

Alert 10-189



ReedSmith Energy Trade & Commodities Alert

Russian grain export ban: keep cool in the heat

After mounting speculation during the last few days, Russia, the world's third largest wheat exporter, announced on 5 August 2010 a ban on grain exports for the next four-and-a-half months. This client alert summarises the likely impact on trade, plus gives some advice to parties on what to do next.

Cause and Effect

As highlighted in press reports, Russia has experienced record drought this year which has destroyed millions of hectares of its crops and caused wildfires across the country. As a result, Russia has cut its 2010 grain harvest forecast to 70-75 million tonnes, compared to 97 million tonnes in 2009, and has therefore implemented a temporary export ban in efforts to keep domestic grain prices low and preserve cattle stocks.

This move by Russia, in addition to its request to fellow members of a regional customs union – Belarus and Kazakhstan – to do the same, has caused global wheat prices to spike to two-year highs. The UN's Food and Agriculture Organisation cut its 2010 global wheat forecast by about 4% and this has reignited fears that governments will begin hoarding their own supplies of grains at a time when memories of world-wide food riots in 2008 are still fresh.

Legal Implications

Resolution No. 599 "On the implementation of a temporary ban for export of some agricultural products from the territory of Russian Federation" dated 5 August 2010 imposes a temporary ban on wheat and meslin, barley, rye, maize, wheat flour or wheat-rye flour (the "banned goods") from the Russian Federation from August 15 2010 until December 31 2010. An official notification has also been released stating no further railway wagons bound for ports of shipment may be loaded with goods which are the subject of the export ban.

Although we are not yet aware of the specific terms of the ban, these restrictions do apply to contracts already entered into and are expected to cause many difficulties for sale contracts specifying the banned goods. There are no apparent "savings" for existing contracts, vessels already queuing, vessels which may have started loading when the ban comes into force or for goods already stored in ports when the ban was announced.

Prohibition clauses

A prohibition (force majeure) clause seeks to excuse non-performance in certain specified circumstances. If a seller cannot bring himself within the clause or uses the clause incorrectly (e.g. no notice is given in time; cancellation is made too early; insufficient efforts to overcome the problem, if some licenses are given for exports), the seller is likely to pay significant damages for non-performance. A prohibition clause is therefore like a "Get Out Of Jail Free" in the monopoly game but needs to be carefully and exactly used to be effective.

GAFTA contracts (which will be incorporated in many of the affected contracts) incorporate a prohibition clause providing for automatic cancellation in the case of prohibition of export as a result of any legislative act done by the government of the country of origin of the goods, which prevents performance of the contract. The wording of the prohibition clause is as follows:

"In case of prohibition of 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 or of the territory where the port or ports of shipment named herein is/are

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

However, we have learnt from experience that bans such as the Russian export ban are fast moving and ever-changing and it is difficult to predict when or if the terms of the ban will be altered. Similarly each contract is different; what origins are permissible, what is the exact shipment period and so on. For this reason we would advise buyers and sellers that no cancellations of existing contracts should be made until after the last day for shipment has passed – a "wait and see" approach.

In the meantime sellers of the banned goods should take the following steps in order to protect their sale contract position:

- Make an effort to inform buyers about the ban and consequent difficulties
- Continue to keep buyers informed of all developments relating to the ban before and during the shipment period
- Expressly reserve the right to rely on the prohibition clause incorporated into the contract under GAFTA, should performance be prevented.

Once the last day for shipment has passed, as is required by GAFTA, sellers should advise buyers "without delay" the reasons for the reliance on the prohibition clause. The cancellation is automatic and does not need to be claimed or declared. Sellers may also be required to produce proof to justify the cancellation.

For buyers, in general, they need to react to information/messages from their sellers, where necessary. In case of "information" they can simply reserve their position. Early "cancellation" messages maybe a repudiation of the contract by their sellers so buyers should then take legal advice. The tricky areas are:

- FOB contract: Do you as a buyer need to nominate and send a vessel? Clearly this is a waste of money if the ban continues but buyers need to take care that they do not find themselves in default for failing to perform;
- Multiple Origin Contract: Can you as a buyer insist on the seller providing goods from a non-banned origin? Clearly there is a possibility for a seller to successfully rely on GAFTA prohibition clause but much would depend of the exact terms of the sale contract.

Compensation from Russia?

Companies with investments in Russia that are adversely affected by the ban, and who are based in a country that has entered a Bilateral Investment Treaty ("BIT") with the Russian Federation, might be entitled to claim compensation directly from Russia under the terms of the relevant Treaty. BITs contain promises to protect foreign investors from "expropriation" (when a business right or asset is taken away by a state without fair compensation), from unfair or discriminatory treatment by the state, from government interference in their business operations, as well guaranteeing other protections. Foreign investors from the other country that is a party to the BIT are in most cases entitled to claim compensation by bringing arbitration proceedings directly against the breaching state.

Countries with which Russia has BITs include (amongst others) Belgium, Canada, France, Italy, The Netherlands, Switzerland, the United Kingdom and the United States of America.

Conclusion

The exact terms of the Russian ban and how it will work in practice and whether there are any "loopholes" is not yet available but we will update this client alert when they are issued. In the meantime it is important to review all open contracts likely to be affected by the ban and carefully follow contract prohibition or force majeure clauses rather than rush to cancel immediately.

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