



# **Conflict in Ukraine:** challenges affecting businesses in the agricultural commodities sector

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The conflict in Ukraine has affected few markets more dramatically and directly than the grains and edible oils markets. International and domestic market participants with interests in the region face myriad commercial and legal challenges and uncertainties.

This paper comments on and seeks to summarise some of these challenges and to provide a framework for identifying and planning for them.

The legal and regulatory landscape continues to evolve as the crisis develops. References to the law are correct at the time of publication.

# Sanctions, tariffs and legal restrictions

There are currently no sanctions or restrictions imposed by U.S., EU or UK laws directed at transactions for agricultural goods with a Russian or Belarusian nexus. However, a transaction may nevertheless be indirectly affected by sanctions where entities or individuals involved in the supply chain are the subject of sanctions. Due diligence to ensure that no party, transporter or port in the supply chain is subject to any counterparty-related sanctions (such as asset freezing measures or transaction restrictions) is therefore required. In response to some criticism that EU sanctions have inadvertently hampered the trade in Russian-origin agricultural goods, the EU has recently announced an intention to pass new legislation to clarify that transactions in the food and agricultural products sector are not prohibited by EU sanctions.<sup>1</sup>



<sup>1</sup> Borrell, J. (2022). 'EU's chief diplomat expects Ukraine deal 'this week' to unblock supplies', *Financial Times*, 18 July. Available at: <https://on.ft.com/3yNxVIX> (Accessed: 18 July 2022).

As regards goods of Ukrainian origin, the UK sanctions regime<sup>2</sup> imposes import bans on certain goods that either originated, or have been shipped, from “non-government controlled Ukrainian territory”. Presently this definition extends only to Crimea and the non-government controlled regions of the Donetsk and Luhansk Oblasts. However, the Ukrainian government has accused Russia of confiscating and attempting to sell grain from elevators in occupied territory, particularly in the agricultural regions of Kherson and Zaporizhia.<sup>3</sup> Kherson and Zaporizhia Oblasts do not currently fall under the definition of “non-government controlled Ukrainian territory”, but the definition may be extended in the future to cover goods sourced from these or other occupied regions, creating legal risks and potentially disrupting contractual arrangements. Even where a buyer is not legally prohibited from purchasing goods that originated or were shipped from Russian-occupied regions within Ukraine, there may be reputational

ramifications to consider in doing so, particularly as Ukraine has accused Russia of imposing “bondage” on Ukrainian farmers, ordering them to hand more than 70% of their future harvests over to Russia.<sup>4</sup>

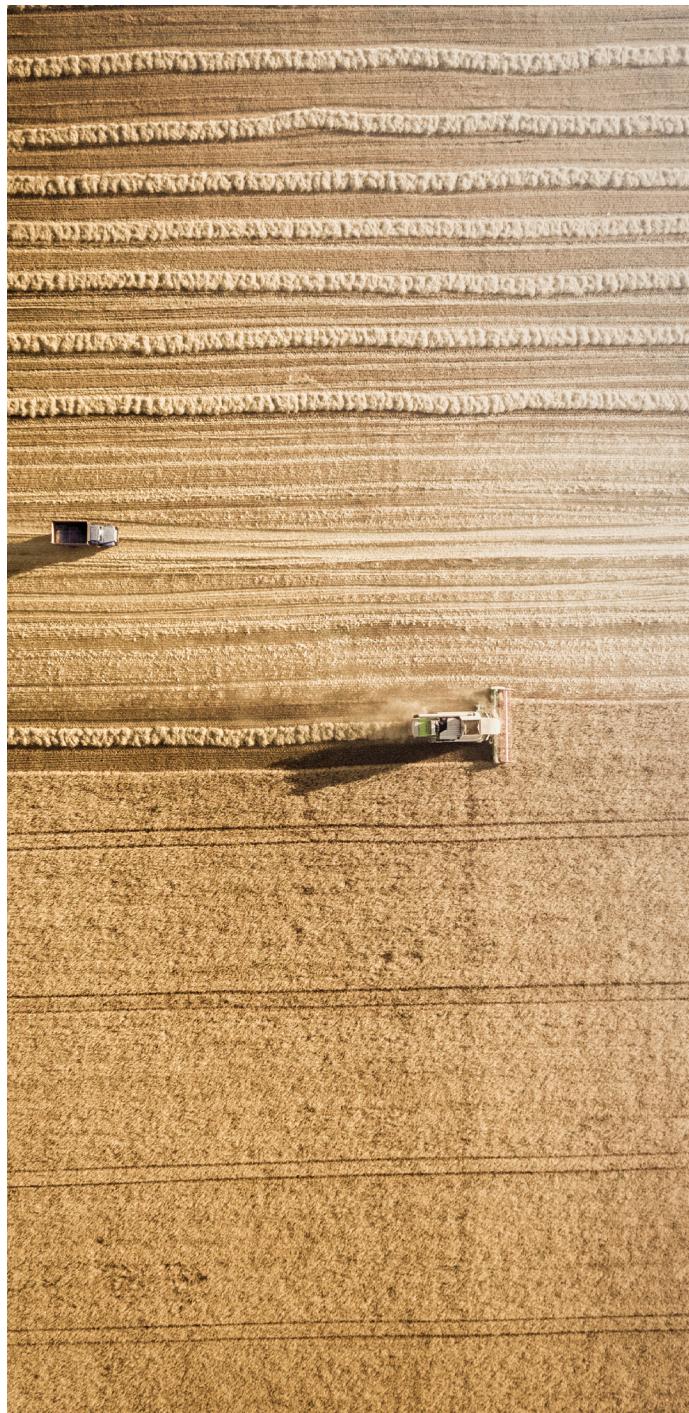
As regards goods of Russian origin, it is notable that a number of businesses have been unwilling to source Russian-origin goods for their own commercial reasons, including potential reputational implications. We do not anticipate, however, that agricultural goods will be as widely affected by ‘self-sanctioning’ as other commodities markets have been.

In addition to sanctions, certain countries have imposed additional tariffs on certain agricultural goods originating from Russia or Belarus.<sup>5</sup> Conversely, in an effort to boost Ukraine’s economy, the UK in particular has removed all tariffs and quotas on goods imported from Ukraine,

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- 2 Department for International Trade (2022). NTI 2953: Russia import sanctions. Available at: <https://www.gov.uk/government/publications/notice-to-importers-2953-russia-import-sanctions/nti-2953-russia-import-sanctions#fn:1> (Accessed: 9 June 2022).
- 3 Reuters (2022). 'Russian-controlled Kherson region in Ukraine starts grain exports to Russia – TASS'. *Reuters*, 30 May. Available at: <https://www.reuters.com/markets/commodities/pro-moscow-kherson-region-starts-grain-exports-russia-tass-2022-05-30/> (Accessed: 9 June 2022); Lister, T. and Fylyppov, S. (2022). Ibid.
- 4 Semchenko, V. (2022). 'На захопленій частині Херсонщини для фермерів запровадили "рабство": окупанти вимагають 70% майбутнього врожаю', *Obozrevatel*, 25 May. Available at: <https://war.obozrevatel.com/ukr/na-zahoplenij-chastini-hersonschini-dlya-fermeriv-zaprovadili-rabstvo-ocupanti-vimagayut-70-majbutnogo-vrozhayu.htm> (Accessed: 9 June 2022); Zmina (2022). "'Вводять рабство': російські військові змушують фермерів на Херсонщині сіяти зерно і соняшник та віддати більшість врожаю' Zmina, 24 April. Available at: <https://zmina.info/news/vvodyat-rabstvo-rosijski-vijskovi-zmushuyut-fermeriv-na-hersonshchyni-siyaty-zerno-i-sonyashnyk-ta-viddaty-bilshist-vrozhayu/> (Accessed: 9 June 2022); Lister, T. and Fylyppov, S. (2022). Ibid. 'Russians steal vast amounts of Ukrainian grain and equipment, threatening this year's harvest', *CNN*, 5 May. Available at: <https://edition.cnn.com/2022/05/05/europe/russia-ukraine-grain-theft-cmd-intl/index.html> (Accessed: 9 June 2022).
- 5 Department for International Trade (2022). Additional duties on goods originating in Russia and Belarus. Available at: <https://www.gov.uk/guidance/additional-duties-on-goods-originating-in-russia-and-belarus#:~:text=On%2025%20March%202022%2C%20the,originating%20in%20Russia%20and%20Belarus> (Accessed: 9 June 2022).

including agricultural goods, under the UK-Ukraine Free Trade Agreement.<sup>6</sup> However, while the import tariff cuts could support Ukraine's economy and increase the supply to local UK markets in the short term, the practical effect is likely to be very limited in view of the constrictions in the supply and movement of goods from Ukraine.

Ukraine itself has imposed export restrictions in order to ensure its own food security, with new rules restricting the export of millet and buckwheat.<sup>7</sup> The Ukrainian government may include other types of crops within the scope of those export restrictions in the future, with the potential further to disrupt performance of contractual arrangements.



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<sup>6</sup> Department for International Trade and The Rt Hon Anne-Marie Trevelyan (2022). 'UK announces new trade measures to support Ukraine'. Available at: <https://www.gov.uk/government/news/uk-announces-new-trade-measures-to-support-ukraine> (Accessed: 9 June 2022).

<sup>7</sup> Harvey, F. and Butler, S. (2022). 'Ukraine's wheat harvest may fall by 35%, raising fears of global shortage', *The Guardian*, 6 May. Available at: <https://www.theguardian.com/world/2022/may/06/ukraine-wheat-harvest-may-fall-by-35-percent-satellite-images-suggest> (Accessed: 9 June 2022); The Associated Press (2022). 'Ukraine bans exports of wheat, oats and other food staples', *ABC News*, 9 March. Available at: <https://abcnews.go.com/International/wireStory/ukraine-bans-exports-wheat-oats-food-staples-83337319> (Accessed: 9 June 2022).

# Other issues affecting the supply of agricultural commodities

Ukraine is the sixth biggest wheat exporter worldwide and 90% of its wheat is exported from its Black Sea ports.<sup>8</sup> Unsurprisingly the Russian military's blockade of ports is fuelling a rising food crisis and rising market prices globally.<sup>9</sup> Currently, it is estimated that exports of grain from Ukraine are down by 64% so far in 2022, compared to the same period last year.<sup>10</sup> The UN has estimated that 25 million tonnes of grain remain stuck in Ukraine following the Russian invasion.<sup>11</sup>

## Price volatility

Grain prices since the outbreak of the conflict have remained high and volatile, with leading global producers unable to bridge the supply gap the conflict is causing. Price spikes and volatility have also been fuelled by governments stockpiling grain reserves, and countries that could have offset grain deficits, including Hungary, Argentina, Turkey, India and China, imposing export restrictions to ensure local food security.<sup>12</sup> The increased prices and price volatility that accompany the ongoing

crisis continue to affect the global grain markets, increasing the risk – and financial implications – of counterparty defaults.

Market commentators have expressed concern that the next two to three years' sowing cycles in Ukraine may be disrupted due to factors such as damage to farmlands and soil fertility, the inability or reluctance of farmers to plant new crops and farm the land, and the alleged theft of Ukrainian farming equipment by Russia.<sup>13</sup> As a result of self-sanctioning and secondary sanctions, Russian

8 Harvey, F. and Butler, S. (2022). Ibid.

9 Reuters (2022). 'Russia ready to set up corridor for ships leaving Ukraine with food, with conditions', *Reuters*, 25 May. Available at: <https://www.reuters.com/world/europe/russia-ready-set-up-corridor-ships-carrying-food-leave-ukraine-ifax-2022-05-25/> (Accessed: 9 June 2022); Harvey, F. and Butler, S. (2022). Ibid.

10 Saul, D. (2022). 'Ukraine Says May Grain Exports Down More Than 60% Compared To 2021 In Latest Alarming Sign Of International Food Crisis', *Forbes*, 19 May. Available at: <https://www.forbes.com/sites/derekaul/2022/05/19/ukraine-says-may-grain-exports-down-more-than-60-compared-to-2021-in-latest-alarming-sign-of-international-food-crisis/?sh=a1458122cc60> (Accessed: 10 June 2022).

11 Farge, E. (2022). 'Nearly 25 million tonnes of grain stuck in Ukraine, says UN food agency', *Reuters*, 6 May. Available at: <https://www.reuters.com/world/europe/nearly-25-mln-tonnes-grain-stuck-ukraine-un-food-agency-2022-05-06/> (Accessed: 10 June 2022).

12 Harvey, F. and Butler, S. (2022). Ibid; Polityuk, P. and Aloisi, S. (2022). 'Explainer: U.N. plan to get Ukraine grains out faces hurdles', *Reuters*, 8 June. Available at: <https://www.reuters.com/markets/commodities/ukraine-looks-ways-get-its-grain-out-2022-05-24/> (Accessed: 9 June 2022); Patterson, W. (2022). Ibid 'Russia-Ukraine conflict: What it means for grain and oilseed markets', *ING*, 7 March. Available at: <https://think.ing.com/articles/russia-ukraine-conflict-what-it-means-for-grain-markets> (Accessed: 9 June 2022); Lee, M. (2022). 'Ukraine conflict prompts countries to hoard grain, endangering global food supply', *Politico*, 13 March. Available at: <https://www.politico.com/news/2022/03/12/ukraine-grain-food-supply-00016764> (Accessed: 9 June 2022).

13 Lister, T. and Fulyppov, S. (2022). Ibid; MacDonald, A. (2022). 'After Russian Retreat, Ukraine's Farmers Discover Fields Full of Mines', *Wall Street Journal*, 28 April. Available at: <https://www.wsj.com/articles/after-russian-retreat-ukraines-farmers-discover-fields-full-of-mines-11651150800> (Accessed: 9 June 2022); Algebris (2022). 'War and Grains: Impact of Ukraine-Russia Conflict on Food Security and Prices', *Algebris*, 25 March. Available at: <https://www.algebris.com/market-views/war-and-grains-impact-of-ukraine-russia-conflict-on-food-security-and-prices/> (Accessed: 9 June 2022).

farmers could also reduce their sowing capacity, which would further exacerbate the supply deficit during subsequent harvesting seasons.

### The search for solutions in Ukraine

The global grain shortage has prompted some European leaders to initiate the negotiation of a safe corridor for grain exports with the Kremlin. To date, progress has been limited. For its part, Russia has only offered to provide safe passage for vessels in exchange for the relaxation of certain sanctions.<sup>14</sup> On the other hand, Ukraine fears that de-mining Ukrainian ports would leave the country vulnerable to attack from the Black Sea<sup>15</sup> and has previously requested guarantees of security (i.e., naval escorts) from third countries, which the West is not currently willing to provide.<sup>16</sup>

At the date of this paper, the EU's chief diplomat has raised hopes of a deal between Russia and Ukraine that would allow Odesa and other Black

Sea ports to reopen, and safe passage of vessels via the Black Sea.<sup>17</sup> Whether such a deal can be agreed and will be adhered to remains to be seen.

Despite the potential for a safe corridor and assuming that de-mining Ukrainian ports takes place, a residual risk of drifting mines remains. Insurers may be unwilling to provide the requisite insurance for vessels and cargoes transiting the Black Sea, and premiums (as well as freight rates) have to date remained high.<sup>18</sup>

The European Commission has suggested alternative transport routes, involving trucking, railways, and river transport, to reroute Ukrainian grain to EU ports, for example via Romania.<sup>19</sup> However, exporting grain by railway is both challenging and costly, not least as the Ukrainian rail network operates on a different gauge from the EU rail system. The deployment of trucks or EU railcars to carry cargo from the Ukrainian border to EU ports has already resulted in congestion. To ease

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14 Faulconbridge, G. (2022). 'Putin ready to facilitate unfettered grain exports from Ukraine's ports – Kremlin', *Reuters*, 30 May. Available at: <https://www.reuters.com/world/europe/putin-russia-ready-facilitate-unfettered-grains-supply-ukraine-2022-05-30/> (Accessed: 17 June 2022).

15 Gumrukcu, T. and Nichols, M. (2022). 'Turkey says Ukraine grain ships could avoid mines, Russia offers safe passage', *Reuters*, 15 June. Available at: <https://www.reuters.com/world/middle-east/turkey-details-un-plan-grain-exports-without-need-de-mine-ukraine-ports-2022-06-15/> (Accessed: 17 June 2022).

16 Gumrukcu, T. (2022). Ibid.

17 Borrell, J. (2022). Ibid.

18 Islam, F. and King, B. (2022). 'Ukraine calls for safe passage for grain exports', *BBC*, 23 May. Available at: <https://www.bbc.co.uk/news/business-61548029> (Accessed: 9 June 2022); Reuters (2022). 'Russia ready to set up corridor for ships leaving Ukraine with food, with conditions', *Reuters*, 25 May. Available at: <https://www.reuters.com/world/europe/russia-ready-set-up-corridor-ships-carrying-food-leave-ukraine-ifax-2022-05-25/> (Accessed: 9 June 2022); Polityuk, P. and Aloisi, S. (2022). Ibid.; Patterson, W. (2022). Ibid.; Food and Agriculture Organization of the United Nations (2022). Information note: The importance of Ukraine and the Russian Federation for global agricultural markets and the risks associated with the current conflict. Available at: [https://www.fao.org/fileadmin/user\\_upload/faoweb/2022/Info-Note-Ukraine-Russian-Federation.pdf](https://www.fao.org/fileadmin/user_upload/faoweb/2022/Info-Note-Ukraine-Russian-Federation.pdf) (Accessed: 9 June 2022); Weil, P. and Zachmann, G. (2022). 'The impact of the war in Ukraine on food security', *Bruegel*, 21 March. Available at: <https://www.bruegel.org/2022/03/the-impact-of-the-war-in-ukraine-on-food-security/> (Accessed: 9 June 2022).

19 Irish, J. (2022). 'France's Macron sceptical on Russia Odesa grain deal, sees Romania option', *Reuters*, 17 June. Available at <https://www.reuters.com/article/ukraine-crisis-macron-grains-idUKKBN2NY0JG> (Accessed: 17 June 2022).

the congestion, the Commission has proposed to increase the availability of transport vehicles and has recommended that member states implement accelerated border-crossing procedures and expand the infrastructural capacities of new export corridors.<sup>20</sup> President Biden has announced that temporary silos will be built along the border with Ukraine in order to allow for the storage of grain whilst it is being transferred from the Ukrainian rail network to the EU rail system.<sup>21</sup>

Reports suggest that, to insulate their customers from logistical difficulties and supply risks, some Ukrainian exporters have been selling grain on terms whereby they assume all risks and costs pending cargoes reaching an agreed point of delivery.<sup>22</sup>

## Financing issues

Increased market prices, rising inflation and higher interest rates all point towards an inevitable increase in the demand for and cost of financing commodities transactions.<sup>23</sup> The increase in demand has coincided with continued reductions in lending activity in commodity finance, in some cases exemplified by a total withdrawal of some lenders from commodity finance for reasons unconnected with the situation in Ukraine.

Many banks have been reluctant to finance the trades of Russian commodities, which may disrupt the commercial objectives of buyers wishing to commit to Russian supplies.<sup>24</sup> Certain banks have been unwilling to process payments to Russian counterparties, even where sanctions do not prevent it. Finally, sanctions placed on Russian banks that were hitherto active in the commodity trade finance market have seen their activities drastically limited or completely prevented.

Some lenders may seek to accelerate loans to Ukrainian companies, whereas others may wish to safeguard their Ukrainian assets through the enforcement of security, triggering a rise of insolvencies along commodities supply chains. Financing arrangements may also be disrupted by termination events that make the performance of a contract illegal, for example through sanctions

that prevent the advancement of finance under a loan agreement or that prohibit the purchase of commodities under prepayment arrangements.

Lenders may also attempt to rely on material adverse change clauses where present in their agreements. Their ability to do so will depend

<sup>20</sup> Petrequin, S. (2022). 'EU plan aims to help get wheat from Ukraine to the world', *AP News*, 12 May. Available at: <https://apnews.com/article/russia-ukraine-health-middle-east-f980a51dab3412aba611277821e2822b> (Accessed: 9 June 2022).

<sup>21</sup> Nichols, M. (2022). 'Biden touts grain silos on Ukraine border to help exports; Kyiv wants ports open', *Reuters*, 15 June. Available at <https://www.reuters.com/world/biden-touts-temporary-grain-silos-ukraine-border-help-exports-2022-06-14/> (Accessed: 16 June 2022).

<sup>22</sup> Speight, A. (2022). 'Changing shipping terms with the Russia-Ukraine conflict: Grain market daily', *AHDB*, 22 April. Available at: <https://ahdb.org.uk/news/changing-shipping-terms-with-the-russia-ukraine-conflict-grain-market-daily> (Accessed: 9 June 2022).

<sup>23</sup> European Central Bank (2022). Financial Stability Review. Available at: <https://www.ecb.europa.eu/pub/financial-stability/fsr/html/index.en.html> (Accessed: 9 June 2022).

<sup>24</sup> Patterson, W. (2022). *Ibid.*

on the factual situation and the drafting of each particular clause. Where triggered, material adverse change clauses can entitle lenders to terminate the loan agreement and demand the immediate early repayment of funds. Therefore, prudent borrowers may decide to seek either a written confirmation that such provisions have not been breached, or a waiver of any such breach from their lenders.

### Hedging and margin calls

Due to volatile commodity prices, clearing members and central clearing counterparties have elevated the initial margins for commodity derivatives. Given that margin requirements must be satisfied by providing either highly liquid collateral or cash, often immediately on demand, some businesses may find such requirements burdensome or even impossible to meet. For others, the price of hedging may outweigh the profit to be made on transactions. Consequently, some businesses may decrease their hedging undertakings, or shift to agreements with less lower collateralisation requirements. In the case of the latter, market participants may be more exposed to greater counterparty credit risk.<sup>25</sup>

A review of existing and future contractual terms to address the particular risks that may arise from the conflict is advisable, to ensure that those risks can be anticipated and mitigated by appropriate drafting.



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<sup>25</sup> European Central Bank (2022). Financial Stability Review. Available at: <https://www.ecb.europa.eu/pub/financial-stability/fsr/html/index.en.html> (Accessed: 9 June 2022).

# Issues affecting inventory and stocks

Threats to domestic agricultural storage in Ukraine have the potential not only to disrupt the physical storage and movement of goods, but also radically to alter the legal and practical bases on which agricultural business has to be conducted, monitored, financed and insured. Domestic storage is an essential aspect of the agricultural supply chain, and plays a part in the secure processing, holding (including for the purposes of financing and sale arrangements), documenting and movement of goods, as well as allowing commodity owners to regulate distribution into the market.

In a typical supply chain model, agricultural commodities might be stored in a number of locations and for a variety of purposes before being exported – for example, immediate processing, documenting and storage subsequent to harvest, further inland storage, documenting and treatment during the transit to the point of export, and final storage at or near to the land or sea border prior to exiting the domestic market.

At all of these points, a prudent owner of goods will seek to have in place measures which both extend the life of the goods (without any material degradation in quality) and ensure their security from external threats such as pilfering, theft and documentary fraud. However, the Russian invasion of Ukraine has the potential to disrupt the safe storage of agricultural commodities in Ukraine in a number of respects – both for goods already in storage, and for those goods which in the ordinary course would be expected to enter into storage at the end of the next growing and harvesting season.

## Degradation

At the most basic level, the inability to move last year's crop out of storage at the usual rates in locations both inland and at the border has resulted in a significant accumulation of goods in silos, warehouses and other storage locations. But can those goods which are already in storage be safely preserved in wartime conditions?

Even in a business-as-usual scenario, the safe storage of agricultural commodities requires considerable expertise, equipment and labour. Typically, crops need to be treated prior to entering into storage, e.g. by cleaning, drying and aerating. To limit degradation and loss of goods, it is common for goods in storage to undergo regular further treatment, potentially including inspections to identify and treat or remove damaged goods, turning, spreading and other processes, which can assist to minimise respiration and heating of the goods. Goods are routinely treated and fumigated to minimise the spread of fungi, rodents and insects, which consume crops and contribute to heating, respiration and toxicity. It is conceivable that shortages of labour,

equipment, chemicals and other essentials due to supply chain disruption and destruction will expose goods to an unusual risk of deterioration and loss.

### Impact on insuring inventory

In practice, these types of risk may make the insurance of goods in Ukraine more expensive and, potentially, more complex to negotiate as commodity owners and insurers grapple to strike the right balance between providing the types of assurance insurance providers are used to receiving (for example, regarding oversight, treatment, documentation and declaration) and the realities of the situation on the ground. The owners of goods in storage may, for example, be unwilling to sign up to traditional insurance terms which impose conditions on coverage which are unlikely to be met, but, on the other hand, may wish to obtain wider than usual coverage in order to reflect the potentially greater risks of their enterprise.

The presence of invading forces in Ukraine also presents a more direct threat of physical destruction and loss. Aside from the physical damage to, or even destruction of, agricultural equipment and storage facilities described above, there have been reports of Russian forces looting crops from within storage.<sup>26</sup> Again, these heightened practical risks will need to be allocated between parties at the contracting stage – both in commodity contracts and in contracts for financing

and insurance – and traditional terms may no longer be fit for purpose.

### Impact on the monitoring of goods in storage

It is commonplace for goods in storage to be subject to regular inspections in order to verify their existence, categorisation, quality and condition. Those inspections may be required not only by commodity owners for their own purposes and in order to generate certificates and other documents for the purposes of their sale contracts, but also by their financiers, insurers and/or customers, for whom either carrying out or being able to see the satisfactory outcome of inspections might traditionally have been an important means of confirming contractual performance and reducing the risk of fraud.

Those doing agricultural business in Ukraine will have to grapple with the potentially increased risk to the physical integrity of goods (and accompanying documents) and reduced availability and/or increased costs of inspections, which have traditionally been used to monitor these risks. Contractual forms (for example, financing agreements and insurance policies) may include conditions regarding the storage, inspection and documenting of goods that it may no longer be feasible to observe, and careful thought should be given to which contract terms can be kept, and which need to be re-thought in order to reflect new realities.

<sup>26</sup> Bove, T. (2022). ‘It’s an almost grotesque situation.’ Nearly 25 million tons of grain are stuck in Ukraine, and the UN says it doesn’t know when it can be accessed’, *Fortune*, 6 May. Available at: <https://fortune.com/2022/05/06/un-warns-millions-tonns-grain-stuck-ukraine-food-prices/> (Accessed: 9 June 2022).

## Goods not yet in storage

As to goods not yet in storage, a key issue will be availability of storage capacity following this year's harvest. In early May, it was reported that because of the inability to rapidly free up storage space by distributing last year's crop, and the practical unavailability of storage capacity in areas under Russian control or subject to heavy fighting, there could be a shortage in Ukraine of around 16.3 million tonnes of storage capacity by the end of 2022.<sup>27</sup>

Goods for which storage cannot be found are at an increased risk of exposure and deterioration or loss as a result of their inherent characteristics, before taking account of human factors, such as increased risk of pilfering and theft on a greater scale. The ability of farmers and other commodity owners to undertake processes of categorising and documenting goods for sale, which ordinarily take place during storage or at the point of exit from storage, may also be disrupted. If proper checking and documenting does not take place, long-established contractual requirements and means of performance may become more challenging and the risks of documentary fraud might also increase.

## Alternative solutions for storage of crops

Alternative solutions are being considered and there have been reports that some Ukrainian producers are turning to less traditional storage solutions such as silo bags.<sup>28</sup> Ukraine's Agriculture minister has recently confirmed that unspecified temporary storage equipment is en route to the country.<sup>29</sup> However, the life expectancy of crops in silo bags is not necessarily the same as crops in traditional silos or warehouses, including due to the materials from which the bags are made, their ability to stand up to the elements, animals and insects, the risk with certain crops that taking on of moisture and/or respiration can cause swelling and split the bag, as well as the practicalities of undertaking some of the treatment processes (for example, inspecting, turning and fumigating) in closely packed bags. Inexperience in the use of silo bags (including preparing the area on which the bag will be placed, proper filling and sealing measures, and different crop preservation measures) versus more traditional solutions may also be a factor.

<sup>27</sup> Reuters (2022). 'Ukraine faces grain harvest storage crunch as exports struggle', *Reuters*, 3 May. Available at: <https://www.reuters.com/world/europe/ukraine-faces-grain-harvest-storage-crunch-exports-struggle-2022-05-03/> (Accessed: 9 June 2022).

<sup>28</sup> Sirosh, Y. (2022). 'Ukrainian grain producers scramble for alternative storage amid high stocks', *Fastmarkets Agricensus*, 19 May. Available at: <https://www.agricensus.com/Article/Ukrainian-grain-producers-scramble-for-alternative-storage-amid-high-stocks-22271.html> (Accessed: 9 June 2022); Reuters (2022). 'Ukraine faces grain harvest storage crunch as exports struggle', *Reuters*, 3 May. Available at: <https://www.reuters.com/world/europe/ukraine-faces-grain-harvest-storage-crunch-exports-struggle-2022-05-03/> (Accessed: 9 June 2022); Higgins, A. and Solomon, E. (2022). 'As Food Shortages Loom, a Race to Free Ukraine's Stranded Grain', *The New York Times*, 1 June. Available at: <https://www.nytimes.com/2022/06/01/world/europe/ukraine-grain-shortages.html> (Accessed: 9 June 2022).

<sup>29</sup> Reuters (2022). 'Ukraine soon to receive first temporary storage for 2022 grain harvest', *Reuters*, 20 June. Available at: <https://www.reuters.com/world/europe/ukraine-soon-receive-first-temporary-storage-2022-grain-harvest-2022-06-20/> (Accessed: 20 June 2022).

# Business and logistical infrastructure

The largest market participants have wholly or partly vertically modelled their international businesses. A locally incorporated entity purchases agricultural goods from the producers at origin, before processing them as closely as possible to the point of export. The goods are then stored near to, or at, the seaport or rail head to await export. Commonly, goods are sold to trading entities within the same corporate group, which then either sell them to external buyers or else on-sell them to corporate relatives. Frequently, the corporate group will hold the entire value chain, with cargoes being sourced at origin, loaded, bought, sold, re-sold, processed and consumed within the same group. In cases where a group does not control the whole value chain for a given cargo, it might nonetheless handle the majority of it, perhaps selling to end-users in the country of import. This vertically integrated model tends to promote operational efficiency and supply security. It also reduces the risk of disputes, which are otherwise a regular facet of international trade.



Ukraine's economy depends on the ability to export bulk and liquid agricultural goods from deep seaports. Before the invasion, the most important of those ports in terms of tonnage exported were Mariupol, Odesa, Chernomorsk, Yuzhny and Mykolaiv, but there were a total of 13 seaports in operation and exporting bulk and liquid cargoes.<sup>30</sup> As the Russian campaign sought to establish a stable land corridor from Crimea in the south to the Donbas region to the north and east, Mariupol became a strategic focal point for Russian forces. While the city has largely been destroyed, much of the port infrastructure has been preserved – a consequence of the importance to Russia of establishing a Black Sea export corridor. Nonetheless, Mariupol currently remains unusable as a port for Ukraine. Even if Russia withdraws from the area in time, the damage to infrastructure inland of the port will ensure it remains so until that infrastructure is rebuilt after the war ends.<sup>31</sup> Odesa has faced the threat of extensive damage from bombardment, with the possibility that its crucial

export infrastructure might also be damaged or destroyed.

The impact on infrastructure has not been confined to seaports and their facilities. Russian military operations have targeted inland storage, railway lines, rail terminals and power distribution infrastructure. It is estimated that the losses to Ukraine's economy from damage to physical infrastructure since the beginning of the war so far total US\$103.9 billion.<sup>32</sup> The result has been significantly increased difficulty in moving goods to storage after harvest and thereafter to ports for export.

Apart from the loss and damage to port and inland infrastructure, Ukraine's Black Sea ports are subject to maritime blockade by the Russian navy, including by the placement of sea mines that present a constant threat to shipping.<sup>33</sup>

<sup>30</sup> Mihai, N., Hryshyna, L., Khmarska, I., Pogoryelova, E., Heyshyna, N. (2021). 'Evaluating performance and development priorities of port industry in Ukraine', *MATEC Web of Conferences*. doi: 10.1051/matecconf/202133901013; Joshi, R. (2022). '5 Major Ports of Ukraine', *Marine Insight*, 14 April. Available at: <https://www.marineinsight.com/know-more/5-major-ports-of-ukraine/> (Accessed: 10 June 2022).

<sup>31</sup> The Odessa Journal (2022). 'The Ministry of Infrastructure of Ukraine has issued an order to close some seaports', *The Odessa Journal*, 30 April. Available at: <https://odessa-journal.com/the-ministry-of-infrastructure-of-ukraine-has-issued-an-order-to-close-some-seaports/> (Accessed: 10 June 2022); Diakun, B. (2022). 'Ukraine completes first post-invasion seaborne iron ore shipment', *Lloyd's List*, 6 June. Available at: <https://lloydslist.maritimeintelligence.informa.com/LL1141141/Ukraine-completes-first-post-invasion-seaborne-iron-ore-shipment> (Accessed: 10 June 2022); Osler, D. (2022). 'Russia failing to reopen port of Mariupol', *Lloyd's List*, 25 May. Available at: <https://lloydslist.maritimeintelligence.informa.com/LL1140935/Russia-failing-to-reopen-port-of-Mariupol#:~:text=RUSSIA%E2%80%99S%20armed%20forces%20are%20trying,the%20Lloyd%E2%80%99s%20agency%20covering%20Ukraine> (Accessed: 10 June 2022); Bakhsh, N. (2022). 'Russia declares Mariupol port mine-free', *Lloyd's List*, 26 May. Available at: <https://lloydslist.maritimeintelligence.informa.com/LL1141021/Russia-declares-Mariupol-port-mine-free> (Accessed: 10 June 2022).

<sup>32</sup> Kyiv School of Economics (2022). *Damages to Ukraine's infrastructure*. June 8. Available at: <https://kse.ua/russia-will-pay/> (Accessed: 10 June 2022).

<sup>33</sup> International Maritime Organization (2022). Circular Letter No. 4573: Maritime security threat posed by free floating sea mines in the Black Sea Region. Available at: [https://wwwcdn.imo.org/localresources/en/MediaCentre/HotTopics/Documents/Ukraine%20crisis%20CL%204524/Circular%20Letter%20No.4573%20-%20Maritime%20Security%20Threat%20Posed%20By%20Free%20Floating%20Sea%20Mines%20In%20TheBlack%20Sea%20Region%20\(Secretariat\).pdf](https://wwwcdn.imo.org/localresources/en/MediaCentre/HotTopics/Documents/Ukraine%20crisis%20CL%204524/Circular%20Letter%20No.4573%20-%20Maritime%20Security%20Threat%20Posed%20By%20Free%20Floating%20Sea%20Mines%20In%20TheBlack%20Sea%20Region%20(Secretariat).pdf) (Accessed: 10 June 2022).

# Business interruption and insurance

The damage to storage and movement infrastructure will severely hamper exports, even if the military situation ultimately eases and the blockade is lifted. For those reasons, while the prospect of a safe corridor remains a potentially positive development, the ability to exploit it will depend on the level of damage that has been done to shore and inland infrastructure in the meantime and the ability of Ukraine and international enterprises to restore that infrastructure in the short to medium term. That, in turn, is likely to depend at least partly on the insurance positions of the local and international owners of those assets.



The key insurance issues concern whether insurers will pay for reconstruction and, if so, whether they will do so within a period that is short enough to mitigate the effects of the damage done to infrastructure. Depending on the cover position, large-value insurance claims are expected.

Even if insurers cover reconstruction costs and infrastructure can be rebuilt, challenges will possibly remain because of shortages and instabilities in the supply of raw materials and labour. Beyond that, the owners of restored assets in Ukraine will potentially face difficulties or greatly increased expense in insuring those assets, depending on the stability of the political and military environment. These factors have the potential to lead international businesses to re-appraise their commitment to rebuilding in the medium term, with a longer-term impact on the Ukrainian agricultural economy. In the meantime, attempts to move grain into Europe by land will also be subject to questions concerning insurance cover for goods and the equipment used to transport them. Those risks and concerns might, however, be offset by the global effect of constricted Ukrainian exports on food supplies and prices. Faced with the increased risk of hunger and food poverty, governments and businesses alike might feel they have to act to mitigate the financial risks faced by those who are attempting to move goods out of Ukraine into Europe. Given the perishable nature of the goods concerned and the urgent need for their supply, these issues could come to a head in the shorter term.

In the meantime, the inability to export agricultural goods by sea will mean local shippers continue to suffer open-ended interruption to their businesses, whether they be independent Ukrainian sellers or part of an integrated international enterprise. Millions of tonnes of grain have been blocked at Ukrainian ports since the invasion began on 24 February 2022. Storage space will become scarcer by mid-August 2022 when this year's crops are harvested,<sup>34</sup> a situation that will be exacerbated by damage to storage and movement facilities and the difficulty of moving crops to port by road or rail in times of conflict. Equally, international traders that had planned on lifting hundreds of thousands of tonnes of goods from Ukraine each month to feed their own value chains or for delivery to external buyers will now need either to pivot to alternative sources of supply or to consider whether their contract terms offer them a legal safety valve. In some cases, business interruption insurance might reduce the losses that result from these interruptions to trade flows, but, again, it is reasonable to expect insurance claims and coverage disputes in time.

<sup>34</sup> Partridge, J. (2022). 'How do you get 20m tonnes of grain out of Ukraine?', *The Guardian*, 7 June. Available at: <https://www.theguardian.com/world/2022/jun/07/how-do-you-get-20m-tonnes-of-grain-out-of-ukraine> (Accessed: 17 June 2022).

# International law and investment treaty considerations

There has been expropriation of agricultural industry assets by both sides in the conflict in Ukraine. **In the Russian-occupied territories of Ukraine:** Russia has taken control of public and private assets and businesses. In the Donbas region in particular, Russia has seized control of numerous agricultural industry assets.<sup>35</sup> For example, the Ukrainian Ministry of Foreign Affairs estimated on 12 May 2022 that Russia had confiscated at least 400,000 to 500,000 tonnes of grain (worth more than US\$100 million) from Ukraine since the invasion began. In addition, storage facilities, farms and farm machinery have been commandeered, and some agricultural businesses are expected to be transferred to pro-Russian business interests.

**In Russia:** The Russian government is preparing legislation that is expected to enable the nationalisation of companies operating in Russia that are more than 25% owned by foreign parent companies registered in “unfriendly countries” (and have more than 100 employees or a book value of more than RUB 1 billion). This legislation could lead to the expropriation of foreign-owned assets and entities in Russia. **In Ukraine:** Separately, Ukraine passed an expropriation law on 7 March 2022 that permits the Ukrainian state to seize assets in its territory that belong to the Russian state, Russian citizens (or individuals with close connections to Russia), and entities with Russian shareholders or beneficial owners. Amendments to the initial version of the legislation also allow for the expropriation of Ukrainian assets belonging to anyone who has supported Russia’s military action, or who has not suspended their business activity in Russia since the invasion.

Individuals and businesses whose businesses or assets have been seized by a state should seek advice as to whether such seizure is lawful as a matter of local and international law.

## Investor-state investment treaty claims

Under customary international law and most investor-state investment treaties, expropriation can be lawful, but only if it is carried out:

- a. for a public purpose in the national interest of the state (i.e., not for some private benefit);
- b. in return for adequate and fair compensation (i.e., meaning that any expropriation that is carried out without prompt payment of compensation at a fair market value is likely to be unlawful as a matter of international law<sup>36</sup>);
- c. on a non-discriminatory basis (i.e., meaning that similar cases are treated in the same

<sup>35</sup> Hall, B. (2022). ‘Russia accused of industrial-scale farm plunder in Ukraine’, *Financial Times*, 11 May. Available at: <https://www.ft.com/content/d28cc77d-9de3-4988-bdba-cfab77268ea3> (Accessed: 9 June 2022).

<sup>36</sup> Interestingly, we understand that the Ukrainian government has suggested that consideration will be given for any assets it expropriates from Russian individuals or businesses by way of set off against future reparations.

way) – however, it is not clear whether the confiscation of assets belonging to those of a particular nationality will be treated as discriminatory as a matter of international law; and

- d. in accordance with legal procedures and the due process of law (meaning that if, for example, there is a procedure under local law for challenges to be made to the expropriation, that process must be followed).

Any foreign investor in Ukraine attempting to protect its assets from expropriation or to seek compensation following expropriation should consider whether its investments in Ukraine are protected under any international investment agreement (IIA).

IIAs are individually negotiated agreements between states that seek to protect investments by nationals of one state in the territory of the other state. As explained above, typically, IIAs include protection against unlawful expropriation. If a state breaches those protections, an investment treaty claim may be brought under the IIA (usually through arbitration) to seek compensation and hold the state to account.

Russia is party to 63 IIAs with other states currently in force, including Canada, China,

France, Germany, Italy, Japan, the Netherlands, Norway, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, the UK and Ukraine, and six multilateral trade agreements with investment protections. Foreign investors incorporated in the United States may be able to rely on the Energy Charter Treaty to bring a claim (as in *Yukos Universal Ltd (Isle of Man) v. Russia*<sup>37</sup>).

A foreign investor seeking treaty protection under an IIA should consider:

- e. whether it is a national of the state party to the IIA that is not the host state;
- f. whether it has made a qualifying investment in the territory of the host state; and
- g. whether the expropriation of its investment (or other adverse treatment) is in breach of the IIA and those actions are attributable to the Russian state.

Examples of successful IIA claims include *Everest Estate LLC and others v. Russia*<sup>38</sup> and *Oschadbank v. Russia*,<sup>39</sup> in which state-owned Ukrainian entities claimed against Russia under the Ukraine-Russia Bilateral Investment Treaty for losses following the Russian annexation of Crimea. In *Stabil LLC and others v. Russia*<sup>40</sup> and *PJSC Ukrnafta v. Russia*,<sup>41</sup> the tribunal found that the

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<sup>37</sup> [2014] 7 WLUK 750.

<sup>38</sup> PCA Case No. 2015-36.

<sup>39</sup> PCA Case No. 2016-14.

<sup>40</sup> PCA Case No. 2015-35.

<sup>41</sup> PCA Case No. 2015-34.

Russian armed forces' seizure of petrol stations and related assets in Crimea that were owned by Ukrainian investors amounted to unlawful expropriation, and the Russian state was ordered to pay a combined sum of over US\$75 million.

That said, a note of caution must be sounded about claims against Russia for expropriation of assets in occupied territories of Ukraine. That is because investment treaty claims against Russia can only be brought in connection with investments within the "territory" of Russia. At the moment, arbitrators are likely to consider that Russian-occupied areas of Ukraine like the Donbas region, for example, are not (yet) part of Russian "territory" for the purpose of an investment treaty claim. The cases involving Crimea mentioned above, by contrast, were brought on the basis of Russia's formal annexation and control of Crimea (which was ratified by the Russian parliament).

### Enforcement of investment treaty claims

A further question is whether any arbitration award under an investment treaty will be enforceable. It is surely unlikely, for example, that the Russian courts would allow enforcement of an arbitration award against Russian state assets in Russia. However, it might be possible to enforce such an award against assets of the Russian government that are held outside Russia, and Russia is a party to the New York Convention.<sup>42</sup> It is even possible that sanctions regimes might be amended so as to allow the enforcement of arbitration awards against assets of the Russian state that have been frozen by foreign sanctions.

Despite some of the notes of caution highlighted above, for some investors whose assets have been expropriated as a result of the war in Ukraine, investment treaty arbitration might be a viable route to recovery.

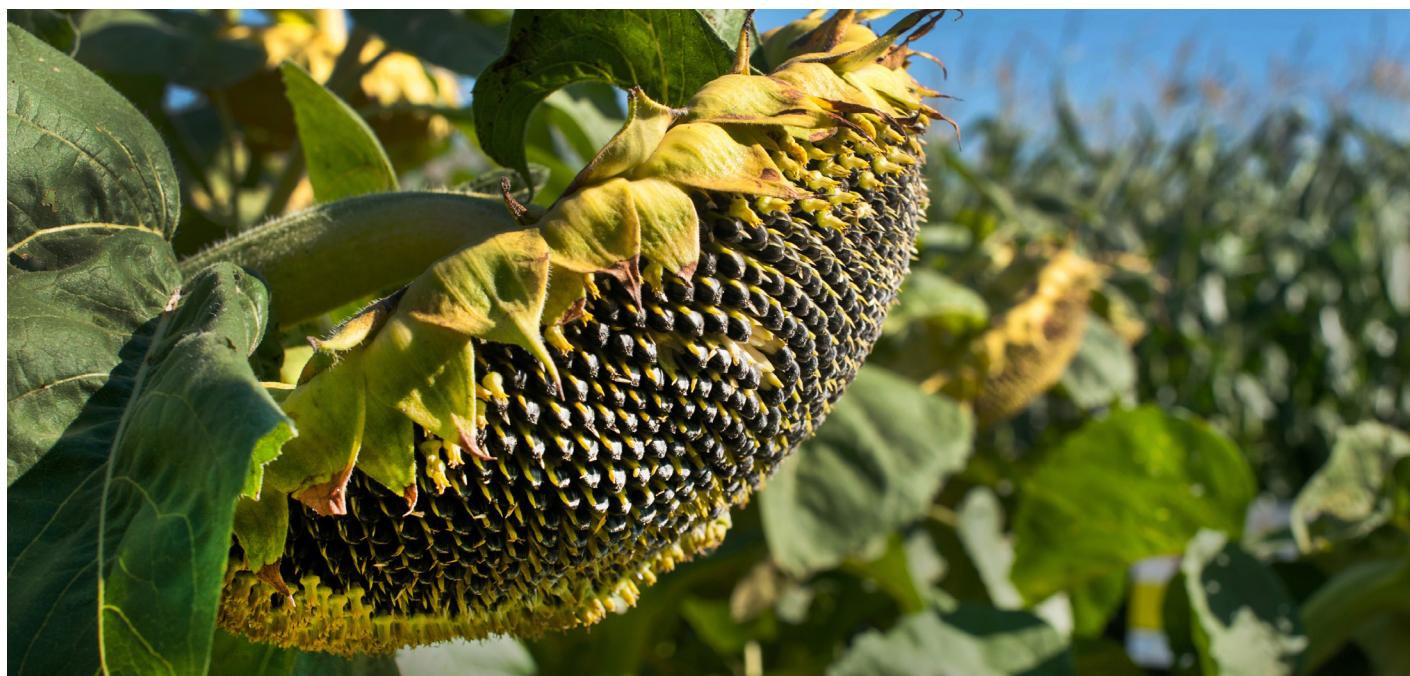
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<sup>42</sup> On the Recognition and Enforcement of Foreign Arbitral Awards 1958.

# Conclusions

Those engaged in the production, supply, export and sale of agricultural goods from Ukraine and Russia face commercial and legal risks at all points along the value chain. Those challenges arise from official and unofficial sanctions, risk to infrastructure and goods, increased prices and finance costs, expropriation of assets and crops, and constrictions in storage capacity. Managing or mitigating those risks will require new approaches to sourcing supply and to finance, price risk management, contracting, insurance and storage. Reversing the effects of the conflict, once it ends, will require a great expenditure of human effort and financial capital. The speed and success of that reconstruction will be partly dictated by the willingness and ability of market participants to drive the process and the response of insurance cover not only to past loss, but also to protect against the risks of future loss.

The challenges posed to the markets for agricultural goods do not end with Ukrainian output. The knock-on effects for commodity and fertiliser supply, demand and prices are already being felt globally at a time when other factors, such as increased energy prices, amplify the difficulties faced. The implication of that wider impact is that many of the considerations set out in this article will be as important to those outside the direct markets for Ukrainian and Russian goods as they are for those inside those markets.



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