Commodities

February 2013

COMMODITIES BULLETIN

Decision on GAFTA Prohibition and Default Clauses

In *Bunge S.A. v Nidera B.V.* (29 January 2013), the English Commercial Court considered the interpretation of the standard GAFTA Prohibition and Default Clauses.

The case concerned a contract for the sale of 25,000 mt of Russian milling wheat on FOB Novorossyisk terms between Sellers (Bunge) and Buyers (Nidera). The terms of GAFTA Contract No 49 were incorporated, Clause 13 of which sets out the standard GAFTA Prohibition Clause. This provides as follows:

"in case of prohibition of export, blockade or hostilities or in case of any executive or legislative act done by or on behalf of the government of the country of origin of the goods, or of the country from which the goods are to be shipped, restricting export, whether partially or otherwise, any such restriction shall be deemed by both parties to apply to this contract and to the extent of such total or partial restriction to prevent fulfilment whether by shipment or by any other means whatsoever and to that extent this contract or an unfulfilled portion thereof shall be cancelled...".

Clause 20 sets out the standard GAFTA Default Clause which provides a contractual scheme for establishing damages payable in the event of default by either party.

The contractual delivery period was 23 to 30 August 2010. On 5 August 2010, the Russian government issued a resolution prohibiting the export of wheat between 15 August and 31 August 2010 (therefore covering the entirety of the contractual delivery period). On 9 August 2010, Sellers purported to declare the contract as automatically cancelled under the Prohibition Clause. Buyers rejected this and brought a damages claim against Sellers for wrongful repudiation.

Both the first tier GAFTA Tribunal and the GAFTA Board of Appeal found in favour of Buyers, and Sellers appealed to the High Court

on the basis of alleged errors of law in the Board's reasoning.

The principal issue considered by the Court (Mr Justice Hamblen) was the construction of the GAFTA Prohibition Clause. The GAFTA Board of Appeal had found that Sellers were required to prove that the prohibition prevented them from performing and decided that they could not do this at the time of termination because it was possible that before the end of the delivery period the ban might be revoked or modified so as to permit performance. The Court agreed with the Board and held that it is necessary for a party relying on the Prohibition Clause to establish a causal connection between the prohibition and the restriction of export of goods of the particular contractual description during the particular contractual shipment period.

In making this decision, the Court reviewed the commercial considerations underlying the competing interpretations of the Prohibition Clause, ultimately finding that the injustice of a ban being revoked before the end of the delivery period (in terms of the unnecessary financial detriment to one party and the unnecessary financial benefit to the other, depending on the movement of the market price) outweighed the certainty of automatic cancellation. The judge commented that automatic cancellation, on the mere announcement of a prohibition regardless of its likely or actual duration, or whether it had any impact on performance, was such a *"crude re-allocation of risk"* that it was most unlikely to have been intended by the parties.

The Court also had to consider the application of the standard GAFTA Default Clause. In accordance with the key principle of the Default Clause that damages are to be based on (but not limited to) the difference between the contract price and the actual or estimated value of the goods at the date of default, the Board of Appeal had awarded Buyers substantial damages. Sellers argued that, on the facts, the damages scheme in the Default Clause should have been overridden by the application of certain common law principles for the assessment of damages, which would have led to the conclusion that Buyers had suffered no loss. The Court rejected Sellers' argument, holding that the parties had agreed that their damages would be based upon the measure set out in the Default Clause and these rules could therefore not be displaced by other principles.

This case provides very clear guidance for parties trading on GAFTA terms, and who may be affected by export restrictions, that the Prohibition Clause must not be relied upon prematurely. We understand that Sellers have applied for leave to appeal to the Court of Appeal.

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REACH - What are your obligations?

EC Council Regulation 1907/2006 on Registration, Evaluation, Authorisation and Restriction of Chemicals is commonly known as REACH. It governs the regulation of chemicals in the EU. Although now in force for over five years, the approaching major registration deadline on 31 May 2013 makes this an apt time for companies to consider their obligations under REACH.

Commodities covered by REACH

REACH is wide in scope; no chemical substance may be manufactured or placed on the EU market unless it has been registered in accordance with REACH. It covers petroleum products such as jet fuel, gasoil and gasoline as well as biofuels like biodiesel and ethanol. Crude oil, coal and liquefied petroleum gas, whilst caught by REACH, are currently exempt from registration provided that they are not chemically modified.

Obligation to register

The main obligation to register is triggered by the volume of substance manufactured or imported. The obligation applies to EU manufacturers and importers of substances, on their own or in mixtures in quantities of 1 tonne or more. Lesser obligations apply to "downstream users" of substances.

Importers

Under REACH, an importer is the entity *"responsible for import"*, with import meaning *"the physical introduction into the customs*

territory of the community". It is sometimes difficult to assess who is the importer in a particular trade scenario. Contractually allocated responsibilities are not necessarily determinative: the European Chemicals Agency, the body responsible for implementing REACH, has indicated that factors such as who orders, who pays and who deals with customs formalities may have a bearing. In light of this, it is prudent for companies to take a cautious approach when assessing whether they are an importer for the purposes of REACH.

Manufacturers

Manufacturing is defined under REACH as the "production or extraction of substances in the natural state". It includes activities such as chemical synthesis, smelting and extraction from naturally occurring substances and minerals. All manufacturers established in the EU are required to register the substances they manufacture, even where those substances are wholly for export outside the EU.

Non-EU manufacturers who export a substance into the EU do not have any responsibilities under REACH. EU importers of non-EU manufactured substances must carry out the required registration of the substance that is imported. However, REACH provides that a non-EU manufacturer can appoint an "Only Representative" to fulfil the registration obligation. The appointment of an Only Representative will mean that the EU importer, who would otherwise be responsible for registration, will be relieved from its registration obligation in relation to that particular supply chain and substance.

When to register

The registration obligation began on 1 June 2008 but various factors determine when a particular substance must be registered. These include whether the substance is a new or "phase-in" substance, its volume and how hazardous it is. Broadly and under certain conditions, phase-in substances are substances which were already being manufactured or placed on the EU market before REACH came into effect and which did not require notification under previous legislation.

Phase-in substances are subject to a special transition regime for registration provided they were pre-registered in the period 1 June 2008 – 1 December 2008. If pre-registered, there are three deadlines for registration, depending on tonnage and hazardousness: 30 November 2010, 31 May 2013 or 31 May 2018.

The 2010 deadline was for phase-in substances manufactured or imported in quantities of 1000 tonnes or more per year (and phase-in substances manufactured or imported in lesser tonnages where they were classified as hazardous, toxic or dangerous to aquatic organisms or the environment). The next deadline, 31 May 2013, is for phase-in substances manufactured or imported in quantities of 100 tonnes or more per year. The final deadline of 31 May 2018 will be for phase-in substances manufactured or imported in quantities of 1 tonne or more per year.

Non phase-in substances and phase-in substances which have not been pre-registered must be registered before manufacture or import can continue.

How to register

Registration requires the submission of a joint dossier (prepared together with other manufacturers and importers of the same substance) and an individual dossier which contains company specific information. Companies intending to register the same phase-in substance must join a Substance Information Exchange Forum (SIEF) to share information on the intrinsic properties of the substance and to reach agreement, if possible, on its classification.

Companies obliged to register by 31 May 2013 which are not already preparing for registration should do so promptly. The consequences of non-registration are severe; aside from the penalties imposed by Member States (in the UK most breaches constitute a criminal offence), they are neatly encapsulated by the EU's REACH slogan: "no data, no market".

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"Companies obliged to register by 31 May 2013 which are not already preparing for registration should do so promptly."

Publication of SCoTA GTCs and EFET Individual Biomass Contract

Two new contractual documents of interest to the physical commodity sector were published during January 2013.

SCoTA GTCs

On 23 January 2013, globalCOAL® published new SCoTA Version 8 General Terms and Conditions (the SCoTA v8 GTCs).

The SCoTA v8 GTCs are based on the SCoTA v8 Master Agreement, which was launched in March 2012. They retain the flexibility introduced by the SCoTA v8 Master Agreement, such that the "Relevant Standard Specifications", which form an integral element of any SCoTA transaction, are published as separate documents. The main operational provisions of the SCoTA v8 Master Agreement are untouched.

The key differences between the two documents are structural, reflecting the change from a master agreement structure to a terms and conditions structure, which is perhaps more familiar to those operating in the physical oil market, where general terms and conditions form the basis of many trades.

Another significant difference is the deletion of the elective Appendix 6 in the SCoTA v8 GTCs. This contains additional credit provisions that parties may negotiate between themselves.

The SCoTA v8 GTCs provide an alternative framework for trading on SCoTA v8 terms without the need to execute a SCoTA v8 Master Agreement. This may appeal to some market participants. It also provides a means to reduce basis risk for parties in contractual chains where not all parties in the chain have executed SCoTA v8 Master Agreements between themselves.

The SCoTA v8 GTCs go live on 24 February 2013.

Individual Biomass Contract

On 18 January 2013, the European Federation of Energy Traders, EFET, published the Individual Biomass Contract. Publication came following a lengthy consultation process with key market participants. As indicated by its title, the Individual Biomass Contract is not a master agreement but a standalone, single agreement. It has been drafted to accommodate transactions on either a FOB or CIF basis only.

The main terms of the Individual Biomass Contract are set out in Part II. Part I contains pro-forma confirmations, one each for FOB and CIF transactions. These confirmations are for recording the particular commercial terms of an agreement and any elections or variations to the main terms in Part II. The Individual Biomass Contract also contains nine Annexes. These include provisions on FOB and CIF shipping terms (Annexes C and D), quantity and quality determination (Annexes E and F), sustainability requirements (Annex G) and credit support (Annex H).

Sustainability requirements are a key consideration for parties to biomass agreements. Potential users of the Individual Biomass Contract may be interested to note that the inclusion of the detailed sustainability requirements set out in Annex G is optional. Parties can elect whether or not to incorporate these requirements (and therefore the consequent obligations on the seller) and if so, whether in the form of Annex G or in some other form agreed by the parties as a replacement.

For more information, please contact Rebecca Lindsey, Associate, on +44 (0)20 7264 8252 or rebecca.lindsey@hfw.com, or your usual contact at HFW.

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Conferences & Events

Lugano Commodity Forum
Hotel de la Paix, Lugano
(5-6 March 2013)
Presenting: Matthew Parish

globalCOAL® SCoTA® Crash Course
London
(7 March 2013)
Presenting: Rebecca Lindsey

Commodities Breakfast Seminars
HFW London
(12 and 26 March 2013)

Global Grain Asia
Shangri La Hotel Singapore
(12-14 March 2013)
HFW Sponsoring
Attending: Stephen Thompson

HFW Energy and Resources Seminar
HFW Perth
(13 March, 10 April and 15 May 2013)
Presenting: Hazel Brewer, Cheryl Edwardes, Julian Sher and James Donoghue

Mines and Money
Hong Kong
(18-22 March 2013)
Attending: Brian Gordon and Cheryl Edwardes

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