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Energy & Natural Resources

Client Alert: Commodities

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* The authors acknowledge the contributions of Daniel Nossa to this Client Alert.

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‘Force majeure’ clauses in commodity sale agreements – what should you be thinking about?

We have written previously about force majeure clauses in the context of market disruption events that have occurred or were anticipated (See previous alerts, 11-027, 11-007, 10-189 and 09-005, on force majeure). Lawyers spend a great deal of time analysing the impact of such events on their clients’ contractual arrangements. This article seeks to suggest some ways in which in-house legal and business teams might treat force majeure as a moving issue that merits regular evaluation of what a contract should say, in anticipation of the unanticipated. In particular, it seeks to identify some guidance points as to what a review of a force majeure regime should focus on, including factors relating to the parties themselves, the nature of the trade and the jurisdiction that will determine its application. We focus here on the laws commonly chosen to govern transactions made in three key trading centres namely London/Geneva, Singapore and Houston.

The importance of tailoring Some events are clearly easier to predict than others. Following the return of major flooding to Queensland’s coal transportation network in January this year – the second time in two years – those buying or selling coal from the eastern Australian ports will no doubt be thinking carefully about how their contracts react to such interruptions. The developing infrastructure in Indonesia and seasonal rains combine to make disruptions a regular and predictable event. Political tensions in West African countries make disruption to oil exports and “declarations” of force majeure at export terminals somewhat commonplace, whilst socio-economic factors in South America have led to restrictions on the flow of agricultural commodities that have become the norm over the past few years. When considering how these types of events impact business flows we recommend that clients consider some of the less-visible considerations.

1. The nature of the contract The form of a force majeure clause included in a contract for the sale of goods may often be based, at least in part, on template wording derived from the standard conditions of sale of one of the parties or an industry standard trading agreement. That wording may be intended to apply across a spectrum of transactions envisaged by those who prepared the templates at the time that the templates were drafted. Whilst a clause that is drafted in this way may be a good starting point, it should not obviate the need to think critically about the clause's application in the transaction at hand. In particular, we recommend that you consider the following:

The subject-matter of the transaction. For instance, whether it is a spot or long-term sale contract or a contract involving participation in internal market aspects of production or transportation. Where you are selling in a contractual chain, are the force majeure provisions consistently worded? Often, the wording may operate strongly in the seller's interest at the top of the chain but be considerably looser at the bottom, potentially leaving intermediate traders open to unexpected exposures. Conversely, a well-worded clause can put a party in a chain in a strong negotiating position should a pre-identified event occur.

The risk appetite of your business in relation to the particular transaction. For instance, is it a new business line or a business that is currently expanding or contracting? Unforeseen events and their consequences have the potential to dramatically affect both the profitability of a transaction and how operationally intensive it becomes, thereby influencing decisions about whether to invest in further transactions. The concept of force majeure has the potential to mitigate some of the consequences of these events, so attention should be increased where there is high sensitivity about a transaction.

The location(s) in which performance is to take place and the anticipated circumstances in those locations at the time that performance is expected. Is the location where performance is to take place associated with risks that are not currently provided for in the force majeure provision?

2. The party's role and identity A party's interest in negotiating the force majeure regime should vary depending on whether it is the buyer/seller under a sale contract; the producer or consumer of that commodity; and/or the party responsible for the transportation of the commodity. In addition, factors relating to the identity of the contractual counterparty or pool of potential counterparties are important and should bear upon the intentions of the force majeure clause. The following may be relevant questions to ask:

- Is one of the parties a government authority, or connected to a government authority? If so, should alterations be made to "government intervention" type events, which might give such parties some control over the occurrence of the event?
- Likewise, is one of the parties connected with, or does it have influence over, the relevant labour force, potentially affecting the operation of the clause regarding "strike" and "lockout" events?
- Is one of the parties susceptible to sudden changes in market conditions, such that it may be incentivised to "declare" force majeure where it stands to suffer a financial loss? Would an express exclusion of events constituting economic or financial circumstances be worth including in the clause?
- In a situation where a party has similar obligations under a series of contracts, would it be appropriate to provide for a discretion regarding the priority of performance of those contracts – sometimes referred to as a "most favoured nation" clause? As we will see below the courts have developed certain rules regarding whether and how a party may prioritise its deliveries.

3. Jurisdictional considerations Whilst the concept of force majeure is broadly understood across the world, its recognition and application by the courts differs significantly across jurisdictions. We identify below some jurisdiction-specific issues that should inform drafting and negotiation priorities.

English law. English courts will not imply a force majeure clause or particular events within it. It must therefore cover all of the potential sources of disruption. The use of the word "whatsoever" in a catch-all provision is more likely to convince the English courts not to restrict the application of the catch-all provision to the general nature of the specific events which precede it. Where the force majeure clause requires performance to be "prevented" then the party seeking to invoke force majeure must demonstrate that performance is physically or legally impossible. This is a very high burden to discharge compared to clauses that become operative where performance is "hindered," "delayed," "disrupted," "impaired," "impeded" or "interfered with." For instance, case law indicates that the burden may be satisfied in circumstances where a seller would, as a result of the event, still be able to perform its obligations under a contract, but to do so would result in the dislocation of that seller's entire business.

Singapore law. While the jurisprudence generally accords with the approach of English law to force majeure, recent judicial analysis gives some further guidance on determining the meaning of "disruption" to a seller's performance. The Singapore Court of Appeal found that a test of commercial practicability should be used, such that where it has become "commercially impracticable" for that party to perform, a disruption will have occurred. On the basis of that decision, a mere

increase in price of supplies of goods which would be used to supply the buyer is unlikely to cause commercial impracticability, but the inability of the seller to negotiate a price for those supplies may cause such impracticability. In relation to clauses that require events to be beyond the control of the party relying on the force majeure clause, the decision proposed a general principle that the party seeking to rely on the clause must take all reasonable steps to avoid relying on the clause, before doing so. These findings introduce significant differences in the application of force majeure clauses governed by Singapore law.

Texan law. Like in England and Singapore, the terms of the contract strictly determine what will constitute force majeure. If a contract does not include a force majeure clause, then the obligation to perform under the contract is absolute and a court will not imply one. Texan courts will not require impossibility of performance, or for an event to be outside a party's control, in order for there to be a valid force majeure event. So long as the contract specifically identifies an event as a force majeure event, it will be treated as such. Unlike under Singapore and English law, there is no implied duty to mitigate one's losses. Therefore, clauses should be drafted specifically to provide for that duty, where, for example an English law governed clause is to be used in a Texan law governed contract and equivalence of application is sought.

Conclusion Unforeseen events are not easy to predict or define. Force majeure clauses continue to be an active source of disputes, particularly in trade in emerging markets. Since force majeure is effectively a contractual exceptions mechanism, it will often be construed against the party seeking to rely on it. Identifying the potential sources of disruption and providing for the consequences, cognisant of the relevant law, can prevent exposures and lead to a quick resolution of a non-performance issue. Regular evaluation and re-evaluation of force majeure regimes is recommended

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The Eurozone and Commodity Contracts 2

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This *Alert* is the second in our series that considers the impact of the Eurozone crisis on the international commodities markets, and follows Alert no. 2012/169 titled, "The Eurozone and Commodity Contracts 1", dated 18 July 2012.

Since that Alert was published, the possibility of a **Eurozone Exit** or **Eurozone Break-up** continues to receive attention in news articles and trade commentary around the world.

This second Eurozone *Alert* will consider whether a Eurozone Exit or a Eurozone Break-up could bring a commodity sales contract to an end under the English law doctrine of "frustration". It also looks at whether these events could trigger "Force Majeure" and "Material Adverse Change" provisions in commodity sales contracts.

Frustration Under English law, it is generally accepted that a contract is frustrated when without default of either party, a contractual obligation, which is or becomes significant, becomes incapable of being performed because the circumstances in which the performance is called for renders it radically different from that envisaged by the parties at the time of contracting. Where a contact is frustrated, the law declares both parties to be discharged from further performance and brings the contract to an end immediately.

Generally, as a result of frustration, the parties are discharged from all future obligations and liability arising from the contract. These are not given a close-out value and the parties are free to 'walk away' without any compensation being paid for the loss of those future obligations (although buyers will be required to pay for any benefits received by way of part-performance, and sellers will be required to reimburse buyers for any pre-payment).

Parties are free to make sufficient provision in their agreements which would limit and narrow the scope of the doctrine, e.g. through "Force Majeure" provisions.

We consider below whether specific Eurozone-related circumstances may lead to a contract being frustrated.

Redenomination Redenomination of payment obligations itself is unlikely to render the contract impossible to perform. As a result, it is unlikely that redenomination would meet the conditions for frustration, even in circumstances where redenomination renders the contract more expensive to perform.

It is also unlikely that the depreciation in the value of the currency into which the obligation has been redenominated would be regarded as sufficient to frustrate a contract. It has been argued that the depreciation in value of the new national currency might disrupt the equivalence of performance on each side. The position may depend on the extent of the depreciation, but it generally appears to us that the better view is that such events should not be regarded as potentially frustrating risks, but as fundamental commercial risks to be borne by the parties.

Further, it is quite possible that UK or EU legislation would provide for: (a) contracts to continue to be valid and binding, and (b) the introduction of the new currency not to operate to frustrate contracts.

Payment in the contractual currency becomes illegal The English common law provides that: (a) if a contract is governed by English law, (b) if that contract is to be performed abroad, and (c) if performance becomes illegal under the law of the place of performance, then the contract will not be enforced in England.

As we noted in the first Alert, an exiting state may introduce exchange controls that make payment in euros illegal. Thus if payment is required to be made in the exiting state and performance in euros has been made illegal in the exiting state, performance of that agreement is likely to be frustrated.

Disappearance of EURIBOR or another euro-based reference rate Some commodity sales contracts provide for default interest to be calculated using an interest rate based on EURIBOR or other euro-based rates.

Where such a rate is no longer available, or is no longer relevant because of a redenomination of the underlying obligation, an English court is, in our view, unlikely to find that the relevant contract as a whole has been frustrated. A court might in these circumstances determine that a term is implied into the agreement to the effect that the original rate shall be replaced with the next most appropriate rate. Of course, the issue will then become one of identifying which is the most appropriate replacement rate source.

Force Majeure A “Force Majeure” clause will usually temporarily release a party that is fully or partly prevented from performing its obligations under one or more contracts for a period of time, and to the extent that such Force Majeure event prevents such performance. It may also allow the parties to terminate the contract if the Force Majeure continues, possibly with the terminated obligations being replaced by an obligation on the appropriate party to make a close-out payment

based on the replacement value of the terminated obligations.

Force Majeure is not a concept of English law, and therefore to apply under English law, the relevant commodity contract must expressly include a Force Majeure provision, as none will be implied by an English court. Parties will need to examine the precise wording of a Force Majeure clause to determine whether it would apply to a Eurozone Exit or Eurozone Break-up.

In order to claim Force Majeure, the scope of Force Majeure in the relevant contract would need to extend beyond the scope of physical performance to include events affecting performance of financial obligations. This is highly unusual in commodity sales contracts, although payment obligations are included within the scope of Force Majeure provisions in some standard contracts used in commodity trading, e.g. the 2002 ISDA Master Agreement. If contracts are being entered into in euros, careful thought should be given to extending the scope of the Force Majeure provisions in the contract to ensure that the parties are adequately protected.

Material Adverse Change In English contract law, there is no principle of “material adverse change”, and therefore to apply, the relevant commodity contract must expressly include a material adverse change provision (a “MAC” clause). Where a MAC clause is included in the relevant commodity contract, whether a Eurozone Exit or a Eurozone Break-up will constitute a material adverse change will depend on how broadly the term is defined. Where a MAC clause is triggered by a party, this will usually result in the other party having the right to demand additional collateral or performance assurance, or the right to terminate the contract.

MAC clauses may include specific, objective triggers such as the counterparty failing to maintain a specific credit rating. They may in addition, or alternatively, include more broadly drafted triggers, such as that the counterparty has, in the other party’s opinion, an “impaired ability to perform” its obligations.

A Eurozone Exit or a Eurozone Break-up is unlikely to be specifically included in the definition of “material adverse change” in a pre-existing contract. But these events are likely to cause the prospects of some counterparties to worsen. This might lead to ratings downgrades or other adverse events that trigger “objective” MAC clauses. It might trigger more subjective and broadly drafted MAC clauses as well.

Whether this would in fact happen will depend on the wording of the MAC clause and the impact a Eurozone Exit and Eurozone Break-up may have on the party in question. Once again, careful consideration should be given to the scope and extent of any MAC clause being negotiated between counterparties.

Risk Mitigation In addition to those measures listed in The Eurozone and

Commodity Contacts 1, the following steps can be taken to minimise the level of legal uncertainty following a Eurozone Exit or Eurozone Break-up:

- *Preclude the application of the doctrine of frustration* – Where an event, which would otherwise be a "frustrating" event, has already been fully dealt with by other provisions in the contract, e.g. illegality or Force Majeure provisions, the doctrine of frustration is less likely to be applied. This is because a court is likely to hold that the event had already been anticipated and provided for in the contract itself. Therefore, to reduce the risk of a contract being discharged on grounds of frustration, with no value being given to future obligations, parties to a contract could add appropriate illegality and/or Force Majeure provisions. It is important these provisions are "full and complete" and are adequate to cover the situation, as otherwise the doctrine of frustration will not be precluded.

- *Including a tailored MAC clause* – Where the contract does not contain a MAC clause, the parties to the contract should consider introducing such a clause.

- *Express exclusions* – Where the intention of the parties is that a contractual provision should not be invoked upon the occurrence of certain consequences of Eurozone events, these should be expressly excluded. For example, if parties to a contract wished to be absolutely certain that a Eurozone Exit would not be used to excuse non-payment or non-performance by claiming Force Majeure, the definition of Force Majeure should be amended to expressly state that this is the intention of the parties.

Conclusion Andrew Bailey, Director of UK Banks and Building Societies at the UK's Financial Services Authority, has been quoted as warning that: "*Good risk management means planning for unlikely but severe scenarios, and this means that we must not ignore the prospect of the disorderly departure of some countries from the Eurozone*".[1]

This statement is as applicable to commodity traders as it is to banks.

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1. http://www.fsa.gov.uk/library/communication/speeches.

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Floods in Australia: what legal implications for Commodity Traders?

Australia has endured one of the wettest spring seasons in its recorded history. Heavy rain in November and December in eastern Australia caused river levels to rise and flood plains to become saturated. This led to widespread localised flooding and to the severe floods reported by the global media over the New Year period.

The most severely affected area covers a wide swathe of the middle part of Queensland State. At least seven major rivers in the area are reported to have flooded. At the time of writing the water levels are still high; states of emergency are in effect across many local authorities in the affected area. Water levels are expected to recede in the coming days but not to return to normal levels for weeks to come.

Affected commodities

Beyond the damage to life, property and infrastructure, the severe rain has impacted Australia's important commodities exporting business. Wheat and sugar trades are amongst those affected. Damage to crops and inland transportation problems have lead to fewer stocks being available for export and a consequential rise in market prices. US Wheat futures were reported to be trading at a five-month high this week following concerns about damage to Australian (the world's fourth largest wheat exporter) crops. Australian sugar export forecasts for this year are reported to have been cut by 25%, exacerbating demand pressure and contributing to raw sugar prices reaching a 30 year high. Conversely, dry bulk freight prices have been forced down by the reduction in cargoes available for seaborne carriage. The Baltic Exchange's dry bulk freight index reached a 20 month low this week.

The most seriously affected trade is coal. Coal is Australia's biggest export business, accounting for approximately a quarter of Australia's total goods and services exports over recent years. Australia is the largest exporter of coal in the world, exporting 28% of the world total in 2008–2009, with exporting capacity increasing since then.

Australia produces both thermal coal (used in the power generating industry) and metallurgical "coking" coal (used in the production of steel). All of Australia's

export output of both types of coal is mined in Queensland and New South Wales in eastern Australia, with Queensland producing the greater quantity. The majority of Queensland's coal is coking coal. Its coking coal exports account for approximately two thirds of world trade. The vast majority of Australian coal imported into China, India and Europe is coking coal. Significant quantities are also exported to Japan, Korea and Taiwan.

With demand still strong in China and India in particular and disruptions prevalent elsewhere in the major producing areas (Columbia – heavy rains; Russia – severe drought and now severe cold) analysts are busy speculating on the effect the disruptions to the world's coking coal supply will have on prices of coal and steel, which relies on coking coal availability. Prices of both types of coal have already risen to recent highs and many predict further increases into 2011.

Our concern in this article is with the legal implications of the supply disruptions for trading contracts. An English law application is assumed but many of the legal principles will be similar under Australian law governed contracts.

Force Majeure?

The flooding has affected coal exports in three ways: (1) disruption to production due to flooding at producing mines; (2) disruption to the transportation of coal from mines to export terminals; (3) disruption to loading operations at export terminals.

It has been widely reported that many of the major coal producers operating in the area have "declared force majeure" in order to protect themselves from defaulting on contractual obligations to supply coal from mines affected by the flooding. The mine operators reported to have done so include BHP Billiton, Rio Tinto, Anglo American, Xstrata, Peabody Energy, Macarthur Coal, Aquila Resources – Vale, Cockatoo Coal and Wesfarmers. In total the mines affected are estimated to produce over a third of Australia's annual production of coal.

Coal is transported from the mines primarily by rail. The rail network is among the busiest for freight traffic in the world with trains of between 1 and 2 kilometres in length carrying 8,000–10,000 tonnes of coal operating 24 hours a day. The main rail operator in the area, QR National has been forced to close parts of three of the four major coal transport lines in the area (Blackwater, Moura, Goonyella) due to the floods. Those closures have restricted or stopped completely the supply of coal to export terminals.

Four export terminals are reported to have been affected: Abbot Point, Dalrymple Bay, Hay Point and RG Tanna (Gladstone). At the time of writing supplies of thermal coal to the major thermal coal export terminal at Newcastle in New South Wales do not appear to have been severely affected. At the affected terminals shortages of coal have been reported due to the lack of stock arriving on the rail system and stockpiles being depleted. RG Tanna terminal announced that it would operate at 50% capacity last week. As at the time of writing, the terminal is reporting that coal stocks are "extremely low" with no more coal expected on the Moura rail system until the end of next week. 18 vessels are waiting at the port with a further 12 expected over the next week. Dalrymple Bay is said to have been

operating at 60–70% of capacity since 1 January, with stocks due to run out this weekend. Of those stocks that are available for export issues may arise in relation to the condition and specification of the "wet" coal.

Who can rely on force majeure?

Force Majeure is a concept of French law. It is similar to the English law doctrine of frustration of contract (events arising subsequent to the execution of the contract that, without fault of either party, render performance of the contract impossible or radically different from that which was envisaged). Force Majeure is relevant to English law contracts only insofar as the concept of an agreed and permitted excuse for failure to perform is written into such contracts. English law commodity trading contracts invariably do so and adopt the term "force majeure" to refer to the permitted excuses.

No party will have a right to rely on "force majeure" to excuse his performance of any contractual obligation unless: (1) there is a clause in the contract that clearly covers the situation that has in fact occurred or there is wording that excuses performance where any other unspecified events outside that party's control occur; (2) there is a causative link between the events that have occurred and the party's inability to perform its obligations; and (3) the procedure specified in the clause is followed. If all three requirements are satisfied then the party claiming force majeure is entitled only to do what the clause permits. Often clauses permit suspension of obligations for a period of time but they differ about if and when a party is entitled to cancel the contract or whether performance must be made once the FM ceases.

Regarding point (1), clauses frequently refer to "floods" but that may not be enough on its own. For example, mine production may not be directly affected by flood water but may be halted because of lack of transportation available due to the closure of rail systems following the floods. Regarding point (2) some clauses require that the FM events must have "prevented" a party from performing its obligations. Others state that it is enough for the events to "hinder" performance for a party to be excused. Often it is difficult to prove that a particular event has prevented a party from performing because it may be able to perform by means other than those anticipated at the time of contracting. Regarding point (3), where both points (1) and (2) are satisfied a party will then need to ensure that it complies with the procedural requirements of the clause regarding, for example, giving notice of the force majeure event to contractual counterparties. Consistent with the law's approach of holding parties to their contracts, a party may be prevented from relying on a force majeure clause unless it has complied with the requirements of the force majeure clause strictly. For more detail on what a force majeure clause should say and how to comply with it in a "force majeure" situation, see our previous alert number 06-045.

Those companies who have contracts with one of the coal producers that has declared force majeure should review their contracts and consider whether the relevant producer is actually excused from performance or not – either because the events do not fall within the clause or because the party invoking force majeure has not complied with the procedural requirements of the clause. A general force majeure declaration is of no legal significance unless it triggers the operation of a specific clause in a contract.

It is to be expected that traders that have bought coal from one of the producers that have declared force majeure for onward sale will seek to pass on that

declaration to their customers and rely on it. Whether they are entitled to do so and thereby avoid their obligation to deliver to their buyer will, again, depend on the precise wording of the FM clause in their contracts. Where the coal to be delivered is stated to be coal produced from specific mines affected by the floods then sellers may have good grounds for arguing that they are prevented from delivering the coal. Where no origin of the coal is specified then sellers will be in a more difficult position, since the law regards their intended source of supply as irrelevant when assessing whether they are able to deliver coal to a buyer. If coal is available elsewhere (albeit at a much higher price) then a seller may be obliged to buy coal from that alternative source or risk being held in default and liable to pay the difference between the contract price and the relevant market price plus any additional freight costs incurred by a buyer. By way of example, the SCoTA contract incorporates this principle at clause 17.8, which states expressly that a failure by the seller's supplier to deliver coal will not constitute a force majeure event.

Where under contracts for the sale of commodities FOB at one of the affected export terminals sellers are unable to deliver within agreed loading windows because of reduced operations at the port or a lack of coal available because of rail disruptions, there are stronger grounds for a seller relying on usual force majeure language. If a seller is unable to buy coal already available at the port or already shipped by another party within the loading window save at an exorbitant price then it may well have grounds for arguing that it has been prevented from delivering coal by the consequences of the floods. The point to remember is that (unless permitted to do so by the relevant contract) a seller cannot safely sit back and expect that he will be excused by the restricted flow of coal to and from the port arising because of the floods. The prudent seller will do all that he can to try to source a cargo to perform the contract or risk being held in default.

Parties that have chartered vessels to load coal from one of the affected coal terminals may find themselves facing large demurrage liabilities or cancellations of vessels that do not load their cargoes within agreed laycans. It is less usual for charterparties to include force majeure clauses, though some of the less commonly used forms do. The Gencon form for example provides no means for a charterer to avoid obligations because of disruptions of the like experienced in Australia at present. The COAL-OREVOY form, in contrast, does include a force majeure clause. Of course a clause may be agreed as part of the additional terms that invariably supplement the standard Gencon form. The major suppliers tend to operate on their own standard terms and shipments under a COA may be governed by more apposite wording. As ever, it has to be borne in mind that a force majeure clause will not apply to interrupt the running of laytime or demurrage unless it specifically so provides. In relation to time charterparties charterers should consider whether "Exceptions" clauses provide them with a means of avoiding hire payments but often they will not.

Conclusion

The severe flooding in eastern Australia will have a major impact on individuals, businesses and the Australian state for weeks to come. It is to be hoped that the rain will subside and the water levels will dissipate quickly. Given Queensland is

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Russian grain export ban: keep cool in the heat

After mounting speculation during the last few days, Russia, the world's third largest wheatexporter, announced on 5 August 2010 a ban on grain exports for the next four-and-a-halfmonths. This client alert summarises the likely impact on trade, plus gives some advice toparties on what to do next.

Cause and Effect As highlighted in press reports, Russia has experienced record drought this year which has destroyed millions of hectares of its crops and caused wildfires across the country. As a result, Russia has cut its 2010 grain harvest forecast to 70-75 million tonnes, compared to 97 million tonnes in 2009, and has therefore implemented a temporary export ban in efforts to keep domestic grain prices low and preserve cattle stocks.

This move by Russia, in addition to its request to fellow members of a regional customs union – Belarus and Kazakhstan – to do the same, has caused global wheat prices to spike to two-year highs. The UN's Food and Agriculture Organisation cut its 2010 global wheat forecast by about 4% and this has reignited fears that governments will begin hoarding their own supplies of grains at a time when memories of world-wide food riots in 2008 are still fresh.

Legal Implications Resolution No. 599 "On the implementation of a temporary ban for export of some agricultural products from the territory of Russian Federation" dated 5 August 2010 imposes a temporary ban on wheat and meslin, barley, rye, maize, wheat flour or wheat-rye flour (the "banned goods") from the Russian Federation from August 15 2010 until December 31 2010. An official notification has also been released stating no further railway wagons bound for ports of shipment may be loaded with goods which are the subject of the export ban.

Although we are not yet aware of the specific terms of the ban, these restrictions do apply to contracts already entered into and are expected to cause many difficulties for sale contracts specifying the banned goods.

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There are no apparent "savings" for existing contracts, vessels already queuing, vessels which may have started loading when the ban comes into force or for goods already stored in ports when the ban was announced.

Prohibition clauses A prohibition (force majeure) clause seeks to excuse non-performance in certain specified circumstances. If a seller cannot bring himself within the clause or uses the clause incorrectly (e.g. no notice is given in time; cancellation is made too early; insufficient efforts to overcome the problem, if some licenses are given for exports), the seller is likely to pay significant damages for non-performance. A prohibition clause is therefore like a "Get Out Of Jail Free" in the monopoly game but needs to be carefully and exactly used to be effective.

GAFTA contracts (which will be incorporated in many of the affected contracts) incorporate a prohibition clause providing for automatic cancellation in the case of prohibition of export as a result of any legislative act done by the government of the country of origin of the goods, which prevents performance of the contract. The wording of the prohibition clause is 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 or of the territory where the port or ports of shipment named herein is/are situate, 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 any unfulfilled portion thereof shall be cancelled. Sellers shall advise Buyers without delay with the reasons therefore and, if required, Sellers must produce proof to justify the cancellation".

However, we have learnt from experience that bans such as the Russian export ban are fast moving and ever-changing and it is difficult to predict when or if the terms of the ban will be altered. Similarly each contract is different; what origins are permissible, what is the exact shipment period and so on. For this reason we would advise buyers and sellers that no cancellations of existing contracts should be made until after the last day for shipment has passed – a "wait and see" approach.

In the meantime sellers of the banned goods should take the following steps in order to protect their sale contract position:

- Make an effort to inform buyers about the ban and consequent difficulties
- Continue to keep buyers informed of all developments relating to the ban before and during the shipment period
- Expressly reserve the right to rely on the prohibition clause incorporated into the contract under GAFTA, should performance be prevented.

Once the last day for shipment has passed, as is required by GAFTA, sellers should advise buyers "without delay" the reasons for the reliance on the prohibition clause. The cancellation is automatic and does not need to be claimed or declared. Sellers may also be required to produce proof to justify the cancellation.

For buyers, in general, they need to react to information/messages from their sellers, where necessary. In case of "information" they can simply reserve their position. Early "cancellation" messages maybe a repudiation of the contract by their sellers so buyers should then take legal advice. The tricky areas are:

- FOB contract: Do you as a buyer need to nominate and send a vessel? Clearly this is a waste of money if the ban continues but buyers need to take care that they do not find themselves in default for failing to perform;
- Multiple Origin Contract: Can you as a buyer insist on the seller providing goods from a non-banned origin? Clearly there is a possibility for a seller to successfully rely on GAFTA prohibition clause but much would depend of the exact terms of the sale contract.

Compensation from Russia? Companies with investments in Russia that are adversely affected by the ban, and who are based in a country that has entered a Bilateral Investment Treaty ("BIT") with the Russian Federation, might be entitled to claim compensation directly from Russia under the terms of the relevant Treaty. BITs contain promises to protect foreign investors from "expropriation" (when a business right or asset is taken away by a state without fair compensation), from unfair or discriminatory treatment by the state, from government interference in their business operations, as well guaranteeing other protections. Foreign investors from the other country that is a party to the BIT are in most cases entitled to claim compensation by bringing arbitration proceedings directly against the breaching state.

Countries with which Russia has BITs include (amongst others) Belgium, Canada, France, Italy, The Netherlands, Switzerland, the United Kingdom and the United States of America.

Conclusion The exact terms of the Russian ban and how it will work in practice and whether there are any "loopholes" is not yet available but we will update this client alert when they are issued. In the meantime it is important to review all open contracts likely to be affected by the ban and carefully follow contract prohibition or force majeure clauses rather than rush to cancel immediately.

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When Russian gas is turned off - do you have any recourse?

The news channels are currently awash with coverage of the Russia/Ukraine gas supply dispute. Tempting though it may be to comment on the broader politico-economic issues both behind and consequential on the dispute, we will restrict this article to two main legal issues that those adversely affected by the dispute may need to address:

1. the effect of gas supply cuts on contracts incorporating EFET General Agreement Terms (the “Terms”) for gas supply; in particular the potential for sellers to avoid the obligation to deliver the gas by invoking the force majeure clause of the Terms, and/or the English doctrine of frustration; and

2. possible rights to arbitrate offered by the Energy Charter Treaty.

Force Majeure The force majeure (FM) clause in the Terms contains nothing unexpected: it allows for the release of a seller from his obligation to deliver gas when it is impossible for him to do so due to an occurrence beyond his reasonable control and which he could not reasonably have avoided or overcome.

Does a cut in supplies caused by the Russia/Ukraine gas supply dispute fall within this provision?

The FM clause specifically excludes “curtailment or interruption of transportation rights or any problem occurrence or event affecting any relevant pipeline system unless it constitutes a Transportation Failure”. Although the distinction is a fine one, this provision is not clear as to whether “curtailment” refers to transportation *rights* only or whether it means *interruption of supply* generally. In a telephone conference called by EFET to discuss this recent crisis, the majority of participants expressed themselves to be in favour of the first interpretation – i.e. that only the curtailment of *rights* is excluded by the FM clause – which in turn means that affected parties can rely on the FM clause in this situation.

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Assuming that the circumstances arising from the dispute do fall within the FM clause, in order for the clause to bite, it must be the **delivery** of the gas which must be **impossible**. If the contract is silent as to the origin of the gas - as usually is the case under EFET - although it may be impossible at present to deliver gas from Russia through the Ukraine as anticipated, it may at least in principle be possible for the supplier to source gas from other regions. Nor does it help that the EFET contract would usually provide for delivery into a given transmission system without specifying an entry point. That could make it possible to perform the contract by making delivery at any entry point of the relevant grid.

The fulfilment of the impossibility requirement under the FM clause is therefore contingent upon the inclusion, as implied conditions of the contract, of the specific delivery terms the parties had in mind. The fact that, under the present circumstances, Siberian gas transported through Ukraine and Slovakia to Europe was the only product that could reasonably be bought and sold at the agreed contract price would be a strong but not conclusive argument.

English Doctrine of Frustration If an FM claim looks as though it must be ruled out, is there a solution to be found anywhere else? A potential answer may be found in the form of the English doctrine of **frustration of purpose**. Frustration can arise where a contractual obligation has become incapable of being performed because the circumstances in which the performance is called for would render it radically different from that which was anticipated by the contract.

As noted in relation to FM above, theoretically it would be possible to source or supply gas from somewhere other than Russia via the Ukraine. In practice, doing so could amount to be such a radical change to the performance of the contract that it could be considered to be frustrated.

Frustration only applies where the situation has not been addressed elsewhere in the contract. Although the presence of the FM clause in itself does not necessarily exclude frustration from applying, where the circumstances leading to the claim for frustration are expressly covered bythe FM clause, it is clear that the parties have contemplated the situation, and frustration will not override the intentions of the parties.

If, however, the interruption of supply falls outside the scope of the FM, it can be argued that frustration may be invoked by the party due to receive the Russian gas under the EFET contract.

One final problem with the application of frustration to these events, is that depending on when the contact was agreed, it could be difficult to prove that the parties did not anticipate these kind of events in light of the fact that the Russia/Ukraine dispute has been ongoing since supplies were first cut in 2006.

It seems then that while frustration may be a runner, it faces some high fences.

Importantly for the present situation, frustration terminates a contract. If therefore a party seeks to claim frustration, it has also to accept that that the contract has gone forever. We suspect that, in most cases, this will not be the outcome that a supplier would want.

The Energy Charter Treaty Gazprom's deputy chief executive Alexander Medvedev in an interview with *The Times* last week called for the creation of a "new international institution" to arbitrate in similar disputes stating that "*what we are missing is an international instrument that could prevent or help resolve such disputes*". Mr Medvedev also said that Russia had proposed such an idea at a meeting of G8 leaders in St Petersburg in 2006 but that the idea had not progressed any further. It is open to speculation as to the motive for this statement in view of the fact that Russia is a member of the Energy Charter Treaty (the "Treaty") (albeit, it has not ratified the Treaty, on which issue, more below). This is a Treaty which specifically covers the kind of dispute that Russia is having with the Ukraine. Perhaps he forgot about it because it prohibits its members from cutting supplies across member borders as a means of forcing the issues in a dispute between those members (Article 7).

While the Treaty offers both Russia and the Ukraine a dispute resolution mechanism, this is of little or no comfort to those affected by the current symptoms of their dispute. But the Treaty offers a whole lot more…

The Treaty provides a framework for international energy co-operation and, among other things, for the Transit of energy without the imposition of any unreasonable delays or restrictions or charges ("Transit" is defined as being the carriage through one Contracting Party of energy products originating from another Contracting Party whether destined for that Contracting Party or a Third Contracting Party) – Article 7.

If, as it appears, both Russia and the Ukraine have breached the Transit provisions, "Investors" affected by the breach, (including companies/organisations registered in a Contracting Party supplying gas under a contract for remuneration) may be able to bring an action in the ICSID, UNCITRAL or Arbitration Institution of the Stockholm Chamber of Commerce against Russia and/or the Ukraine, to recover damages resulting from the breach.

However both the referral of an arbitration and the arbitration itself can be lengthy processes. Before the dispute can even be referred to arbitration, a request for amicable settlement must be made and only if this is not achieved within 3 months can the dispute be referred to the Secretariat of the Charter. Once referred, the arbitration itself can take a long time - for instance, some of the current Treaty cases that are at a preliminary stage, were registered in 2005.

The Ukraine has signed and ratified the Treaty and so is subject to all of its provisions. Russia, in contrast, has not ratified the Treaty. This means that in the current cases against Russia, all of them are bogged down in dealing with

the initial and complex question of whether Russia can be subject to a Treaty-based arbitration because it has not ratified the Treaty. It may therefore be the case that Russia is not threatened by the potential of such arbitration claims. It is, however, encouraging to note that it was held in a similar case against Georgia that the whole of the Treaty must be applied as if formally in force, including the arbitration provisions, despite Georgia not having ratified the Treaty.

We have been championing the Treaty for some time now and we maintain that it has a great deal more to offer than many either recognise, or choose to remember.

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Frustration!

Last week the new Registrar of the LCIA came to talk to us. We knew that the volume of disputes we were handling had increased this year, but we were surprised when he told us that, this year so far, the LCIA has received twice the amount of references that it had for the same period last year. He said that this trend seemed to be most noticeable in the energy and other commodity sectors.

There is no doubt that the current buoyancy/volatility in these areas has led and is likely to lead to parties trying ever more inventive methods of enhancing their existing positions. Some have sought refuge in some of the less-used legal doctrines and have tried to see whether, or if they can bend a prevailing scenario into a certain doctrine to their benefit.

A recent case demonstrates this point. It concerned the legal doctrine of frustration and an attempt by a party to use it to be extricated from an unfavourable contractual position.

Most will have an idea of what the frustration is, and many will know that it is generally only available in exceptional circumstances.

Under English law it is generally accepted that frustration occurs when, without the default of either party a contractual obligation has become incapable of being performed because the circumstances in which the performance is called for would render it radically different from that which was undertaken by the contract[1]. To put it another way, the doctrine of frustration applies when unpredictable events take place after the date the contract was formed that make performance of it legally or physically impossible or highly impracticable. However, not every event which prevents the performance of a contract will constitute frustration. The new event must be fundamentally different from one originally contemplated by the parties. If the contract is wide enough to apply to the new situation, then it cannot be an event giving rise to frustration.

The doctrine of frustration can easily be confused with the similar doctrine of impossibility. The main difference between the two is that the latter relates to the particular duties (terms) specified in the contract while frustration concerns the

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purpose and reasons why a party entered into the agreement.

The Emergence of Frustration

Frustration evolved at the beginning of the 20th Century. This was due to the combination of serious political disturbances (i.e. World Wars), great economic crises (inflation, strikes, and devaluations) and also the significant increase in the number of international trade transactions.

There is no uniform international approach to the use of the doctrine and that is why each case has to be considered carefully in light of the national laws under which the contract was made. The approach of national laws varies from the English test of fundamental difference in performance, through to commercial impracticability in the US, good faith in Germany and force majeure in France. Furthermore, each situation has to be examined on its own facts having in mind matters such as the kind of commodity, the type of the contract (e.g. FOB or CIF) and the bargaining position of the parties.

CIT v Transclear

The recent Court of Appeal decision in CIT v Transclear confirmed that the application of the doctrine does not provide an easy way out of contractual obligations.

The case concerned the FOB sale of cement. Both parties knew that the goods would not be shipped by the Sellers themselves, but by a supplier in Padang with whom the Sellers had entered into a non-binding arrangement for the supply of the cement. The Buyers were buying the cargo to distribute in Mexico, in breach of a cartel operated by a local company, Cemex.

Cemex exerted pressure on the suppliers in Padang to withdraw their offer of the cargo. When the Sellers entered into a similar arrangement with suppliers in Taiwan, Cemex exerted the same pressure, with the result that those suppliers also withdrew their offer.

The Seller contended that because of the unforseeable actions of Cemex it was impossible to provide the goods to the Buyer in this geographical region and that, therefore, the contract was frustrated.

The issue:

The Court couched the issue for it to determine as follows: ‘it is important… to recognise that the root cause of the seller's inability to deliver the goods they had contracted to sell was the abuse by Cemex of its commercial position combined with the willingness of suppliers to acquiesce in its demands. The primary question in this case is whether such conduct was sufficient to frustrate the contract.’

It went on to decide that the contract was not frustrated. The decision emphasised that the Sellers' inability to deliver is not sufficient to frustrate a

contract of this kind. At the same time the pressure of Cemex could not be treated as a supervening event which made the performance of obligations impossible or fundamentally different in nature, mainly because the character of the performance remained the same. They also determined that the cargo was not physically unavailable for shipment or that shipment would have been unlawful: It was the Padang supplier's own choice not to make the cement available, which they were free to exercise as they had no legal obligation to the Seller.

This case reconfirmed that, in the absence of some exceptional and supervening event, a contract will not be frustrated by the failure on the part of the ultimate supplier to make the goods available for delivery. What is needed is:

- a supervening event,
- not contemplated by the contract,
- which renders performance impossible or fundamentally different from what was originally envisaged.

In this case there was no finding that the cargo was physically unavailable for shipment, or that shipment from either Padang or Taiwan was unlawful. The supplier chose not to make the cement available for shipment and the Sellers bore that risk.

The fact that the case went to the Court of Appeal reflects that the Sellers had what you might call a near miss. It was not the sort of hopeless non-starter that got thrown out at the first stage. However, it also appears that the Court reached the correct decision and that a decision the other way might have opened the frustration floodgates.

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IMPACT OF UNFORESEEN EVENTS ON CONTRACTS: Part 2 – "Prohibitions" and government restrictions

This is the second of two Client Alerts considering the impact on international sales of unforeseen events. Our first Client Alert (dated 7 April 2008) considered some of the contractual issues which may arise out of the strikes by the agricultural sector workers in Argentina. This Client Alert focuses on government intervention, which in the current period of strong demand and shortages in supply is becoming widespread. The problem of shortages in supply has been widely publicised by the global media, the reports of which suggest that export restrictions, prohibitions and controls have been implemented in many of the world's major producing countries. The aim of this Client Alert is to examine the implications that such governmental measures may have upon forward and/or long term contractual agreements for the supply of commodities.

The effect on consumers and contracts

Argentina is not the only country to be affected by the current crisis. In early April the Financial Times reported on the measures introduced by the Egyptian government, which included a six-month ban on rice exports (effective from the start of April 2008), the removal of customs tariffs on food items and increased food subsidies. Most recently, the threat of government export taxes made the front page in Brazil.

The combination of poor harvests, increased production costs, use of products in biofuels and an acute increase in demand for agricultural commodities can be seen most spectacularly in the rice market, with prices hitting the $1000-a-tonne level for the first time. The severity of the situation for Asia is revealed in the comments of the Sri Lankan Central Bank Governor, quoted as saying that the rise in food prices was "definitely" a bigger problem for Asia than the ongoing credit crunch. Closer to home it has also been reported that some of the famous London 'Brick Lane' curry houses have been forced to close because of the increasing price of rice!

It has also been reported that restrictions have or are being imposed in Kazakhstan, Ukraine, Russia, Indonesia, India, Vietnam, Cambodia, China and Senegal.

The law on "prohibition" type clauses

The starting point is that contracts are made to be performed and obligations

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cannot lightly be avoided. The effect of government export restrictions on pre-existing contractual commitments (e.g. under FOB or CIF/CFR/C&F contracts) depends, largely, upon the existence and wording of the specific provisions covering such events. Such clauses have many names: Hardship, Material Change, Change of Law, Change of Circumstance, Prohibition or Force Majeure; and often these clauses overlap. The aim of all such clauses is generally the same, to enable one party (usually the Seller) to avoid liability for non-performance. How the clauses achieve the result can be very different – renegotiation, extension, cancellation or price increase.

The first important point is that without such a specific clause, under English law, a party will be liable for non-performance in almost all cases unless the legal doctrine of "frustration" applies. However, this doctrine only applies in very restricted circumstances, hence the practice of inserting express contract clauses. The exact wording of the clause in the contract is key. The usual structure is:

- What does a party have to show? "Prevention" of performance, only a "hindering" or "delay", or that performance is now "excessively onerous".
- Does the event have to be shown to be outside the parties' control and/or that it cannot be overcome by reasonable means?
- What notices are required and when?
- What is the effect? Cancellation or extension or re-negotiation? At whose option? How long does the "prohibition" have to last?

It is interesting to note that in relation to quasi-state bodies and the question of whether they can rely on their own government's actions, case law has established that an independent state trading organisation may be able to demonstrate that it has been prevented from delivering by "government intervention beyond its control" even where an export embargo is imposed by its own, closely linked, government. This will depend on the facts and precise nature of the relationship between the government and entity. If it can be shown that the entity has a separate legal personality and in practice makes its own decisions then it should be able to rely on the relevant clause of the contract.

Evidence of a "prohibition" event

Gathering evidence and documenting any claim is vital. It may be easier to prove the existence of a government export restriction if the restriction is well publicised by the world's media or documented by official government papers/statements. However, commercial arbitrators usually want to see evidence of the real situation rather than simply a government piece of paper. Proving the export restriction is legitimately imposed and followed through by the correct authority could be harder than it first sounds. The timing and extent of restrictions when compared to the contract shipment period is also vital. Often the announcement of a restriction and the de facto implementation are two very different things. There are often periods of confusion and uncertainty before and after government announcements or a time lag before the exact nature and extent of the restriction are clarified. If an embargo is not absolute, but subject to certain exceptions Sellers may be obliged to show that there are no goods of the contract description available within the "loopholes" to which the embargo is subject. Therefore recording all communications and efforts to perform made by the Seller from day one is crucial.

Generally standard form/trade association contracts used to trade agricultural

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commodities contain such a "prohibition" or alternatively named clause, which applies to govern the rights and obligations when government export restrictions are imposed. For example, the London Rice Broker's Association standard terms contain a "Force Majeure" clause which covers "Prohibition by Export". In comparison the GAFTA and FOSFA contracts have both specific "Prohibition" and "Force Majeure" clauses.

The GAFTA prohibition clause

In contracts governed by the GAFTA forms (e.g. GAFTA 27, 30, 38, 39 for FOB sales and GAFTA 100,101 for CIF sales), the prohibition clause (clause 16 in GAFTA FOB contracts and clause 18 in GAFTA CIF contracts) provides as follows:

"PROHIBITION - 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 or of the territory where the port or ports of shipment named herein is/are situate, restricting export, whether partially or otherwise, any such restrictions 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 any unfulfilled portion thereof shall be cancelled. Sellers shall advise Buyers without delay with the reasons therefor and, if required, Sellers must produce proof to justify the cancellation."

Analysis of the GAFTA wording

The first point of note is that the GAFTA prohibition clause is more wide reaching than may be expected. It covers "any executive or legislative act done by or on behalf of government" (i.e. potentially stretching to acts of administrative bodies) as well as "blockades or hostilities," potentially covering situations such as the riots reported to have taken place in Haiti, Bangladesh and the Ivory Coast as a result of the increasing price of rice. In this regard there is also the possibility of overlap with the force majeure clause making careful consideration of the particular facts and contractual wording important. This clause is a "prevented" clause, which makes it a difficult clause to operate and bring oneself within.

Unlike the GAFTA force majeure clause, the GAFTA prohibition clause does not contain the same complex notice provisions. The Seller is simply obliged to "advise Buyers without delay", although this leads to the question of how soon is "without delay"? Should Sellers notify Buyers as soon as they know an export restriction is being imposed and is reported by the media, or should they wait and see if the restriction is fully implemented? In general, the answer is to inform and notify as early as possible, then wait and see how the situation develops, but taking care to keep the contract open for the whole of the shipment period. Cancelling the contract too soon could leave you in repudiatory breach and subject to a damages claim. The cancellation under the clause is not an option or to be triggered by either party, but automatic at the end of the 30 day period: "shall be cancelled," not "may".

It should also be noted that the Seller only has to produce proof if required by the Buyer, but one would expect all Buyers to require such proof. Therefore, as discussed earlier, evidence gathering is important.

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The FOSFA prohibition clause

The FOSFA prohibition clauses, while similar in some respects to the wording of the GAFTA clause, contain a different timing mechanism in respect of cancellation of the contracts, because the clause first extends, then cancels, the contract. Within the FOSFA contracts, the prohibition clause applicable under FOB contracts (such as FOSFA 4 and 51 – clause 26/25) also differs from that of the CIF contracts (i.e. FOSFA 5 and 11 – clause 24).

The wording of the prohibition clause in FOSFA contracts is as follows. The words underlined show the FOSFA CIF wording, while the words in bold and square brackets show the alternative wording under the FOSFA FOB contract:

PROHIBITION: In the event, during the contract shipment [delivery] period, of prohibition of export or any other executive or legislative act by or on behalf of the Government of the country of origin or of the territory where the port/s of shipment [delivery] named herein is/are situate, or of blockade or hostilities, restricting export, whether partially or otherwise, any such restrictions 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 [delivery] or by any other means whatsoever and to that extent this contract or any unfulfilled portion thereof shall be extended by 30 days. In the event of shipment during the extended period still proving impossible by reason of any of the causes in this clause [21 days beyond the termination of the prohibition event. But should prohibition continue for 30 days], the contract or any unfulfilled part thereof shall be cancelled. Sellers invoking this clause shall advise Buyers with due despatch. If required, Sellers must produce proof to justify their claim for extension or cancellation under this clause.

Analysis of the FOSFA wording

The main difference between the GAFTA and FOSFA clauses is that the FOFSA prohibition clauses allow for an additional period of time before the contract is deemed to be cancelled. This extended ‘wait and see’ period could be sensible in some cases, especially if the prohibition is likely to be of relatively short duration. However, under the GAFTA clause, if a government restriction is announced the parties can then take immediate action at the end of the shipment/delivery period to make any necessary alternative arrangements and thus reduce the losses incurred.

There are also important differences between the two FOSFA clauses themselves. Under the FOSFA FOB wording once a restriction which falls within the prohibition clause occurs then the contract is deemed to be extended by 21 days beyond the termination of the prohibition event. This gives the Seller an additional three weeks in which to deliver the goods and the Buyer some notice to fix and present a vessel for loading once the prohibition event has ceased. However, the parties are not required to wait indefinitely for resolution of the prohibition event. If the prohibition event continues for 30 days then the contract will be cancelled.

In contrast, the CIF wording of the FOSFA prohibition clause simply allows for an extension period of 30 days: if the cargo cannot be shipped in this time the contract shall be cancelled, again not an option of either party but automatic cancellation.

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Crude oil general terms and conditions – an example of a "New and Changed Regulations Clause"

The GTCs of the oil majors also generally include a similar provision to govern situations where the laws change or restrictions are imposed. See for example those used by BP (clause 30), Exxon Mobil (article 11), Shell (clause 14) etc. Generally, these clauses are drafted widely to include changes to "laws, rules, regulations, decrees, agreements, concessions and arrangements" made by "governments, government instruments or public authorities" or "any person purporting to act therefore." This would cover the government export restrictions being imposed all over the world and arguably it could also be used to cover more borderline cases where a local public authority has imposed such measures, again subject to the provision of sufficient evidence. In a similar vein to the ICC provision (see further below), if the new regulation/change is not covered by a provision of the agreement, and the new regulation/change has or will have "a material adverse economic effect on the Seller, the Seller shall have the option to request renegotiation of the price(s) or other pertinent terms of the Agreement." Further, Sellers may exercise this option at any time after the change is promulgated by written notice to the Buyer, rather than in a specific, say 30 day, period. If terms cannot be agreed within 15 days after the date of the Seller's notice, either party may terminate the agreement at the end of the 15 day period.

ICC Hardship Clause 2003

It may not be called a "prohibition clause" but the ICC hardship clause can potentially, if specifically incorporated into your contract, apply when export restrictions are introduced. This clause is generally less used and contains a different emphasis to the GAFTA and FOSFA prohibition clauses. It is a clause designed for use by parties by incorporation into their contract, and has a wider application than simply for commodity traders. It is available for purchase from ICC bookshops and is designed as a neutral clause which is fair between the parties. It begins with the principle that contractual duties should normally be performed. The trigger for operation of the clause is that continued performance becomes "excessively onerous" due to events beyond a party's "reasonable control", which it could not have been expected to take account of when the contract was made and could not "reasonably have avoided." The ICC hardship clause, unlike the GAFTA and FOSFA provisions, also requires the parties to negotiate alternative contractual terms which reasonably allow for the consequences of the event. Whether this proves realistic and beneficial will depend on the individual facts and nature of the export restriction or event being invoked. Only if alternative terms are not agreed can the party invoking the clause opt to terminate the contract.

Conclusion

A number of the comments made in our first Client Alert on unforeseen events also apply here. We cannot emphasise strongly enough the need for both parties to carefully check the precise contractual wording. The following checklist of points should be remembered when faced with an export restriction type situation:

Checklist

Both parties, but particularly Sellers, should bear in mind;

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1. Check your contract. Which clauses cover the event - there could be more than one applicable clause; which clause you choose will impact on your future actions.
2. The situation should be carefully monitored as it unfolds. It is important not to 'jump too soon' as this could result in repudiatory breach of the contract if, say, the restriction was lifted at a later date.
3. Ensure all formalities and notices are complied with. There may be strict time limits.
4. Sellers should provide regular and effective communication with Buyers, but care should be taken to inform Buyers, rather than saying the Sellers will not perform.
5. Clear internal communication is also vital. Do you need to communicate with your internal finance, logistics etc departments? Take care that inconsistent messages are not being sent out to your counterparty or internally.
6. Both parties, but particularly the Seller who has the burden of proof, should retain all evidence and document all action taken including;
   a. All correspondence/meetings with the relevant government/authority;
   b. All evidence of the implementation and enforcement of the restriction – is the restriction being strictly adhered to and enforced? What other products are being taken in/out of port? What 'loopholes' are there (e.g. part loaded vessels)? What is the availability of those goods to satisfy the contract?;
   c. What information is available from the relevant port authority;
   d. What are the press reports, local, national and international saying; and
   e. What is being done with available supplies (e.g. pro rating, earlier contract first etc)?
7. Buyers should also probably reserve their position under the contract pending seeing all of the supporting evidence (after all, the Seller who cannot operate the relevant 'unforeseen events' clause is likely to be in default).

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IMPACT OF UNFORESEEN EVENTS ON CONTRACTS: Part 1 – "Strikes in Argentina"

As many of you will already know, Argentina is currently experiencing problems affecting the agricultural commodities sector. A poor domestic wheat yield led the government to impose "temporary" export restrictions in November 2007. These were lifted in December then re-imposed. They are still in place today. The problems created by governmental moves to regulate exports have now been compounded by strike action in the agricultural sector. It is widely reported that these strikes are said to be preventing a normal flow of grain and soya to and from warehouses and to ports for export.

This document is the first of two client alerts which consider the impact on international sales of unforeseen events such as these. This client alert in particular seeks to highlight some of the contractual issues that arise in light of the general strikes reportedly taking place and the effect of such events on contracts for the sale of Argentine commodities.

A second client alert dealing with "prohibitions" and government restrictions on exports, many of which have been the subject of extensive media coverage, will follow.

What is the current factual situation?

By it's decree of 11 March 2008, the Argentinian Government imposed higher taxes on exports of soyabeans and other crops. The National Agricultural, Cattle and Industrial Sector reacted to this move by commencing its strike on 13 March 2008, initially for a period of seven days. The strike was subsequently extended, and remained in place until April 2, when a 30 day "suspension" of the strike was reportedly declared by the farmers.

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On 25 March 2008, Argentina's President, Cristina Fernández, gave a nationally televised address in which she declared that the export taxes would be maintained. The Argentina Agriculture Federation reacted to this message by declaring that the strikes would continue for "as long as necessary." There appears to be significant public support for the strikers, with reports of demonstrations being held in support of the farmers last week. Negotiations aimed at resolving the situation over the weekend of 28-30 March 2008 proved unsuccessful. Therefore, it remains unclear whether the suspension will become permanent.

It is difficult to determine precisely how far-reaching the strikes are and which areas are affected. There have been reports of trucking routes being disrupted in the Buenos Aries province, Cordoba, Rosario and many other parts of the country. By way of an example of the level of disruption caused, it has been reported that as few as 23 trucks reached Rosario port on 25 March, where the port would normally expect to receive between 5,000 and 6,000 trucks on a normal March day. Clearly, it may take some time for the situation to return to normal, even after the suspension of the strike.

How (if at all) does this affect your contract?

As a starting point, pre-shipment obstacles generally do not affect delivery obligations under shipment-based sale contracts (e.g. on CIF, CFR and C&F terms) which do not identify the origin of the commodity as Argentina i.e. "any origin" type contracts. The position can be different where the parties have stated an intention (e.g. in correspondence) that Argentina will be the main or sole source of supply for the contractual goods or loading has already commenced and time for an alternative is realistically not available. Failing that, the position is that a Seller will be obliged to perform its delivery obligations notwithstanding that the Seller may intend (on a unilateral basis) to source produce from Argentina and is now in difficulty doing so.

Beyond that, the effect of a strike upon pre-existing contractual commitments (under FOB or CIF/CFR/C&F contracts) depends, in a large part, upon the existence and wording of provisions specifically covering such events; most commonly "force majeure" and "strike" clauses.

In the absence of any provisions in your contract covering the exact event in question, the legal doctrine of frustration may apply. However, this is a very restricted doctrine. If applicable, this would operate to discharge a contract (i.e. terminate it) when something occurs after the contract is made which makes it impossible to perform the contract or which makes the obligations to be performed under it radically different from those which were agreed at the time the contract was made.

Many of the standard form sale contracts and trade association forms, on which

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agricultural commodities are traded, contain express clauses that seek to regulate the rights and obligations of Buyers and Sellers where a strike situation affects performance.

The GAFTA "force majeure, strikes etc" clause

In contracts governed by the many GAFTA forms (e.g. GAFTA 38 and 39 for FOB sales and GAFTA 100 for CIF sales) the "force majeure, strikes etc." clause (which is clause 17 in GAFTA 38 and 39 and clause 18 in GAFTA 100) provides some assistance in answering the questions about the Seller's obligations in the face of strikes. It provides as follows (the wording in square parenthesis is the alternative or additional wording included in the GAFTA 100 form):

"Sellers shall not be responsible for delay in delivery/[shipment] of the goods or any part thereof occasioned by any Act of God, strike, lockout, riot or civil commotion, combination of workmen, breakdown of machinery, fire or any cause comprehended in the term "force majeure". If delay in delivery/[shipment] is likely to occur for any of the above reasons, shall serve a notice on Buyers within 7 consecutive days of the occurrence, or not less that 21 consecutive days before the commencement of the contract period, whichever is later.

The notice shall state the reason(s) for the anticipated delay. If after serving such notice an extension to the delivery/[shipping] period is required, then the Sellers shall serve a further notice not later than 2 business days after the last day of the contract period of delivery/[shipment] [stating the port or ports of loading from which the goods were intended to be shipped, and shipments effected after the contract period shall be limited to the port or ports so nominated]. If delivery/[shipment] be delayed for more that 30 consecutive days, Buyers shall have the option of canceling the delayed portion of the contract, such option to be exercised by Buyers serving notice to be received by Sellers not later than the first business day after the additional 30 consecutive days.

If Buyers do not exercise this option, such delayed portion shall be automatically extended for a further period of 30 consecutive days. If delivery/[shipment] under this clause be prevented during the further 30 consecutive days extension, the contract shall be considered void. Buyers shall have no claim against Setters for delay or non-delivery/[non-shipment] under this clause, provided that Sellers shall have supplied to Buyers, if required, satisfactory evidence justifying the delay or non-fulfilment."

Analysis of the Gafta wording

FOB Contracts

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Where a Gafta "strike" clause applies and has not been amended, a Seller will not be excused from delivering merely by giving the above notices. It would appear from the relevant legal authorities which give guidance on this wording that the Seller must actually prove that it has been prevented from delivering on time by the strike. That will be a question of fact in each case depending on the particular Seller's circumstances and the particular nature of his obligations under the contract. For this reason collection of evidence is vital. Sellers should be able to document their efforts to perform and the exact factors preventing performance in time.

It should be noted that two notices are required for a Seller to extend the delivery period following a strike. After and in spite of a "first" notice given by the Seller, the Buyer remains obliged to present a vessel for loading within the original delivery period. A failure to do so would involve a risk of being in default. This leaves the Buyer in a difficult position, for he may not know until two business days after the end of the delivery period whether the Seller will serve a "second" notice claiming an extension. If the Buyer decides not to tender a vessel for loading by the end of the original delivery period he will be in default. If he does tender a vessel, then there is a commercial exposure arising out of the possibility that the strike may continue to prevent delivery. The Buyer may, therefore, wish to claim an extension himself rather than tender a vessel but may then become liable for carrying charges in doing so.

It should also be kept firmly in mind that the period of any extension required by the Seller due to the strike will end on the day that the strike is no longer responsible for delay and it becomes possible to deliver again. Accordingly, both Buyer and Seller should be ready to give/take delivery as soon as the strike ends, or should agree expressly a period for delivery after the end of the strike. The period after the end of the strike but while logistically performance is still difficult because of knock on or residual affects is a grey area under the GAFTA clause.

CIF Contracts

The effect of the additional wording in relation to the Seller's "second" notice highlighted in bold above is questionable. It might be argued that the wording intends to give the Seller the right to rely on the clause in circumstances where he intended to ship from a particular port that is affected by the strike even though he was not obliged by the contract to ship from that particular port. This may have the effect of reversing the normal rule which obliges a CIF Seller to perform as long he can ship from an alternative port than the one he intended to ship from. There are legal cases to support such an interpretation of the clause, though its wording is not, it is submitted, completely clear. It is possible for a contract term

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to modify the normal liability regime under a CIF sale. As far as we know this particular wording has not yet been judicially scrutinised. Where the Seller wishes to rely on this part of the clause he must give the requisite notice, which then binds him to ship from that port, if that becomes possible within the extended shipment period.

The FOSFA "force majeure" clauses

Under FOSFA FOB contracts (such as FOSFA 51) the position is different from the GAFTA clause. Clause 24 (force majeure) provides as follows:

"Should Sellers be prevented from loading the goods on board Buyers' ship or should Buyers be prevented from taking delivery by reason of fire, strikes, lockouts, riots, civil commotion or any cause comprehended in the term Force Majeure at ports of loading, or elsewhere preventing transport of the goods to such port/s, the contract delivery period shall be extended by 21 days beyond the termination of the Force Majeure event. Should such cause exist for a period of 60 days beyond the contract delivery period, the contract of any unfulfilled port thereof so affected should be cancelled, The party invoking this clause shall advise the other with due dispatch. The party claiming Force Majeure must provide proof to justify their claim if required."

The wording of the Force Majeure clause in relevant CIF contracts (such as FOSFA 5, 11 and 25) is as follows:

"Should shipment of the goods or any part thereof be prevented at any time during the last 30 days of the contract shipment period by reason of Act of God, strikes, lockouts, riots, civil commotions, fires or any other cause comprehended by the term Force Majeure at port/s of loading or elsewhere preventing transport of the goods to such port/s, the time allowed for shipment shall be extended to 30 days beyond the termination of such cause, but should the contract shipment period be less than 30 days such extension shall be limited to the number of days allowed for shipment under the contract shipment period. Should such cause exist for a period of 60 days beyond the contract shipment period the contract or any unfulfilled part thereof so affected shall be cancelled. Sellers invoking this clause shall notify Buyers with due dispatch.

When goods of a specific origin are sold with the option of shipment from alternative ports and shipment from all alternative ports is not prevented Sellers may only invoke this clause with regard to the specific port/s provided that the port/s has/have been notified to Buyers as the intended port/s of loading prior to or within 7 days of the occurrence but if the occurrence commences within the last 7 days of the contract shipment period the port/s of loading to be notified not

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later than the first business day following the contract shipment period. Shipment after the contract shipment period shall be limited to the port/s so nominated.

Buyers have no claim against Sellers for delay in shipment of cancellation under this clause provided that Sellers shall have supplied to their Buyers, if required, satisfactory evidence justifying delay or non-fulfilment to establish any claim for extension or cancellation under this clause. In case of default after extension the default date shall be similarly deferred".

Analysis of the FOSFA wording

FOB Contracts

Similar considerations apply to FOSFA contracts (both FOB and CIF) as they do to GAFTA contracts in relation to reliance on the strikes as a reason for non-performance. In other words, a Seller must be able to prove that he was prevented from loading the goods on board the Buyers' ship.

However, in relation to the presentation of vessels, the position is different. The FOSFA clause provides for an automatic extension of the contract by 21 days beyond termination of the strike, provided that the strike prevents loading within the delivery period. This automatic extension means the Buyer has greater certainty as a result of the further 21 day period after the strike ends in which to present a vessel. The Buyer does not have to wait for a Seller's notice and may not, therefore, have to make a decision about whether to claim extension himself. In order to rely on the extension, a party is required to inform the other with due despatch.

CIF Contracts

The FOSFA CIF Force Majeure clause referred to above provides for an automatic extension of up to 30 days beyond the termination of the force majeure/strike, unless the original shipment period is itself less than 30 days, in which case the extension is for the same length as the original shipment period.

The second paragraph of the clause like the one in GAFTA 100, seeks to give the Seller the right to invoke the clause where a strike/Force Majeure event prevents the Seller from loading at one or more of the possible loading ports but not all of the possible ports provided the goods to be shipped are of a specific origin and provided the Seller notifies the Buyer of the intended loading port/s within 7 days of the occurrence or not later that the first business day after the shipment period if the occurrence commences within the last 7 days of the shipment period.

The FOSFA wording is likely to be clear enough to reverse the general position

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under CIF contracts. Here a Seller is not obliged to ship from an alternative port or buy afloat where the loading port he intends to use is affected by the strike. It should be noted that a Seller has the right to make his declaration of an intended port after the strike/force majeure occurs so as to take advantage of the extension. He will, however, then be obliged to ship from that port if shipment becomes possible within 60 days beyond the original shipment period. A sensible Seller should, therefore, be sure he is able to ship from a nominated port before he gives notice.

Conclusions

GAFTA have issued several strike notices in respect of the situation in Argentina. There has also been widespread coverage in the media of the strike. It seems unlikely therefore that a Buyer could feasibly challenge the fact that a strike has occurred in Argentina. Any issues of disagreement between Buyers and Sellers trading out of Argentina are more likely to focus on whether the strike in fact prevented delivery within the contractual delivery period, including any extension.

In this regard, a sensible Seller will keep monitoring the situation and consider alternative methods/routes for ensuring that delivery can take place. A Seller that simply gives notice of a strike and then waits for it to end risks finding himself unable to rely on the relevant clause of the GAFTA or FOSFA contract. Buyers should be pro-active in contacting their Sellers if they suspect there may be a problem with performance. A Seller might reasonably seek to document his efforts to perform as evidence in support of any argument that he was prevented from performing (note that where a more expensive alternative route is available to the Seller for performing his obligations, he will be in difficulty in proving that the event in fact “prevented” his delivery).

Regular and effective communication between Sellers and Buyers is key in avoiding disputes. Sellers seeking to rely on the “strike” clause, would be well advised to keep their Buyers informed of the position, what is making delivery impossible and when it is likely that delivery will again become possible. Buyers should seek to agree with Sellers any extensions to be applied to the contract well in advance of the end of the delivery period, so they can avoid problems in the chartering and presentation of vessels.

Careful checking of the particular clauses in your contract and the notice requirements will also be important.

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Force Majeure

Force majeure claims are on the increase: this note gives a brief overview of matters to consider when drafting a force majeure clause and what to do when faced with a claim of force majeure from a counterparty. The recent Indian sugar embargo shows the importance of such clauses and the need to link them to other contract clauses, such as licensing clauses.

What is force majeure? A force majeure clause is an agreement between the parties that one or both parties are excused from performing the contract where their performance is affected by the occurrence of a force majeure event listed within the clause.

Unlike some civil law systems, there is no doctrine or concept of force majeure under English law. It must be specifically and expressly included in contracts in order to have effect, it will not be implied by the English Courts. In general, English law assumes contracts must be performed: if not, a party is in breach and must pay damages even if not responsible for the problem – hence the need for a suitable force majeure clause.

"Frustration" The English law doctrine of "frustration" arises in some similar situations to that of force majeure. Frustration of a contract in the discharge of a contract by a supervening event. However, frustration occurs **in narrow circumstances**, where performance becomes impossible or completely different from that contemplated by the contract. Clauses such as Prohibition, Strikes and Force Majeure seek to deal with a much wider range of circumstances than frustration.

Drafting your force majeure clause There are some "off the shelf" ready-made clauses, such as the ICC Force Majeure and Hardship clauses, or particular trade clauses such as GAFTA Force Majeure and Prohibition clauses. However, arguably every force majeure clause should be unique – making sense in the business context of the particular contract and making a sensible allocation of the risks which may affect performance. A general rule would be that the longer the term of the contract, the more important the force majeure

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clause may be. When drafting afresh, you should try to anticipate events that may occur which would make it difficult or impossible for you to perform the contract, or events which you are not prepared to accept the risk of the occurrence. You should expressly make clear in the clause that there is no liability to the other party where the force majeure circumstances apply.

In general, a force majeure clause includes:

- definition of events – long or short list and 'sweep up' provision;
- obligations as to notice to the other party;

NB1: Notice provisions should be straightforward: do not add to this part details of evidence to be supplied or counter signature by a third party (e.g. local Chamber of Commerce). This can be dealt with elsewhere.

- effect of the event e.g. suspension and then termination without liability.

NB2: Think about recovery of advance payments/closure of performance bonds.

NB3: If the effect is to be termination, who can terminate? Logically it would be either party, since neither party can be 'blamed' for the force majeure event.

When drafting a force majeure clause, there is no standard meaning of the phrase "force majeure" under English law; specific events which may affect the parties' performance under the contract should be listed. "Usual force majeure events to apply" could be held void for uncertainty and "force majeure to apply" is not sufficient and may lead to disputes over what it is meant to encompass.

Long clause/short clause? There is often conflict of opinion on drafting force majeure clauses:

- short clause, wide as possible, with no long list – to avoid being 'caught out' by lack of the very thing that happens;
- long clause, covering many (some unlikely!) possibilities.

Both have merits, but a longer, better thought out clause is generally preferable. It is a more realistic sharing of risks, whereas the short clause gives too much freedom to the arbitrator or judge to decide if something should or should not excuse nonperformance.

What should you include? Some of the commonly listed events are: "Act of God, war or war-like operations, riot, strikes, fire, storm tempest or flood, perils or accidents of the sea, civil commotion, acts of Government, partial or total prohibition of export/import". Wider events (and therefore more controversial) would include "restriction, non-delivery or delayed delivery from suppliers, shortages of raw materials or transport, requests of governmental authority, adverse weather conditions, breakdown of intended performing vessel". If you anticipate that you are more likely to be the party seeking to bring yourself

within a force majeure clause, it is a good idea after you have listed the events to end with a catch all phrase such as “any other cause beyond a party’s control” and “whether or not similar to the foregoing”. This will go some way towards protecting you from an event, which you have not anticipated. Be careful of prefacing force majeure clauses with phrases such as “whilst every effort will be made to carry out this contract…” as this may make it virtually impossible to activate the force majeure clause as you will have to prove that every effort has been made! Also look at the rest of your contract: if some obligations are intended to be outside force majeure (e.g. seller’s obligation to obtain and maintain an export licence), say so expressly.

How much must performance be affected? Generally force majeure clauses are drafted in terms of performance being “prevented”,“hindered” or “delayed”. Which of these three you decide to opt for will depend on how high a burden of proof you wish to place on the party seeking to rely on the clause.

- “Prevented” or “unable to perform” indicates that performance is virtually impossible;
- “Hindered” means that it is made considerably more difficult (financial hardship is not sufficient);
- “Delayed” is the lowest test, but you may wish to further qualify delay with a provision for how much of a delay activates the force majeure clause and whether it is an actual or anticipated delay which must occur.

The fact that a contract is now uneconomic or commercially impractical because it has become greatly more expensive, is effectively never within a force majeure clause. (Although such problems can fall within suitably drafted ‘hardship’ clauses).

Force Majeure clauses when in a string situation Where you are in a string situation it is important that your force majeure clauses are back to back or you may find yourself on the end of a claim for force majeure from your Seller, whilst having to pay damages to your Buyer for non-performance even though events are beyond your control. We have seen this in a number of cases, where slightly different wording in the two sale contracts made all the difference.

Relying on Force Majeure A party wishing to make use of a force majeure clause to excuse them from performance must prove that they come within the terms of the clause. The English courts will generally construe the terms of the clause narrowly.

Notice provisions and Time limits Force majeure clauses usually have provisions regarding the notices, which must be given under the clause when an event occurs. A failure to comply with the notice requirements may lead to the loss of the right to claim force majeure (whether it does so will depend on the wording of the clause). It is always better, if you do invoke a force majeure clause, to watch and comply with all time limits carefully.

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What should you do at the time of the Force Majeure incident? If you fail to mention force majeure at the time of an incident, it becomes much harder in practice to bring yourself within the clause at a later date. Messages that you send at the time of the force majeure event should clearly set out that it is a force majeure event, or you may waive your right to claim force majeure. Even if you are unsure, it is usually better to invoke the clause at the earliest opportunity and then collect evidence and clarify e.g."On the information presently available to us, it appears that the situation is one of force majeure within clause [ ]. We therefore as a precaution hereby give notice of force majeure as required by clause [ ]. We are, however, making further enquiries and will revert".

Collection of evidence Once you have claimed force majeure, the next step is to collect evidence as it will be up to you to prove that you fall within the terms of the clause. Make sure to keep written details of all efforts made to overcome the problem. Internal correspondence may be disclosable, so keep this consistent with your efforts. Further, published materials, such as newspapers and trade reports, government warnings and requests, port authority or agent communications, emails from other traders relating to the problem are valuable, as is on the spot evidence such as surveyor's and inspector's accounts of the incident. They will all help you prove your force majeure claim in arbitration or encourage the other party to settle due to the strength of your evidence.

When a Force Majeure event affects more than one contract Where a Seller has sufficient goods to fulfil some, but not all of his contracts due to a force majeure event, he should (if there is nothing express in the force majeure clause) allocate the goods in the way in which the trade would consider reasonable and proper, whether this is by dividing them equally amongst his counterparties, or by allocating them in the order in which the contracts were concluded, but he cannot allocate his supplies to new contracts concluded after the force majeure event to take advantage of a rise in price, nor simply choose the highest price contracts to perform.

Conclusion Force majeure clauses arise frequently in commercial contracts and they are often the cause of disputes or litigation. Parties increasingly attempt to rely on force majeure to excuse themselves from liability. Usually, a little extra time spent at the contract stage thinking about the content of the force majeure clause and the possible events affecting performance will be time well spent.

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Legal implications of escalating hostilities in the Eastern Mediterranean

Introduction On Thursday 13 July 2006, Israel announced an air and sea blockade of Lebanon, as part of their response to the capture of two Israeli soldiers by Hezbollah guerrillas the previous day. The situation has since escalated. Israeli warships are enforcing a full naval closure of access to and from Lebanese ports because, they say, those ports (including Beirut and Tripoli) have been used to facilitate anti-Israeli activity by serving as a conduit for the importation of weapons and terrorists. Israel has also mounted a number of air strikes on the port cities of Beirut,Tyre and Tripoli. The Israeli port of Haifa is closed due to retaliatory rocket attacks. A missile has struck an Israeli warship, and an Egyptian flagged merchant ship has also been hit. Evacuation of foreign citizens has commenced.

The enforced closure of the Lebanese ports is particularly significant given Beirut's recent rise as a commercial shipping and trading hub, now handling more than 3,000 ships a year.The port is capable of handling 700,000 TEU a year. Recent reports indicate that as at the weekend of 15/16th July, nearly 50 ships are currently within the port, with a similar number imminently expected and which are therefore likely to have their voyages suspended by the blockade.

There will also be implications for other regional ports; diminishing trade out of Beirut might be matched by ports neighbouring the Lebanon being used as an alternative destinations for ships and cargo, but some tonnage (including cruise ships) is reportedly already avoiding calling at Syrian ports, following the recent violence.

Press reports note that Israel is blaming Hezbollah for the rocket attack on the railway maintenance depot in Haifa, leaving at least 25 people dead or injured on 16th July. This is of some commercial significance to the shipping and trade community because of reports that Israeli defence officials have recommended that shipments into the Port of Haifa be suspended, following

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the rocket strikes. Further, because missiles have reached as far the outskirts of Nazareth, some 33 miles into Israel, and the Hezbollah leader, Sheik Hassan Nasrallah, has already threatened to attack Israel “beyond Haifa”, Tel Aviv has been placed on missile alert.

Hezbollah contested the parliamentary elections last year, alongside the Amal Party, gaining 14 of the 128 seats in parliament and 2 ministerial positions in government. Pointing to Hezbollah’s political involvement, the press has reported that Israel hold the Lebanese government responsible for the recent actions of Hezbollah.

G8 leaders have proposed sending a security monitoring force to Lebanon, while setting the conditions for a ceasefire, including the return of the Israeli soldiers and an end to the shelling of targets in Israel, but it remains unclear if, and on what timescale, this could be achieved. In the meantime, whilst Israel’s current actions have been characterised as tit-for-tat recriminations to bring about the release of their captured servicemen and to put an end to the missile strikes from the Bekaa Valley, rather than an outright declaration of war, Israel’s allegations concerning the peripheral support for Hezbollah by Syria and Iran might lead to a yet further escalation of the crisis.

In the above context, these notes are intended to address the legal issues that are likely to face the shipping and trading communities in the coming days and possibly weeks. They are merely intended to summarise and update the issues, so for further detailed advice on any particular set of circumstances please speak to your usual contacts at Richards Butler.

The relevant contractual considerations for those in shipping and trading can be markedly different, not least because force majeure type clauses are often found in international trade contracts but seldom found in contracts of carriage. Part 1 of this note addresses shipping matters, i.e. those relevant to chartering and carriage contracts, and also to a certain extent, insurance. Part 2 covers the international trade aspects. At all times an English law perspective is assumed.

Part 1 – Shipping Issues The legal issues concerning shipping and carriage contracts fall mainly into five categories: (1) the legal meaning and definition of “war”, (2) rights of cancellation, (3) frustration, (4) port safety, and (5) payment of additional insurance premiums.

Meaning and Definition of War In any contract of carriage or insurance where an event of “war” triggers certain consequences, the exact meaning of the word “war” will depend upon what is presumed to be the intention of the parties to that contract. The guiding factors as to whether a state of war exists were set out in *Spinney’s (1948) Ltd v Royal Insurance Co* [1980] 1 Lloyd’s Rep 406; these are —

(i) whether one can identify a conflict between opposing “sides”;

(ii) the existence of objectives of the "sides", and the means of pursuing them (as for an objective, it can be enough if the aim is to force changes in the way in which power is exercised without fundamentally changing the existing political structure) and;

(iii) the scale of the conflict, its effect on public order and the life of the inhabitants. This factor can include the number of combatants, the amount of territory occupied, the amount and nature of the armaments employed, the scale of the casualties, the degree to which the population is involved, the degree of interruption to public services and private life and the duration. None of these are essential, it is a question of assessing the scale of the conflict.

Applying these factors, and considering the expressed objective of Israel in eliminating the political and military power of the Hezbollah group, the latter's stated objective of eliminating the state of Israel, the scale of the forces recently deployed by Israel, the attacks in either direction, the blockade of Lebanese ports, the rising casualties and the extent to which public and private life in Lebanon has been impaired, there can be no doubt that a state of war exists.

However, we stress that before drawing such a conclusion in relation to any contract, the particular context of the contract term being relied upon would have to be taken into account, as well as the precise factual circumstances which prevailed at the relevant time.

It should be noted that there are a number of legal authorities on the precise meaning of other words often used in clauses along with the word "war". The standard "war risks" cover under the Institute War and Strikes Clauses 1/11/95 extends to "civil war", "revolution", "rebellion", "insurrection", "hostile act by or against a belligerent power", and the actions of "any terrorist or any person acting maliciously or from a political motive" (i.e. mirroring the express exclusions under the standard ITC Hulls form. Suffice to say that each of these concepts has a distinct meaning. The term "war like operations" (which appeared in the pre-cursor to the 1995 clauses) gave rise to conflicting authorities. While the meaning of "war like operations" is obviously wider than "war", it required a consideration of the predominant cause of the event giving rise to the claim.

Cancellation due to war A contract can be cancelled or automatically terminated by the outbreak of a war if the parities have expressly stipulated that it should be. A number of charterparty forms use standard war clauses, which may or may not entitle a party to cancel on the happening of a defined event or set of circumstances. One has to consider the particular cancellation clause to see if it is applicable.

Most war cancellation clauses operate by reference to (a) war involving the flag state of the ship, (b) war between any two or more specified countries or, (c) war breaking out at the destination or other location.

War involving the flag state – The Court of Appeal has recently refused permission to appeal an arbitration decision concerning an attempt to cancel under a standard charterparty clause owing to Germany (as the flag state) being involved in military operations in Kosovo. Four ships were chartered on the NYPE form, which included a provision in clause 31 that –

"…in the event of the nation under whose flag the vessel sails becoming involved in war (whether there be a declaration of war or not) either the Owners or Charterers may cancel this charter…"

The charterer purported to cancel on account of Germany's participation as a member of NATO in deploying fighter planes against the Milosovic regime in Kosovo. There is nothing in the legal report of the case that suggests military operations in Kosovo had any actual impact whatsoever on performance of the charters, so one may suppose that the charterer was motivated to cancel for other, purely commercial, reasons. However opportunist the charterer's position may seem, it appears that the arbitrators decided against them (by a majority) to find the cancellation invalid on the basis that the operation in Kosovo was not a war, and even if it was then Germany was not involved. The arbitrators also ruled that the charterer was out of time in purporting to exercise its right of cancellation, as over a month had elapsed since the alleged events giving rise to the cancellation right purportedly being exercised.

A similar situation did arise around the time of the 1991 Gulf War, showing the other side of the coin. Two Italian war ships were moved to the eastern Med in apparent, albeit tentative, support of the military forces gathering in the Persian Gulf. Again, opportunistic charterers of two tankers tried to cancel on the basis that this was a "war like operation" by the flag state of the tankers, Italy. A tribunal upheld the cancellation.

These cases reaffirm the importance of carefully considering the facts of the military operations in question against the wording of the contractual clause before concluding whether or not the cancellation option can be validly invoked. In the case of future charters involving what could be trade to the eastern Med, it may be relevant to consider whether the events in question already existed as at the date the business was fixed.

War between any two specified states – Any contract may expressly provide a cancellation on the outbreak of war between specified states. Such a clause would operate in a similar way to 'War involving a flag state' above, if the states were in fact at war with each other. An example is the Institute Automatic Termination of Cover clause, whereby the insurance automatically terminate if war breaks out (whether actually declared or not) between any of the UK, USA, France, Russia or China. This provision (thankfully) needs no further consideration here.

War at the voyage destination or other location – This kind of provision inevitably arises for consideration alongside the issue of port safety, and of the possibilities dealt with here it might be the most likely to arise. A war clause in

a contract of carriage will usually provide that the ship is not to proceed to a place in which there is a state of war, hostilities, or blockade where it is at risk of capture. The clause may require the place to be "dangerous" before rights under it are triggered. Sometimes, the requirement is dependent upon how, in his reasonable opinion, the Master or his principals perceive the events. In this case, the discretion conferred upon the Master or the shipowner must be exercised reasonably and in good faith, and not arbitrarily or capriciously.

If such a clause is triggered, there is normally provision for discharge of cargo at an alternative destination and/or for payment of additional insurance.

The commonly used war clauses give the ship liberty to comply with the orders or directions of various authorities or bodies, for example, her flag state, war risk underwriters, any other government or the UN Security Council, or directives of the European Community.

Frustration of contract due to hostilities If there is no provision in the contract of carriage for war or hostilities, the parties can still be discharged from further performance if the effects of war or hostilities frustrate the contract by creating a fundamentally different situation, or rendering performance as intended by the parties impossible. There is a distinction to be drawn between performance, which becomes "wholly different to that intended", as opposed to a situation where one party's obligations simply become more onerous or expensive; the latter does not frustrate the contract. It is to be noted that it is not the mere existence of hostilities that potentially frustrate a contract; it is the actual impact of the acts done in furtherance of the hostilities on performance of the contract that may frustrate it.

When considering the possibility of frustration, one must first consider what the charter terms provide for and whether they are wide enough to apply to the new set of circumstances. But the mere existence of a war clause apportioning the risk of delay and extra expense between the parties to the contract does not necessarily preclude the operation of frustration.

Again, just because the parties are aware of the risk of war and hostilities and conclude a charter for a voyage to an area which could be affected, which must apply to much recently fixed business, this does not necessarily mean that frustration cannot arise. It may be relevant to enquire whether the consequences of war or hostilities, which followed, had been in the minds of the parties when fixing the business.

If the effect on the contract of carriage caused by the hostilities is delaying its performance, whether the delay is sufficient to amount to a frustrating event will depend upon a number of factors, such as whether the cargo is perishable, whether delivery is urgent, and the length of the actual or anticipated delay compared with the anticipated duration of the voyage as contemplated at the time of fixing the business.

In relation to contacts for affreightment, it may be that the shipment in a particular period might be frustrated without bringing to an end the whole term contract, leaving over future liftings to still be performed.

It is important to remember that the assessment as to whether the relevant events frustrate the charter should be objectively made as at the time frustration is claimed, regardless of how events actually unfold thereafter.

Prospective unsafety of ports due to hostilities A charterparty requirement that the charterer shall not order the ship to an unsafe port encompasses the concept that a nominated port could be dangerous if hostilities exist that put the ship at risk of loss or damage. The classic test as to the safety of a port is whether, if in the relevant period of time, the particular ship can reach it, use it and return from it without, in the absence of some abnormal occurrence, being exposed to unavoidable danger. The requirement of safety can be spelt out in the charter or it can be implied, for example where the charterer is given a choice to nominate any port within range. The rationale is that a warranty of safety given by the charterer is necessary where the ports are not specifically identified by the contract and the shipowner cannot therefore make his own enquiries as to their safety.

The warranty given by the charterer is prospective, i.e. that, when nominated, the port will be safe to approach, to use and to depart from. Thus there would be no breach of warranty by the charterer if the unsafety arose from causes that could not be anticipated as at the time of his nomination to the shipowner. However, whilst the prospective safety of a port is to be measured at the time of nomination by the charterer, if events subsequently occur while the ship is on her way to the port which renders that port unsafe, the shipowner may be able to legitimately refuse to go there.

If the charterer nominates a port that is known to be unsafe due to the outbreak of hostilities, the shipowner would be within his rights to refuse to go there and to ask the charterer to nominate a safe alternative. A shipowner is entitled to a reasonable opportunity to evaluate a nomination, and if the ship proceeds to an unsafe port despite the shipowner's misgivings, then in the absence of an express reservation, the right to reject the unlawful nomination by the Charterer would be waived. However, the charterer could still be liable in damages for breach of the safety warranty in respect of any loss actually sustained by the shipowner owing to the danger experienced.

It should be remembered, however, that where there is an applicable war clause in the charter wide enough to cover a state of hostilities, the wording of this clause could displace the general warranty of safety of the destination port and the shipowner would need to look to the war clause to check what his rights were before deciding whether or not to accept or reject orders. The war clause should therefore be checked very carefully.

Liability to pay increased additional war risks premium Charterparties normally assume or expressly allocate the cost of normal insurances to the shipowner,

and to allocate any additional premium to a charterer. The contract must contain a specific clause allowing the shipowner to recover the extra insurance expenses from him. At present, it seems that a charterer wishing to trade to the eastern Med is accepting that he must pay the extra insurance costs involved in trading there.

If an event such as war or hostilities occurs, this significantly alters the assessment of risk; most policies allow the insurer to cancel the insurance on notice, subject to reinstatement within the notice period at a new (invariably higher) rate. It is understood that, as at 17th July, the market was quoting no new rate for Lebanon because it is blockaded, whereas Haifa attracts a 1% AP basis 7 days and Ashdod 0.25% again basis 7 days.

Part II – International Trade Issues

Frustration For a trader, the main question will be whether the contract is "frustrated" (if the contract is silent on these issues, i.e. no force majeure clause). Will the war or warlike operations or inability to ship goods to Israel or Lebanon constitute a "frustrating event"? If so, a performing party may be excused performance. The party seeking to avoid performance will be expected to prove (a) the fact of the frustrating event (b) the fact that the event effectively **prevented performance** and was beyond his control and (c) that no reasonable steps could have been taken to mitigate the consequences. These are onerous conditions.

Lebanon: The Lebanese ports are blockaded by Israeli war ships and no commercial shipping is getting through. As a result, performance of a **delivered Lebanon** contract would appear to be impossible at present. For such a contract to be "frustrated", i.e. discharged with no liability to other side, the blockade would have to continue throughout the contract shipment/delivery period.

CIF contracts are much harder to frustrate in reliance on problems at the discharge port because of the limited nature of a CIF contract: the discharge of the goods at the CIF discharge port is usually not a fundamental term of the contract. The question therefore is whether the Seller is prevented from performance, i.e. shipment and obtaining a contract of carriage (B/L) for the Lebanon during the shipment period. In general, the risk of unavailability of shipping space is on the Seller and any failure to find a vessel and ship goods within the contract period is simply a breach. In very exceptional circumstances, however, a CIF contract can be frustrated, e.g. on requisitioning of all available shipping space due to war. Logically, with good evidence, this could be extended to non-availability of shipping space to the CIF destination because of war/blockade at the destination. Again, this would have to continue throughout the contract shipment period.

Israel: Commercial vessels are still using some of the Israeli ports but as of 17th July, Haifa port was closed (Reuters, Lloyd's List). Some shipowners are

refusing to go to the area at all. Again, frustration will be difficult to establish and will depend on the terms of the contract (e.g. delivered or CIF, what ports are within the contract range), the length of the shipment period compared to the period of closure/hostilities and the evidence available that performance was prevented.

Force Majeure Most sale contracts will have a "force majeure" clause which is likely to be considerably wider than "frustration". The effect of such a clause is usually to excuse non-performance so no damages are payable.

The question whether a party is excused for non?performance by force majeure will depend completely upon the **particular clause** in your contract rather than on general legal principles.

The important things to look for are:

- What and when are the performance requirements of the sale contract? The shipment period will be key to determine how long the "force majeure" must last for performance to be excused. The sale contract parity (FOB/CIF/DES) will be key to determine whether "performance" is in fact affected.
- How wide is the force majeure clause, e.g."war" or "war (declared or not) or warlike operations"; does it cover discharge port problems at all as well as shipment port (many standard Grain clauses do not).
- What is the burden of proof – e.g."prevented" (difficult to show) or "hindered" (much easier)?
- What are the notification requirements? (try to stick rigidly to these – it may be important)
- What exactly is the effect of force majeure – termination or suspension? If suspension, for how long, at whose expense, from when? If termination, who may terminate, when and what is the effect of termination on advance payments, performance bonds or letters of credit.

It is also worth noting that the fact that the cost of insurance or freight goes up, even astronomically, will not usually amount to either force majeure or frustration.

Cargo Insurance War risks are not automatically included in most standard cargo policies. Where "war risks" are included in the cover they are usually accompanied by a cancellation clause which gives the underwriter the right to cancel the policy at short notice if/when war breaks out. If underwriters do cancel they will usually re-offer the cover at a high rate having obtained increased cover themselves.

Many sale contracts do provide for increased cargo war risk to be passed on to Buyers, but this does not assist the CIF seller facing vastly increased freight costs to payfor the increased war risk cover on the vessel.

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Conclusions These notes pick up some of the legal issues for the shipping and trade community. The fast changing situation will undoubtedly throw up further issues and further problems. Already some vessels are trapped in Lebanese ports unable to leave. It is to be hoped that a ceasefire is swift in coming for all involved.

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