Trade Wars and Commodity Arbitration

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Throughout the modern history of mankind, trade wars accompanied almost every military or political conflict between hostile states, ready to take the most radical actions for the sake of the victory. This is not surprising as trade directly affects the economy and, accordingly, the ability of the country to fight and resist successfully.

Unfortunately, in order to understand what "trade war" means, we do not have to look into the past, but we just need search in the latest news. As before, such actions nowadays constitute an integral part of any international conflict: trade blockades, sanctions, import duties, quotas and licenses, preferences and many other "weapons" are actively used by world players for their own purposes. Of course, the least "guilty" participants of the market – producers and trading companies of both countries – suffer the most from such conflicts. These players are blatantly forced to incur huge losses as a result of all sorts of restrictions and prohibitions, which often are fatal for their business.

The sphere of commodity trading is particularly at risk, as it is always likely that circumstances preventing contract execution will appear during a significant period of time between the moment of the conclusion of the contract and its execution. The probability of the ban can sometimes be foreseen, as in the cases with the adoption of mirroring sanctions. However, such events have the tendency to occur suddenly, especially given an ongoing armed conflict and the political situation. What can be done in this case?

Import duty

To illustrate, it might happen that goods are sold in April and are to be delivered in September, but official authorities of a buyer's country introduce additional duties for the import of goods. Who should bear such losses? Is it possible to refuse to supply or to take the goods?

Let us take as example the recent case of the introduction of import duties on the import of Russian products to Turkey and, in particular, the duty on corn and wheat which was established at 130%, and considering that the sale of corn of Russian origin took place in February with subsequent delivery in May.

First of all, it is worth paying attention to the contract concluded between the parties. As a general rule, the parties explicitly determine the buyer to be the party responsible for the import of the goods and for all the formalities associated with the import, including the payment of taxes and duties in the country of import. If the contract is silent, majority of grain and oil commodities contracts incorporate standard contract forms developed by Grain and Feed Trade Association ("GAFTA") and Federation of Oils, Seeds and Fats Associations ("FOSFA"), which expressly state that all import duties, taxes, levies, etc., present or future, in country of destination, shall be for buyers' account. If the contract does not incorporate any standard contract form, the parties should refer to any specific rules regulating their obligations under the contract. Most of such transactions are carried out by sea on the basis of CIF or FOB in accordance with the international rules of Incoterms, according to which taxes, duties and other official fees, as well as customs formalities payable upon importation of goods, are paid by the buyer.

Moreover, such contracts tend to incorporate English Law by implication from a standard form or an express agreement. Under the general rule, English law consider such duties as business risks, which do not release the responsible party from performing contractual duties.

That is, under the conditions described above, payment of the import duty on Russian wheat introduced by Turkey will lie with the buyer and will not release it from the obligation to take and pay for the delivered goods.

Import ban

And, what is the case if the authorities of the buyer's country prohibit the import of goods completely? Is the buyer's refusal to take the goods due to force majeure circumstances reasonable in this case? The answer is not so clear and it depends on many factors.

Let us take as example a case under the Rules of Arbitration of FOSFA concerning a ban on import of agricultural products in the country of destination. A large agro-holding company ("Seller") concluded a contract with agro-industrial company ("Buyer") for the delivery of goods for import and further processing on the territory of the Buyer. According to the contract, the Seller should have delivered the goods on the DAF terms (Incoterms 2000). The place of delivery was the border between the states of the parties and the governing law of contract was English law.

The contract had a force majeure clause that ambiguously interpreted the consequences of imposing import restrictions and the Buyer's responsibility for not obtaining an import license and other official permits necessary for the import of goods into the territory of his country. Soon after the contract was concluded, the Buyer reported on the governmental restrictions on imports of goods from the Sellers' country and referred to the force majeure circumstances, making the execution of the contract impossible. Despite the official prohibition, the Seller refused to accept the Buyer's notification of force majeure and proceeded to fulfill its obligations. During the next several months, the Seller repeatedly notified the Buyer about its readiness to deliver the goods and asked the latter to provide documentary instructions, without which further execution of the contract by rail was impossible. The Buyer confirmed that it could not take the goods, justifying its position by the onset of force majeure circumstances. In the meantime, the price of goods had significantly decreased, making the contract extremely unfavorable for the Buyer. By the end of the delivery period stipulated in the contract, the Buyer had terminated the contract, under the force majeure clause. In response, the Seller considered the Buyer to be in default. As the price for the goods decreased, the Seller demanded compensation for the difference between the contract price and the market price, to which the Buyer objected, arguing the force majeure circumstances and referring to the frustration doctrine under the English law which provides for an exemption from liability. Eventually, the case was submitted to the FOSFA arbitration at the request of the Buyer.

The Seller's position consisted of two key arguments. Firstly, according to DAF terms, the obligation to obtain a license to import goods in the territory of the Buyer's country rested on the Buyer, while the Seller's duty was limited to the delivery of the goods to the borders between the states and did not imply importation into the territory of the Buyer's country. Secondly, any restrictions on the import of goods into the territory of the Buyer's country are not force majeure circumstances either within the framework of the contract concluded, including under the DAF terms, or in accordance with English law. In particular, restrictions on import of goods do not fall under the frustration doctrine referred to by the Buyer, as this circumstance did not prevent the Buyer from lawfully performing its contractual obligations, namely, accepting the goods at the contracted place of delivery.

The Tribunal observed that the ban on import had no effect on the fulfillment of the contractual obligations by either the Seller or the Buyer: the Seller could deliver the goods and the Buyer could accept them at the border between the states. At the same time, the import of goods to the Buyer's country was not the responsibility of the Seller, who was responsible only for export while the Buyer had the obligation to import the goods. Consequently, the ban on imports was not a force majeure circumstance either under the contract, or under English law. Finally, the Tribunal decided that the Buyer could not refer to the ban on the import of goods and refuse to fulfill its contractual obligations. Having terminated the contract, the Buyer itself infringed the contract and therefore must compensate the Seller for the losses incurred as a result of the Buyer's non-fulfillment of the contract.

The position of the arbitral tribunal under the FOSFA rules shows that impossibility to import will not discharge the contract under the doctrine of frustration. The intention for the goods to be processed in Buyer's state was indeed the reason why the Buyer concluded the contract; however, the impossibility for such purpose to be achieved was not a sufficient ground to discharge the Buyer from its contractual obligations. The decision generally follows the line adopted by English courts in cases with similar circumstances. (See Congimex Companhia Geral de Commercio Importadora & Exportadora S.A.R.L. v. Tradax Export S.A [1983] 1Lloyd's Rep. 250 and Bangladesh Export Import Co Ltd v. Sucden Kerry S.A. [1995] 2 Lloyd's Rep. 1) The parties clearly outlined the scope of their duties in the contract and did it in such a way that the import ban would not make the performance illegal. First, the parties agreed on the DAF Incoterms which specifically provides that the Seller's obligation is to place the goods at the border between the parties' states, cleared for export but not cleared for import. Second, the parties agreed to English law as the governing law, which provided adequate level of protection against import prohibitions, preventing the parties to use such circumstances in bad faith and escape from their respective contractual obligations.

Conclusion

Unfortunately, trade conflicts are part of the current trade and economic policy of many countries and they are an inherent risk factor, which must be taken into account when doing business with these countries. Mostly driven by political reasons, the states are always ready to introduce trade restrictions in order to harm the opponent as much as possible. Like any war, a trade conflict entails losses on both sides. In most cases, this practice becomes detrimental to both states, not only to the one introducing the ban, as the case presented above shows.