

GLOBAL GRAIN GENEVA



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16 November 2011

Topics

- "Laycan" and Shipment Period
- Seller lets time go by
- Soufflet Negoce v Bunge
- The "Mercini Lady"
- Clause Collision
- RG Grain Trade v Feed Factors
- Insolvency Protection
- Recoverability of Hedging Losses

Contracts of Sale: Laycan and Shipment Period

Shipment Period

- Cargo to be shipped within specific limits of time
- If period not adhered to, innocent party has right to cancel

Laycan

- Commencement of laydays
- Date after which charter can be cancelled if vessel has not by then arrived

One word in a sale contract can **TRANSFORM** its meaning.

FOB: The "Luxmar" [2007] EWCA Civ 494

Facts

- The claimant agreed to sell to the defendant a quantity of gasoline FOB ISAB refinery North side Priolo terminal – Delivery Period 27/30 May.
- On 17 May the defendant nominated the vessel Luxmar to load the cargo.
- On 21 May the **laycan was narrowed** to 29/30 May.
- The vessel arrived at Priolo at 1000 on 28 May and gave NOR. The cargo was not ready because of technical problems at the claimant's plant. The necessary repairs were not completed until 3 June.
- On 3 June the defendant terminated the contract on the basis that the claimant's failure to commence loading constituted a repudiatory breach.
- The claimant asserted that the defendant terminated the contract unlawfully and claimed damages for its breach. The defendant counterclaimed general damages for late delivery in addition to demurrage.

FOB: The "Luxmar" [2007] EWCA Civ 494

- The claimant argued that its only obligation under the contract was to load the vessel within the laytime allowed by clause 9, or pay demurrage, if any, in accordance with clause 10. Clause 7 did not impose any other "delivery" obligation on it, and the defendant had no right to terminate the contract.
- The defendant contended that clause 7 imposed a delivery period within which the claimant was bound to deliver the cargo. Alternatively, the defendant could justify the termination of the contract because (1) the failure to complete delivery within the laytime provisions was a breach of condition entitling the defendant to terminate, and (2) the claimant was in breach of an obligation to deliver within a reasonable time, entitling the defendant to terminate. The defendant claimed general damages for late delivery in addition to demurrage.
- At first instance Langley J gave judgment in favour of the claimant ([2006] 2 Lloyd's Rep. 543). He held that clause 7 did not impose a delivery period; it provided for a laycan and no more. The defendant's remedy for the delay was limited to demurrage. There was no obligation on the claimant to deliver in a reasonable time, breach of which could justify the termination of the contract. Accordingly, the defendant was liable to the claimant for wrongfully terminating the contract. The defendant was not entitled to general damages for delay in addition to demurrage. The defendant appealed.

FOB: The "Luxmar" [2007] EWCA Civ 494

"6. PRICE

"IN USD/MT, FOB ISAB REFINERY NORTH SITE (PRIOLO TERMINAL - AUGUSTA BAY) ON B/L WEIGHT CORRECTED IN AIR, CALCULATED AS FOLLOWS:

AVERAGE OF ALL PLATT'S HIGH FOB QUOTATIONS FOR PREM UNL AS PUBLISHED BY PLATT'S EUROPEAN MARKETSCAN UNDER THE RUBRIQUE "FOB MED (ITALY)" EFFECTIVE AND VALID IN THE PERIOD 25/05-01/06/2004,

PLUS 2.25 USD/MT."

"7. DELIVERY

FOB ISAB REFINERY NORTH SITE (PRIOLO TERMINAL - AUGUSTA BAY) IN A SINGLE LOT BY M/T "TBN"/SUBS TO BE NOMINATED BY BUYER AND TO BE ACCEPTABLE TO SELLER IN THE PERIOD 27-30/05/2004.

BUYER WILL NARROW SUCH PERIOD TO A TWO DAY LAYCAN LATEST BY 21/05/2004 C.O.B. ITALIAN TIME.

THE LAYCAN IS AN ESSENTIAL ELEMENT OF THE CONTRACT, IN FAVOUR OF SELLER."

FOB: The "Luxmar" [2007] EWCA Civ 494

"9. LAYTIME

36 RUNNING HOURS SINCE WEATHER PERMITTING PLUS 6 HOURS NOTICE ALWAYS DUE, (NOTICE OF READINESS MUST BE TENDERED ONLY AFTER THE VESSEL HAS ARRIVED WITHIN THE CUSTOMARY ANCHORAGE) PROVIDED VESSEL CAN RECEIVE THE TOTAL CARGO IN A PERIOD OF TIME EQUIVALENT TO THE TWO THIRDS OF THE AGREED LAYTIME HOURS.

IF THE VESSEL TENDERS N.O.R. AFTER THE FIRM AGREED LAYCAN, LAYTIME SHALL BEGIN UPON BERTHING.

LAYTIME SHALL COMMENCE EITHER 6 HOURS AFTER N.O.R. TENDERED AT LOADPORT OR UPON BERTHING, WHICHEVER IS EARLIER AND EXPIRE AT HOSES DISCONNECTION, OR RECEIPT OF DOCUMENTS, WHICHEVER IS EARLIER. TIME USED FROM HOSES DISCONNECTIONS TILL RECEIPT OF DOCUMENTS ON BOARD SHALL BE EQUALLY SHARED BETWEEN BUYER AND SELLER AFTER THE THREE HRS USUALLY GRANTED BY SHIP."

"10. DEMURRAGE

DEMURRAGE, IF ANY, WILL BE REQUESTED BY BUYER ONLY IF SHIP-OWNERS ACTUALLY CLAIM IT. DAILY RATE AS PER CHARTER PARTY . . ."

FOB: The "Luxmar" [2007] EWCA Civ 494

Key issues

1. Whether an FOB contract which provides for a delivery period to be narrowed to a laycan period (viz a period before which laydays will not start and after which a seller may cancel the contract if the ship which is due to take the cargo has not served a notice of readiness to load) is a traditional FOB contract in which the buyer can terminate the contract if the goods are not shipped within the period originally designated for delivery.
2. Whether the defendant was in any event entitled to terminate the contract when it did since the time for loading had been substantially exceeded.
3. Whether the defendant was confined to the remedy of demurrage since its loss was considerably more substantial than that.

FOB: The "Luxmar" [2007] EWCA Civ 494

"It is not sensible that an obligation relating to time of delivery should be a condition in one factual circumstance but not in another. It is either a condition or it is not. In the context of the present contract with an entitlement on the part of the buyer to present a vessel at any time up to the last moment for contractual delivery, it cannot, in my judgment, be right to hold that the words "DELIVERY. . .27-30/05/2004" constitute a condition of the contract."

"The use of a laydays/cancelling provision in the contract (particularly a provision entitling a vessel to present at any moment up to the end of the delivery period) makes the contract a non-traditional fob contract in that time of delivery has become an obligation which is not of the essence of the contract. That is not a surprise, since traders are constantly adapting and even changing traditional fob contracts in the course of their business. If they want to rely on delivery obligations as they have been traditionally construed, they may well be advised not to employ cancelling provisions but that is, as always, a matter for them."

FOB: The "Luxmar" [2007] EWCA Civ 494

"It is, as I have already indicated, axiomatic in charterparty law that failure to load within the laydays is not a repudiatory breach... A provision that a vessel be loaded within a particular time is never treated as a condition of the contract in shipping cases and there is no reason why the position should be any different in other cases (such as sale cases) where the relevant obligation is to load within the laydays. In such cases it would be irrational to treat the obligation as a condition for exactly the same reason as it is irrational in charterparty cases; the innocent party can only terminate after what has been called a "frustrating time" has elapsed. That may in appropriate circumstances be a comparatively short time but no one has suggested that the lapse of time up to 3 June in the present case could have been a frustrating time."

"...it has never been made clear what loss the buyers have suffered as a result of the delay. There is no claim for loss of market which is perhaps unsurprising since the market moved in the buyers' favour. The judge has awarded demurrage to the buyers as provided for in clause 10 of the contract. To the extent that the buyers have been rendered liable to the shipowners for demurrage that is no doubt a genuine loss and that has been (or will be) compensated. The judge rightly held that, where a demurrage figure is contained in a contract it is intended to cover loss for delay and general damages for delay cannot be awarded as well."

FOB: The "Luxmar" [2007] EWCA Civ 494

Court of Appeal's decision

- The appeal was dismissed.

(1) The concept of the laycan in the second paragraph of the delivery clause was an essential part of the clause as a whole and the word "delivery" had to be construed accordingly. The use of a laydays/cancelling provision in the contract, particularly a provision entitling a vessel to present at any moment up to the end of the delivery period, made the contract a non-traditional FOB contract in that time of delivery had become an obligation which was not of the essence of the contract.

(2) The defendant's submission that it was in any event entitled to terminate the contract because the time for loading had been substantially exceeded was rejected. A provision that a vessel be loaded within a particular time was not treated as a condition of the contract in shipping cases and there was no reason why the position should be any different in other cases, such as sale cases, where the relevant obligation was to load within the laydays. The innocent party could only terminate after a frustrating time had elapsed.

(3) The defendant's submission that it was entitled to general damages for delay in addition to demurrage was also rejected. Where a demurrage figure was contained in a contract it was intended to cover loss for delay, and general damages for delay could not be awarded in addition.

CIF: The "Azur Gaz" - [2005] EWHC 2528 (Comm)

CIF Contracts

The Azur Gaz - SHV Gas Supply and Trading SAS v Naftomar Shipping & Trading Co Ltd Inc [2005] EWHC 2528 (Comm)

➤ SHV agreed to sell to Naftomar butane CIF Tunisia Port – La Goulette or Gabes.

"Laycan

17-19 February 2003 consequently ETA Gabes 20 February am, La Goulette 19 February pm."

➤ Also: contract incorporated Seller's charterparty – laydays were to commence 16 February, cancelling date 19 February.

CIF: The "Azur Gaz" - [2005] EWHC 2528 (Comm)

Facts

- *Azur Gaz* arrived loadport 17 February.
- Due to bad weather, did not berth until 3 March.
- On 25 February, Buyers cancelled contract, relying on failure of Sellers to ship within period 17-19 February.
- **Buyers maintained "Laycan" was to be construed to mean "Shipment Period".**

Were they correct?

CIF: The "Azur Gaz" - [2005] EWHC 2528 (Comm)

"The absence of a shipment period and the use of "laycan" in a CIF contract are both unusual."

*"The word 'laycan', which was intentionally chosen, **does not mean 'shipment'**. It is perfectly capable of applying in its ordinary sense to the present contract and for it to do so is consistent with the incorporation of the charterparty. Whilst I recognise that the terms of the charter are only to be incorporated insofar as not in conflict with the main terms of the contract, the incorporation of the charter (which in clause 5 explains the meaning of laycan) is a pointer to the fact that expressions in the contract and charter were intended to have the same meaning. Further **the addition of the words 'consequently ETA Gabes Feb 20 am, La Goulette Feb 19 pm'** appear to me to point away from the word 'laycan' signifying an agreed shipment period. Rather the function of the ETAs seems to me to have been to give Naftomar some assurance of when the cargo was likely to arrive in circumstances where a shipment period had not been agreed. If the shipment period was guaranteed an ETA at the discharge port was hardly necessary.*

If the word 'laycan' does not provide for a shipment period, one will be implied... "

The seller lets time go by

Time is of the essence

- Setting up Letters of Credit
- Shipping on time
- Documentary instructions

Innocent party has right to cancel contract if time limit is not complied with.

Oppenheim: By electing to continue with the contract, one waives the right to repudiate.

The seller lets time go by

Example – setting up Letters of Credit

- Seller has right to cancel contract when buyer exceeds time to open credit.
- If seller, through action or inaction, affirms contract, **he waives his right to cancel.**
- Seller must make time of the essence again: notice given to buyer, who should be given **a reasonable time** to comply.
- Once buyer fails again to perform obligation, seller entitled to cancel contract.

The seller lets time go by

- As long as seller can establish that further time would not have assisted the buyer, he cancels within his rights.

Etablissement Chainbaux SARL v Harbormaster Ltd [1955]
1 Lloyd's Rep. 303

- Harbormaster correct to cancel contract.
- Proved that buyer could not satisfy obligation to open letter of credit within reasonable time.

Soufflet Negoce SA v Bunge SA [2010] EWCA Civ 1102

Facts

- Sellers agreed to sell and the Buyers agreed to buy 15,000 metric tons of Ukrainian Feed Barley, “free from alive insects and foreign smell” for a price of US\$135.00 per metric ton FOB stowed/trimmed Nikotera, Ukraine. Agreed that weight, quality and condition were to be “final” at load port as per surveyor’s certificates “Sellers’ option and costs”.
- **Delivery was to be:— “Between 9th – 22nd October 2006 at Buyers’ call both dates included (No Extension).”**
- The contract incorporated the GAFTA contract form 49 to the effect that the vessel be “presented at loading port in **readiness to load**”.
- The sellers were obliged to load and the agreement provided for laytime and demurrage. The commencement of laytime was tied to a valid tender of notice of readiness with demurrage. The vessel gave NOR to load on the last day of the delivery period.
- The sellers refused to load its cargo on the basis that the vessel’s holds were unclean and thus were not presented in “readiness to load”.
- The buyers disputed this and treated the sellers’ refusal to load as repudiatory and it claimed damages.
- The sellers argued that the degree of readiness required was such that the vessel should be ready to load in all respects as would permit a valid notice by a shipowner to a voyage charterer for the commencement of laytime.
- The buyers said that the degree of readiness required was such that it was physically and legally possible for the sellers to load even if the circumstances did not justify the shipowner giving such notice.

Soufflet Negoce SA v Bunge SA [2010] EWCA Civ 1102

➤ GAFTA 49

"Clause 6 PERIOD OF DELIVERY

Delivery duringat Buyers' call.

Nomination of Vessel. Buyers shall serve not less than consecutive day's notice of the name and probable readiness date of the vessel and the estimated tonnage required. The Sellers shall have the goods ready to be delivered to the Buyers at any time within the contract period of delivery.

*Buyers have the right to substitute the nominated vessel, but in any event the original delivery period and any extension shall not be affected thereby. **Provided the vessel is presented at the loading port in readiness to load within the delivery period, Sellers shall if necessary complete loading after the delivery period, and carrying charges shall not apply.** In case of re-sales a provisional notice shall be passed on without delay, where possible, by telephone and confirmed on the same day in accordance with the Notices Clause."*

Soufflet Negoce SA v Bunge SA [2010] EWCA Civ 1102

Key issue

- If, in a typical FOB contract, the buyer presents a vessel at the loading port which is not ready to take the cargo because the holds need to be cleaned, is the seller obliged to begin loading?

Soufflet Negoce SA v Bunge SA [2010] EWCA Civ 1102

Decision of the Court of Appeal

- It did not follow that, merely because the technical rules relating to NORs had been incorporated into the sale contract for the purpose of calculating laytime and demurrage, those technical rules had been incorporated for all purposes by the use of the phrase "in readiness to load" in the printed form of GAFTA 49.
- By making clear that a valid NOR was required to operate the laytime and demurrage provisions of the contract, the parties were by implication saying that a valid NOR was not required for other purposes.
- All that was required within the delivery period was that the vessel was presented in readiness to load. That required no more than that the vessel should be ready in the sense of it being lawful and possible for loading to take place.
- The fact that the holds needed cleaning on arrival did not mean that the sellers could use the sale contract on the basis that no vessel had arrived during the period fixed for delivery
- If the buyers assumed the risk of loading the cargo into unclean holds, the state of the holds was not a matter in which the sellers had any real legitimate interest.

The "Mercini Lady" [2010] EWCA Civ 1145

Facts

- Sale by Petroplus to Bominflot of cargo of EU gasoil FOB Antwerp.
- Quantity and quality to be final at loadport.
- Analysis of composite sample at loadport met the contractual specifications.
- On arrival in Spain (El Ferrol) Bominflot alleged that the gasoil was off-spec, particularly as to sediment and that the receivers accordingly rejected the cargo.
- Bominflot brought proceedings against Petroplus claiming over US\$3 million, made up of damages for the difference in value of the cargo, freight, demurrage and other consequential losses.
- Bominflot contended that Petroplus was in breach of the implied condition as to satisfactory quality pursuant to section 14(2) of the Sale of Goods Act 1979 and/or were in breach of an implied term at common law that the gasoil would, on shipment, be capable of enduring a reasonable voyage such that upon arrival at destination, and for a reasonable time thereafter, it would still be of satisfactory quality and/or in accordance with the contractual specification.
- Petroplus denied that there was any implied term, whether under section 14(2) of the 1979 Act or at common law, extending the quality clause 4, containing the gasoil's specification, beyond the point of loading so as to reach prospectively into the future.
- Petroplus further suggested common law implied term was excluded by clause 18.
- Bominflot argued that clause 18 did not have effect to exclude any conditions implied by law because the word "condition" was not mentioned in the clause.

The "Mercini Lady" [2010] EWCA Civ 1145

"4. QUALITY *Following quality to apply:*

...

Total sediment mg/l D-2709/88 ..."

"7. SHIPMENT FOB *one safe port/berth BRC Antwerp ..."*

"12. QUANTITY/QUALITY

Quality and quantity, basis shoretank, to be determined by a mutually agreed independent inspector at the loading installation, in the manner customary at such installation. Such determination shall be final and binding for both parties, except in case of fraud or manifest error ..."

"15. RISK AND TITLE FOB *Antwerp*

Each delivery shall be completed and title shall vest absolutely in buyer when the product passes the vessel's permanent hose connection at the port of loading at which time buyer assumes all risks pertaining thereto."

"18. OTHER CONDITIONS

INCO Terms 2000 plus latest amendments ...

There are no guarantees, warranties or misrepresentations, express or implied, [of] merchantability, fitness or suitability of the oil for any particular purpose or otherwise which extend beyond the description of the oil set forth in this agreement."

The "Mercini Lady" [2010] EWCA Civ 1145

Key issues

1. Whether there was a common law implied term that the gasoil had to remain in accordance with the contractual specification after delivery on the vessel for a reasonable period; and
2. Whether clause 18 excluded the implication of those statutory and common law implied terms.

The "Mercini Lady" [2010] EWCA Civ 1145

"It is not easy to see how a cargo of gasoil which is admitted to be within contractual specification on loading and delivery at the time when risk and title passes, that admission being made irrespective of the evidential quality (which can be conclusive) of the loading certificate, can nevertheless be delivered in breach of contract in a matter going to its specification. I can understand that the subsequent condition of a cargo can be evidence of its seller's failure to deliver it within specification, but when it is admitted that the cargo was delivered within specification, it is hard to see how later events can render its delivery a breach of contract in a matter defined by that same specification."

"...the additional implied term was simply not part of the intention of the parties to this contract and would not have been understood by reasonable merchants to have been part of its meaning ... If it had been otherwise, the whole point of a final and binding determination by an independent inspector on loading would be rendered pointless, for the buyer could always say that although the goods were within specification on loading, and had been conclusively determined so to be, they had nevertheless fallen out of specification during the contemplated voyage or within a reasonable time. All certainty in international sale of goods, which such inspection clauses are designed to provide would be utterly broken. Such clauses, plain and express as they are, would simply be a snare and a delusion, because they would always have to make way for the special additional term, even though it was merely implied and not express."

The "Mercini Lady" [2010] EWCA Civ 1145

"The whole point of the final and binding determination by an independent inspector on loading would be rendered pointless, for the buyer could always say that although the goods were within specification on loading, and had been conclusively determined so to be, they had nevertheless fallen out of specification during the contemplated voyage or within a reasonable time. All certainty in international sale of goods, which such inspection clauses are designed to provide would be utterly broken. Such clauses, plain and express as they are, would simply be a snare and a delusion..."

"Finally, although it was not a point made at the hearing, it is hard to see how the alleged additional term can survive section 14(1) of the 1979 Act. That provision, which limits the implication of terms about quality or fitness to the statutory terms contained in the 1979 Act, thus retains, in the background, the most fundamental rule of all so far as quality is concerned, namely that, despite the huge inroads made by first the common law and then statute, the underlying principle is still caveat emptor, let the buyer beware."

The "Mercini Lady" [2010] EWCA Civ 1145

Court of Appeal's decision

- There was no such common law implied term as suggested by the buyers. The contract made it clear that the specification had to be met at the time of delivery, that the intention was that the gasoil should be inspected by an independent inspector prior to loading, "basis shoretank", and that the inspector's determination should be conclusive. The sediment was within specification limits at the time of loading and delivery. Therefore gasoil of the correct specification was delivered.
- After delivery Bominflot assumed "all risks pertaining thereto" (clause 15). "All risks" included the risk of transport, and the risk of cargo instability. A clause for conclusive inspection and determination on loading replaced or redefined the implied terms as to quality, and prevented any further implication that it was legitimate to take account of changes in the cargo's specification after delivery.
- As to clause 18 of the contract, the implied obligations which Petroplus said had been excluded were not only fundamental obligations of English law but there was a judicial consensus that such obligations could only be excluded by language which expressly referred to conditions. It was not open to the court to depart from that long-established consensus.

The "Mercini Lady" [2010] EWCA Civ 1145

Summary

- Concerns over "final and binding" clauses being undermined where goods deteriorated after shipment.
- Court of Appeal –
 - ❖ Implied condition of satisfactory quality applies only at the time of delivery.
 - ❖ A fixed point or perspective warranty – not a continuing warranty.
- If goods not of satisfactory quality on arrival? Evidence of a possible breach – not a breach in itself.
- Emphasis on buyer expressly assuming "all risks" on delivery.
- "All risks are all risks. They include the risk of transport, and they include the risk of cargo instability".
- Certificate final and binding.
- Appeal to the Supreme Court has been rejected.

Clause Collision

- Problems caused by several sets of terms incorporated into one contract.
- Also: ambiguous inspection clauses, for example:
- "Inspection
Weight, quality and condition final at time and place of loading as per relevant tender. Buyer's liberty to appoint 1st class GAFTA approved Superintendent. Should there be a material discrepancy between the analyses carried out by the Superintendents, a mutually agreed 1st class GAFTA approved third Superintendent to act as mediator or decision maker. "

RG Grain Trade v Feed Factors International [2011] EWHC 1889 (Comm)

- GAFTA 119 terms. Sellers sold to the buyers 1,500 mt +/- 10 per cent in buyers' option Ukrainian origin sunflower expeller fob Nicolayev sea port.
- *“Protein min 32% – Moisture max 7% – Fiber max 23% – Fat min 11%”.*
- *“Warranted to contain not less than ... % of oil and protein combined and not more than 1.50% of sand and/or silica. Should the whole, or any portion, not turn out equal to warranty, the goods must be taken at an allowance to be agreed or settled by arbitration as provided for below ...”*
- *“Quality and condition to be final at time and place of loading as per certificate of first class superintendent approved by GAFTA at seller's choice and expense.*

The buyers have the right to appoint their own GAFTA approved supervisor at their expense. In this case the sampling to be done conjointly, as per GAFTA terms and conditions.

2nd analysis, if any, as per Salamon and Seaber, London.”

RG Grain Trade v Feed Factors International [2011] EWHC 1889 (Comm)

- When the cargo was loaded, the buyers exercised their option to appoint their own supervisor, Control Union, to act on their behalf.
- Sampling was carried out conjointly by Control Union and Inspectorate Ukraine. Inspectorate issued certificates showing that all analysis results of the cargo were in accordance with the contract specifications.
- Buyers wrote to the sellers to say that their analysis results in respect of the first loaded portion suggested that the cargo was off specification for protein and fibre content. Samples were sent to Salamon and Seaber for analysis.
- Protein content of the cargo was 26.8% (less than the minimum of 32% specified in the contract) and the fibre content was 26.57% (more than the maximum of 23% specified in the contract).
- Buyers rejected the goods and the documents. They were subsequently sold for US\$101 pmt by agreement between the parties. Sellers claimed US\$670,296.61, the balance of the purchase price.
- Buyers counterclaimed damages of US\$360,374.52 and £13,071.92.

RG Grain Trade v Feed Factors International [2011] EWHC 1889 (Comm)

- Seller's claim succeeded before first-tier arbitrators
- Board of Appeal dismissed seller's claim and allowed buyer's counterclaim – second analysis certificate from Salamon and Seaber, not Inspectorate, was final and binding.
- Appeal on points of law:
 - ❖ Whether certificates of quality and condition issued by superintendent chosen by sellers (Salamon and Seaber) were final and binding.
 - ❖ Whether fibre content provision was a condition of the contract so that the buyers were entitled to reject.
- Held:
 - ❖ Board were correct to conclude Salamon and Seaber analysis was final and binding.
 - ❖ They had erred in law in concluding breach of fibre content provision gave rise to right to reject.

RG Grain Trade v Feed Factors International [2011] EWHC 1889 (Comm)

- *"The starting point is, as the sellers submit, that quality is final as certified by the superintendent appointed by them. In circumstances where the buyers do not appoint their own supervisor there can be no doubt that that is the applicable regime. There can also be no doubt that in such a case rule 4 of GAFTA 124 means that rule 5 does not apply. In that case the contract does provide that a "certificate of inspection of a superintendent...at time of loading shall be final as to quality" and that superintendent "shall be solely responsible for drawing samples"."*
- *"The effect of conferring a right on the buyers to call for a second analysis necessarily meant that, where that right was exercised, the certificate final regime did not apply. It followed that, where the buyers called for a second analysis, the contract did not provide that a "certificate of inspection of a superintendent ... at time of loading shall be final as to quality". This was the type of question of law upon which some deference should be accorded to the Board, the trade tribunal, as the arbitrators' experience is likely to be of assistance."*

Insolvency Protection

➤ GAFTA 100 Insolvency clause

"26. Insolvency

If before the fulfilment of this contract, either party shall suspend payments, notify any of the creditors that he is unable to meet debts or that he has suspended or that he is about to suspend payments of his debts, convene, call or hold a meeting of creditors, propose a voluntary arrangement, have an administration order made, have a winding up order made, have a receiver or manager appointed, convene, call or hold a meeting to go into liquidation (other than for re-construction or amalgamation) become subject to an Interim Order under Section 252 of the Insolvency Act 1986, or have a Bankruptcy Petition presented against him (any of which acts being hereinafter called an "Act of Insolvency") then the party committing such Act of Insolvency shall forthwith serve a notice of the occurrence of such Act of Insolvency on the other party to the contract and upon proof (by either the other party to the contract or the Receiver, Administrator, Liquidator or other person representing the party committing the Act of Insolvency) that such notice was served within 2 business days of the occurrence of the Act of Insolvency, the contract shall be closed out at the market price ruling on the business day following the serving of the notice."

Insolvency Protection

➤ GAFTA 100 Insolvency clause cont.

"If such notice has not been served, then the other party, on learning of the occurrence of the Act of Insolvency, shall have the option of declaring the contract closed out at either the market price on the first business day after the date when such party first learnt of the occurrence of the Act of Insolvency or at the market price ruling on the first business day after the date when the Act of Insolvency occurred.

In all cases the other party to the contract shall have the option of ascertaining the settlement price on the closing out of the contract by re-purchase or re-sale, and the difference between the contract price and the re-purchase or re-sale price shall be the amount payable or receivable under this contract."

Insolvency Protection

➤ BHP set-off clause (Old version)

"CLAUSE 70 – BHP BILLITON SET-OFF CLAUSE

Following a default by either party hereunder (the "defaulting party") the other party (the "non-defaulting party") shall be entitled, at its option, to set off any undisputed amounts believed in good faith and on reasonable grounds by the non-defaulting party to be payable (whether at such time or in the future or upon the occurrence of a contingency) by the defaulting party to the non-defaulting party (whether under this charter party or otherwise), against any undisputed amounts believed in good faith and on reasonable grounds by the non-defaulting party to be payable (whether at such time or in the future or upon the occurrence of a contingency) by the non-defaulting party to the defaulting party (whether under this charter party or otherwise), irrespective of the currency, place of payment or booking office of either party's obligations and the parties' respective obligations shall be discharged promptly and in all respects to the extent they are so set-off. The non-defaulting party will give 3(three) days prior notice to the defaulting party of any intended set-off to be effected under this provision. For this purpose, any such undisputed amount payable by one party to the other (or the relevant portion of such amount) may be converted by the non-defaulting party, acting in good faith and in a commercially reasonable manner, into such currency as may reasonably be required in order to effect such set-off at an exchange rate determined by the non-defaulting party acting in good faith and in a commercially reasonable manner. If an obligation is unascertained, the non-defaulting party may in good faith estimate that obligation and set off in respect of the estimate, subject to the relevant party accounting to the other when the obligation is ascertained."

Insolvency Protection

➤ BHP set-off clause (New version taken from BHP Voyage Contract 2010)

"60. Termination on Bankruptcy of Either Chartering Party

The following provision shall apply to this Contract only if there is not in force between the parties an effective netting agreement in respect of all outstanding Transactions (as defined in Appendix C) between them. The provision shall not apply to, or be incorporated into, any Bill of Lading.

(a) The parties to this Contract agree that if at any time a Bankruptcy Event (as defined in Appendix C) occurs in relation to either of them (the "Defaulting Party"), the other party (the "Non-Defaulting Party") may by not more than 20 days' notice to the Defaulting Party designate a close-out date in respect of all Transactions then outstanding between them on which the process set out in paragraph (b) shall occur (subject to paragraph (c) below)."

Insolvency Protection

➤ BHP set-off clause (New version taken from BHP Voyage Contract 2010) cont.

"(b) As of the close-out date (i) all performance obligations of the parties under outstanding Transactions shall terminate (ii) the Non-Defaulting Party shall promptly calculate its Loss (as defined in Appendix C) in respect of each Transaction (iii) the Losses so calculated shall be aggregated and netted to the greatest extent possible (and, in order to effect this, the Non-Defaulting Party may convert any such Losses at commercially reasonable rates into such currency as may be required) and (iv) the net resulting amount, if positive, shall be paid by the Defaulting Party to the Non-Defaulting Party within 3 days of the close-out date. If the net resulting amount is negative, no amount shall be due from or payable by either party to the other. Interest on the net resulting amount shall accrue at the rate of overnight LIBOR plus 3% if such amount is not paid when due.

(c) A close-out date (as described above) shall occur automatically as of the time immediately before the start of a Bankruptcy Event specified in paragraph (1), (3), (4), (5), (6) or, to the extent analogous, (8) of that definition.

(d) The parties to this Contract acknowledge and agree that the Transactions between them form a single agreement and have entered into the Transactions on this basis."

Insolvency Protection

➤ BHP set-off clause (New version taken from BHP Voyage Contract 2010) cont.

"61. Set-off

....

(2) Set-off

(a) Following a Default, either Party shall be entitled, at its option, to set-off any amounts due to the Set-off Party from the other Party (whether under this Contract or any other contract between the Parties, including Forward Freight Agreements), against any amounts due to the other Party from the Set-off Party (whether under this Contract or any other contract between the Parties, including Forward Freight Agreements), provided always that one of the amounts to be set off shall be due or claimed under this Contract.

(b) The right to set off exists irrespective of the currency, place of payment or booking office of either Party's obligations and the Parties' respective obligations shall be discharged promptly and in all respects to the extent they are so set-off.

➤ **BHP set-off clause (New version taken from BHP Voyage Contract 2010) cont.**

(c) The Set-off Party must, if they intend to exercise their option to set off, within 30 days of a Default, send a notice of set-off to the other party stating:

(i) The dates and details of the contracts under which the set-off is to take effect;

(ii) The amount to be set-off.

(iii) The basis on which amounts to be set-off are believed to be owed.

If a notice of set-off is not sent within 30 days of a Default, the right to set-off shall be lost in respect of that Default.

(d) For the purposes of this clause, any such amount due by one Party to the other (or the relevant portion of such amount) may be converted by the Set-off Party, acting in good faith and in a commercially reasonable manner, into such currency as may reasonably be required in order to effect such set-off at an exchange rate determined by the Set-off Party acting in good faith and in a commercially reasonable manner.

(e) The rights of the Parties under this provision shall apply without prejudice to the Bankruptcy clause (clause 60) or any other right of set-off which it may have whether by agreement, operation of law or otherwise.

(f) Nothing in this provision shall be effective to create a charge or other security interest."

Insolvency Protection

➤ Alternative set-off clause

"In the event that undisputed sums are owed under this Charter Party, the party to whom such sums are owed ("the non-defaulting party") may, provided that 3 working days' notice have been given to the other party ("the defaulting party"):

- 1. Exercise a possessory lien over the cargo or any other cargo carried on another vessel to which a Charter Party between the parties relates; or*
- 2. Arrest this or any other vessel and/or bunkers owned or chartered by the parties; or*
- 3. Deduct such outstanding sums from any other amounts owed by the non-defaulting party to the defaulting party under this Charter Party or any other Charter Party or forward freight agreement between the parties.*

It is clearly understood by both parties that if there is not more than one contract between the named parties in this Charter Party, then this set off clause does not apply."

Insolvency Protection

➤ Solvency clause

- "1. Both Owner and Charterer agree that if at any time during the charterparty a Bankruptcy Event occurs in relation to either of them (the "Defaulting Party") the other party ("the Non-Defaulting Party") may exercise the option to terminate the charterparty at any time by giving 5 calendar days' notice (the "Termination Notice") to the Defaulting Party. A Termination Notice shall be valid if sent by e-mail.
- 1.1 Following service of a Termination Notice the charterparty shall terminate on the given date (the "Termination Date"). As at the Termination Date all performance obligations of both the Defaulting and Non-Defaulting Party shall terminate.
- 1.2 Termination of the charterparty in accordance with this clause is without prejudice to and shall not affect any rights, accrued or otherwise, that either party may have against the other.
- 1.3 For the purposes of this clause a "Bankruptcy Event" shall have occurred if a party:
- (a) Institutes a proceeding seeking any relief or protection under any bankruptcy or insolvency law;
 - (b) Has instituted against it a petition for its winding up or liquidation and which is not dismissed or discharged within 30 days of the date of petition;
 - (c) Has an administrator, receiver or equivalent appointed over its assets;
 - (d) Enters into a scheme, arrangement or plan with or for the benefit of its creditors;
 - (e) Is subject to a reorganization under any bankruptcy or insolvency law; or
 - (f) Is subject to an event in any jurisdiction which has a similar effect to any of the events listed in (a)-(e) above."

Insolvency Protection

➤ Long form insolvency clause (automatic & semi-automatic termination)

Termination on Bankruptcy of Either Chartering Party

"The following provision shall apply to this Contract only if there is not in force between the parties an effective netting agreement in respect of all outstanding Transactions (as defined in Appendix C) between them. The provision shall not apply to, or be incorporated into, any Bill of Lading

*(a) The parties to this Contract agree that if at any time a Bankruptcy Event (as defined in Appendix C) occurs in relation to either of them (the "Defaulting Party"), the other party (the "Non-Defaulting Party") may by not more than 20 days' notice to the Defaulting Party **designate** a close-out date in respect of all Transactions then outstanding between them on which the process set out in paragraph (b) shall occur (subject to paragraph (c) below)**

(b) As of the close-out date (i) all performance obligations of the parties under outstanding Transactions shall terminate (ii) the Non-Defaulting Party shall promptly calculate its Loss (as defined in Appendix C) in respect of each Transaction (iii) the Losses so calculated shall be aggregated and netted to the greatest extent possible (and, in order to effect this, the Non-Defaulting Party may convert any such Losses at commercially reasonable rates into such currency as may be required) and (iv) the net resulting amount, if positive, shall be paid by the Defaulting Party to the Non-Defaulting Party within 3 days of the close-out date. If the net resulting amount is negative, no amount shall be due from or payable by either party to the other. Interest on the net resulting amount shall accrue at the rate of overnight LIBOR plus 3% if such amount is not paid when due

**Section 5(a)(vii) of the 1992 ISDA Master Agreement*

(2) Becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due; and (7) has a secured party take possession of all or substantially all its assets or has a distress, execution, attachment, sequestration or other legal process levied, enforced or sued on or against all or substantially all its assets and such secured party maintains possession, or any such process is not dismissed, discharges, stayed or restrained, in each case within 30 days thereafter.



Insolvency Protection

➤ Long form insolvency clause (automatic & semi-automatic termination)

Termination on Bankruptcy of Either Chartering Party (continued...)

(c) A close-out date (as described above) **shall occur automatically as of** the time immediately before the start of a Bankruptcy Event specified in paragraph (1), (3), (4), (5), (6) or, to the extent analogous, (8) of that definition.*

(d) The parties to this Contract acknowledge and agree that the Transactions between them form a single agreement and have entered into the Transactions on this basis."



Section 5(a)(vii) of the 1992 ISDA Master Agreement

* (1) – dissolved (other than pursuant to a consolidation, amalgamation or merger);

(3) – makes a general assignment, arrangement or composition with or for the benefit of its creditors;

(4) – institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding-up or liquidation.

(5) – has a resolution passed for its winding-up, official management or liquidation (other than pursuant to a consolidation, amalgamation or merger);

(6) – seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official ;

(8) Causes or is subject to any event with respect to it which has an analogous effect to any of the events specified in clauses (1) to (7)

Insolvency Protection



➤ Financials

If a party fails to pay a final arbitration award and/or judgement (within 15 days of receiving a demand) and/or breaks a material banking covenant and/or suffers a rating downgrade and/or is posted as a defaulter on the GAFTA web site, the other party shall have the right to demand the provision of a third party performance guarantee (the provider being a bank or other reasonably acceptable provider) which must be procured within 10 days of demand failing which the other party shall have the option to cancel the contract.



Derivatives

- Focus on relationship between physical breaches and paper losses:
 - ❖ Charterparty context
 - ❖ Sale contract context
- The latter is more promising.



Derivatives – link between physical breaches and paper losses

Glencore Energy UK Ltd v Transworld Oil Ltd [2010]

- Claim by Glencore Energy UK Ltd ('Glencore') against Transworld Oil Ltd ('Transworld') concerning a contract on FOB terms
- Glencore claimed the difference between the contract price and the value of the oil on the date when it ought to have been delivered
- The contract provided that: "BUYER TO DECLARE AT ITS OPTION ITS PREFERRED FIVE (5) DAY QUOTATION PERIOD WITHIN THIS WINDOW LATEST ONE (1) WORKING DAY PRIOR TO THE FIRST (1ST) DAY OF THE ADVISED PRICING PERIOD". The parties referred to this as the "pricing declaration"

Derivatives – link between physical breaches and paper losses

Glencore's arguments:

- the hedges were independent transactions entered into by Glencore prior to Transworld's repudiatory breach in order to cover its exposure to the price risk created by the discrepancy between its sale and its purchase contracts.
- the hedges, like an insurance policy, should be ignored. *A fortiori*, Transworld cannot take the benefit of Glencore's hedges when it has merely reduced its exposure to paper loss.

Transworld's arguments:

- Glencore's recoverable loss has to reflect the price at which it closed out its hedging.
- Glencore was bound to take proper steps to mitigate its loss. It did so by closing out the hedges, and thereby reduced its loss to USD8,665,496.00. To permit Glencore to recover USD11,112,626.00 by reference to the market price at the time of the delivery would be to give it a windfall of some USD2.4million.

Derivatives – link between physical breaches and paper losses

*"As Glencore puts it, correctly in my opinion, if on 26 June 2008 one wanted to buy a cargo of Brent, that is the price one would have to pay on that day, albeit with a future delivery date. **The swaps prices prevailing weeks previously are essentially predictive, and do not (in my view) provide a basis for valuing the oil at the time of non-delivery.** By then, the price may have gone up, or it may have gone down. I reject Transworld's case in this regard. It follows that, subject to mitigation, I accept that Glencore's claim is correctly calculated"*

*"The only act in mitigation, it is said, which was open to Glencore was the purchase of a substitute physical cargo and it is common ground that this was not possible. The hedges it is submitted are independent transactions entered into by Glencore prior to Transworld's repudiatory breach in order to cover its exposure to the price risk created by the discrepancy between its sale and its purchase contracts. They are res inter alios acta. **Transworld would not be entitled to the benefit of Glencore's hedges insofar as they lessened any loss arising out of Transworld's wrongdoing: if delayed delivery in a falling market meant a loss on the physical sale, Transworld would not be entitled to the benefit of Glencore's concomitant profit on its hedges.** The hedges, like an insurance policy, should be ignored. A fortiori, it is submitted, Transworld cannot take the benefit of Glencore's hedges when it has merely reduced its exposure to a paper loss"*

Derivatives – link between physical breaches and paper losses

*"However it appears to me that its argument on mitigation is inconsistent. In that context, it is submitted that the court has to ignore the hedging contracts ... It is, in my view, plain on the evidence in this case that, having accepted Transworld's breach as bringing the contract to an end, **Glencore not only did but was required to mitigate its loss by closing out its hedges.** To have allowed them to run on would have been to speculate in the movement of the price of oil, which Glencore has asserted is no part of its business for present purposes ... Hedging is on the evidence an integral part of the business by which Glencore entered into this contract for the purchase of oil, and since the closing out on early termination established a lower loss than would otherwise have been incurred, that has to be taken into account when determining recoverable loss. To put it another way, if the seller had duly performed the contract Glencore would have closed out its hedges at the then current prices, and there is no reason to put it in a better position in the case of non-performance"*

Derivatives – Hedging clauses too remote thus court unprepared to make link

"MSC Amsterdam" – Trafigura vs Mediterranean Shipping Co SA [2007]

- Cargo discharged by fraud
- Trafigura brought proceedings against the shipowner defendants claiming delivery of the cargo or damages for conversion (when their agents issued a delivery order in exchange for the fraudulent bill of lading). It claimed:

Damages based on the value of the goods at the date of trial

Damages in respect of hedging losses (Trafigura used hedging to limit the risks caused by fluctuations in the value of copper on the world market)

- Trafigura was never in a position to deliver the cargo to its purchaser, thus it had been obliged to keep its hedge position open, and had consequently incurred additional costs in the form of “rollover” costs



Derivatives – Hedging clauses too remote thus court unprepared to make link

Judgment of Lord Justice Lloyd:

- *"The judge held that hedging losses as such **were not foreseeable by the shipowners and were thus not recoverable**. The form of judgment given against the shipowners provides that, if the shipowners do not deliver the cargo, they are to be liable to pay the value of that cargo at the date of judgment. The judge considered that this was the figure which would most fairly compensate the cargo owners for their loss as a result of the shipowners' conversion of the goods. **He gave four reasons for so holding, and I agree with those reasons**"*

Query – Shipowners becoming more exposed to hedging instruments in modern trade. Future attitudes of courts regarding foreseeability of hedging losses for non-traders may not be so forgiving?



Derivatives - Enhancing the prospect of recovery of hedging losses

Recommendations to enhance recovery:

- Incorporate an express contractual term regulating recoverability of hedging losses (see below)
- In absence of clear contractual wording, use an express pre-contract representation stating that one or both parties propose to hedge physical exposure
- Maintain accurate internal systems that show a link between physical exposure and paper exposure



Derivatives - Enhancing the prospect of recovery of hedging losses

Hedging clauses

"The parties acknowledge that the Buyer's/Seller's business model involves frequent hedging of its trading position".

WARNING

Paper losses can enhance or reduce a claim for physical breach.



Questions

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