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Government Prohibition of the performance of Agreements of Sale and Purchase

Putin, the Ukraine and Russian Wheat

The Russian Government prohibited the export of wheat from Russia in 2010, thereby obliging legal forums to consider the prohibition of the sale of the goods. The use of the prohibition in order to cancel the transaction would be considered justified, only if the prohibition directly prevented the performance of the transaction.

It is accepted in international trade transactions to regard the use of accepted designations such as cif, fob together with a description of the goods traded and their delivery dates – are sufficient to define the terms of the transaction. It transpires that in certain circumstances this is not so. Between the time of agreeing the transaction and the time of performance, circumstances both foreseeable and unforeseeable, require addressing.

The Russian Government, by prohibiting the export of wheat from its territory, gave rise to the legal implications of the consequences of such action on transactions for the sale of goods. As consequence of the Russian influence over Ukraine, this country was also affected by the prohibition and its activities contributed to the complications of the transaction.

Accordingly, the English Courts were required, in two separate instances, to consider transactions which were affected by the Russian prohibition.

The first transaction was for the sale of 25 thousand tons of Russian wheat fob Novorissisk This transaction was in accordance with the accepted terms of GAFTA 49 (drafted by the Grain and Feed Trade Association) for contracts for "Delivery of Goods in Bulk or in Bags" the contract was agreed and signed by the parties in June 2010 and delivery was agreed for the last week in August of that year. The sellers chartered a vessel to load the wheat at the intended load port. Whilst the parties were coordinating the logistic of the transaction, the Russian President, Vladimir Putin, change the "rules of the game" under Decision No.599 of the Government of Russia signed by him which forbade the export of wheat from the Russian federation during the period 15 August to 31 December 2010.

The Sellers invoked the "Prohibition Clause" in GAFTA 49 under which the parties to the transaction agree in advance that in the event of embargo or government action, preventing the performance of the transaction, the parties agree that part of the transaction which became incapable of performance will be cancelled – even to the extent of cancellation of the transaction as a whole.

PRESENT OR FUTURE PROHIBITION?

The prohibition clause states as follows:

"Prohibition

In case of prohibition 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 of the

goods, or the country from which the goods are to be shipped, restricting export, whether partially or otherwise, any such restriction shall be deemed by both parties to apply to this contract and to extent to such total or partial restriction to prevent fulfillment whether by shipment or by any other means whatsoever and that extent this contract or any unfulfilled portion thereof shall be cancelled. Sellers that advise Buyers without delay with the reasons therefor and, if required, Sellers must produce proof to justify the cancellation."

Experience shows there is a tendency not to allow prohibitions of the above nature. Additionally, in most cases they are imposed for internal political reasons and are contrary to international trade agreements of the country concerned.

Accordingly, having regard to the government prohibition published on 11 August 2010 and relying on the Prohibition clause the Sellers advised of the cancellation of the agreement. The purchaser accepted the cancellation but claimed damages from the Sellers in arbitration proceedings.

The arbitration was conducted in accordance with the GAFTA arbitration procedure. The arbitration determined the matter in favour of the buyers. The Arbitration panel accepted that although at the time of the cancellation the export prohibition was in place, experience shows that prohibitions of this nature are generally cancelled and that in the majority of cases the prohibition are imposed for internal political considerations contrary to international trade agreements of the country concerned and taking cognizance of the possibility prior to the time of performance, the prohibition may be listed – the sellers could not reply upon the prohibition to cancel the contract.

The sellers filed an appeal before the High Court in England. There they argued that immediately upon the publication of the prohibition the contract was automatically terminated and that the prohibition was applicable to the commodity comprising the subject matter of the contract and covered the full period of the contemplated transaction. Accordingly, the sellers contended that the prohibition is applicable from the time of the publication of the prohibition and the "prohibition clause" by its nature, relates to future events and it was not necessary to prove or investigate if the prohibition which was published in fact prevented the seller from performing the contract.

Accordingly the effect of the sellers interpretation of the prohibition clause, is that there is no significance to the question of whether the prohibition prevented the transaction and that there is no need to establish a causal connection between the prohibition and the fulfillment of the transaction. According to the sellers, the publication of the prohibition in itself was sufficient to allow for cancellation. In support of their contention the sellers made reference to the wording in the prohibition, such as "shall be cancelled" and the wording at the end of the clause relating to the giving of the immediate notice by the sellers to the buyers of the cancellation and the production of proof to justify the cancellation. The sellers contended that the clause speaks of immediate cancellation – on the publication of the prohibition as being sufficient and this in order to allow the buyers to take advance action and for example, to purchase alternatively from another seller or at another place. Accordingly a correct interpretation of the clause is "cancellation at the time of publication" (in other words "in advance") without having to await for the performance date in order to rely on the prohibition clause.

The purchaser however relied upon the expression in the prohibition "restricting export" in order to contend that the prohibition in itself requires a causal link in order that a seller who wishes to cancel the contract may benefit from the clause and that it was insufficient to argue that the contract is cancelled as a result of the publication of the prohibition and that the seller is obliged to prove that the prohibition in fact prevented the implementation of the contract.

In other words: In order for a seller which cancels the translation under the protection of the prohibition clause and to contend that the contract is cancelled as a result of the publication of the prohibition, the seller is obliged to prove that the prohibition actually caused the inability to implement the transaction.

The English Court reviewed other instances where the Prohibition clause was considered. In a 1922 case (Sanday vs.McEwan) the Court rejected a similar argument of the

seller namely that the contract is cancelled upon publication of the prohibition order even if in practice it did not prevent performance of the transaction, on the basis that if the transaction can be cancelled on the publication of the prohibition and did not in fact prevent the implementation of the transaction means that if a prohibition order is published which is cancelled on the same day of its issue or a number of days thereafter, the act of publication of the prohibition causing cancellation – is an interpretation that cannot be supported.

In another case of 1983 (Pancommerce vs. Veecheema) a similar argument that mere publication of the prohibition establishes a right to cancel was rejected by the Court for commercial reasons, namely if the sellers are entitled to cancel as a result of publication and thereafter, if the prohibition order is cancelled, this will enable them to renegotiate the terms of the contract with the buyers from a position of strength. Accordingly, for commercial reasons it is not possible to accept the sellers' interpretation of the clause.

The sellers contended that the above matters related to a different version of the clause and that under the version contracted for by the parties which was concerned with the export of wheat from Russia, the sellers relied upon a 1915 case (Ford & Sons vs. Letham & Sons) where it was held that the seller could be released from the contract on the strength of only the publication of the prohibition order. However in this matter – the transaction was not an international but rather a local sale and purchase and that the right to cancellation related to a situation where the prohibition of export would affect the price of the goods sold under the contract. The English High Court held that the prohibition clause entitled the sellers to cancel without having to prove that they were capable of performing the conditions of the sale. However the publication of the prohibition in itself was insufficient and that it was necessary for the sellers to establish a causal connection between the prohibition and the inability to perform at the time determined for delivery.

The Court held that as the sellers had unlawfully cancelled the transaction they are obliged to compensate the buyers and that under the relevant GAFTA clause the compensation would be the difference between the contract price and the market price/value at the time of the cancellation. The parties can agree on this value. In the absence of an agreement this will be determinate between the arbitration.

In addition, the injured party is also entitled to expenses deriving from the breach of the contract. However, generally the injured party is not entitled to compensation for loss of profit due from subcontractors or onward purchasers as a result of the injured party not being able to perform its obligations, unless the arbitration should determine, as a result of special circumstances, to award such damages and that the terms of GAFTA enable the injured party to receive agreed liquidated damages, being the difference between the contract price and the market value as at the time cancellation and not proven damages. In other words the injured party would not be entitled to compensation for loss of profit from "onward" sales.

The sellers contended that no loss was suffered by the buyers. After the cancellation the sellers offered the same transaction to the buyers who declined same. In these circumstances the sellers contended that the buyers refusal negates the buyers right to compensation.

The GAFTA arbitrators held and the English Court upheld this finding that the clause is for the pre-agreed sum as damages and is intended to provide commercial certainty to traders. Accordingly the clause does not concern itself with interpretation and investigations as to "what may happen" and what damages would pass from one side to the other. The clause does not allow for damages for loss of profit and any departure from the terms of the clause would cause commercial uncertainty and for this reason question of consequential loss or damages are not countenanced by the clause which provides for commercial certainty.

An additional factor considered by the Court was that it was not possible to regard the buyers behavior as lacking in good faith denying them the right to the agreed compensation.

For these reasons the sellers appeals was rejected.

A TOO BROAD INTERPRETATION

In another instance a similar transaction was considered in July 2010 relating to the sale of 3,000-tons of wheat from the Ukraine or Russia to Israel on CIF terms. The agreed loading period was between 15-30 August 2010.

As stated above during the relevant period, a prohibition order was published prohibiting the export of wheat from Russia.

The sellers contended that the prohibition order resulted in the Ukrainian Customs Authorities demanding that all export wheat samples would be tested by the same laboratory. This demand created a backlog and in effect prevented the export of wheat, the sellers therefore

contended that as one laboratory could not handle the demand for testing, this effectively frustrated the possibility of exporting wheat. Accordingly and in accordance with subsequent publications, as from October 2010, 17 million tons of wheat was held up in vessels and in port storage facilities in the Ukraine at the relevant time and in effect between August and September it was not possible to purchase or load wheat. Vessels which had loaded prior to this period were delayed and that the "market" had come to a complete halt, as per publications and assessments presented by the sellers. Accordingly the sellers advise of cancellation of the agreement on the strength of the prohibition clause and attempted to justify the cancellation on the limitation relating to the trading of the wheat in the Ukraine. The purchaser instituted a GAFTA arbitration demanding compensation for the breach of the agreement.

The Arbitration Award determined that the purchasers were entitled to US$ 270,000- plus expenses and interest. The sellers lodged an appeal before English Court which considered if the above Ukrainian customs order constituted a "government action" and if this was so whether the sellers are obliged to prove that they exercised maximum endeavors to give effect to the sale or whether the publication in itself was sufficient to allow the right of cancellation.

The English Court determined that the transaction was finalized following action taken and the publication of the customs authorities which followed the publication of August 2010 so that the sellers entered into the transaction with "eyes wide open" and being aware of the steps taken by the Ukrainian customs authorities. The arbitration had determined that practically there was a "prohibition" by the Ukrainian authorities of the export of wheat from the Ukraine but that the sellers had not exercised all their endeavourers to give effect to the implementation of the contract.

It was possible that the performance of transaction might have been encountered difficulties, for example, as a consequence of the Ukrainian customs demand that testing should be done by the one approved laboratory – however this did not constitute the "prohibition" contemplated by the clause.

The guiding principle in international transaction particularly is "COMMERCIAL CERTAINTY" or in other words "transactions have to be performed" and cancellations of or exemptions from obligations to supply goods are not to be treated lightly.

The English Court further held the interpretation contended for by the sellers to the effect that the laboratory testing constituted an "administrative action" was too broad and effectively derogates from the commercial certainty envisaged by the clause in effect depriving it from all commercial meaning. Additionally the clause relates to administrative action preventing export either partially or fully. There is nothing in the clause which relates to administrative action resulting in effect on the limitation of exports. Only direct orders preventing export are envisaged by the clause. If the interpretation contended for by the sellers were accepted it would lead to uncertainty and litigation if a consequence of the administrative action is to prevent export and that only administrative action directly preventing exports "triggers" the prohibition clause.

In the result the Court rejected the sellers appeal also in this matter.

The sellers in both the matters mentioned above, appealed to the English Court of Appeal. The Appeal Court affirmed the High Court Judgments which endorsed the GAFTA Arbitration Awards. The fact that this was a clause in a GAFTA recommended contract was considered by the Supreme Court which attributed significance to GAFTA's "commercial" understanding and interpretation of its recommended contracts.

The conclusion is that in international sales contracts the principle of commercial certainty is a dominant factor and exceptions or cancellations exonerating sellers from their obligations not readily available unless specifically stated in the contract and the matter falls squarely within the bounds of the "exonerating" clause.

"Bungle S.A vs. Nidera B.V – Court of Appeal EWCA CIV 1628-12"

"Seagrain LLC vs. Glencore Grain – Court of Appeal EWCA CIV 1627-12"

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