Commodities

April 2015

COMMODITIES BULLETIN

Welcome to the April 2015 edition of our Commodities Bulletin.

The first article of this edition will be of interest to those involved in energy trading. Associate Taïs Jost and Partner Robert Finney review the introduction of UK criminal sanctions to enforce the EU's 2011 Regulation on wholesale energy market integrity and transparency (REMIT) and the start of EU-wide REMIT reporting obligations.

In our second article, for those trading on the basis of standard terms or in long established course of dealings, Associate Michael Buffham considers the lessons to be learned from the recent Commercial Court case of *Transformers & Rectifiers Ltd v Needs Ltd* (13 February 2015).

Next, Associate Nick Moon reports on the latest decision in *Impala Warehousing and Logistics (Shanghai) Co Ltd v Wanxiang Resources (Singapore) PTE Ltd* (25 March 2015). The judgment illustrates the detailed level of analysis required to isolate the relevant relationships under which claims are to be pursued where goods are traded using financing and stored in warehouses. The analysis of the transactions in this case and reiteration of the nature and function of warehouse receipts will provide helpful guidance for parties resolving their disputes under English law.

Finally, Associate Caroline West reflects on the decision in *Volcafe Ltd & Ords v Compania Sud Americana De Vapores SA* (5 March 2015), which will be of interest to traders shipping commodities in containers stuffed by the carrier, and to receivers.

Should you require any further information or assistance with any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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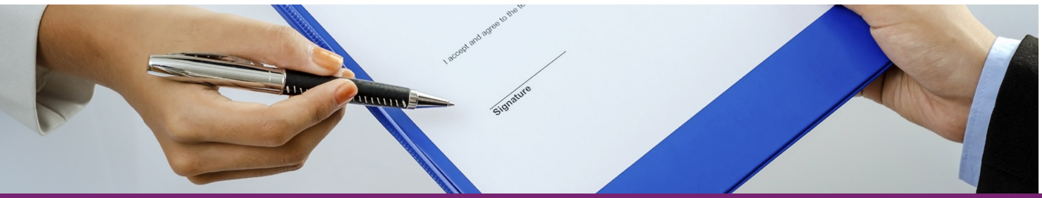

Major developments in gas and power regulation

There is renewed focus on the EU's 2011 Regulation on wholesale energy market integrity and transparency (REMIT), in light of the introduction of UK criminal sanctions to enforce REMIT and the start of EU-wide REMIT reporting obligations.

From its entry into force in December 2011, REMIT has required market participants trading wholesale energy products (contracts and derivatives relating to electricity and gas, including LNG) to comply with:

- Obligations to publish insider information in an effective and timely manner (and notify Agency for Cooperation of Energy Regulators (ACER) and national regulators of any delay).
- Prohibitions against insider dealing and market manipulation.

REMIT also establishes a framework for reporting trades (and orders) to ACER, but it has taken over three years to implement. National regulators are responsible for enforcing REMIT but the Regulation does not require breaches to be a criminal offence in Member States.

Criminal sanctions in the UK

Since 2013 the regulator of gas and power markets in Great Britain, Ofgem, has had a range of civil enforcement powers available to it to enforce REMIT. However, the British Government has reinforced these with criminal sanctions to tackle the most serious breaches of REMIT, in particular insider trading and/or market manipulation in relation to wholesale energy products.

From 13 April 2015, breaches now carry criminal liability, with maximum penalties of two years' imprisonment, an unlimited fine or both.

The two new offences created for this purpose largely mirror the insider trading and market manipulation prohibitions in REMIT. However, they are broad in their geographic scope and in applying to management of market participants.

Participants in wholesale gas and power markets should consider how these new criminal sanctions might impact their activities and what procedural changes might be appropriate to limit potential criminal liability.

The offences apply extra-territorially to a significant degree. Although some nexus to the UK is required, for derivatives it is sufficient that the contract relates to electricity or gas that is produced in, traded in, or is for delivery in the UK. Neither party to the trade, nor any intermediary or venue, need be based or present in the UK if the underlying electricity or gas is produced in, traded in, or for delivery there. Accordingly, non UK (including non EU) market participants, too, should consider the potential impact of this new criminal sanctions regime.

In addition to the individuals involved in committing an offence, companies and their officers may also be criminally liable, the latter if the offence was committed with their consent or connivance or was attributable to their neglect.

REMIT reporting obligations

The European Commission finally adopted its REMIT Implementing Regulation on data reporting in December 2014 and market participants are busily preparing for the reporting start dates:

- 7 October 2015 for trades executed on "organised market places" or "OMPs".
- 7 April 2016 for contracts concluded outside those OMPs.

Although REMIT's insider dealing and market manipulation prohibitions have been in force for several years, there remains uncertainty as to the scope of the Regulation, in particular its geographic scope and the definitions of "wholesale energy products" and "market participant". What is clear is that non-EU participants will generally need to report their trades in EU wholesale gas and power (and derivatives).

From each reporting start date, EU and non-EU market participants must be registered with the relevant national regulator before entering into trades that have become reportable. Market participants not established or resident in the EU should register in the Member State in which they are

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TAÏS JOST, ASSOCIATE

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most active. Note also the backloading requirement: existing, outstanding contracts must be reported to the Agency within 90 days of the applicable reporting start date.

REMIT allows a market participant to delegate its reporting and distinguishes market participants required to report from the persons who actually report. Generally, market participants cannot report direct unless they register as a Registered Reporting Mechanism (RRM), meeting the additional requirements for this. Accordingly trades executed at OMPs (including matched and unmatched orders) will be reported through the OMP concerned or by trade matching or trade reporting systems and other trades will generally be reported through RRMs. Derivatives trades reported under EMIR (or, in due course, MiFIR) will not need to be reported again under REMIT. There is also an exception for certain financially settled derivatives traded outside the EU.

Obligations under REMIT are far from straightforward for energy market participants both within and outside the EU. Its various requirements and knock-on implications demand serious thinking to ensure compliance and to avoid UK criminal liability.

These are just some of the substantial regulatory requirements affecting energy trading that are due to come into effect in the next two years. REMIT compliance should be a key and immediate action point for all trading wholesale gas and power.

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hfw Whose terms are you trading on?

For parties trading on the basis of standard terms or a course of dealing, the recent English Commercial Court decision in *Transformers & Rectifiers Ltd v Needs Ltd* (13 February 2015) offers some important reminders.

The dispute concerned contracts for the sale and purchase of nitrile gaskets between Transformers & Rectifiers Ltd (T&R) as buyer and Needs Ltd (N) as seller. There was a course of dealing between the parties over about 20 years and T&R had placed orders on an almost weekly basis, by fax, email or post.

For two contracts concluded by email, T&R alleged that the gaskets supplied were unsuitable for purpose and not in accordance with the contracts.

T&R claimed that its terms and conditions applied because they were printed on the back of the purchase orders. Importantly, there was no reference to them on the face of the purchase orders. N asserted that its own terms applied, because they were referenced on its acknowledgements of order (which stated that copies were available on request), and that liability for breach of contract was limited or excluded by those terms.

The Court considered the authorities and summarised the following principles that apply in this sort of case:

- Where A makes an offer on A's conditions and B accepts that offer on B's conditions and, without more, performance follows, assuming that each party's conditions have been reasonably drawn to the attention of the other, there is a contract on B's conditions.

- If a previous course of dealing is relied upon, it does not have to be extensive. Three or four occasions over a relatively short period may suffice.
- The course of dealing relied on by the party contending that its terms are incorporated must be consistent and unequivocal.
- Where trade or industry standard terms exist, it will usually be easier for a party contending for those terms to persuade the court that they should be incorporated, provided that reasonable notice has been given of the application of the terms.
- A party's standard terms will not be incorporated unless that party has given the other party reasonable notice of those terms.
- It is not always necessary for a party's terms to be included or referred to in the contractual documents. It may be sufficient if they are clearly contained or referred to in invoices sent subsequently.
- By contrast, an invoice following a concluded contract effected by a clear offer on standard terms which are accepted, even if only by delivery, may be too late.

It was held that neither party's terms applied to the contracts.

T&R had not sent its terms when placing orders by email or fax, or made it clear that it was seeking to rely on those terms. T&R did not follow a consistent practice of enclosing its terms with every purchase order and where the purchase order did not on its face refer to the terms on its back, N was entitled to assume that T&R was not intending to rely on them.

N's terms did not apply to the contract either. N did not provide T&R with a copy of its own standard terms and T&R did not ask for them. If a seller wishes to incorporate its own terms by referring to them in an acknowledgement of order (which would amount to a counter offer), it must at least refer to the terms on the face of the acknowledgement and make it clear that those terms are to govern the contract. If they are not in common industry use, the terms must also be printed on the reverse of the acknowledgement.

Alternatively, the seller could send the buyer a copy of its terms, making it clear that they are the only terms on which the seller is willing to do business.

Issues to consider in concluding contracts

This case provides a useful summary and application of the law concerning incorporation of terms and conditions in the context of modern business practices, where contracts may be concluded through a variety of methods of communication. Parties seeking to rely on their own standard terms should bear in mind the following issues:

- If your terms are printed on the reverse of purchase orders or acknowledgements, it is advisable to make sure they are referred to on the face of the document.
- If the terms are not in common industry use, they should be printed on the reverse of the document and not merely referenced.
- If you are concluding a contract by email or fax, make sure that any terms printed on the reverse of documents are emailed or faxed to the counterparty.
- The safest way to ensure that the contract is governed by the desired standard terms may be to send a copy to the counterparty expressly stating that they are the only terms on which you are willing to do business.

If a previous course of dealing is relied upon, it does not have to be extensive. Three or four occasions over a relatively short period may suffice.

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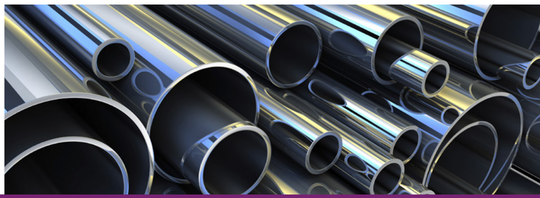


Qingdao: another English Court decision

In the February edition of this Bulletin (http://www.hfw.com/Commodities-Bulletin-February-2015) Associate Nick Moon reported on the interlocutory decision of the English High Court in *Impala Warehousing and Logistics (Shanghai) Co Ltd v Wanxiang Resources (Singapore) PTE Ltd* (15 January 2015). The case was one of the first to come before the English Courts arising from the alleged large-scale fraud involving metals warehoused in Qingdao, China. Another decision in the case was made on 25 March 2015, offering further insight into how the English Court views the relationships and contracts involved in warehousing and financing metals, in particular warehouse receipts.

Although the underlying facts are complex, the relevant background put simply is that Wanxiang claims to be the owner of a quantity of aluminium stored in a warehouse in Qingdao, which it bought from Impala through financing provided by Rabobank. The relationship between the three parties was under a tripartite Collateral Management Agreement (CMA) by which Impala sold the goods to Wanxiang who obtained financing for the sale from Rabobank and in return pledged the goods to Rabobank until they had repaid the finance provided. Warehouse receipts in respect of the aluminium were initially issued by Impala to Rabobank. When the sums advanced by Rabobank were paid off, it is said the warehouse receipts were endorsed to Wanxiang.

Wanxiang commenced proceedings against Impala in China seeking delivery of the aluminium. Impala sought an injunction ordering Wanxiang to discontinue the Chinese proceedings because of an exclusive jurisdiction clause in favour of the English Court incorporated into the warehouse receipts.

This was significant because, according to the parties, the English Courts (unlike the Chinese Courts) will recognise provisions in Impala's terms and conditions, limiting their liability to Wanxiang.

At the interlocutory stage, Impala's application for a final or interim mandatory injunction ordering Wanxiang to discontinue the proceedings in China was refused. Impala were unable to show "a high degree of probability" that they were entitled to restrain the foreign proceedings.

The English Court ordered that the trial of Impala's application for an injunction should happen soon after the interlocutory hearing and it took place in March 2015. Impala sought:

1. A final mandatory injunction requiring Wanxiang to discontinue the proceedings in China.
2. A final prohibitory injunction restraining Wanxiang from commencing or continuing proceedings other than in the English Courts against Impala.

Wanxiang disputed the English Court's jurisdiction for three reasons:

1. Wanxiang's claim in the Chinese Courts is non-contractual.
2. The English jurisdiction clause was not incorporated.
3. The English Courts should not grant an injunction because there were "strong reasons" for not doing so, in particular that an English judgment would not be enforceable against Impala in China.

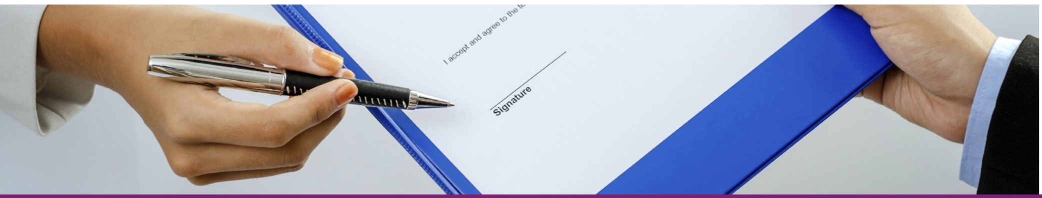
"Non-contractual" nature of Chinese claim

The English Court decided that under Chinese law, Wanxiang's claim was contractual. Interestingly, it endorsed Impala's expert evidence on Chinese law that in practice, warehouse receipts are proof of contract and not just a receipt.

On an English law analysis, the English Court found that there was a bailment on terms and the underlying relationship with the warehouse was contractual. It rejected Wanxiang's argument that because the purchase was financed by a bank, the contractual nexus between Wanxiang and Impala was broken. It found there was *"no commercial reason that the terms of the warehouse receipt should apply to the purchaser in one case but not the other"*.

The English Court reiterated the nature and function of warehouse receipts under English law as follows:

- They are common instruments in trade and finance.
- They may contain or evidence a contract between the warehouse and the party on whose behalf the goods are stored.
- They represent goods in the possession of a warehouse.
- They give a description of the goods.
- They are a receipt for the goods stored.
- At common law, they are not treated as negotiable documents of title (unlike bills of lading).



- They do not confer possession of the goods on the holder.
- They in effect give the holder the right to possession of the goods.
- They are the subject of specific statutory provision in some countries (including China).

Incorporation of jurisdiction clause

At the interlocutory stage, the English Court had decided that the English jurisdiction clause was validly incorporated into the warehouse receipts. Wanxiang argued that this was immaterial as the CMA, which provided for Singapore law and jurisdiction, governed these transactions.

The Court found that in a commercial transaction like this, no warehouse would accept goods for storage except on terms.

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The Court found that in a commercial transaction like this, no warehouse would accept goods for storage except on terms. The only real issues were whether it was on the terms of the CMA and if on the terms of the warehouse receipts, whether the exclusive jurisdiction clause was incorporated.

It held that the CMA applied to the transactions to the extent the bank was involved with them. However once Wanxiang had repaid the sums advanced by Rabobank, the relationship was between Wanxiang and Impala and governed by the warehouse receipts. The jurisdiction clause was validly incorporated and therefore applied.

Enforceability

Neither party could cite a case where the fact that an English judgment was not enforceable in a foreign country amounted to a strong reason for not granting an injunction. The English Court considered that it may amount to a strong reason in rare circumstances, for example where the claim was to recover property situated in such a foreign country. This was not the case here as Wanxiang had submitted that the ingots had been shipped out of China. Therefore, their claim in China must be for damages rather than delivery up.

Conclusion

The English Court commented that this was a case in which there was a *"genuine and difficult dispute as to jurisdiction"*. It concluded that Impala was entitled to the injunctions sought, noting that both parties were part of major international commercial groups aware of the importance of dispute resolution clauses so that it was not commercially unreasonable to hold them to an exclusive jurisdiction clause.

The parties must now go on to resolve the underlying dispute. Their experience illustrates the detailed level of analysis required to isolate the relevant relationships under which claims are to be pursued where goods are traded using financing and stored in warehouses. The English Court's analysis of the transactions in this case and reiteration of the nature and function of warehouse receipts will provide helpful guidance for parties resolving their disputes under English law.

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Wake up and smell the coffee: protection under the Hague Rules where cargo arrives damaged

In *Volcafe Ltd and others v Compania Americana de Vapores* (5 March 2015), the English Commercial Court has clarified the carrier's duty under the Hague Rules to properly and carefully load, carry and care for cargo.

The decision will be of interest to both receivers and carriers, particularly in the context of containerized cargoes. It identifies both the scope of the Hague Rules and the inadequacy of relying on market practice to establish a sound system of carriage.

The case concerned a claim by receivers under various bills of lading for condensation damage to a cargo of coffee beans. The cargo was stuffed into containers by the carriers and a layer of Kraft paper laid around the walls and roof of the container to trap moisture. On outturn a number of bags were found to be water damaged. Warm moist air rising from the stow appeared to have condensed on the cold walls and ceiling of the container then dripped onto the coffee below.

The bills of lading contained a standard Clause Paramount, incorporating the Hague Rules. Article III(2) of the Hague Rules states:

"Subject to the provisions of Article IV, the carrier shall properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried".

Receivers and cargo insurers brought a claim against the carriers for breach of Article III(2). The bills of lading stated that the cargo was *"packed in apparent good order and condition"*. However, on discharge the cargo was found to be damaged. The claimants argued that this showed carriers had breached their duty under Article III(2).

Decision of the English Commercial Court

The Court considered first whether the Hague Rules applied. This was significant because it determined whether certain exceptions in the bill of lading would be available to the carriers.

Article I(e) of the Hague Rules states that the Rules apply to carriage *"from the time when the goods are loaded on to the time they are discharged from the ship"*. The carriers argued that the claim fell outside the Hague regime as it related to the way the containers were packed – which had occurred several days before loading.

The Court did not find this argument compelling, holding that parties are free to agree on what constitutes "loading" for the purposes of Article I(e). Where the carrier agrees to stuff the container, stuffing forms part of "loading" for the purposes of Article I(e).

Further, properly analysed, carriage in a container which had been inadequately prepared to protect the cargo was a breach at the heart of the contract of carriage.

The Court then considered Article III(2) in more detail, finding that "properly" in this context meant "in accordance with a sound system of carriage".

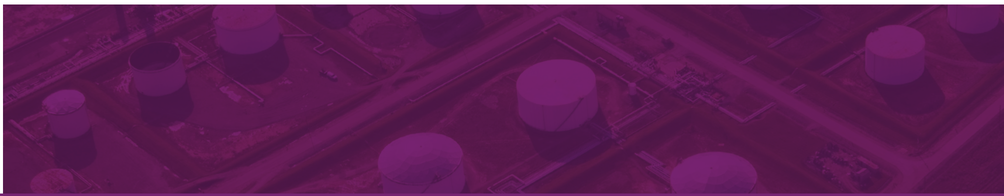
Acknowledging that the goods were loaded in apparent good order and condition but arrived damaged, the Court held that this can be sufficient to justify an inference that a breach of Article III(2) has occurred. The burden will thereafter be on the carrier to establish compliance with Article III(2) by demonstrating a sound system of carriage has been employed. This effectively reverses the standard burden of proof.

The carriers argued that by lining the containers with Kraft paper they had adopted a sound system of carriage and relied on certain manuals and textbooks to show this practice was industry standard.

The Court found that carriers must demonstrate the existence of a rational, adequate and reliable basis for concluding that a system will

The Court found that carriers must demonstrate the existence of a rational, adequate and reliable basis for concluding that a system will prevent cargo damage.

CAROLINE WEST, ASSOCIATE



prevent cargo damage. Evidence of market practice was insufficient, instead theoretical calculations or an empirical study would be required. In the absence of this evidence, the Court held that the carrier had breached its duty under Article III(2) and awarded damages.

Analysis

From the outset, this case was understood by the parties to have key precedent value because of the significance of the issues involved.

The judgment is a useful clarification of the scope of a carrier's duties under the Hague Rules. It demonstrates that in certain circumstances, where the carrier is responsible for stuffing the container, the Hague Rules may apply even before cargo is placed onboard a vessel. It also highlights that where cargo is shipped under a clean bill of lading but arrives damaged, the usual burden of proof may be reversed so that the defendant carriers bear the burden of establishing that the cargo was carefully and properly carried.

Receivers should bear this decision in mind where cargo arrives damaged.

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Conferences and events

ICC Trade Finance Seminar
HFW London
18 May 2015
Presenting: Daniel Martin, Marc Weisberger and Robert Wilson

CWC Oil & Gas EPC Conference
Dubai
19 May 2015
Attending: Max Wieliczko, Michael Sergeant and Robert Blundell

HFW Geneva Seminar Series: Dangerous Cargoes
HFW Geneva
27 May 2015
Presenting: Michael Buisset

Intercem 30th Anniversary Conference
London
1-3 June 2015
Presenting: Rory Gogarty

International Trade and Commodities Seminar
Hong Kong
3 June 2015
Presenting: Peter Murphy, Andrew Johnstone, Guy Hardaker and Fergus Saurin

Lugano Commodity Forum
Lugano
8 June 2015
Presenting: Michael Buisset and Sarah Taylor

SwissMarine Services 3rd Geneva Shipping and Trading Seminar
Geneva
17 June 2015
Presenting: Paul Wordley and Brian Perrott

IECA Summer Conference
Rome
23-25 June 2015
Presenting: Robert Wilson and Marc Weisberger
Attending: Robert Finney