country where it is located. But if you cannot find an asset, or if you do find an asset but it is located in a country where obtaining an attachment order over it is very difficult, or at best slow and expensive, the London court can provide additional enforcement weapons. In the right circumstances for example, if the defendant has a reputation to protect - they can prove very effective very quickly.

In our March 2017 Commodities Bulletin[1] we wrote about enforcement of an LMAA Award against a Chinese counterparty achieved by obtaining a worldwide freezing order from the London court, with penal sanctions against the company's director for failing to comply with the court's orders.

But to obtain a worldwide freezing order from the London court you need to be able to establish a real risk that your counterparty will dispose of or dissipate their assets - that if the court order is not made, there is a significant risk that the award or judgment will not be enforced. What if there is no or little evidence of risk of dissipation?

In two recent cases, we obtained on behalf of our clients London GAFTA arbitration awards against two different defendants in Vietnam. Both defendants ignored initial demands for payment, perhaps thinking that they were beyond the reach of any enforcement action, but the defendants underestimated the reach of the London court.

We made applications to the court in London to enforce the awards as if they were court judgments, and at the same time for orders that the defendants give disclosure of their assets in the form of an affidavit sworn by a director within 14 days. We also applied for orders to dispense with formal requirements for service so that the orders could be served by email on the defendants.

The court made the orders, but both defendants failed to give disclosure of their assets. However, the first defendant agreed to settle the claim shortly after receiving the asset disclosure order.

If the second defendant had complied with the asset disclosure order, this could have provided invaluable information as to the extent and location of their assets which could have led to successful attachments of those assets. However, the second defendant continued to ignore the court orders and demands for payment. But their failure to comply with the asset disclosure order laid the ground for a further application against them.

We then applied to the London court for a worldwide freezing order against the second defendant, using their failure to comply with the asset disclosure order to establish the risk of dissipation of assets, which is a pre-condition of the worldwide freezing order. The failure to comply with the asset disclosure order amounted to a contempt of court, which the court took very seriously.

The court granted the worldwide freezing order which we served on a number of the second defendant's

1. http://www.hfw.com/Commodities-Bulletin-March-2017

trading partners and banks as well as on the second defendant themselves. At that stage, the second defendant came to the negotiating table and agreed settlement terms.

Although not required in this case, in other cases we have also obtained court orders to commit directors of defendant companies to prison for failure to comply with asset disclosure orders. This process is described in more detail in our March 2017 Commodities Bulletin[2].

In summary, no matter where a defendant is located, if they wish to continue doing business, the London court offers a cumulative series of remedies which can be used to put significant pressure on them to honour awards and judgments.

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Letters of credit: what is an issuing bank entitled to know before paying out?

Letters of credit (LCs) are very widely used as a secure means of financing international trade. In the last year, there have been several English court judgments[1] about the role and responsibilities of issuing banks in an LC transaction, and in particular their obligation to pay against receipt of conforming documents.

Now, the English High Court has ruled[2] on an issuing bank's entitlement to require further information as to whether a confirming bank has made payment under an LC before reimbursing it.

Background

HFW represents CIMB Bank Berhad (CIMB) in an action brought against them by Deutsche Bank AG in the English High Court. CIMB was the issuing bank under 10 letters of credit to which Deutsche Bank added its confirmation.

The substantive hearing of this case will take place later this year, but an interesting point of principle arose at the first case management conference, which is of significant interest to issuing and confirming banks under LCs.

Deutsche Bank argued that having made payment to the beneficiary, its client, under the LCs and having passed what it alleged to be compliant documents to CIMB, it was entitled to reimbursement from CIMB. CIMB disagreed.

The issue between them related to the interpretation of Article 7(c) of the UCP 600, which states:

"An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank [...] An issuing bank's undertaking to reimburse a nominated bank is independent of the issuing bank's undertaking to the beneficiary."

In its pleadings, Deutsche Bank asserted that it had made payment and CIMB had made a formal Request for Further Information as to whether payment had actually been made.

Deutsche Bank refused to comply with this Request, contending that as a matter of principle, an issuing bank must accept on its face a statement from a confirming bank that it has paid the beneficiary – there is no entitlement on the part of an issuing bank to enquire as to whether a confirming bank has actually made payment before reimbursing it. It argued that CIMB's undertaking to reimburse Deutsche Bank arose once Deutsche Bank had sent CIMB the allegedly conforming documents and stated that it had paid the beneficiary. To permit issuing banks a right of enquiry as to whether payment has in fact been made would be *"uncommercial, unworkable and plainly not what the parties must be taken to have intended"*.

CIMB on the other hand argued that its undertaking to reimburse Deutsche Bank under UCP 600 Article 7(c) is contingent on Deutsche Bank having actually made payment to the beneficiary. The question as to whether or not a confirming bank has actually paid is therefore fundamental to this reimbursement undertaking, and an issuing bank must therefore be entitled to enquire as to whether payment has in fact taken place.

The decision

On 25 May 2017, the English High Court found in favour of CIMB and allowed its Request for Further Information.

This judgment is the first conclusive authority to deal with this point, although some existing judicial commentary and practitioners' texts lent support to CIMB's position.

The court agreed with CIMB that whether the presentation of documents has been honoured by payment is a relevant matter for investigation, endorsing previous judicial comment that: "What matters is the fact of honouring or negotiating a complying presentation."[3]

Deutsche Bank had also argued that the words "states that" should be read in to UCP 600 Article 7(c), so that an issuing bank's reimbursement undertaking would arise when the confirming bank says that it has paid the beneficiary, rather than when it has actually done so.

The court rejected this, holding that it is not correct in principle to construe Article 7(c) of UCP 600 *"by writing in words that materially change its sense."* The court also pointed out that *"UCP is revised periodically, and this is the occasion for introducing changes if thought desirable."*

HFW comment

This decision provides a clear interpretation as to the extent of an issuing bank's responsibilities under UCP 600 Article 7(c), which will stand unless and until the decision

2. http://www.hfw.com/Commodities-Bulletin-March-2017#page_2

1. *National Infrastructure Development Co Ltd v Banco Santander* [2017] EWCA Civ 27; *Petrosaudi Oil Services (Venezuela) Ltd v (1) Novo Banco SA (2) PDVSA Servicos SA (3) PDVSA Services BV* [2017] EWCA Civ 9, [2017] All ER (D) 92 (Jan)

2. [2017] EWHC 1264 (Comm)

3. *Fortis Bank v Indian Overseas Bank* [2009] EWHC 2203 (Comm)

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is overturned by a higher court, or the Article is amended during the periodical revision process.

Whilst it is unlikely in most cases that an issuing bank would have cause to question a confirming or negotiating bank's assertion that it has honoured presentations under LCs, this decision gives them scope to do so if they find it necessary.

It may prove useful in the context of synthetic trades, or where standby LCs are being used as a form of security and where it is often difficult for issuing banks to resist demands for reimbursement from confirming banks.

It will be of particular relevance in the heightened regulatory and compliance environment in which international banks operate, as it opens the possibility for issuing banks to acquire further information from confirming banks about the movement of funds in trade deals in which they are involved.

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MiFID II position limits and reporting regimes: an update

The MiFID II regime will come into force throughout the EU on 3 January 2018. Many of the new rules will directly impact commodity market participants both inside and outside the EU. Two key areas are the new commodity derivatives position limits and reporting regimes.

What are the new regimes?

MiFID II arguably enacts the most extensive position limits regime anywhere in the world. The regime requires regulators in member states, or national competent authorities (NCAs), to determine limits on the size of positions (long or short) that any market participant (regardless of their location or regulatory status) can take in any commodity derivative contract executed on an EU trading venue. This includes regulated markets, multilateral trading facilities (MTFs), and organised trading facilities (OTFs)), along with "economically equivalent OTC contracts" (EEOTCs).

The position limits regime will be reinforced by a position reporting regime. This will require members/participants of trading venues to report their positions in commodity derivatives to the trading venue on a daily basis, as well as the positions of their clients, their client's clients, and so on, down to the 'end client'. In addition, investment firms trading in commodity derivatives outside a trading venue must report to the relevant NCA on a daily basis their positions in all commodity derivatives as well as those of their clients down to the 'end client'. Trading venues are also required to make daily and weekly reports to their NCA concerning positions held by their members and the aggregate positions held by different categories of persons in different commodity derivatives respectively.

Recent Guidance and Remaining Areas of Ambiguity

Below, we have summarised some of the key areas where recent guidance has been provided or further clarification is required to remove ambiguities relating to the position limits and position reporting regimes.

EEOTC

Article 5 of the Position Limits Delegated Regulation states that EEOTC contracts must have "identical contractual specifications, terms and conditions" to contracts executed on trading venues. Certain minor deviations such as lot size, delivery dates deviating by less than one calendar day and post-trade risk

management, are permitted. In practice, given that the requirement is for all terms and conditions, and not just contract specifications, to be identical, it is possible that very few, if any, contracts will be EEOTC. ESMA has now confirmed that it will not be publishing a list of EEOTC contracts, so it will be for market participants to decide whether or not any particular contract they enter into will be EEOTC.

C(10) Contracts

The definition of commodity derivatives" includes certain "exotic derivatives" which do not have a commodity underlying, such as those based on "indices and measures", and "inflation rates". There has been industry feedback querying what, if any, limits should apply to these contracts, as well as whether they should be reportable under the position reporting regime.

The European Securities and Markets Association's (ESMA) updated Q&As on commodity derivatives clarify that position limits should only be applied to derivative contracts relating to indices if the underlying index is "materially" based on commodity underlyings (commodities have a weighting of more than 50% in the composition of the underlying index), and that inflation derivatives are outside the scope of the regime.

There is an expectation that ESMA may soon be issuing guidance that financial instruments outside the scope of the position limits regime will not be subject to position reporting because the purpose of position reporting is to monitor position limits.

"Hedging exemption"

Non-financial counterparties (NFCs), firms which are not authorised under EU financial services regulation, and third country firms that would not need to be authorised if established in the EU, are able to apply for an exemption from a position limit for a contract where it can be demonstrated that the contract is being entered into to hedge risk directly relating to their commercial activity - the so-called "hedging exemption".

Regulators are starting to inform market participants how they intend to apply the hedging exemption,

and their approaches are not always consistent. The UK NCA, the Financial Conduct Authority (the FCA), has indicated that firms should apply for the exemption when they consider they may be close to exceeding the limit in a particular contract. By contrast, the German NCA, BaFin, has suggested that position limits should only apply to speculative trading and that once an exemption has been obtained, a firm may disregard all its hedging trades. ESMA has indicated that there will be no further Q&As on this and it appears that there may end up being some regulatory arbitrage as to how this exemption is applied throughout the EU.

"End client"

The term "end client" (used in the context of position reporting) is not defined in MiFID II. This has led to some concerns among market participants as to how the term will work in practice. ESMA has recently updated its Q&As on commodity derivatives to clarify that all positions in commodity derivatives must be included in such reports. This means that where an investment firm is reporting the positions of an end client that is not an investment firm and does not therefore have reporting obligations of its own under MIFID II, its report should cover both the end client's own account positions and any positions that the end client holds on behalf of third parties. ESMA encourages that such third party reporting should be disaggregated on a person by person basis, although it notes that there is no legal obligation to do this and that it may be impractical in certain circumstances. ESMA has also stated that the requirement to identify clients and clients of clients until the end client in position reports cannot be waived

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- even where to identify a position holder would breach legal, regulatory, or contractual impediments, such as non-EU data protection laws. The FCA, which is responsible for monitoring compliance with the position reporting regime, has not yet commented on the practical consequences of failing to identify a position holder in light of this latest guidance from ESMA.

Conclusion

The publication of further guidance by ESMA and the FCA is necessary, given that firms may require a substantial lead-in time to get the IT infrastructure in place to monitor, capture, and report the required information under the position limits and reporting regimes, to ensure they can be compliant on day one. We anticipate that further guidance, and the position limits themselves, will be published in the coming months. In order to manage the evolving regulatory landscape, firms should monitor future publications by ESMA and the FCA and seek legal advice if they are unclear as to how they will be impacted.

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HFW and Grant Thornton: Brexit Japan

On 28 June 2017, HFW hosted a joint event with Grant Thornton on Brexit in Tokyo. The Right Honorable Jack Straw delivered a keynote speech focusing on the current political situation noting how *"the composition of the new Parliament is likely to mean that Brexit will be less disruptive for industry and investment"* and that *"the chances of there being a second referendum are slim, but could not be ruled out altogether."*

HFW Partner Brian Perrott delivered an engaging opening speech as well as a presentation on international trade around Brexit. HFW Partners Peter Coles and Anthony Woolich also gave thought provoking presentations addressing the key issues for the Aviation and Competition and Regulatory sectors. GT's Pete Dawson addressed the economic factors to consider, noting that it is a great time for International countries to invest in the UK.

A panel session closed the day, in which Mr Kodaira, Economic Journalist of Nikkei and HFW Partner Andrew M Johnstone joined the other speakers to engage in some lively discussion and questions from clients around whether Article 50 could be revoked and whether Brexit will impact English arbitration.

Conferences and events

3rd LNG Marine Fuel Forum 2017
Singapore
17-18 July 2017
Presenting: Scott Pilkington

AGIC Australia Conference
Melbourne
2-4 August 2017
Presenting: Stephen Thompson and Peter Murphy

HFW/GAFTA Commodities Workshop
Jakarta
10 August 2017
Presenting: Chris Swart, Adam Richardson, Eviaty Jenie, Suzanne Meiklejohn

HFW Commodities seminar
Dubai
13 September 2017
Presenting: Damian Honey, Richard Strub and Tien Tai

GVA Seminar Series – OHADA the Organisation for the Harmonization of Business law in Africa
Geneva
14 September
Presenting: Georges Racine

HFW has over 450 lawyers working in offices across Australia, Asia, the Middle East, Europe and the Americas. For further information about our commodities capabilities, please visit hfw.com/commodities

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