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Introduction

The commodities markets have seen some turmoil over the last 8 months globally. Within the USA and China, tariffs have been the main cause of disturbance both in the soft and hard commodity markets. Combining this with the unsure future of UK and European trade deals, legal challenges in the next 12 months are promising to be an interesting period of unorthodox opportunities.

With the input of tariffs on steel by the USA, the industry has once again been set back globally and the full effect of this is yet to come. And with the value of copper hitting a 5 year low, alongside the decrease in the value of gold due to a rise in the value of the dollar, the metal trading market is in a period of instability.

In the soft commodities markets we have seen some interesting movements, with the USA's soya bean exports to the world's biggest market, all but disappearing despite the sanctions being removed. This has meant Brazil has seen growth in soya bean exports which has benefited them greatly, since the price of Arabic coffee beans dropped to a 12 year low. Technical advances in farming (growing bananas without soil) matched up with the stability in prices have provided opportunities that look to be strong in the coming year.

The development of financial technology has caused new threats for companies; however the evolving industry is bringing up new opportunities for investment, providing a new dynamic market away from the traditional structure and process. This is likely to have a major effect of the market in 2019.

In this latest edition of In-Short, we look at some of the issues that have arisen in relation to derivatives with the impending approach of BREXIT; how the US have reacted to the continuation of shipping petroleum from the Middle East; the changes to GAFTA regulations and the practical effect of this on the industry; and cyber security breaches that are affecting our clients.

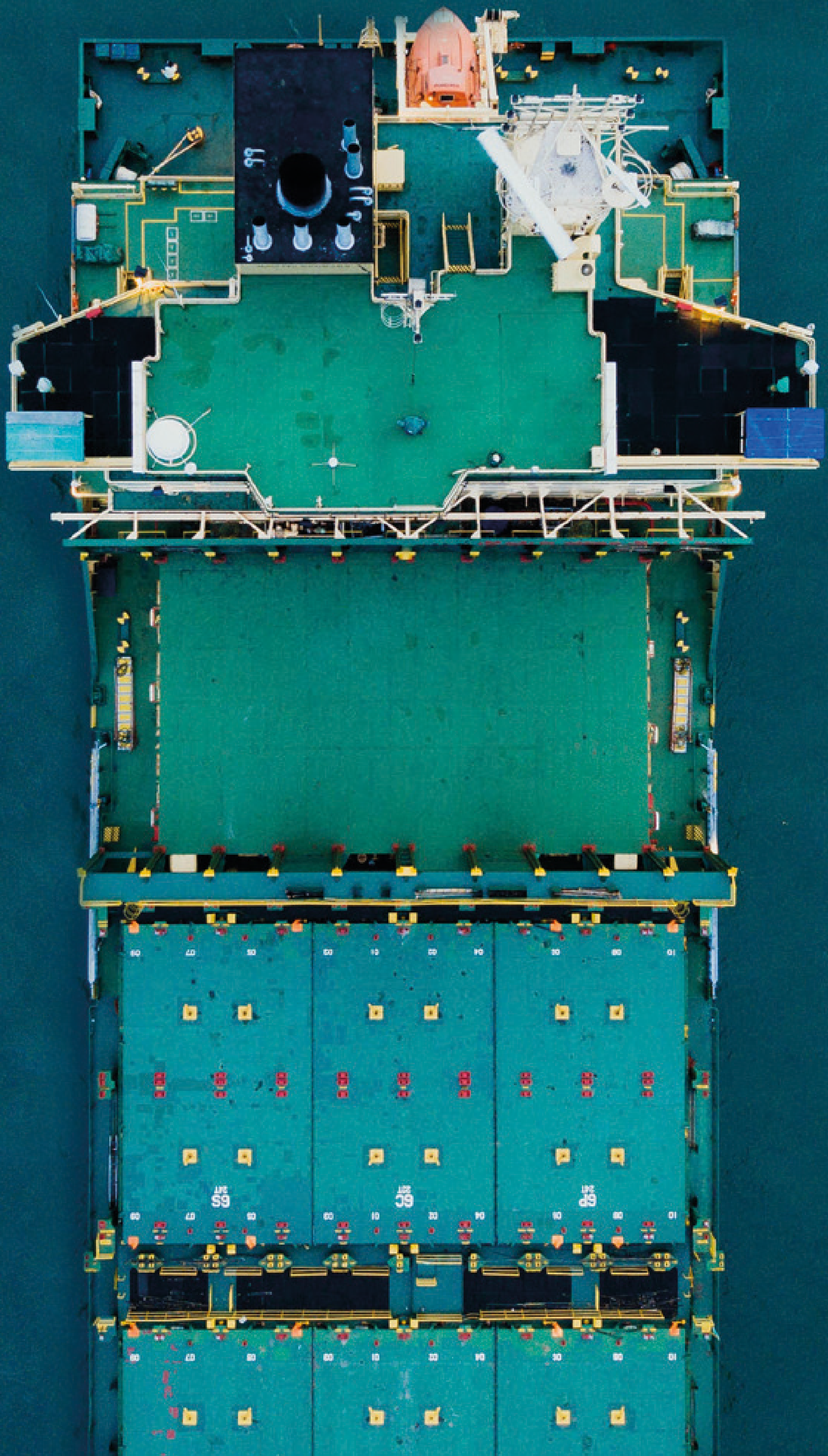
In this issue we cover:

– OFAC fires shot across the bow of Middle East shipping industry

– Review of recent Gafta contract amendments

– More than market access: the regulatory impact of Brexit on EU and UK firms

– Cyber fraud – follow the money



OFAC fires shot across the bow of Middle East shipping industry

By Patrick Murphy (Partner, Dubai)

OFAC, together with the US Coast Guard and the US Department of State, has just issued a timely reminder of the risks of shipping petroleum products to Syria and Iran.

At the same time that it added 9 persons and entities to the SDN list, whom OFAC suspect were involved in the shipment of petroleum products to Syria, OFAC has reminded the shipping, oil trading and financial institution communities generally that anyone (including non-US persons) who provides support to the Syrian regime by, for example, facilitating imports of oil to the Government of Syria could be designated as a SDN.

The notice also warns persons generally who own, control or insure a vessel that transports crude oil from Iran to Syria, or countries that have not received a reduction exemption waiver, that they could be subject to secondary sanctions penalties for engaging in those activities.

The notice itself does not impose any new sanctions on Iran or Syria; it is, rather, a reminder of the existing US primary and secondary sanctions in force against both Syria and Iran in relation to the sale and transportation of oil cargoes. However, there are two particularly notable elements to the notice. Firstly, it sets out a non-exhaustive list of 35 vessels that are suspected of having delivered oil to Syria between 2016 and 2018. The vessels themselves have not all been added to the SDN list, but the implication of naming the vessels is clearly that the United States has been monitoring carefully their activities and will be monitoring others in the future.

Secondly, it sets out a list of known deceptive practices used to ship petroleum products to Syria, including falsifying cargo documentation such as bills of lading, carrying out STS transfers of cargo at sea, and the disabling of AIS systems to conceal locations. None of these measures are new in themselves; they have been employed for years by parties engaged in "sanctions busting". However, OFAC is saying that it knows this too and is actively on the lookout for parties engaging in such activities.

"OFAC has reminded the shipping, oil trading and financial institution communities generally that anyone (including non-US persons) who provides support to the Syrian regime by, for example, facilitating imports of oil to the Government of Syria could be designated as a SDN"

And it warns others to look out for them as well. In a list of risk mitigation measures, it encourages financial institutions, such as insurers, as well as ship registries, charterers and port operators to look out for AIS manipulation or documentary discrepancies that would be red flags for potential sanctioned cargoes.

Coming just two weeks after the re-imposition of the second tranche of secondary sanctions against Iran, this notice is therefore a timely reminder that shipping and oil trading in the Middle East, with its unique concentration of sanctions risks, is firmly at the centre of US regulatory attention. For those engaged in the industry, the risk mitigation measures identified by OFAC are a sensible starting point for managing sanctions risk. For example, caution should be exercised in relation to suspicious requests in relation cargo documentation (such as issuing bills of lading with suspicious "Eastern Mediterranean" discharge ranges) or when dealing with vessels with suspicious periods of time with no AIS connectivity. With the political climate in the region showing no sign of changing, those risk mitigation measures might well be in force for some time yet.

More than market access: the regulatory impact of Brexit on EU and UK firms

By Owen Williams (Associate, London)

A hard Brexit will not only affect UK firms and gives rise to more issues than just market access.

Much attention has been given to the problems which UK firms will face in accessing EU markets in the event of a hard Brexit. However there are a number of less headline-grabbing changes which firms will also need to consider. These changes will not just impact UK firms and EU firms should not think of Brexit as simply a British problem. Indeed, a number of the changes brought about by a hard Brexit may have a bigger impact on EU firms than on UK firms.

As with any article on Brexit, this one comes subject to the usual caveat that the actual position following the UK's withdrawal from the EU will depend on the terms of any agreement reached between the UK and EU. This article considers what the position would be in the event of a no deal Brexit, assuming no side arrangements are made between EU and UK regulatory bodies.

For commodity traders, some of the most important changes relate to the impact a hard Brexit will have on their status and obligations under the main pieces of legislation governing derivative trading, namely the European Market Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Directive (MiFID II). This article will focus on the ways in which these two pieces of EU legislation are to be "on-shored" in the UK following Brexit, the approach to central counterparties (CCPs), the calculation of the clearing threshold, and the availability of the intragroup exemption, under EMIR, and the calculation of the ancillary exemption under MiFID II.

On-shoring

Readers are likely to be familiar with the general process by which the UK will on-shore EU law following Brexit. Under the European Union (Withdrawal) Act 2018 (the Withdrawal Act), the UK will retain all UK legislation that implements EU Directives and incorporate EU Regulations into UK law.

Unsurprisingly, this is not a straightforward task. It is not possible to simply cut and paste EU legislation into UK law. For example, references to EU agencies need to be replaced with their UK equivalents. For this reason, the Withdrawal Act allows the government to correct deficiencies in retained EU legislation that result from the UK's withdrawal from the EU. .

The UK has published three statutory instruments (some of which are still in draft form) to onshore EMIR under the Withdrawal Act (UK EMIR) and a draft statutory instrument to onshore MiFID II (UK MiFID II). The process of correcting deficiencies in UK EMIR and UK MiFID II may result in some differences in firms' status and obligations after Brexit.

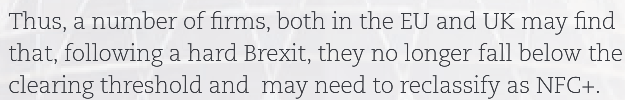
EMIR - Clearing threshold

Both EU and UK firms will have to consider whether their clearing status under EMIR will change following a hard Brexit.

Currently firms whose speculative OTC derivative contracts (as opposed to speculative contracts traded on exchanges) are valued above a certain threshold, known as the "clearing threshold", must comply with stricter risk mitigation rules under EMIR.

In the event of a hard Brexit, UK exchanges will no longer be recognised by the EU and contracts traded on UK exchanges will be classed as OTC. As a result EU firms will need to treat contracts traded on UK exchanges as OTC and include such contracts when calculating whether their speculative OTC trading exceeds the clearing threshold.

Similarly, under UK EMIR, contracts traded on EU exchanges will be considered OTC and UK firms will need to include such contracts in calculating whether they exceed the clearing threshold under UK EMIR.



Thus, a number of firms, both in the EU and UK may find that, following a hard Brexit, they no longer fall below the clearing threshold and may need to reclassify as NFC+.

EMIR - Intragroup exemption

A hard Brexit could mean that companies are no longer able to rely on the intragroup exemption under EMIR.

The intragroup exemption exempts trades between two EU members of a group, or between an EU company and a company in a third-country which benefits from an equivalence decision, from EMIR's clearing obligation.

If Britain leaves the EU without a deal or any equivalence decision, intragroup trades between an EU company and its UK sister company will no longer benefit from the intragroup exemption. As a result, certain EU companies will be required to clear intragroup trades with UK companies.

For UK companies, the position is different. Under UK EMIR, the government has proposed a temporary exemption regime, which will allow UK companies that relied on an intragroup exemption prior to exit day, to continue to rely on this exemption after Brexit. This appears to be one area in which Brexit will have a more direct impact on EU firms than on UK firms.

EMIR - Central Counterparties

One of the main concerns of EU firms over the past few months has been the risk that EU will no longer recognise UK CCPs.

Under EMIR, certain firms are required to clear their OTC derivatives with a CCP which is authorised or recognised by the EU. The vast majority of derivatives are currently cleared through UK CCPs. In the event of a hard Brexit, these UK CCPs will no longer be recognised by the EU for the purposes of EMIR. Thus clearing an OTC trade with a UK CCP will no longer be sufficient to meet the clearing obligation under EMIR.

With an estimated £67 trillion worth of notional derivatives cleared by EU firms on UK CCPs, the EU has recognised that this is an issue which could potentially undermine market stability. On 19 December 2018 the European Commission adopted an Implementing Decision which will allow UK CCPs which were authorised prior to Brexit to continue providing clearing services after Brexit. The European Securities and Markets Authority has said that it is aiming to adopt recognition decisions in relation to UK CCPs well ahead of Brexit. It appears that this is one of the few issues where a hard Brexit should have a limited impact.

MiFID II – Ancillary activities exemption

Following a hard Brexit, firms will need to consider their status under MiFID II. In particular, those commodity traders which currently rely on the ancillary activities exemption will need to ensure that they can still do so after a hard Brexit.

The ancillary activities exemption allows firms that trade commodities derivatives on own account largely for the purposes of hedging to remain outside the regulatory scope of MiFID II. In order to rely on the exemption firms must pass two tests, one of which, the "market share test", compares the size of their speculative trading activity in the EU against the overall trading in the EU in each particular asset class.

In the event of a hard Brexit, trading data from the UK will no longer be taken into account in determining the overall volume of trading undertaken in the EU. In addition, EU firms will no longer have to consider trading done on UK venues when considering the size of their own speculative positions. Given that almost all trading in certain asset classes, such as coal, oil and metal, takes place in the UK, the fact that UK data will no longer be included in the market share test could lead to problems for EU firms. It remains to be seen whether the EU will make any amendments to the market share test following Brexit. However, without UK trading data, the calculations will look quite different after Brexit.

For UK firms, there is a little more certainty. Under UK MiFID II firms must continue to consider trading in the EU in determining their status under the "market share test". Thus most UK firms which currently pass the market share test are likely to continue to do so after a hard Brexit. Again this is another area where a hard Brexit may have a bigger impact on EU firms than UK firms.

More than market access

A hard Brexit will impact commodities firms beyond the obvious market access issues. This article does not provide a complete list of factors which firms will need to consider. However firm's should note that a hard Brexit will require all firms, and not just those in the UK, to look closely at all aspects of their business. Unfortunately this is a task for which there are no short-cuts.

Review of recent GAFTA contract amendments

By Eurof Lloyd-Lewis (Partner, UK) and Sophie Morrison (Trainee Solicitor, UK)

This article was first published in Gaftaworld, December 2018 issue

GAFTA have approved the amendment of a number of its standard form contracts, the most significant of which are the removal of the contractual limitation period, or "time bar", in respect of claims for "amounts payable" from GAFTA Arbitration Rules No. 125 ("GAFTA 125"), and the elimination of the express obligation, in GAFTA No 49, for FOB sellers to have cargo ready at any time during the agreed period of delivery.

GAFTA 125 – Abolition of Rule 2.3

Prior to 1 September 2018, Rule 2.3 provided that:

"In the event of non-payment of amounts payable, either party may notify the other that a dispute has arisen and, within 60 consecutive days from the date of that notice, appoint an arbitrator or apply to Gafta for an appointment of an arbitrator".

A degree of ambiguity surrounded which disputes fell within its remit. Prior to September 2016, the 60 day time bar was triggered by notice that a dispute had arisen as provided for in the "Payment Clause" of the contract. Removal of the reference to "Payment Clause", in the September 2016 iteration, arguably meant that it now applied to all claims for "amounts payable" arising out of the contract.

GAFTA has now decided to remove this rule in its entirety from contracts which incorporate GAFTA 125 entered into on, or after, 1 September 2018.

Save for disputes where arbitrators need to examine samples – the time limit here being counted in days, depending on whether Rye Terms or others are used – the limitation period (being one year) is determined by reference to the parity of the contract (FOB, CIF, etc.), thereby simplifying the time limits scheme.

GAFTA has also removed from the Payment Clause in all of its contracts the term that:

"Amounts payable under this contract shall be settled without delay. If not so settled, either party may notify the other that a dispute has arisen and serve a notice stating his intention to refer the dispute to arbitration in accordance with the Arbitration Rules."

Practical Effect of Change

Traders who incorporate GAFTA 125 into their contracts would be well advised in the event of a dispute to commence GAFTA arbitration proceedings at the earliest opportunity. As a matter of English law, which governs all GAFTA contracts, the commencement of arbitration proceedings in accordance with GAFTA 125, interrupts the running of time, i.e. protects the time limit. This protective measure comes at little or no cost to the claimant, and does not carry an obligation for the parties to immediately progress the reference, so commercial negotiations can continue. Once proceedings have been commenced, the claimant has one year, from the date of commencement, to prepare and serve submissions, or to renew their claim to arbitrate for another year – see clause 4.10.

GAFTA 49

Previously, Clause 6 of GAFTA 49, provided:

"The Sellers should have the goods ready to be delivered to the Buyers at any time within the contract period of delivery".

This term was unique to GAFTA 49.

At common law, under a "classic" FOB contract, where the contract does not state who has the option as to the time of shipment, the buyer is normally entitled to call for shipment at any time during the period. The seller is correspondingly obliged to put the goods on board any ship nominated by the buyer but this does not mean that the seller is bound to have the goods ready at the port of shipment for the whole of the period.

GAFTA 49 provides for delivery at buyer's call, but contrary to the common law position the previous edition required the seller to have the goods ready to be delivered to the buyer at any time within the contractual delivery period. This could be onerous for the seller. Under the new clause, sellers have been relieved of this obligation, but the contract still provides for delivery at "Buyers' Call" so the seller has to have the goods ready within a reasonable time of receiving proper shipping instructions from the buyer.

Practical Effect of Change

This amendment sees a return to the common law position and aligns the contract with the other GAFTA FOB contract forms. As a consequence, a buyer will only have grounds for rejection and termination if the seller fails to load the goods within the contractually agreed delivery period. If a buyer wants the right to terminate because the goods are not available for shipment at any time during the delivery period then an express term must be agreed.

This is not however necessarily all good news for FOB sellers as there may be a greater potential for delay which may result in demurrage and detention claims by buyers. Sellers are also exposed to such claims because clause 6 obliges them to continue loading beyond the agreed delivery period, provided that the carrying vessel was presented within it.

Cyber fraud – follow the money

By Andrew Rourke (Partner, UK) and Kirsty Garvey (Associate, UK)

In 2018 we saw clients of all sizes, sectors and domicile affected by cyber-security breaches. Perhaps the most prevalent in the commodities and trading sector was the trend of email hacking and faking. A chain of correspondence between Party A and Party B arranging payment for the sale of goods, for example, is intercepted by hackers who then impersonate the parties using a very slightly altered email address so as not to arouse suspicion. Typically the hackers then advise Party A that the payment account details have been changed and Party A transfers sums to the wrong account.

These altered account details are very often not suspicious in and of themselves. The fraudster's email account may be as subtle as a single letter change to the email domain name. It is not hard to see how even the most sophisticated business may fall victim to such fraud.

Basic checks can help to prevent such fraud, including checking email addresses carefully particularly if there is a change in tone of correspondence or a change to payment details and checking any requested changes to account details via telephone (ideally with a known individual) with your counterparty. Having a strict policy of rigorous checks on account changes can go a long way to solving the problem. Even with the most extensive training procedures for staff, mistakes can still happen and there is no question that as monitoring techniques improve, fraudsters will find alternative ways of disrupting business for financial gain.

In the event payment is made to a fraudulent account, the payer should notify their bank immediately of the suspected fraud. If notified early enough, the paying bank may be able to interrupt the payment or, if not, alert the receiving bank who should freeze the receiving account pending further investigation. Informing the police and, where relevant/ appropriate, the Action Fraud service in the UK or a local equivalent elsewhere is also important.

Employees should also be made aware of the need for care in how they deal with such incidents as, for example, 'tipping off' is an offence under the Proceeds of Crime Act 2002 and, as such, legal advice should be taken as soon as a suspected fraud takes place.

If the payment cannot be interrupted, there are a number of legal steps available in the English courts which may assist in recovering any payment obtained fraudulently. The assistance available from the courts will depend on the specific facts of each case but include:

1. A 'Norwich Pharmacal Order': Such order requires the receiving bank to disclose certain documents or information about the receiving bank account and the account holder, with a view to tracing the location of the funds. This type of Order is typically obtained where a party knows that wrongdoing has taken place against it but does not know the identity of the wrongdoer, yet can identify a third party who has this information.
2. A Bankers Trust Order: This is often referred to as a sub-species of the Norwich Pharmacal Order and is available where (i) there is a fairly clear cut fraud and (ii) the claimant seeks disclosure of confidential documents, usually from a bank, to support a proprietary claim to trace assets. This type of relief is only available where, on the face of it, there is a clear case that the relevant funds held by, or passed through, the bank, belong to the claimant. It is also necessary to demonstrate a real prospect that the information might lead to the location or preservation of assets to which the claimant makes a proprietary claim.
3. A Freezing Injunction: Such order restrains the bank from allowing transfer of the money in the account and/or fraudster from disposing of or dealing with its assets. The purpose of a freezing order is, typically, to preserve assets until judgment can be obtained or enforced. It is often possible to seek a freezing order in conjunction with the above two remedies.

No matter what action is taken, acting quickly is key. The English courts stand willing to assist victims of corporate fraud with urgent applications to freeze monies or trace funds, but if a party is slow to act, the monies are likely to have disappeared, often overseas, with little chance of recovery. In such circumstances, the party who is left out of pocket will have no remedy or will be left to explore claims against its counterparty and/or the bank(s) involved.

50+

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