COMMODITIES BULLETIN
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Welcome to the June Commodities bulletin.

We are delighted to have some of our newly promoted lawyers write for this edition. We begin with an article by Melbourne Partner Owen Webb and London Senior Associate Rosie Harrison on a recent English Court of Appeal decision on hedging: *Rhine Shipping DMCC v Vitol SA [2024] EWCA Civ 580*. This is followed by a piece from Singapore Partner Suzie Meiklejohn and Senior Associate Jefferson Tan considering the effects of the EU Deforestation Regulation on Asia Pacific companies. Finally, London Legal Director David Chalcraft covers *UBS Switzerland AG v Anil Kumar [2024] EWHC 1058 (Ch)*, an English High Court judgment which offers a salutary tale for company directors and trade financiers about insolvency, directors' duties, and fraudulent payments.

You can find out where to meet us next and read other team news on the final page.

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AN OPPORTUNITY MISSED? ENGLISH COURT OF APPEAL RULES IN *RHINE SHIPPING DMCC V VITOL SA*[1]

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Relatively few cases on hedging have come before the English courts. Each new decision is therefore worthy of close consideration, although this recent judgment by the Court of Appeal might be considered an opportunity missed.

Background

In a charterparty dispute between Rhine Shipping DMCC (**Owners**) and Vitol SA (**Vitol**), Owners were found in breach due to the delayed arrival of the vessel at the loadport. Vitol had a related sale contract in place with a third-party supplier (**TOTSA**) for the purchase of a cargo of crude oil (the **TOTSA Cargo**). The price payable by Vitol under the sale contract increased significantly because of the delay and Vitol claimed damages from Owners.

Vitol used an internal risk management system called Vista, in which purchase and sale transactions were matched. This was referred to as a 'Vista hedge'. However, it was not a 'hedge' in the traditional sense: usually a hedge is a transaction with an external third-party to offset the risk of a physical transaction.

The Vista risk management system was a way for Vitol to identify its net total pricing exposure across its book of physical trades and to decide whether any risk management steps, such as external hedging or choosing to run an unhedged position, were required. It was not for the mitigation of specific price risk on an individual trade, such as the TOTSA contract.

Within Vista, Vitol entered into a series of internal swaps, whereby the risk of an increase in the market price arising from the delayed loading of the TOTSA Cargo was matched against the risk of a decrease in the market price. When it became clear that the pricing dates for the TOTSA Cargo would be delayed, the swaps in place for those dates were 'rolled', so that the pricing dates of the internal hedge matched the revised dates. But for the delay, the swaps would not have been rolled in this way.

Vitol had to pay TOTSA an additional USD 3,674,834 due to the delay. However, the rolling of the swaps generated a gain (within Vista) of USD 2,871,971. The loss recorded in the Vista system in relation to the TOTSA Cargo was therefore only USD 802,863. Vitol claimed the full increase in the amount paid to TOTSA but Owners argued that the benefit of the internal hedging must be taken into account, so that only the lower amount in the Vista system was due to Vitol by way of damages for breach.

High Court judgment

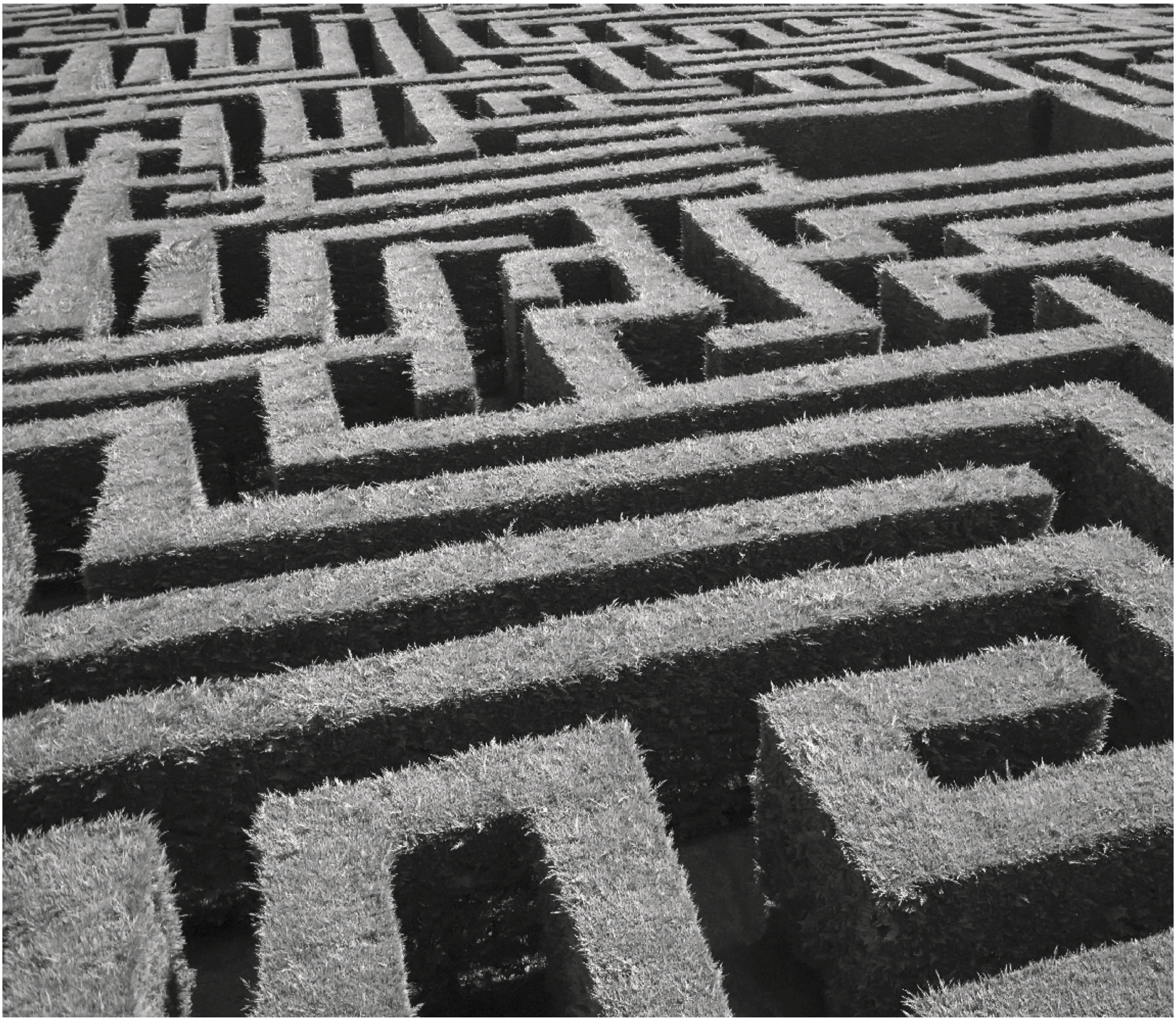
At first instance, the High Court found that if the hedge had been external, this benefit would have been taken into account in mitigation. However, the internal rolling of the swaps could not be treated as having any effect on Vitol's profit or loss; it merely transferred the risk between Vitol's portfolios and did not operate as mitigation to remedy any loss to Vitol as a company. This confirmed that a company cannot contract with itself.

The Appeal

Owners appealed. They were granted permission to appeal on one ground: whether the internal swaps that had been entered into *as a direct consequence* of the breach of charter by Owners were lawfully relevant to the assessment of recoverable damages suffered by Vitol, in that they were not lawfully or materially different from external swaps.

Just before the hearing, Owners applied for permission to amend the grounds of appeal. They wanted to argue that when the breach occurred, a pricing risk was added to Vitol's overall net position. This was matched somewhere within the system with an opposite risk. Without the breach, the opposite risk of the fall in market value would have existed in Vitol's book without the matching market increase risk.

1 *[2024] EWCA Civ 580*



Vitol's policy was to hedge risk wherever possible, and inferences from the evidence suggested that they would have bought an external hedge against the oppositional risk of a decrease in price, which would have created a loss. This loss was avoided by virtue of Owners' breach.

Applying the principles to be considered before allowing a new point on appeal, the Court of Appeal held that Owners' argument was entirely new conceptually, factually and legally and reached the conclusion that it would not be allowed, in particular because it would require new findings of fact not made by the judge at first instance and a significant volume of additional evidence. Having reached this decision, the Court of Appeal left open the legal question of whether an avoided hedging loss could be considered mitigation of loss or a collateral benefit, beyond expressing a view that the collateral benefit principles would place "formidable difficulties" in the way of Owners' new argument.

As to the original ground of appeal, the Court of Appeal indicated that it agreed entirely with the judge at first instance. The avoided loss on other physical transactions was not a benefit derived from mitigation. The other transactions were not entered into for the purposes of hedging the TOTSA contract and Vitol did not enter into them as a result of the price risks to which it was exposed under the TOTSA contract.

HFW Comment

Large oil trading companies run very complex trading books. It would have been helpful to have had further guidance from the Court on the effect of these on damages claims, had Owners been given permission to appeal on the new ground. As it is, this decision by the Court of Appeal at least endorses previous decisions of the lower courts that the benefit of external hedges can be taken into account to reduce the amount of damages due in oil trading.

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THE EU DEFORESTATION REGULATION: WHAT ARE THE CHALLENGES AND OPPORTUNITIES FOR ASIA PACIFIC COMPANIES AND WILL THE BRUSSELS EFFECT TAKE HOLD?

It has been observed that *"the adoption of environmental and human rights standards beyond Europe's supply chains to make more than just a dent in tropical deforestation and other sustainability issues depends either on their adoption by Asian consumer markets or on Europe imposing its standards on companies that trade or finance those commodities irrespective of who consumes them".*[1]

The European Union Deforestation Regulation[2] (**EUDR**) is a recent addition to the EU's arsenal of regulatory tools aimed at externalising its sustainability standards. This is part of what is called the 'Brussels effect', namely the EU acting as a global regulatory power by exporting its standards globally – either by forcing companies to streamline their operations according to European standards (known as the 'de facto Brussels effect') or by having other countries follow suit and adopt similar policies (known as the 'de jure Brussels effect').

In this article, we discuss what the EUDR is, how it may create further divergence in global supply chains, how it impacts companies in the Asia Pacific region, and what steps those companies should consider taking to comply with the EUDR.

What is the EUDR?

Briefly, the EUDR prohibits the placing on the internal market, or export from the EU, of seven commodities if they were produced on land deforested after 31 December 2020 (the **Deforestation-free Requirement**). The seven commodities are cattle, cocoa, coffee, palm oil, rubber, soy and timber. The EUDR also includes products derived from these commodities, such as beef, chocolate, furniture, leather, paper and tyres (together with the commodities, the **Subject Products**). The Subject Products must also be legal (i.e. compliant with all relevant applicable laws in force in the country of production) (the **Legal Requirement**).

Operators who place Subject Products in the EU and traders who make Subject Products available in the EU must cover the Deforestation-free Requirement and Legal Requirement with a due diligence statement. The statement includes three main components:

1. **Traceability:** This requires provision of the geographic coordinates of the farm or plantation where the products are produced.
2. **Risk assessments:** Companies must use the gathered information to evaluate the deforestation risk of the Subject Products. Only Subject Products with 'negligible' or 'non-existent' deforestation risk can be placed in the EU market.
3. **Mitigation measures:** Companies must adopt adequate and proportionate mitigation measures against any risks identified.

Non-SME corporate operators must publicly report on their due diligence system including on the steps taken to fulfil their obligations on due diligence under the EUDR.

Subject Products from low-risk countries will only require a simplified due diligence check whilst those

1 See Mairon G. Bastos Lima & Almut Schilling-Vacaflor, "Supply chain divergence challenges a 'Brussels effect' from Europe's human rights and environmental due diligence laws" (2024) 15 Global Policy 260 at 261.

2 Regulation (EU) 2023/1115 of the European Parliament and of the Council of 31 May 2023 on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010. It came into force on 29 June 2023.

Factor	Asia Pacific context
The lower the adjustment costs relative to the benefits of market access, the more likely the producer will adjust to the importing country's standard and enter the market	Producers in Asia Pacific will need to provide documents and certificates of traceability which is likely to increase costs of exporting to the EU. Many farmers and small and medium-sized companies are likely to struggle adapting to the EUDR's certification and traceability procedures as they would require new technologies, processes and administrative and ongoing costs for compliance, for example with geolocation rules and the need for segregation. It should be noted that even in the context of a voluntary standard such as the Roundtable on Sustainable Palm Oil (**RSPO**), the benefit of a premium does not justify the cost of certification. Smallholder production areas constitute approximately 30% of the total cultivated landbank in Malaysia and about 40% in Indonesia. Their exclusion from the supply chain would have a drastic effect both within the local industry and in international markets. Indonesia and Malaysia are reported to have asked for their existing standards to be used to meet EUDR requirements of traceability, deforestation-free, legitimate land title and good labour practices.
The better the exporter's ability to divert trade to third-country markets or increase demand in its home market, the less likely the Brussels Effect will occur	It is unclear whether the EU will be able to set a worldwide benchmark for sustainability in agricultural commodities given its loss of market share to emerging countries such as China and India. For instance, Malaysia has made attempts to safeguard its palm oil industry since the EUDR came into force, announcing a deal to double palm oil exports to China in September 2023. It has also been suggested that 'green' and 'brown' supply chains might be created as a result. For example, in Indonesia, palm oil meeting sustainability requirements could be exported to the more demanding European market and other types of palm oil might head towards emerging markets with fewer demands (such as China, India and Pakistan). Other demands are growing to make producing countries less dependent on exports. For example, there is an increasing demand for palm oil for internal use as cooking oil and other uses such as biofuels.

from high-risk countries will require more scrutiny to ensure that they are deforestation free.

Will the EUDR create further divergence in Asia Pacific-linked supply chains?

For the Brussels effect to take hold, it has been suggested that a number of conditions must apply. One is that the EU must remain an attractive market and it is not clear that this will continue to be the case for Asia Pacific in light of the EUDR. The complexity and extensiveness of the EUDR's due diligence requirements is expected to create issues for Asia Pacific companies. In the context of agricultural supply chains in particular, there may be further divergence in Asia Pacific-linked supply chains. See examples in relation to palm oil above.

How does the EUDR impact companies in the Asia Pacific region and what steps they should consider taking to comply with the EUDR?

Firstly, this will depend on whether you are a producer or an intermediary (e.g. a trader). Next, bear in mind that even if you are not directly subject to the EUDR's restrictions, where an entity downstream from you operates or trades in the EU, that downstream entity will impose certain requirements on you so as to itself be compliant under the EUDR. Looking ahead, EU-based or EU-related companies may also have to take the EUDR into account once the EU CSDDD[3] comes into effect.

With this in mind, steps towards compliance include:

1. **Consider whether you are a 'trader' or a 'producer' under the EUDR**
2. **Assess your readiness** – do you have due diligence systems in place?
3. **Evaluate your upstream and downstream chains** – do you have any exposure to the EUDR (directly or indirectly). Is this significant? If

3 Corporate Sustainability Due Diligence Directive.

so, should you potentially divest away from exporting to the EU by selling domestically or exporting to other jurisdictions?

4. **Conduct a gap analysis** – what else is needed on top of any existing sustainability standards you follow?[4]
5. **Consider any smallholders** – if there are smallholders in your supply chain, how can you help them be compliant? What are the costs involved?
6. **Consider the costs of compliance** – these could include the costs of geolocation, segregation (new or additional storage facilities), maintaining documentation (including so as to comply with other regulatory requirements/regimes) and using digital solutions to ensure transparency and traceability.
7. **Consider a green premium** – would your Subject Product be able to command a 'green premium' that would justify additional costs associated with compliance?

Conclusion

Given the quantity and volume of Subject Products exported from Asia Pacific into the EU, the EUDR imposes a widespread compliance challenge on Asia Pacific companies. Whilst this could be an opportunity for an EUDR compliant company to have a competitive edge in the European market, this must be balanced against the related costs, the challenge of compliance (especially where smallholders feature in the supply chain) and the ability to claim costs from counterparties.

HFW can advise on compliance obligations (including how to assist smaller entities with their compliance obligations), assess the issues holistically across the entire supply chain and importantly, assist in the creation and implementation of a deforestation compliance programme in conjunction with existing compliance processes.

As for the Brussels effect, it remains to be seen whether the EU's desired outcome will be achieved or whether greater divergence will result instead.

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4 E.g., RSPO; consider also WWF or OECD guidance.

A SALUTARY TALE: FORMER DIRECTOR OF COMMODITIES TRADER FOUND IN BREACH OF HIS DIRECTOR'S DUTIES AND MAKING FRAUDULENT PAYMENTS

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The long-awaited judgment in *UBS Switzerland AG v Anil Kumar*[1] has finally been handed down. It is the latest arising from the liquidation of Vincom Commodities Limited (Vincom), which went into liquidation in January 2018.

Background

Vincom was a London-based commodities trading company and Anil Kumar was its sole director. Vincom's business model was to enter into matching deals: buying from a supplier and selling to a customer or offtaker. Vincom financed this trading pattern by establishing credit lines with various banks. The banks would provide credit to enable Vincom to pay the supplier, take security of, for example, bills of lading, the goods and/or the customer's obligation to pay the price, and receive repayment once goods were delivered. During the trial, Mr Kumar stated that this business model was based on a high turnover/low profit margin – sometimes as low as 0.3% per trade.

Vincom had facilities with several banks, including the claimant, UBS Switzerland AG (**UBS**).

In the course of trading, Vincom issued credit notes in a total value of US$7.769m in favour of a customer called Donald McCarthy Trading Pte Limited (**DMT**). All of the credit notes were issued in late 2017 or early 2018 and related to nickel shipments sent by a supplier of Vincom's called AST Metals LLC based in Dubai (**AST**).

On 24 November 2017, Vincom was served with a winding up petition by one of the banks with whom it had a credit line. After service of the winding up petition, Vincom issued further credit notes in favour of DMT. Mr Kumar stated at the time and again during the trial that they had been issued as the cargoes of scrap nickel were contaminated with acid and therefore worthless. Mr Kumar also caused Vincom to make payments totalling US$5.568m to AST.

Vincom was placed into liquidation in January 2018. UBS is a creditor of Vincom and in January 2021, Vincom's liquidators assigned any potential claims against Mr Kumar to UBS.

The claim

UBS issued proceedings against Mr Kumar, claiming that he had issued the credit notes in breach of his director's duties. Specifically, the breaches were said to be of s171, 172 and 174 Companies Act 2006 which provide, in summary, that a director of a company must:

- (b) only exercise powers for the purposes for which they are conferred;
- act in good faith, to promote the success of the company for the benefit of its members as a whole and in doing so, have regard (amongst other matters) to – (a) the likely consequences of any decision in the long term…; and
- exercise reasonable care, skill and diligence.

Mr Kumar's position was that payments were made by Vincom's office staff even after service of the winding up petition; that hundreds of transactions were carried out by him every year and yet UBS had chosen to focus on only eleven of them; that his decisions were entirely appropriate; and UBS' claims frivolous and unjustified.

Complicating factors

Both DMT (Vincom's customer and beneficiary of the credit notes) and AST (Vincom's supplier and beneficiary of the payments made after service of the winding up petition) were owned and/or controlled by Mr Kumar's brothers or other family members.

1 [2024] EWHC 1058 (Ch)

In addition, Mr Kumar had used other names. Initially, he had denied that he went by the name Anil Kumar Didwania or Anil Ramgopal Didwania. Subsequently, he amended his defence to accept that his full name was Anil Kumar Ramgopal Didwania. There was an issue about his connection to the Didwania family and the links between that family and Vincom's trading partners: all the entities relevant to the disputed transactions the subject of this claim involved Didwania family members as directors of the relevant companies.

At a hearing in 2022, UBS applied for and was granted a worldwide freezing order over Mr Kumar's assets. Accordingly, whilst Mr Kumar had legal representation up to the stage of filing his witness statement for trial, thereafter he represented himself as a litigant in person.

Findings

The Court made the following findings:

1. Mr Kumar issued the credit notes on behalf of Vincom. The credit notes were not issued contemporaneously with the relevant transactions, but more likely created in late December 2017 or January 2018 (i.e. after service of the winding up petition).
2. The acid-contaminated cargoes were not damaged to any material extent. The credit notes should not have been issued as a result of any purported damage: the damage alleged by Mr Kumar did not exist.
3. Mr Kumar did not have any acceptable subjective reason to issue the credit notes. It is more likely than not that the operative belief of Mr Kumar was to help DMT (a company under his brother's control) and to protect DMT from claims made on Vincom's behalf in the imminent liquidation.
4. Two of the cash payments to AST were made fraudulently. A third was found to be a breach of Mr Kumar's duty to promote Vincom's business mindful of the interests of its creditors as a whole.
5. Mr Kumar was also found to be in breach of his director's duties to use his powers for proper purposes.

Mr Kumar was ordered to pay equitable compensation to UBS of over US$13m plus interest.

Key Takeaways

- Directors must be mindful of their statutory and fiduciary duties to the company. As demonstrated in this case, the actions of Mr Kumar in his capacity as a director have resulted in personal liability of millions of US dollars. It is not known if Mr Kumar had the benefit of D&O insurance policy, however given the findings of fraud, it is likely that any such policy would not be responsive.
- Directors must pay particular attention to the interests of creditors when a company finds itself in financial distress. Where a company finds itself in an insolvency situation (either on a cash flow basis or on a balance sheet basis), the directors must ensure that the interests of creditors as a whole (i.e. including secured, preferred and unsecured) are borne in mind when taking decisions.
- For counterparties, especially those advancing credit or credit lines, it is essential that the first signs of financial distress are spotted early and measures taken to try to minimise any losses. Regular due diligence and monitoring is required. In this case, Vincom had defaulted on various facilities in 2015, 2016, and 2017. Some of these facilities were restructured, but again Vincom defaulted. Prompt and early action is advisable in such circumstances.
- Regular monitoring of security is also necessary. In this case, all of Vincom's lenders had the benefit of security, normally over the cargoes. However, as the judgment records, there were several instances where the cargoes subject to the security had been released without the lender's consent.

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EVENTS & TEAM NEWS

Where you can meet the team next

We will host a Trade Finance webinar on 9th July; please email events@hfw.com for more information.

We are silver sponsors at the upcoming Australia Wind Energy Conference in Melbourne, from 9th-11th July. For more information click here; to register click here.

We are a long-time supporter of AGIC and are pleased to sponsor AGIC Australia, which will be held in Melbourne from 31st July – 1st August. To register, click here.

Our global International Arbitration team are pleased to invite you to our 2024 Arbitration Webinar Series. The series aims to provide valuable insights and practical knowledge on various aspects of arbitration. The webinars will be presented by members of our arbitration team based in the Americas, Europe, Middle East and Asia Pacific. For more information on the event, please email events@hfw.com.

For more information on upcoming HFW events, click here.

Other team news

We are pleased to share that we won 'Best Advisor of the Year' in the C4DTI Digital Trade Awards. London Partners Matthew Cox and Matthew Wilmshurst received the award on 18th April 2024.

Partners Michael Buffham, Sarah Hunt, Dan Perera and Peter Zaman have published the latest briefing in their Bioenergy series, exploring how forest biomass is affected by RED III. You can read the full briefing here.

Geneva Partner Sarah Hunt recently spoke with Paul Chapman, Managing Partner of HC Group, on a podcast exploring how sanctions affect commodity markets. They focused on the Russian sanctions imposed since the invasion of Ukraine. You can listen to the full episode here.

Geneva Partner Michael Buisset wrote for Swiss commodity trading association SUISSENÉGOCE looking at the significance of the UK Supreme Court decision in *Herculito Maritime Ltd v. Gunvor International BV [2024] UKSC 2 ('The Polar')*, for traders, charterers, and owners under their contracts of carriage when navigating the Red Sea.

Partners Jo Delaney, Jo Garland, Ruth Dawes, Peter Sadler and Dan Perera have contributed an article to the GAR Asia-Pacific Arbitration Review 2025. They explore key developments in the Australian energy transition landscape, notable regulatory changes such as the proposed Climate Disclosure Bill and disputes regarding greenwashing. You can read the full article here.

Peter Zaman, Jefferson Tan and Christopher Ong have published a briefing on how the Brazilian carbon market is taking shape. You can read the full briefing here.

We recently published a new edition of the HFW International Arbitration Quarterly, which features articles from colleagues across our network of global offices. You can read the full quarterly here.

HFW has over 700 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our commodities capabilities, please visit hfw.com/Commodities.