COMMODITIES | SEPTEMBER 2022

HOW DEEP DO YOU NEED TO DIVE TO MITIGATE AGAINST A FM EVENT?

The Russian invasion of Ukraine has turned the spotlight onto two particular types of clause in commodities contracts: sanctions and force majeure ("FM"). The avalanche of global sanctions imposed in response to the invasion created huge challenges for commercial parties and many found themselves having to put sanctions related contractual wording to the test as a result.

In addition, a large number of affected commercial parties triggered the FM clauses in their contracts. Doing so always involves risk: it is difficult successfully to argue that contractual performance has been prevented or delayed by FM, in part because English courts and arbitration tribunals will interpret such clauses strictly and narrowly, against the party seeking to rely on them.

Given all this, a recent decision of the Commercial Court[1] (unrelated to the Ukraine war) has attracted particular interest because it required first the arbitral tribunal and then the Commercial Court to interpret a FM provision in light of the application of sanctions.

Background

In June 2016, MUR Shipping BV ("**Owners**") concluded a Contract of Affreightment ("**COA**") with RTI Ltd ("**Charterers**") for the carriage of bauxite over several shipments.

The COA provided for payment of the freight in US dollars. It also included a FM clause, which stated, amongst other things, that the FM event could not be *"overcome by reasonable endeavours from the Party affected."*

In April 2018, the US Department of the Treasury's Office of Foreign Assets Control applied sanctions to Charterers' parent company. Owners invoked the FM clause and issued a notice which stated that:

- it would be a breach of sanctions to load any further cargoes under the COA.
- the sanctions would prevent dollar payments, which were required under the COA.

Charterers responded that sanctions would not interfere with cargo operations and that payment could be made in euros instead. Owners argued that freight had to be paid in US dollars and the FM event did impact cargo operations, as they could not be expected to load and discharge cargo without receiving payment in accordance with the COA.

Charterers found alternative tonnage and brought a claim for the additional costs incurred by way of arbitration under the terms of the COA.

Tribunal's Decision

The Tribunal held that payment in US dollars would fall foul of sanctions, as any US dollar payments would very likely have to pass through a US intermediary bank, which would stop the transfer based on Charterers' status as a blocked party in order to investigate further. It held that *"common sense indicates that any US bank would exercise extreme caution before making a payment that could conceivably fall foul of sanctions legislation."*

[1] MUR Shipping BV v RTI Ltd [2022] EWHC 467 (Comm)

The Tribunal found that Owners' case on FM would have succeeded, but for the "*reasonable endeavours*" provision in the FM clause. It held that this required Owners to accept payment in euros rather than in US dollars. As Charterers had indicated they would bear any additional costs or exchange rate losses incurred, Owners would have suffered no detriment. Owners appealed.

Commercial Court Decision

Two issues of particular interest came before the Court. First, Owners argued that the exercise of reasonable endeavours did not require an affected party to agree to vary the terms of the contract, or to agree to a non-contractual performance. Second, Charterers contended that the Tribunal's award should be upheld on additional grounds, because of a problem with causation, namely that the imposition of sanctions and difficulties with payment did not interfere with cargo operations.

Reasonable endeavours

On this point, the Court overturned the Tribunal's decision, finding in favour of Owners. It confirmed that the COA required payment to be in US dollars only:

"If there was a contractual right to payment in US$, and a contractual obligation to pay in that currency, then this was a right and obligation which formed part of the parties' bargain. The exercise of reasonable endeavours required endeavours towards the performance of that bargain; not towards the performance directed towards achieving a different result which formed no part of the parties' agreement."

A payment in euros that would be converted to US dollars was still a non-contractual payment. Charterers' offer to cover any costs incurred as a result only highlighted that the alternative method of payment was non-contractual, as it required workarounds to be inserted so that Owners could receive fair payment under the COA.

Causation

Here, the Court disagreed with Charterers' contention that the Tribunal had been wrong to find that the imposition of sanctions caused a delay to cargo operations. It held that:

"It [was not] possible to discern any error of law in the Tribunal's conclusion that (reasonable endeavours apart) the Owners' case on FM succeeded in all other respects."

Consequences for mitigation

In English law, a party affected by a FM event generally has an obligation to mitigate the effect of that event. Where the obligation begins and ends, however, has proved difficult to judge for commercial parties.

This decision, although in the context of a specific requirement to use reasonable endeavours, does offer some guidance. It suggests that although a party affected by a FM event is always required to mitigate, it need only do so in line with the contractual bargain and is not required to accept performance outside of the original contract terms.

For the many commercial parties affected by the invasion of Ukraine and ensuing sanctions who may be invoking FM provisions, that guidance will be helpful.

The decision is currently being appealed.

This article will form part of our next Commodities Bulletin, in which we will be reflecting on some of the wider impacts of Russia's invasion of Ukraine on the commodities sector.

For more information, please contact the author(s) of this alert

BRIAN PERROTT
Partner, London
T +44 (0)20 7264 8184
E brian.perrott@hfw.com

Research conducted by Remi Cruttenden, Trainee Solicitor