Kluwer Arbitration Blog

The GAFTA Default Clause and the Scope of Arbitration Appeals

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In the case of Sharp Corp Ltd v Viterra BV (formerly known as Glencore Agriculture BV [2024] UKSC 14, the UK Supreme Court has decided the proper measure of damages under the Grain and Feed Trade Association ("Gafta") default clause and reaffirmed the interpretation of section 69 of the Arbitration Act 1996 ("AA 1996"). Whilst the facts of the case as presented are a little unusual, the Supreme Court's conclusion provides guidance as to how damages are to be assessed generally in cases of default under standard Gafta contracts.

This post will guide you through the background to the case and how the Supreme Court reached its decision in this landmark case.

Gafta Contracts and Arbitration

Gafta provides standard form contracts on which it is estimated that 80% of the world's trade in grain is shipped. Each of the Gafta standard form contracts include an arbitration clause which provides that all disputes arising out of the contract are to be determined by arbitration in accordance with the Gafta Arbitration Rules under English law.

The arbitral process is administered by Gafta at both first tier and appeal levels, and disputes are determined by tribunals comprised of Gafta-trained arbitrators who have been actively engaged in the grain and feed trade for at least 10 years.

In this case, the dispute was heard in Gafta arbitration and then appealed to the High Court under s.69 AA 1996 on a point of law.

The Background Facts

The parties concluded two contracts on C&FFO Mundra (India) terms in January 2017 for 20,000mt of lentils and 45,000mt of yellow peas (the "Goods"). C&FFO is a shipping term which stands for Cost and Freight Free Out meaning that generally the sellers pay for the shipping charges and the costs of unloading the goods at their destination. In this case, Mundra, India, was the discharge port, such that the price included transportation to and unloading at Mundra.

The Goods arrived at Mundra in June 2017, but the Buyers failed to make payment prior to arrival. The contracts were amended to extend the period for payment.

On 8 November 2017 and 21 December 2017, the Indian government imposed import tariffs on yellow peas and lentils respectively. On 9 November, the Sellers declared Buyers in default and notified them that they intended to sell the Goods to a third party.

On 2 February 2018, Sellers were given permission to obtain possession of the Goods and then sold them to a related third party.

Contractual terms

The standard Gafta default clause, as incorporated, provides:

> "DEFAULT. In default of fulfilment of contract by either party, the following provisions shall apply:
>
> (a) The party other than the defaulter shall, at their discretion have the right, after serving a notice on the defaulter to sell or purchase, as the case may be, against the defaulter, and such sale or purchase has established the default price.
>
> (b) If either party be dissatisfied with such default price, or if the right at (a) is not exercised and damages cannot be mutually agreed, then the assessment of damages shall be settled by arbitration.
>
> (c) The damages payable shall be based on, but not limited to, the difference between the contract price of the goods and either the default price established under (a) above or upon the actual or estimated value of the goods, on the date of default, established under (b) above."

The Gafta Appeal Board

Arbitration was commenced in relation to the contracts. In the arbitration, the Gafta Appeal Board (the "Tribunal") found that:

- Buyers were in default for failing to pay for the Goods and were liable to pay damages in accordance with the Gafta Default Clause.
- The date of default was 2 February 2018 when Sellers obtained possession of the Goods and could sell them.
- Damages should be assessed on the market value of the Goods on or about 2 February 2018 on C&FFO Mundra terms in bulk.

The Commercial Court Decision

The Court granted permission to appeal under s.69 of the AA 1996 on whether the actual or

estimated value of the goods on the date of default (for the purposes of sub-clause (c)) should be assessed by reference to:

- Market value of the goods at the place where they are located on the date of default; or
- The theoretical cost on the date of default of buying the goods FOB on the original terms plus the market freight rate to the discharge port free out.

The Court dismissed the appeal, holding that the Buyers had not shown the Tribunal had erred in law. Two imperfect proxies were presented (those at (a) and (b) above) and the Tribunal was entitled to conclude which offered the better match.

The Court of Appeal

Permission to appeal to the Court of Appeal was granted, again under s.69 of the AA 1996. The Court of Appeal amended the question of law it was to determine and held that damages were to be assessed on the basis of a notional substitute contract for the goods on the same terms as the original contract, save as to price.

However, the Court of Appeal went one step further and concluded that the contract was no longer a C&FFO Mundra contract as it had been varied into an ex warehouse contract. In finding such a variation, which neither party had argued, the Court of Appeal found that the Tribunal had erred in treating the notional substitute contract as one on C&FFO Mundra terms. Therefore, the Court of Appeal remitted the matter back to the Tribunal to determine damages on the correct basis.

The Supreme Court

Permission was then granted to appeal to the Supreme Court on three grounds. Firstly, had the Court of Appeal erred in amending the question of law for which permission had been given? Secondly, had it erred in deciding a question of law which had not been before the Tribunal? Thirdly, had the Court of Appeal erred in making findings of fact on matters which the Tribunal had not been asked to determine and on which they had made no finding?

Whilst the Supreme Court did not find that the Court of Appeal had erred on the first ground, it was found that they erred by deciding a question of law which the Tribunal were not asked to determine and, secondly, erred in making findings of fact on matters which the Tribunal made no finding.

The Cross-Appeal in the Supreme Court

Buyers cross-appealed on the basis on which damages had been assessed.

In calculating damages, the Supreme Court focused on the two common law fundamentals: the compensatory principle (to put the innocent party back into the position they would have been in had the breach not occurred) and the principle of mitigation (that the injured party is required to take reasonable steps to reduce its losses).

The Supreme Court determined that the Gafta default clause is intended to reflect both principles. An approach which also reflects that of the Sale of Goods Act 1979, at ss50(3) and 51(3). According to the Supreme Court, these provisions "assume that, where there is an available market, the reasonable injured party will go into that market and make a substitute sale or purchase, and normally that market price will then establish the default price. As has often been observed, this is based on a deemed mitigation." The Supreme Court considered this to be consistent with the compensatory principle.

In summary, under the Gafta default clause:

- The starting point is the price achieved in a substitute sale or purchase contract (paragraph (a)). Only when a sale or purchase does not occur, or a party is dissatisfied with the price achieved, then do damages come to be determined by the Gafta tribunal.
- If the tribunal decides that the default price under paragraph (a) is inappropriate, or there was no sale or purchase, then damages are to be determined under paragraph (c) on the basis of the actual or estimated value of the goods on the date of default.
- Where there is an available market for a sale or purchase on the same terms as the original contract on the default date, that sets the default price.
- If there is no available market on the same terms, then the estimated value of the goods should be determined by reference to the reasonable market. This approach recognises that goods are left in the seller's hands when a buyer defaults. What steps the seller should then take will be influenced by the location of the goods and their circumstance. This then is consistent with the compensatory principle, for example where that circumstance means the goods have a greater value.

Concluding Remarks

The Supreme Court's judgment provides useful guidance on the approach to damages under the Gafta default clause and generally in sale of goods disputes under English law. It also reaffirms the approach to s.69 of the AA 1996.

Generally, as the Supreme Court appeared to recognise, a degree of flexibility is built into the Gafta default clause allowing the tribunal to determine whether a re-sale or purchase is appropriate and what is the relevant market in the particular circumstance, all against the background of the principles of compensation and mitigation.

The judgment makes clear that whilst the Court can consider a tribunal's determinations, it is limited to issues that were argued before and addressed by the tribunal. Furthermore, the Supreme Court has reaffirmed the approach to findings of fact in appeals against arbitral awards. The Court's jurisdiction is limited to appeals on questions of law and it has no jurisdiction in relation to errors of fact, nor can it make its own findings of fact.

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