COMMODITIES BULLETIN
APRIL 2022

Welcome to the April 2022 edition of the Commodities Bulletin.

As HFW's new Global Senior Partner, I am delighted to be the guest editor for this edition. HFW has a truly global reach, which we have set out to reflect in this bulletin: here you will find articles from our teams in Brazil, the BVI, Hong Kong and London. Sustainability is a particular passion of mine and so I am grateful to Rafael Rodrigues for his valuable input into our opening piece on developments in the sugar, ethanol and bioenergy markets in Brazil. From Brazil, we move to our newest office in the BVI, with an article on why a growing number of commodities clients are choosing to use BVI joint venture companies.

Next, our Hong Kong office provides an update on the pending introduction of the UN Convention on Contracts for the International Sale of Goods. We conclude with a piece on sanctions imposed following the invasion of Ukraine, from our London team. You will find team news and details of forthcoming events on the final page. It only remains for me to congratulate Commodities' newest joiner, Colin Chen, who qualified into the group last month. Congratulations Colin – and happy reading all!

GILES KAVANAGH
Global Senior Partner

SUGARCANE IN BRAZIL

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"The aim to use everything and waste nothing is helping the Brazilian sugarcane market to comply with sustainability commitments and best environmental practice."

Sugarcane has a long history in Brazil. In this article, we consider how its use is developing and expanding to become more sustainable and how innovation, legislation and regulation are assisting in that. Sugarcane in Brazil is now a highly versatile crop, responsible not only for sugar production, but for the production of ethanol and bioenergy as well.

Sugar

According to the Brazilian Sugarcane Industry Association (UNICA), Brazil is responsible for 23% of the global production of sugar and 49% of world exports. Approximately two thirds of all sugar in Brazil is exported, heading to more than one hundred countries around the world.

In 2020, Brazil exported USD 8.95 billion in raw sugar, making it the largest exporter of raw sugar in the world. In the same year, sugar (raw, refined and molasses) was one of Brazil's most exported products, behind soybeans, iron ore and crude oil. The main destination and fastest growing export market for sugar was China (worth USD 1.29 billion in 2020).

Brazil's 2021-2022 sugarcane harvest was 487.33 million metric tons, a decrease of 9.6% compared to 2020-2021. This was mainly due to unfavourable weather conditions and the impact of COVID-19 on the market. Despite the difficulties of the sugar market, the ethanol industry remained resilient.

Ethanol

Brazil is now the world's largest sugarcane ethanol producer and the second largest producer of ethanol in the world, behind the United States, which has corn-based production. Brazil has an advantage over many countries in this, namely the flexibility to shift some sugar production to biofuels, since Brazilian biofuels are predominantly made from sugarcane, while other countries use different commodities, like corn. Most Brazilian mills can make adjustments to their production mix in response to international sugar prices, domestic ethanol prices and freight costs.

Most of Brazil's production is absorbed by the domestic fuel market where it is sold as either pure ethanol fuel (E100; hydrous ethanol) or blended with gasoline (E27; anhydrous ethanol). Brazil is a pioneer in using ethanol as motor fuel. 90% of new cars sold in Brazil are flex fuel and these vehicles make up about 70% of the country's entire light vehicle fleet. Legislation has played a significant part in this: the mixing of ethanol with gasoline is required by law and has stood at or around 27% since 2015.

Again, Brazil has used the advantage of flexibility here: every time they fill up, Brazilian drivers have a choice between sugarcane ethanol and gasoline. They can opt for the more efficient fuel based on sustainability and/or price. (In order to be competitive on cost, the price of ethanol at the pump must be at least 30% below that of gasoline, due to the relative level of efficiency between the two fuels.) This choice plays an important role in determining the supply of sugar and its price in world markets.

The ethanol industry in Brazil is assisted by the National Biofuels Policy, known as RenovaBio, which came into effect in December 2017 under Law No. 13.576/2017. RenovaBio is a key tool in reducing greenhouse gas emissions to help Brazil fulfil its commitments under the Paris Agreement.

With the expansion of the domestic sustainable biofuels market, from production to the use of cleaner fuels, RenovaBio supports the use of biofuels over fossil fuels. Using annual targets to increase the use of renewable fuels in the transport sector, the programme is expected to prevent the release of more than 600 million tons of carbon dioxide into the atmosphere over 10 years.

In recent years and following significant investment in technology, ethanol is also produced from the by-products of sugarcane, like the straw of the sugarcane and bagasse, the dry pulpy residue left after the extraction of juice from the sugarcane. This is known in Brazil as second generation ethanol. The challenge is to make it economically feasible on a large scale, however

important developments are already in progress.

Bioenergy

For centuries, sugarcane fields around the world have been burned, wasting up to 30% of the energy content of the crop. This facilitates manual harvesting but creates smoke which can potentially endanger public health.

However mechanised harvesting – now a reality in almost all sugarcane fields in Brazil - does not require burning and sugarcane straw can be preserved and its energy harnessed. A few decades ago, bagasse was considered to be waste with no economic value. Nowadays, it is considered to be a valued by-product of sugarcane, often traded between mills and used to produce bioenergy.

Most sugarcane mills in Brazil are now energy self-sufficient, producing more than enough energy to cover their own needs and selling surplus energy into Brazil's energy grid. In 2020, sugar cane mills supplied more than 22,600 GWh to the grid, representing approximately 80% of all electricity from biomass in the country, or 5% of Brazil's electricity requirements.

Using only 15% of their potential, Brazilian sugarcane mills are the fourth most important electricity supplier in Brazil. There is significant scope for growth in this area, with installed capacity for 148,000 GWh, which is enough energy to power a country the size of Argentina or Norway.

Compared to other electricity sources, bioelectricity is known to be more environmentally friendly due to lower pollutant emissions. Another important aspect is the fact that it is complementary to hydroelectric power, since a larger amount of biomass from sugarcane is available during the dry season.

Other developments

In addition to sugar, ethanol and bioenergy, numerous other important end-products with economic value can be derived from sugarcane and its by-products and residues, including for example fertilizers, fibrous products, molasses and animal feed. The aim to use everything and waste nothing is helping the Brazilian sugarcane market to comply with sustainability commitments and best environmental practice.

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"In the context of a major project or asset acquisition, establishing and setting up a BVI joint venture company is a relatively straightforward and cost-efficient process."

WHY DO COMMODITY TRADERS CHOOSE BVI JOINT VENTURE COMPANIES?

Global demand for British Virgin Islands (BVI) joint venture companies is commonplace across commodity markets and clients. They are typically used to facilitate the holding of shares in operating companies or to finance the acquisition of a specific asset or project. Broadly, there are three main reasons why commodity traders choose them:

- Firstly, the BVI is an established and mature jurisdiction for joint venture projects and holding companies due to its well-regarded international reputation, low tax offering and independent and experienced commercial judiciary.
- Secondly, BVI joint venture companies are well known for their flexibility and ease of use in international transactions and typically have been used for major energy, construction, and infrastructure projects.
- Thirdly, BVI common law and statute has adapted and developed to assist founding parties and shareholders in providing certainty if disputes arise in relation to joint venture companies.

We consider how these advantages work in practice in more detail below.

Setup and incorporation

In the context of a major project or asset acquisition, establishing and setting up a BVI joint venture company is a relatively straightforward and cost-efficient process. Typically, significant issues for parties to consider and document in the company's incorporation documents and shareholder agreements will include:

- who is intended to be involved and in what roles
- what business the company will undertake
- how the company will operate
- how income, profits and losses will be distributed
- how and what contributions will be made by whom
- how any disputes which arise are to be resolved.

Security and financing of BVI joint venture companies

A common form of financing for BVI joint venture companies is via the issuance of convertible notes from the company to a partner or third-party, in return for finance. Commonly, securitised notes in the company will provide for convertible shares in exchange for loan monies or other forms of investment into the joint venture entity. Such notes may well be governed by BVI or other law depending on the financing and/or lender requirements.

Dispute resolution

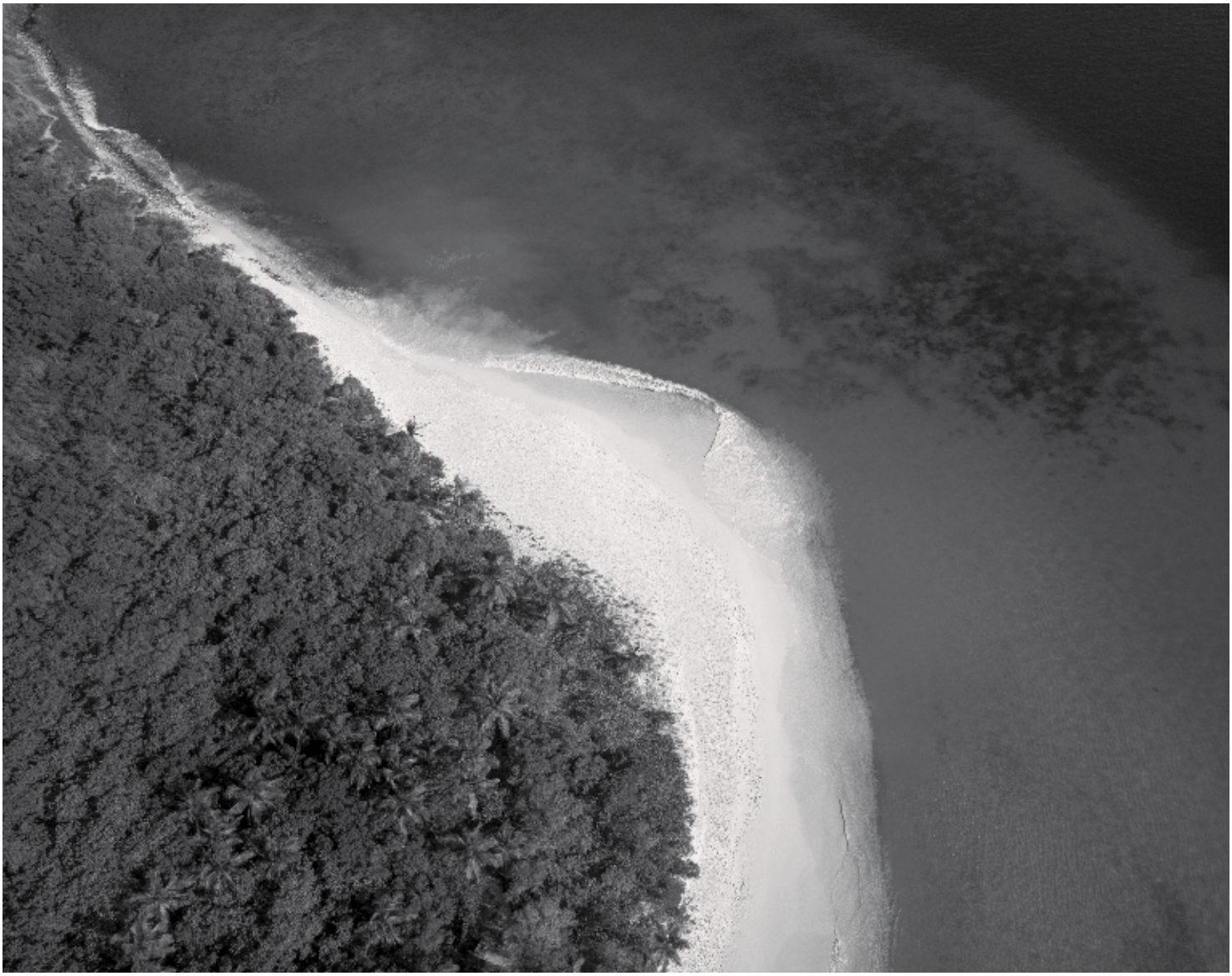
Over the recent past, there has been a noticeable increase in BVI shareholder disputes, many of which have related to minority shareholders electing to dissent to mergers and private transactions in BVI joint venture companies.

One such example is *Nettar Group Inc v Hannover Holdings S.A.*, in which the BVI Commercial Court delivered a judgment which considered the rights of a member to dissent from a proposed merger under section 179 of the BVI Business Companies Act (the **BCA**).

The BCA confers on shareholders a statutory right to demand a payment of fair value of its shares upon dissenting in five statutory transaction types, being:

- a merger
- a consolidation
- a transaction which results in the disposal of more than 50% in value of the assets or business of the company outside of its ordinary course of business
- a compulsory redemption of a member's shares by the company
- an arrangement.

In *Nettar*, the BVI Commercial Court confirmed that in circumstances



where a shareholder dissents to a statutory transaction – in this case a merger - this right only exists if the share is in existence and issued by the company to that member.

Whilst this appears obvious, it was of particular significance in the facts of Nettar, as the dissenting minority shareholder had a number of convertible loan notes which entitled them to obtain a much larger and more significant shareholding on the conversion of those notes. Importantly, at the time at which the shareholder's dissent was exercised in this case, the merger had not yet taken place and the notes had not been converted.

The BVI Commercial Court went on to find that the minority shareholder who dissented in *Nettar* was only entitled to demand payment of a fair value of the shares it held that were in existence at the time the dissent was made and that it was not entitled to any statutory compensation in respect of shares which it might have held if it had exercised its rights under the loan notes, but which were not yet issued or in existence.

The case is a helpful reminder of why it is important for parties to consider the structure and financing of their joint venture companies and the remedies which might, or might not, be available to them in the event of a dispute.

BVI's statutory protection for minority shareholders

The legislative intention and effect of section 179 of the BCA is to give minority shareholders of a BVI company a right to exit a company in exchange for fair value of their shares where they dissent to certain types of transaction which the majority of shareholders wish to enter into. It is a significant right and remedy for minority shareholders and, in particular, for those in joint venture companies. (In our experience these disputes commonly occur due to either commercial or personal reasons and disagreement. When this happens, and so as to best maintain value for all parties, it is key that prompt advice is sought to protect or understand the interests and rights of the minority shareholder(s).)

Finally, unlike in certain jurisdictions where fair value of a dissenter's shares is determined by a court, the BCA provides for an expedited process whereby if the parties cannot agree on the amount to be paid, fair value will be fixed by three appraisers within a twenty-day period. The value ascribed by the appraisers is binding on the company and the dissenting member(s) for all purposes and therefore can be a powerful negotiation tool to deploy as part of any negotiations which take place alongside formal litigation.

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A NEW TRADE ROUTE FOR HONG KONG WITH THE INTRODUCTION OF THE CISG

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"It is estimated that as many as 70% of CISG related disputes are resolved by way of arbitration. Given Hong Kong's standing as the third most popular seat for international arbitration, we expect the introduction of the CISG may provide further encouragement for parties to choose Hong Kong arbitration as their preferred forum for dispute resolution."

Introducing a new dimension to the legal framework for the international sale of goods, the Hong Kong Legislative Council passed the Sale of Goods (United Nations Convention) Ordinance (Cap.641) (the Ordinance) on 29 September 2021. The law, which applies the UN Convention on Contracts for the International Sale of Goods, also known as the Vienna Convention, (the CISG) to Hong Kong, is expected to take effect in the third quarter of 2022. This article looks at key changes which will be introduced into Hong Kong law by the adoption of the CISG.

The significance of the CISG to Hong Kong

Certainty

Subject to completion of the relevant process under Art.153 of the Basic Law and formal notification by the Central People's Government of China to the Secretary-General of the United Nations, China will extend the application of the CISG to Hong Kong later this year. While China ratified the CISG in 1988, the application of the CISG was not extended to Hong Kong in 1997. The Ordinance removes any uncertainty and incorporates the CISG into Hong Kong law.

Facilitation of cross-border trade

The CISG is a welcome development in Hong Kong to facilitate cross-border trade. It provides a neutral system of uniform rules to govern international sale of goods contracts within its scope. From 15 contracting states in 1988 when the CISG came into force, there are now 94 contracting states. Over half of Hong Kong's top 20 trading partners are CISG contracting states.

Impact on dispute resolution

The CISG is often applied as the substantive law to govern international trade related disputes. It is estimated that as many as 70%[1] of CISG related disputes are resolved by way of arbitration. Given Hong Kong's standing as the third most popular seat for international arbitration[2], we expect the introduction of the CISG may provide further encouragement for parties to choose Hong Kong arbitration as their preferred forum for dispute resolution.

When will the CISG apply?

The basic premise is that the CISG applies to contracts for the sale of goods made between parties whose 'places of business' are in different contracting states.[3] It applies automatically unless the parties have chosen to exclude it under Art.6 – party autonomy is a key principle of the CISG.

Under Art.1(1)(b) of the CISG, it can also apply indirectly when the rules of private international law lead to the application of the law of a contracting state. Although China has made an Art.95 reservation to declare that it will not be bound by Art.1(1)(b), it is intended that the CISG will apply to Hong Kong in full without this reservation.

The CISG will not apply automatically to transactions between Hong Kong and Mainland China because they are intra-country transactions. However, Hong Kong is actively considering a bilateral arrangement between the two jurisdictions to provide for such application.

There are limits to the CISG's application depending on the subject matter of the contract. It only covers business to business sales and certain types of sales contracts are excluded, such as the sale of ships, aircraft, corporate transactions, and sale by auction.

Art.4 clarifies that the CISG only regulates certain aspects of the sale contract, namely contract formation, the rights and obligations arising from the contract of sale and remedies for breach of contract. It is not concerned

1 UN Convention on Contracts for the International Sale of Goods (CISG) 2011 – Arbitration as a special case. Page 26.

2 2021 Queen Mary University of London, White & Case International Arbitration Survey: Adapting Arbitration to a Changing World.

3 Art.1(1)(a).

with the validity of the contract and issues of title or property.

When applicable, the CISG will prevail over any other law of Hong Kong,[4] including the Sale of Goods Ordinance (**SOGO**) (Cap.26) to the extent inconsistent.

Introduction of new concepts to Hong Kong law

The CISG provides a hybrid regime for international sale of goods contracts, which harmonises elements of civil and common law. This brings into play some new concepts unfamiliar to Hong Kong's common law system. The compromise position adopted in the CISG is however largely compatible with SOGO (Cap.26).

Some of these new concepts include:

- Art.8(3) expressly allows the court or tribunal to take into account pre-contractual/post-contractual statements and the conduct of the parties to interpret the parties' intent. This departs from the common law parole evidence rule (albeit that too is subject to some exceptions).
- The CISG does not classify contractual terms into conditions or warranties and Art.25 introduces the concept of fundamental breach. There is, however, a high threshold to establish such a breach as the CISG favours the continuation and fulfilment of the contract.
- The CISG includes strict notice obligations for the buyer in respect of defects. Art.38 provides that on delivery, the buyer must inspect the goods 'within as short a period as is practicable in the circumstances'. SOGO has less stringent requirements under s.37.4. The buyer must also give notice of any non-conformity within a reasonable time or lose the right to a remedy (Art.39).

What should you do now?

When the Ordinance comes into force, the CISG will apply to relevant contracts as a matter of Hong Kong law without the express agreement of the parties.

- Special attention should be paid to choice of law and jurisdiction clauses:
  - Clear words will be needed to exclude the CISG. Parties are recommended to use express words and to be as specific as possible in any choice of law clause to ensure it reflects their intention.
  - Where the sales contract contains an arbitration clause, be aware that the CISG could potentially govern aspects of the arbitration. Ensure that the dispute resolution clause expressly refers to the CISG doing so, if that is the intention.
- The CISG provides a structured framework around concepts of offer and acceptance with which parties are recommended to be familiar. Notably, even a lapsed offer can be accepted. To avoid unintended consequences, use clear communications in pre-contractual negotiations, consider including an 'entire agreement' and/or 'no oral modification' clause to limit the operation of the CISG and ensure that any additional terms or counter-offers are objected to without delay.

New horizons

There will be a learning curve while Hong Kong becomes familiar with the new rules, notwithstanding that many legal practitioners will already be familiar with the CISG from arbitral practice. But with the benefit of comprehensive CISG resources, any such difficulties should be short lived.

The CISG is viewed as a 'neutral' choice to avoid encountering unfamiliar systems of law and to increase certainty in commercial contracts. Its introduction has the potential to increase the prevalence of trade related dispute resolution from across the region happening in Hong Kong, through parties selecting Hong Kong law/CISG as the choice of law.

Once the current Covid-19 restrictions are eased, it is apparent that Hong Kong is keen to strengthen its co-operation within the ASEAN region, having made a formal application to join the Regional Comprehensive Economic Partnership[5] free trade agreement (RCEP) in early 2022. The RCEP free trade agreement partners are all CISG contracting states, hence Hong Kong continues to ensure that it speaks the lingua franca of international trade in the region.

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4 S.5 Cap 641.

5 RCEP a free trade agreement (FTA) between the 10 Association of Southeast Asian Nations (ASEAN) member States (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam) and its 5 FTA partners (Australia, China, Japan, New Zealand and Republic of Korea).

CONFLICT IN UKRAINE AND SANCTIONS

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In the absence of direct military intervention, many governments opposed to Russia's invasion of Ukraine have focused their efforts on imposing new and extensive sanctions on banks, companies, regions, sectors and individuals. Given Russia's importance as an importer and exporter of commodities, commodity traders have been significantly affected.

Minimising risk

Aside from the risk of hefty criminal penalties including fines and imprisonment, breach of sanctions can attract civil penalties in the form of fines (with a forthcoming change to create strict liability offences under UK legislation). There are also reputational risks, the impact on banking relationships and facility agreements and the cost of investigating a breach and dealing with regulators to consider.

How can commodity traders protect themselves? In some ways, nothing has changed here. The HFW team has been advising on sanctions issues for over a decade, helping commercial organisations to manage the associated risks and ensure compliance. However, what has changed is the extent and focus of the sanctions - they are much wider and deeper than we have seen before.

We recommend two key ways to avoid a breach of sanctions:

1. Due diligence

The first key is to conduct (and be able to demonstrate that you have conducted) compliance checks and due diligence. Ideally this should be done early in the contractual process and updated regularly. And remember that the whole contractual landscape of trading will be relevant. Consider two examples:

- Where your FOB buyer nominates a vessel to carry goods (from any location in the world), you must now be sure that it is not a specified ship, not owned, controlled, chartered or operated by a designated person, or by persons connected with Russia, not flying the Russian flag and not registered in Russia.
- Many insurance contracts include clauses which automatically terminate cover without notice in the event of sanctions being imposed, so you will need to ensure that your cover is still in place.

2. Contractual provisions

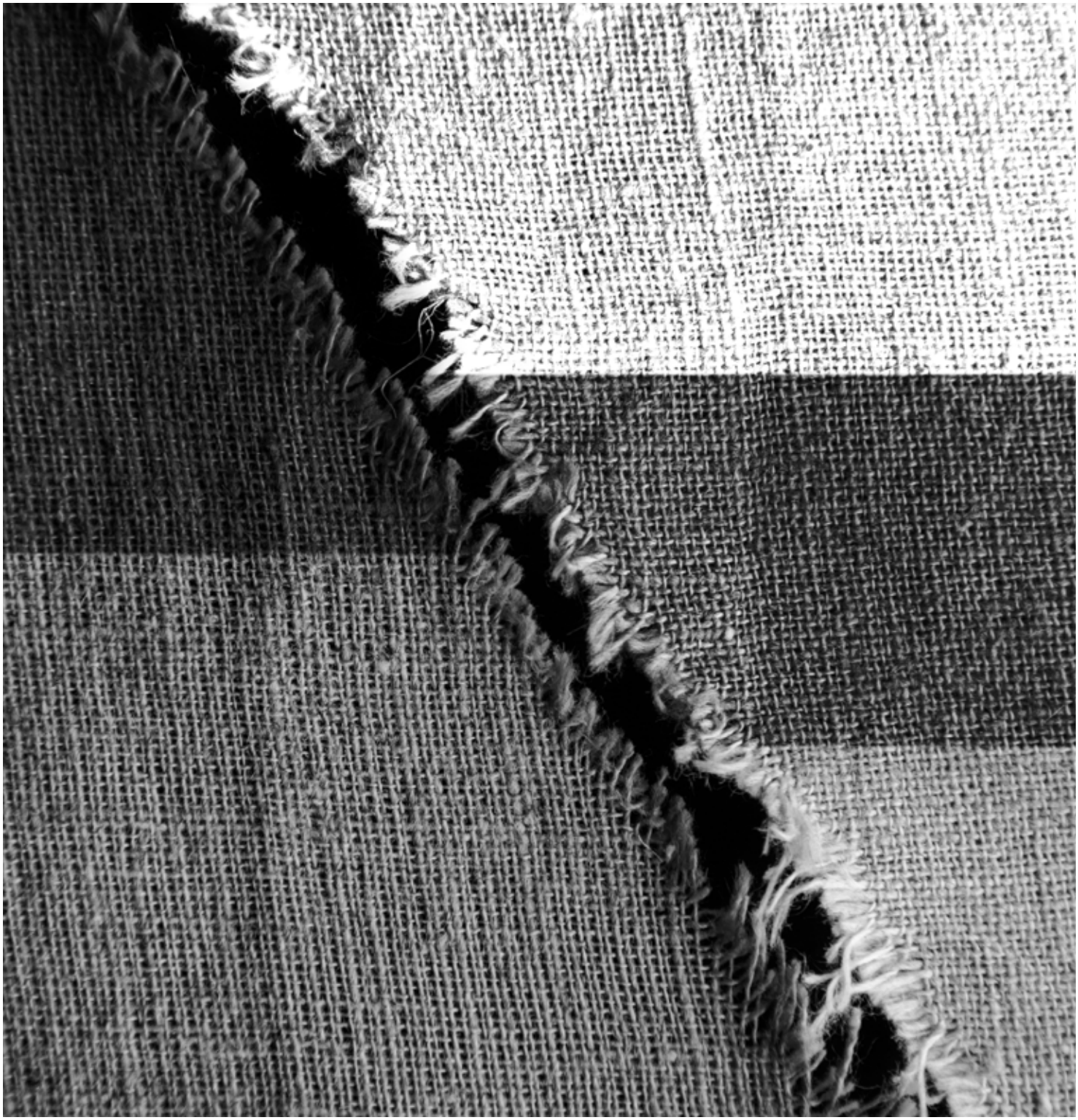
The second key is to make sure that your contracts contain suitable protective wording. Many commercial, financial and insurance contracts now routinely include sanctions clauses. It would be wise to give these "standard" clauses more attention at the drafting and negotiating stage, both in order to ensure that they are sufficiently robust to deal with the current situation and in order to assess the impact on your business if the clause were to be triggered.

The chilling effect

Finally, it is worth bearing in mind that it is not just the sanctions themselves which are having an impact. A significant consequence of such a wide and fast-changing sanctions landscape is the chilling effect it has on trade: companies and banks become increasingly reluctant to undertake business which they see as high risk, even where that business might be permitted, for fear of committing an inadvertent breach. This is especially the case where legislation is not as clear as it might be, either because it has been drafted in haste (as has often been the case in this situation) or because of a deliberate decision by the drafters. Where there is ambiguity, risk averse organisations will err on the side of caution. If they are prepared to trade even in the face of increased risk, they may be reluctant to enter into longer term contractual commitments, in case the sanctions landscape changes further and the parties find themselves subject to new restrictions affecting performance.

Is trade with Russia still an option?

The sanctions imposed by the rest of the world will create practical challenges for those seeking to



trade with Russia. Obtaining finance and insurance, making payments, arranging transport and dealing with service providers in Russia are all likely to be difficult. Extensive compliance checks and due diligence will be required and should be frequently updated. Although there is scope to continue permitted trade, this current environment is the most challenging we have seen. Aside from all these practical issues, a careful analysis of the wider risks associated with trading with Russia will be required.

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Where you can meet the team next

TXF Global Commodity Finance Amsterdam
10-11 May 2022

Sarah Hunt, Olivier Bazin and Matthew Cox will be attending the upcoming TXF two day conference in Beurs van Berlage, Amsterdam.

HFW: Sanctions, Global Investigations and Enforcement
19 May 2022

Hosted by Sarah Hunt and joined by Daniel Martin, Anne-Marie Ottaway, and Barry Vitou – the team will be discussing the Russian invasion of Ukraine and its impact on sanctions. This seminar will be taking place at the **Hotel Métropole** in Geneva.

LCTA Global Commodities Conference: Energy, Metals, Financing
23-24 June 2022

Ian Cranston and members of the Geneva team will be attending the two day LCTA conference at the LAC Lugano Arte e Cultura.

Other team news

Hiring of commercial disputes team led by former State Solicitor for Western Australia

In April 2022, HFW continued to expand its fast-growing Australian business with the hire of a disputes team in Perth led by senior partner **Paul D Evans** – one of Australia's leading commercial litigators and the former State Solicitor for Western Australia.

Paul joins HFW alongside Special Counsel Peter Sadler, Senior Associate Monika Mečević and Consultant Dr Elise Bant.

Paul, Peter and Monika join HFW from elite US law firm Quinn Emanuel Urquhart and Sullivan, where Paul was the founding partner of its Perth office, while Elise is a Professor of Private Law and Commercial Regulation at The University of Western Australia and a Professorial Fellow at The University of Melbourne, having previously worked alongside Paul in private practice.

Launch of a new office in the BVI

In January 2022, HFW launched in the British Virgin Islands by acquiring a leading disputes practice in the BVI, led by senior partner **Scott Cruickshank** and including senior associate **Jonathan Child** and associate **Helen Chen**.

HFW has been litigating for clients in offshore jurisdictions for more than 20 years, and HFW's new BVI team will work closely with HFW expert litigators in London, Hong Kong, Shanghai and other offices across the Americas, Europe, the Middle East and Asia-Pacific.

'Asia Super 50 Disputes Lawyers'

Congratulations to Partner **Karen Cheung**, who has been recognised in **Asian Legal Business** (ALB) 'Asia Super 50 Disputes Lawyers' list this year. ALB puts the spotlight on the top disputes lawyers in the region when it comes to client service. The lawyers were selected based on client recommendations sent directly to ALB.

Other news

- Welcome to our new qualifier, Colin Chen. Colin trained at the firm and qualified into the Commodities group in London in March.
- Welcome to our two new London associates, Cindy Laing, who joins the Global Investigations & Enforcement Team and Tom Serafin, who joins the Fraud & Insolvency team.

HFW has over 600 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

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