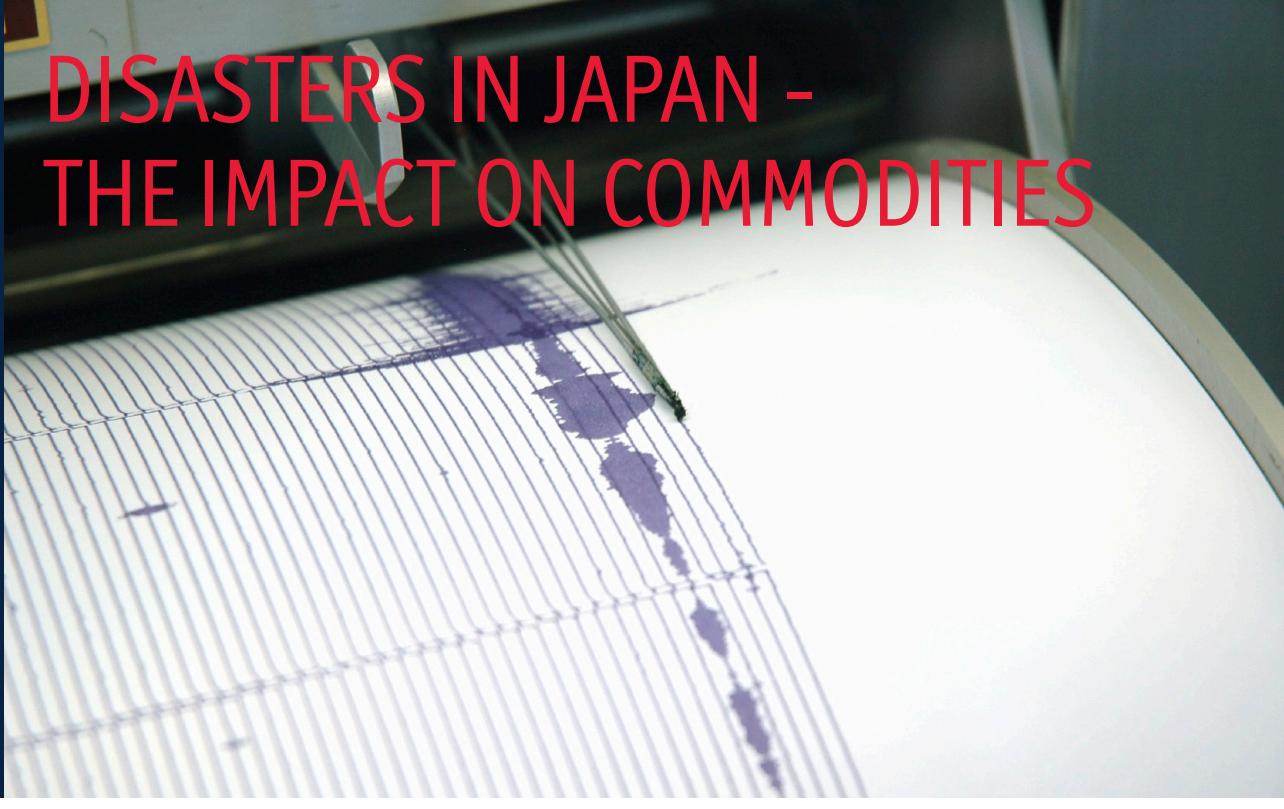


# DISASTERS IN JAPAN - THE IMPACT ON COMMODITIES



London

The earthquake and tsunami in Japan, and the resulting crisis at the Fukushima I Nuclear Power Plant, are the latest in an extraordinary series of natural disasters and crises this year. The Queensland floods and the continuing popular uprisings in the Middle East have seriously disrupted global commodities trading. Events in Japan add another major element to this pattern of turmoil.

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## Legal issues

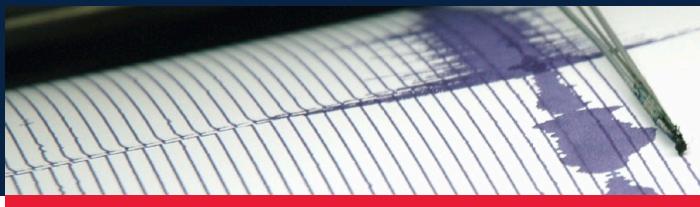
Japan is among the world's largest importers of commodities, particularly of agricultural and energy products. Traders are therefore inevitably badly affected by the disaster. A familiar range of issues has arisen: ports and terminals have been damaged; steel mills, oil refineries and coal burning plants in the affected areas are out of action or struggling to operate; gas and oil storage tanks have been damaged or have caught fire; transport links are disrupted; and there are shortages of manpower, food, water and power.

## Force majeure

Despite the severity of the situation, it does not automatically follow that affected parties will be able to rely on force majeure to excuse a failure to perform. Under English, Australian or Singaporean law contracts, force majeure will only be available to the extent that contracts provide for it. In other words, affected parties may rely on a force majeure provision only if it covers the circumstances preventing performance. If there is any ambiguity, it will be resolved against the affected party. Furthermore, as time passes, the circumstances preventing performance may change, and may no longer be covered by force majeure provisions, even if the initial circumstances were.

## Frustration

Under English, Australian and Singaporean law, a contract may be discharged by frustration where an extraneous event occurs after the contract is agreed which is not caused by the



fault of one of the parties and is not catered for in the contract (by a force majeure clause or otherwise), and where the event so fundamentally changes the nature of performing the contract that it would be unjust to require continued performance.

Courts tend to be reluctant to find that there has been a frustrating event. Normally, contracts are only discharged by frustration when they become impossible to perform. That performance may have become substantially more difficult, or more expensive, will not amount to a frustrating event.

#### Demurrage

Traders who have chartered ships to load or discharge at an affected terminal may incur significant demurrage liabilities, or even cancellations. Even if their charterparty includes a force majeure clause, it will not interrupt the running of laytime or demurrage unless it uses clear words to that effect; and it will only interrupt whilst the specific force majeure circumstances apply.

#### Deviation

Deviation by a vessel is permitted where it is a genuine attempt to deal with a danger, emergency or its consequences. The liberty to deviate must be exercised in good faith and not arbitrarily, capriciously or unreasonably. There is a continuing risk of aftershocks at Japanese ports and the impact of the nuclear incident at Fukushima remains unclear, with the situation changing frequently. Higher than expected radiation levels have also been found in food and water supplies nearby.

Where ports are inside an exclusion zone, the need to deviate from those ports may be straightforward. If vessels were to deviate from ports near to but outside the exclusion zone because of concerns about radiation, the position may be less clear cut. The particular terms of the "liberty to deviate" clause in the parties' contract would need to be considered in each case.

#### Impact on markets

Commodities prices have been convulsed by the disaster in Japan. Coal and LNG prices have risen steeply, whilst the price of oil fell, apparently on the basis that the closure of many Japanese refineries may lead to a fall in demand. This downward pressure on oil prices is of course offset by the upward pressure generated by the continuing crisis in the Middle East and prices jumped again following the commencement of air strikes against Libya. Iron ore prices fell after the disaster on 11 March 2011, but recovered somewhat after Japan's two largest steel makers, Nippon Steel and JFE, restarted their blast furnaces a few days after the earthquake. Prices of aluminium, copper, rubber, corn, coffee and sugar have all fallen.

#### Power

Japan is estimated to have lost 25% of its power supply and with the nuclear incident continuing, demand

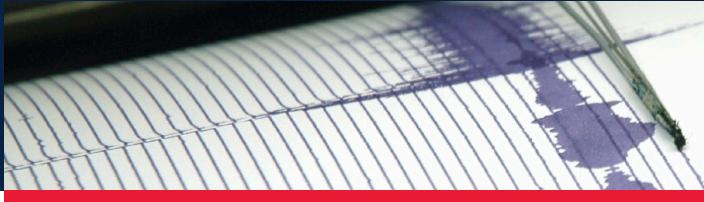
for other sources of energy is likely to soar. The crisis has prompted China, which is building more nuclear reactors than any other country in the world, to suspend approval of new nuclear power stations and undertake checks on existing reactors. Following an emergency meeting to review safety measures at nuclear reactors across Europe, the European Union has announced it will now conduct stress tests on all its nuclear power stations, while Germany has declared it will shut down seven of its old reactors. If this cooling of enthusiasm for nuclear energy continues long-term, it could increase further global demand for hydrocarbons and renewable energy.

#### LNG

Japan is the world's largest importer of LNG. In contrast to the position with the country's oil refineries, all but one of Japan's LNG facilities have continued operating since the earthquake. The exception is Sendai City Gas Shinminato LNG facility, 80 miles from the earthquake's epicentre, which is believed to have been flooded by the tsunami and is not expected to operate for at least a month. LNG shipments into Japan do not appear to have been disrupted.

Approximately one fifth of Japan's nuclear power generation capacity is no longer in operation. It is estimated that Japan may import up to 10 million metric tonnes of additional LNG to cover this energy shortfall. In response

**"Japan is estimated to have lost 25% of its power supply and with the nuclear incident continuing, demand for other sources of energy is likely to soar."**



to a request for increased LNG supplies, Indonesia has indicated that it could ship an additional 59 cargoes to Japan this year, and the Japanese government is currently negotiating with other major LNG producers such as Qatar, Russia and Australia with a view to securing extra supply. In the short term, other regional LNG importing countries, South Korea and Taiwan, have agreed to swap April deliveries with Japan. Asia's spot LNG market has dried up as major producers have earmarked all extra cargoes for Japan.

Elsewhere there are indications of increasing pressure in LNG markets, with spot LNG prices and natural gas futures rising slowly in Europe and North America. Some analysts speculate that if LNG production remains level, spot LNG prices may rise to up to US\$15/MMBtu from recent levels of US\$10-11/MMBtu.

For suppliers locked into long-term supply contracts at lower rates, there may be a temptation to divert supplies to meet short-term demand in the spot market, leading to performance defaults.

The impact of the extraordinary events of early 2011 is likely to be felt by commodities traders for some time to come. The volatility of both the markets and the global situation makes the long-term effects unpredictable. Contractual difficulties, especially in long-term supply contracts agreed before these events took place, are almost inevitable.

Our Shipping group has produced a complementary briefing dealing with issues specific to their area of expertise. If you have not received a copy of their briefing and would like to, please contact [mailings@hfw.com](mailto:mailings@hfw.com).

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