COMMODITIES BULLETIN
MAY 2023

Welcome to the May 2023 edition of the HFW Commodities bulletin.

In our first article, London Associate Colin Chen and I have identified some key takeaways from the UK Department for Transport's update on progress in support of developing a UK Sustainable Aviation Fuel (SAF) industry, part of the move towards the decarbonisation of the transport sector in the UK.

Next we move to recent case law. There have been several interesting judgments affecting the commodities sector recently, two of which relate to insurance. London Partner Jonathan Bruce and Associate Alex Walley assess an English Court of Appeal decision, which offers some welcome news to policyholders involved in the sale and purchase of commodities held in bulk. Geneva Senior Associate Shane Gibbons reflects on an Australian Court of Appeal decision on the impact of fraud on cover under trade credit insurance, also favourable towards policyholders. Finally, Monaco Senior Associate George Kaye writes about a UK Supreme Court decision which could have an impact on the interpretation of final and binding clauses. We are always delighted to feature articles from newly promoted lawyers - congratulations, Shane and George!

As always, team news and information on where to find us next can be found on the back page.

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KEY TAKEAWAYS FROM THE UK DEPARTMENT FOR TRANSPORT'S UPDATE ON SUSTAINABLE AVIATION FUEL (SAF)

The UK's Department for Transport (DfT) has released an update which includes details of a second consultation on a SAF mandate in the aviation sector and methods for improving the production and availability of SAF in the UK.

What has happened?

As part of the UK Government's Jet Zero Strategy (a five-year plan committed to delivering net zero aviation by 2050), the DfT has released an update on progress made in supporting the development of a UK SAF industry. This provides details of (i) the proposed introduction of a UK SAF mandate requiring jet fuel suppliers to blend an increasing proportion of SAF into aviation fuel from 2025; (ii) the publication of a second consultation as to how the mandate will work in practice; and (iii) the availability of further funding from the Advanced Fuels Fund to support the construction of UK SAF plants.

What is the UK's SAF mandate and how will it work?

The Government has committed to introduce a SAF mandate in 2025. This will require jet fuel suppliers to ensure that a minimum of 10% of UK aviation fuel is made from sustainable feedstock by 2030[1]. The SAF mandate will build on the progress made towards decarbonisation of the road transport sector under the Renewable Transport Fuel Obligation (RTFO).

SAF can be made from a variety of feedstock. Incentives under the proposed scheme will only be provided for SAF made from wastes, residues (biomass or recycled carbon fuels (RCFs)) or low carbon energy (electricity or nuclear), to avoid the risks associated with the use of crop-based biofuels, such as deforestation and food v fuel competition. SAF must also meet strict sustainability criteria, including achieving a carbon intensity reduction of at least 40% compared to conventional aviation fuel. Sustainability data will need to be independently verified, as it is currently under the RTFO.

As part of the first consultation on the SAF mandate in 2021, views were sought on the need for a SAF mandate and broad principles of the scheme, such as fuel and feedstock eligibility and sustainability criteria. The second consultation (ending on 22 June 2023) seeks views on targets to be set for 2030 and beyond and invites stakeholders to comment on the finer details of the scheme, such as the buy-out price and how certificates will be traded.

The intention is that the mandate will increase UK SAF demand, reduce GHG emissions and provide price support for SAF supply, so encouraging investment and kick-starting a domestic SAF industry. Similar schemes have been successfully introduced elsewhere; Norway was the first country to launch a SAF mandate in 2020, requiring a blend of 0.5% SAF combined with conventional jet fuel, which will increase to 30% in 2030.[2] The Council of the EU and the European Parliament have recently reached a provisional political agreement on the ReFuelEU aviation initiative, which includes an obligation for jet fuel suppliers to ensure that all fuel made available to aircraft operators at EU airports contains a minimum share of SAF from 2025 and, from 2030, a minimum share of synthetic fuels, with both shares increasing progressively until 2050.

What will be the impact for the UK aviation sector?

One advantage of SAF is that it is a 'drop-in fuel' which can be used in existing aircraft without the need (or with a relatively limited need) to modify engines or infrastructure. This also allows for incremental increases in mandated SAF over time.

However, there is a substantial price differential between conventional fossil jet fuel and SAF. It is hoped that the introduction of the mandate will incentivise production but, at least initially, it is likely to be costly for the industry to start using SAF on a larger

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scale, given the current limited SAF production capability[3].

What other measures are being taken to develop UK SAF production and availability?

The Government has taken other measures to promote SAF in the UK, including:

- The second application round of the Advanced Fuels Fund, which provides funding to projects that will contribute to the production of SAF. Projects supported last year included a commercial scale plant in Teesside which will convert black bin bag waste to SAF and a plant in Port Talbot that uses alcohol-to-jet technology to produce SAF from steel mill off-gases[4]. As part of its Jet Zero Strategy, the Government aims to have a minimum of five SAF plants under construction in the UK by 2025.
- The Energy Act 2004 is expected to be amended to allow for RCFs and nuclear derived fuels (NDFs) to be rewarded under renewable fuel schemes for the transport sector, including aviation.
- In summer 2023, the Government will set up a UK SAF Clearing House, in conjunction with the Energy Institute at the University of Sheffield, to support the testing and certification of SAF.
- The Government commissioned Philip New to prepare an independent report to identify the conditions required to create a successful UK SAF industry and to provide recommendations on how to support it. The report was published on 17 April 2023, together with the Government's response.[5]

These developments highlight the UK Government's commitment to reducing emissions in the transport sector, with renewable fuels playing a key part in the transition towards a low carbon and sustainable economy.

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1. Pathway to net zero aviation: developing the UK sustainable aviation fuel mandate - GOV.UK (www.gov.uk)
2. Renewable Fuel Blending Mandates | NetZero Pathfinders (bloomberg.com)
3. European aviation industry claims bill of €800bn to reach net zero emissions | Financial Times (ft.com)
4. https://www.gov.uk/government/publications/advanced-fuels-fund-competition-winners/advanced-fuels-fund-aff-competition-winners
5. https://www.gov.uk/government/publications/developing-a-uk-sustainable-aviation-fuel-industry

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INSURABLE INTEREST IN "DOUBLE SOLD" COMMODITIES: A GRAIN OF TRUTH?

The Court of Appeal considered the issue of insurable interest in its recent judgment in *Quadra Commodities SA v XL Insurance Company SE*. In this article we discuss the judgment and its implications for insurers and insureds.

Facts

The background to this matter was the "Agroinvest Group Fraud" which was uncovered in Ukraine in 2019. The fraud involved the Agroinvest Group obtaining parcels of agricultural commodity products from local farmers (such as grain, corn and sunflower seeds) before selling the same parcels of commodities many times over to multiple traders via the issuance of fraudulent warehouse receipts.

The insured, a commodities trader, entered into various contracts with entities in the Agroinvest Group for the purchase of grain. In performance of the purchase contracts, warehouse receipts were provided to the insured confirming that the relevant quantities of grain were held in common bulk in stipulated warehouses, or "Elevators".

It transpired that the Elevators issued multiple warehouse receipts in respect of the same goods to different buyers. Some reports suggested that up to five or six warehouse receipts may have been issued with respect to the same grain. The fraud unravelled when buyers sought to execute physical deliveries against the fraudulent warehouse receipts, and it became apparent that there was insufficient grain to go around. The insured sought to recover its losses under its Marine Cargo policy. Insurers denied the claim on the basis that there had been no physical loss of grain, and that the insured had, instead, suffered a purely financial loss on the basis of fraudulent warehouse receipts.

Key issue – Insurable Interest

Insurable interest was the main issue under consideration in this matter. Without an insurable interest in the subject matter of the insurance, the insured did not stand to suffer a loss or disadvantage upon the happening of an insured event.

In these circumstances, the key question was whether the insured could establish an insurable interest in unascertained grain it had purchased but may have difficulty physically identifying, due to the overselling at the Elevators.

First Instance

At first instance Mr. Justice Butcher found that the insured did have an insurable interest in the goods as payment had been made under purchase contracts, and an insurable interest could therefore be established in the unascertained goods of the relevant description in the Elevators. Further, as the Insured could show an immediate right to possession of the grain, this was further evidence of an insurable interest.

Court of Appeal

The insurers appealed the decision of Mr. Justice Butcher and argued that an insurable interest could not be established in the grain for the following main reasons:

- There was no grain of the corresponding quality and quantity in the Elevators at the time the warehouse receipts were issued (a challenge to the first instance factual findings).
- The insured's grain, which formed part of a common bulk, could not be sufficiently identified.
- The insured did not have an immediate right to possession.

The Court of Appeal rejected the insurers' appeal.

On the first ground, the Court found that there had been ample evidence before the first instance judge entitling him to find that there was such grain present at the time the receipts were issued. It had been integral to the fraud that there was grain present in the Elevators which, on inspection, would match the amount being purportedly sold to any trader.

On the second point the Court found that the insured did have an insurable interest in the grain it had purchased. Even where property nor risk had passed in the goods, payment or part-payment of the purchase price will give the buyer an insurable interest because if the seller went insolvent, the buyer would stand to suffer a loss/be disadvantaged by this adverse development. Upon making payment, the insured stood in a legal or equitable relation to the grain and any subsequent loss arising as a result of over-selling or otherwise, was a loss arising out of the insured's legal or equitable relation to the property. This was a principle approved in the American case of *Cumberland Bone*[1] which, whilst consistent with English law commentary on the establishment of an insurable interest, had not until now been recognised in the English courts. The insurers' submissions, it was held, had confused the concept of insurable interest between insurer and insured with that of a proprietary interest as between buyer and seller.

Finally, although the decision on the first two grounds was enough to determine the appeal in the insured's favour, the Court went on to consider the issue of right to possession. It was held that the judge had been right to conclude that the insured had an immediate right to possession under the applicable Ukrainian law.

Conclusion

The Court of Appeal's decision will be welcome news to policyholders involved in the sale and purchase of commodities held in bulk. To establish an insurable interest in goods held in common bulk, a policyholder is not required to ascertain the goods or sufficiently identify them within part of the bulk. Whilst this exercise may still be necessary to establish a proprietary interest, evidence of payment for the goods held in bulk will now be sufficient to establish an insurable interest as a matter of English law. A word of warning for insurers: where multiple policyholders are able to evidence payment for the same commodities that have been oversold, this decision may result in insurers paying several indemnities in respect of the same parcels of goods.

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1. Decision of the Supreme Judicial Court of Maine in *Cumberland Bone Company v Andes Insurance Co 64 Me 466 (1874)*

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TRADE CREDIT INSURANCE AND FRAUD

A recent Australian Court of Appeal decision[1] represents another example of a common law court ruling in favour of trade credit insurance policyholders. The judgment is of particular interest for its comments on the impact of fraud in the underlying contracts on the insured's ability to recover under the policy.

Background

Thera Agri Capital No 2 Pty Ltd ("Thera"), an Australian non-bank structured credit financier specialising in agricultural commodities, entered into a supply chain finance facility with the Phoenix Group, a commodity trader operating out of Dubai, to facilitate the pre-export operations of grains and pulses from Australia for sale in Asia. The facility was guaranteed by the Phoenix holding company in the BVI. Thera also took out a trade credit insurance policy with BCC Trade Credit Pty Ltd ("BCC") to cover any non-performance of the guarantee by Phoenix BVI (the "Policy").

So as to comply with sharia law, the facility was structured as follows:

- Phoenix would approach Thera with a request to finance certain trades by way of Murabaha Contract. The parameters of the trade and the supplier was organised by Phoenix.
- If the request was accepted, Thera would appoint Phoenix as its agent to purchase certain approved commodities from the supplier on Thera's behalf.
- The funds would be provided to Phoenix by Thera to allow them to purchase the commodities as agent of Thera.
- Following purchase, Thera would acquire title to the commodities from the supplier.
- Thera would then immediately sell the commodities back to Phoenix, inclusive of a pre-agreed margin (i.e. a profit disclosed sale).
- Phoenix would repay Thera in full (inclusive of the agreed margin) on credit terms at an agreed deferred payment date.

Pursuant to the facility, Thera advanced around USD 7.3 million to Phoenix in four drawdowns. However, it was agreed that the actual drawdowns did not operate in compliance with the structure. Phoenix never purchased the commodities as agents of Thera and the funds were advanced by Thera to Phoenix after entering into the purchase and sale contracts, not before.

Both Phoenix BVI and Phoenix Dubai went into liquidation. None of the funds advanced to Phoenix were repaid and the guarantee did not respond.

Thera filed a claim under the Policy which BCC rejected, citing the following reasons for doing so:

- The documents used by Phoenix to obtain financing were "shams".
- Thera had failed to establish that it had acquired title to the goods before selling to Phoenix, particularly as the funds advanced to "purchase" the commodities had been advanced after the purchase and sale contract had been entered into.
- Thera had failed to comply with the appropriate structure.

Court of First Instance Decision[2]

The Court found in favour of Thera:

Sham documents

The Court held that although certain of the underlying trade documents were shams, Thera was entitled to an indemnity under the Policy because it was not involved in any fraud but rather was a victim of it:

"Loss caused by the material default or fraudulent, dishonest or criminal acts of the Counter-Party or Guarantor falls within the insuring clause."

The Court held that to construe the contractual documentation in any other way would be commercial nonsense.

Title to the goods

The issue of title, insofar as it was relevant to the policies, would need to be judged on the faith of the invoices

and supporting documents provided by Phoenix, relied on by Thera and presented to BCC. An actual sale and purchase of the goods was not necessarily required. In reaching this conclusion, the Court relied on the case of *MGICA Ltd v United City Merchants (Australia) Ltd* and the principle that *"whether title to the goods had passed to the customer was a matter within the customer's knowledge but not matters which the insured and insurer contemplated would be within their knowledge"*.

Failure to comply with the structure

The variations from the facility structure did not take the transactions outside the scope of the Policy. Thera was still entitled to repayment from Phoenix and to call on Phoenix BVI to honour the guarantee.

BCC appealed.

Court of Appeal Decision

In the Court of Appeal, a majority accepted the reasoning of the lower court and dismissed the appeal. The key point was that *"the Insured's loss arose out of the non-fulfilment of contractual obligations of the Counter-Party (and Guarantor) of the type described in the Exhibit A documents, and therefore as contemplated by the Policy"*.

The dissenting judge was of the view that the departure from the structural framework was sufficiently material to deprive Thera of cover under the Policy. However, the majority disagreed, in particular because there was no dispute as to whether Phoenix was liable under the guarantee.

Fraud

The majority judgment included some useful dicta on the relevance of allegedly sham contracts to the issue of trade credit insurance cover and whether fraud on the part of the buyer could deprive an insured of cover. On this point, Macfarlan JA held that:

"By reason of the objective theory of contract, a fraudulent intention of only one party to the contract, uncommunicated to the other, does not suffice to render the contract a sham".

This was consistent with the fraud exclusion in the Policy, which excluded loss arising out of fraudulent, dishonest or criminal acts on the part of the insured (Thera), but not on the part of the buyer (Phoenix). On the contrary, *"Loss arising from such acts of a person with whom the Insured has contracted is however the very type of loss one would expect to be covered."*

The key question was whether the contract between the Thera and Phoenix giving rise to the receivable was enforceable or not: *"the Insured is entitled to claim indemnity for its contractual loss suffered under its genuine contracts entered into with another party (here the Counter-Party), notwithstanding that that other party may, unbeknownst to the Insured, have acted fraudulently."*

The Court's reasoning in this regard should provide guidance on how instances of fraud are to be interpreted in trade credit insurance policies going forward.

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1. BCC Trade Credit Pty Ltd v Thera Agri Capital No 2 Pty Ltd - NSW Caselaw
2. *THERA AGRI CAPITAL NO 2 PTY LTD V BCC TRADE CREDIT PTY LTD [2022] NSWSC 669*

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FINAL AND BINDING: AN UNEXPECTED CHANGE OF APPROACH IN CONTRACTUAL INTERPRETATION?

Commodities traders will be familiar with provisions stipulating that certificates of quality or quantity are final and binding on the parties save for, or in the absence of, fraud or manifest error. In a recent decision[1], the UK Supreme Court considered similar wording in a different context and reached an interesting decision, one that was not sought by either party and one that perhaps indicates a change in approach to the interpretation of contracts by the English Courts.

Background

Sara & Hossein Asset Holdings (the "Landlord") was the landlord of a commercial premises which commenced proceedings to recover service charge sums from its tenant, Blacks Outdoor Retail Ltd (the "Tenant").

For the payment of service charges by the Tenant, the lease provided that:

"The landlord shall on each occasion furnish to the tenant as soon as practicable after such total cost and the sum payable by the tenant shall have been ascertained a certificate as to the amount of the total cost and the sum payable by the tenant ***and in the absence of manifest or mathematical error or fraud such certificate shall be conclusive****."*

There was no challenge to the certificate on the grounds of *"manifest or mathematical error or fraud"*. However, the Tenant refused to pay the sums claimed by the Landlord on the basis that they were excessive (they were several times higher than previous charges) and were not properly due. The dispute went before the courts.

Decision in the Lower Courts

The Landlord's case was that its certificate was conclusive and subject only to the permitted defences i.e. manifest or mathematical error or fraud. In other words, it argued the right approach was to "pay now, argue never". The Tenant disputed this, arguing that the Landlord's interpretation failed to consider the contract as a whole, in particular the dispute resolution provisions and a right to inspect the Landlord's receipts and invoices relating to the service charge. In other words, it argued the right approach was "argue now, pay later".

In both a summary judgment application and at first instance, the courts agreed with the Tenant. The Court of Appeal sided with the Landlord and held that the natural and ordinary meaning of the certification provision dictated that it was conclusive. The Tenant appealed.

Decision in the Supreme Court

The Supreme Court was asked to decide whether the "permitted defences" were the only options for the Tenant to dispute its liability.

The majority determined that the Landlord's case fitted well with the terms of the clause but criticised it on the basis that it produced a: *"... surprising and uncommercial..."* result. On the other hand, the Tenant's case was supported by the contract as a whole, but not by the certification provision.

The majority ultimately decided that neither party's interpretation was satisfactory, instead opting for a compromise "pay now, argue later" regime. The certificate was found to be conclusive as to the sum payable but it did not stop the Tenant from later disputing liability. This was deemed *"consistent with the contractual wording"* and avoided *"unsurprising implications and uncommercial consequences"*.

This emphasis on the wider commercial considerations of the contract was not supported by the full panel with Lord Briggs notably dissenting on the basis that, in his view, the Court should not be able to invent a solution to mend the parties' bargain.

Wider Implications

The Supreme Court's emphasis on reaching a decision that fitted the commercial bargain as a whole rather than focussing on the natural and ordinary meaning of the contract may have wider implications.

Clearly, it remains critical to ensure that contracts accurately reflect the parties' commercial intentions and that they work well as a whole. Specific attention should be paid to final and binding provisions to ensure that the contract emphasises their final and binding effect, where that is sought, or otherwise that dispute resolution provisions are properly drafted to ensure that any dispute in relation to a certificate is resolved quickly and in a way that does not conflict with the final and binding provisions.

The outcome of a dispute of this nature will ultimately depend on the specific terms of each contract. However, the Supreme Court's engineering of a more commercial result in this case that, to a certain extent, downplays the primacy of the language of the contract, may reflect a new trend toward a more liberal approach to interpreting contracts by the courts, where the parties' wider commercial intentions are taken into greater consideration.

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1. *Sara & Hossein Asset Holdings Ltd v Blacks Outdoor Retail Ltd* [2023] UKSC 2

Where you can meet the team next

- Please contact us **here** if you would like to register for our upcoming Commodities Global Compliance Forum.
- Barry Vitou and Anne-Marie Ottaway will be in Switzerland on 4th and 10th May for two presentations on sanctions enforcement with Sarah Hunt.
- We will be in Zug for a joint event organised with the Zug Commodity Association on 10th May.
- Rick Brown will be speaking at the Thought Leadership FIRE International in on 17th – 19th May in Portugal.
- Join HFW's global industry experts for a series on Trade Seminars. In the first instalment, taking place at Vida Emirates Hills on Wednesday 17 May 2023, John Barlow and Luke Garrett will be exploring current trends in trade credit insurance (TCI). Click **here** to register.
- Barry Vitou will be speaking at C5's 17th International Conference on Anti-Corruption on 20-21st June. Please use this code (**S10-626-626I23.S**) for a 10% colleague/client discount – click **here** to register.

For more information on upcoming HFW events, click here.

Team News

- We are very pleased to announce that Michael Buffham has been promoted to partner effective from 1st April 2023. Congratulations Michael!
- Welcome to Gibran Alaoui who has joined our trade finance team in Geneva.
- We are pleased to announce that HFW Geneva has been ranked in two categories in the newly published 2023 edition of The Legal 500 (Legalease) EMEA, a guide to the region's best lawyers and law firms. Find out more about our rankings **here**.
- Matthew Cox featured in The Times recently, discussing the UK's new Electronic Trade Documents Bill. Read the full article **here**.
- Matthew Cox was also quoted in GTR, click **here** to find out more.
- Commodities partner Adam Richardson wrote in Trade Finance Global (TFG) sharing five tips to help avoid metal frauds. You can read the article **here**.

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.