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Three months in: the legal implications of the Russia-Ukraine conflict for traders

In early February, we published an article on the legal implications of the escalating Russia-Ukraine crisis.[1] At the time, there was still hope that diplomacy might prevent violence. Nevertheless, commodities markets were already reacting to the uncertainty with price rises and we recommended that those with live trades in the Black Sea region and with Russian and/or Ukrainian counterparties carry out risk assessments.

On 24 February 2022, Russia launched its invasion of Ukraine. Since then, commodity prices have surged further and traders have been impacted by the disruption to supply chains, sanctions against Russia/Russian entities and the "self-sanctioning" of banks and other institutions.

Three months into the conflict, we reflect on some of the important legal issues for traders that we have seen arise, and those that might still be to come. We continue to follow closely the unfolding of events in Ukraine and the international responses to them.

Sanctions

The sanctions that have been imposed against Russia, by the UK, the EU, Switzerland, the US, and other nations, are unprecedented in their size and scope as well as the rate at which new measures are being imposed. Never before has a country that is so deeply embedded in global supply chains being targeted so heavily. Current forecasts are that Russia's economy will contract by more than 10% in 2022, which is its biggest fall since 1994.[2] The sanctions may still go further. Infrastructure issues and heavy reliance on Russian fossil fuels have so far prevented an EU import ban on Russian oil, which has maintained this revenue stream[3] – even as Russia has retaliated by sanctioning gas shipments to the bloc.[4]

In very brief and broad overview, the sanctions include financial and investment restrictions on entities owned/controlled by the Russian government, asset freezes on individuals and corporations associated with Vladimir Putin's regime and/or supporting the war, bans on Russian aircraft, prohibitions against Russian vessels, embargoes on the trade of goods (e.g. iron, steel and luxury goods) and technologies (e.g. oil refining technology, quantum computing) and activities associated with their export.

While the various governmental bodies have been working together such that many of the sanctions imposed are very similar and/or overlap, they are not identical. For example, the EU has banned Russian flagged (and recently reflagged) vessels from EU ports, whereas the UK prohibition goes further by also banning vessels which are "*owned, controlled, chartered or operated*" by "*designated persons*" or "*persons connected with Russia*". A trade may be caught by sanctions for various reasons beyond the trade of the goods, such as extending credit via payment terms or demurrage provisions. Given the volume and the rapid development of the sanctions against Russia, we recommend seeking legal advice before proceeding with existing contractual commitments and/or entering into new contracts.

Secondary to the sanctions themselves is the impact of "self-sanctioning" as parties take more stringent steps to avoid Russia-related trade. Some buyers are looking to amend contractual terms or washout

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1 the-edge-of-war---legal-implications-of-the-escalating-russia-ukraine-crisis-for-traders.pdf (shlegal.com)
2 Russia's economy set for biggest contraction since 1994, Kudrin says | Reuters
3 Europe’s push to plug its energy gaps | Financial Times (ft.com)
4 European gas prices soar after Moscow imposes sanctions on EU energy companies | Financial Times

contracts to avoid the risk of being stuck with Russian-origin product that can only be on-sold at a discount. In such instances it would be prudent to obtain legal advice as to the precise nature of each party's rights and obligations under the sale contract because, where it is not possible to reach a resolution with a seller, the buyer risks finding itself in breach of contract for failing to perform by not taking delivery of the goods in question. Likewise, shipowners are unwilling to send their own tonnage into Russian ports or to pay a premium to charter in tonnage,[5] and "self-sanctioning" by (particularly US) banks can delay payments or even go so far as to prevent performance of the contract itself where the contract price is in US dollars.

The third impact of international sanctions is the shifting of global trade flows as traders reflect on where they should establish networks and locate assets in the future. For example, India has traditionally not been a huge wheat exporter but recently emerged as a key supplier to countries that are largely dependent on Ukrainian wheat.[6] The Indian government was encouraging an accelerated campaign of exports before u-turning and imposing an export ban on 14 May 2022 in the face of domestic inflation.[7] New trading patterns often require fresh analysis of the particular legal requirements (e.g. for effective transfer of title) in new jurisdictions.

More generally, parties should continue to conduct thorough customer due diligence as new sanctions continue to be imposed. Parties should also review the sanctions clauses in their contracts to ensure they remain fit-for-purpose, or to ensure that sanctions clauses are included in their contracts going forward. However, while sanctions clauses may make it easier to terminate a contract, they are not a substitute for conducting appropriate due diligence and risk assessments.

Place of delivery

The Russian offensive initially targeted both northern Ukraine, in an effort to capture Kyiv, and the eastern areas where separatist and Russian-backed forces have been fighting since the 2014 annexation of Crimea. At the start of April, there was a pivotal refocusing after Russian troops retreated from the Ukrainian capital and withdrew from other northern cities. Now, Russia's attack is focused on capturing the eastern Donbas region, which has led to heavy fighting in the port city of Mariupol over the recent weeks.[8]

As we anticipated in our previous briefing note, the location of fighting has affected different parties in the supply chain differently depending on both their location and the Incoterm rules applicable under their contracts. The Ukrainian military ordered all commercial ports to shut down on 24 February 2022 and Russia banned shipping in the Sea of Azov,[9] so parties have been using rail and river barges to transport their product to Ukraine's western border with Europe.[10] Trading patterns have changed too with port calls to Romania rising above the annual average.[11]

Grain traders are currently considering how to export the commodity to the market ahead of the summer months, but plans to use rail to transhipment ports are facing hurdles as the ports do not all have the throughput capacity for the anticipated volumes.[12] The pressure to keep cargoes moving is likely to lead to less contractual flexibility with delivery periods and laycans, so these should be documented carefully. We recommend that parties also consider

[5] Baltic bulk carriers in disarray after Russian fertiliser turns untouchable | TradeWinds (tradewindsnews.com)
[6] India eyes wheat exports of 11 mil-12 mil mt in MY 2022-23 on Black Sea disruptions | S&P Global Commodity Insights (spglobal.com)
[7] India bans wheat exports as heat wave hurts crop, domestic prices soar - CNN
[8] Ukraine Maps: Tracking Where Russian Forces Are Invading - The New York Times (nytimes.com)
[9] Ukraine military shuts down country's commercial ports | TradeWinds (tradewindsnews.com)
[10] Ferrexpo's Ukraine iron ore exports continue despite port closure | Financial Times (ft.com)
[11] Data shows Black Sea trade slowing with more headed to Romania | TradeWinds (tradewindsnews.com)
[12] Ukraine plots mission to kick-start grain exports | TradeWinds (tradewindsnews.com)

and contract for the allocation of risk in relation to transhipment/transloading and the expenses arising from storage.

Financing

Prices for commodities, from aluminium to barley to crude, have risen sharply, as have the costs of related goods, such as fertiliser, as a result of restricted supply from Ukraine and Russia and sanctions/"self-sanctioning". This market volatility has led to large margin calls that are stretching traders' working capital requirements, particularly those of (typically smaller) traders for whom access to additional credit lines might be more limited.[13] The pressure on liquidity and cash reserves has increased the risk of contractual non-performance.

In secured financing, if the commodity's price outstrips the level of security then this disparity needs to be bridged by the buyer either making interim payment(s) or putting up additional security. Holding insufficient security can amount to a breach of contract, again increasing the likelihood of defaults, especially where borrowers are not actively engaging with their lenders to try and resolve such issues or have any breaches waived.

Where an index is the primary pricing mechanism for a particular commodity but is no longer considered to be reflective of market fundamentals (for example, the 250% increase in the LME nickel price in early March),[14] the market has seen trades at discounts to the index price. While such arrangements may be beneficial to both parties to a (longer term) transaction, it is important to consider whether the transaction could be viewed as a transaction at an undervalue and unwound in an insolvency situation.

Given the heightened risk of defaults and insolvencies, we suggest that greater attention should be given to assessing issues such as this and the changing creditworthiness of counterparties before agreeing sale contracts and concluding financing.

Contract of carriage

The afternoon that Russian forces entered Ukraine, a Turkish bulker was struck by a shell or bomb.[15] Since then, at least five commercial vessels have been struck by missiles.[16] On 7 March 2022, the Joint War Committee (JWC) of the Lloyd's Market Association expanded the Listed Areas designated in the Black Sea, the Sea of Azov, and the inland waters of Ukraine, Russia and Belarus.[17]

More recently, there have been reports that mines laid near Ukrainian shores may have broken loose and become adrift in the Black Sea, so war risk issues could arise even where vessels are transiting the area to other countries (e.g. Romania).[18]

As we anticipated in our earlier article, the ongoing danger to vessels in the region has led to shipowners invoking war risk and/or unsafe port clauses. For the trader/charterer, such declarations (and any subsequent charterparty cancellations) have often had causal effects under the sale contracts.

Russian ports in the Pacific Ocean and the Baltic Sea have been/may also be deemed unsafe due to the Russian imposition of counter-sanctions on "*unfriendly*" nations leading to inspections/potential detention and the additional scrutiny of Ukrainian crew members. Port inspections and crew changes may lead to delays thereby impacting delivery dates under the sale contract. The JWC added Russia to its designation on 4 April 2022.[19]

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[13] Big commodity traders reap rewards as margin calls squeeze smaller rivals | Financial Times (ft.com)
[14] Commodities go crazy: nickel edition | Financial Times (ft.com)
[15] Cargill-chartered Turkish bulker hit by shell in Black Sea | TradeWinds (tradewindsnews.com)
[16] Over 300 vessels and at least 1,000 seafarers are stuck in Ukraine :: Lloyd's List (informa.com)
[17] See: JWLA-029.
[18] Industry News: Russia – Ukraine military action: Impact on shipping (nepia.com); War in Ukraine – impact on maritime situation - GARD
[19] See: JWLA-030.

Traders/charterers should continue to look closely at: (a) the permitted trading areas and any named ports in their charterparties; and (b) the precise delineation of covered areas under vessels' war risk insurance and how these fit with the transfer of risk under their sale contracts.

Force Majeure and Frustration

In addition to vessels travelling to/from the region, there are approximately 140 foreign flagged vessels trapped at Ukrainian ports or anchorages.[20] For these vessels, this may trigger a force majeure (FM) event under the charterparty and the sale contract. Lack of maintenance of port canals and silting mean that even once the immediate danger has passed and the area has been de-mined, there will still be problems leaving ports. Against this background, we have also started to see frustration arguments being raised.

Frustration discharges a contract where an event renders it physically, legally or commercially impossible to perform, or changes an obligation into a radically different one from that undertaken when the contract was concluded. It is usually a high bar to meet, and in the context of the sale of goods, the English Court has held that increased cost or delay in performing an obligation are insufficient to frustrate a contract.

For these reasons, if there is an FM clause in the contract, traders are more likely to rely on FM in relation to the variety of obstacles they are currently facing, both the physical (e.g. transport to port, trapped vessels) and the legal (e.g. sanctions). While the ability of a party to rely on FM depends on the specific wording of the clause (construed in the context of the particular facts), there is some language that is frequently used:

- "*Unforeseeable*": Some FM clauses state that the triggering event must be unforeseeable. As we have seen with reliance on such clauses during the Covid-19 pandemic, as the situation becomes more and more prolonged it will become harder to argue that the event triggering FM was unforeseeable and could not have been avoided. Three months into the conflict, we expect to see this defence to FM raised with more frequency.
- *"Reasonable endeavours":* FM clauses often expressly require the affected party to use reasonable endeavours/efforts/means etc. to overcome the FM event. In the recent decision *MUR Shipping BV v RTI Limited*,[21] the Court held that the "*reasonable endeavours*" provision did not require the affected party to accept non-contractual performance. This appeal under section 69 of the Arbitration Act 1996 arose out of Owners' exercise of a FM provision in response to Charterers' difficulties paying freight in US dollars following US sanctions against Russia in 2018. Mr Justice Jacobs decided that Owners were not required to accept payment in Euros instead of US dollars (the contractual currency).[22]
- "*Prevented*" vs "*hindered*": Whereas words like "*prevented*" require a physical or legal prevention of performance, words such as "*hindered*" refer to performance becoming more difficult rather than impossible. In both cases, however, performance becoming more expensive as a result of (for example) higher commodity prices or freight rates is unlikely to be sufficient.

Many FM clauses contain a time period after which, if the FM event is continuing, the contract may be cancelled (whether automatically or at the election of one/both parties). For example, the GAFTA prevention of delivery clause gives the buyer the option to cancel the contract if the FM event continues for 21 days after the end of the shipment/delivery period, with the contract being cancelled automatically after a further 14 days. FOSFA and SCoTA provide for cancellation 60 days after, respectively, the contract delivery period and the notification of the FM event, at the non-affected party's option. We are now 90 days into the war, so as more of these time periods are reached and contracts are cancelled, there will be knock-on effects and, likely, more defaults across the market and along string sales.

[20] Over 300 vessels and at least 1,000 seafarers are stuck in Ukraine :: Lloyd's List (informa.com)

[21] [2022] EWHC 467

[22] See our more detailed commentary here: Reliance on force majeure in the face of sanctions: MUR Shipping v RTI (shlegal.com)

Conclusion

Notwithstanding that we are now three months into the conflict between Russia and Ukraine, the situation continues to evolve and have wide-ranging effects on global commodity markets. While other considerations and scenarios have since emerged, our fundamental recommendations remain as set out in our first briefing note: carefully consider your contracts, the clauses contained therein, and the parties in your contractual chains to establish where your risks lie. As the NATO Secretary General commented in early April, "*we need to be prepared for the long haul*".[23]

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[23] NATO - Opinion: Doorstep statement by NATO Secretary General Jens Stoltenberg ahead of the meeting of NATO Ministers of Foreign Affairs on 6 and 7 April 2022, 06-Apr.-2022

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