

PART I

INTERNATIONAL SALES GOVERNED BY ENGLISH LAW

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INTRODUCTION TO INTERNATIONAL SALES

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A. Subject Matter

Introduction

Scope This is a book that consists of two parts. The first and larger part deals with the law of international sale of goods as administered in the English courts and arbitral tribunals, in those cases where English law is the applicable (or proper) law of the contract. The second part deals with attempts to create for international sales of goods a uniform law designed as a substitute for a national applicable law.¹ In the first part, the focus is firmly placed on those aspects of the English law of sale that are particularly relevant to contracts with an international dimension. No rigorous definition of such contracts is possible because the size of the category is a matter of relative judgment and not of the interpretation of a statute. When it comes to the application of English law, contracts of sale that are performed exclusively in England, such as an ex works sale where delivery takes place at the factory gate, will not come under consideration in this book, even though they might take place between parties resident in different countries. The international dimension of such contracts does not bulk sufficiently large for them to be included in a book of this kind. Instead, the internationality of a contract will be judged according to the place of performance of the contract. A striking feature of reported cases on international sale before the English courts is that they are invariably bound up with marine transportation. There is a noticeably close connection between the contract of sale itself and contextually related, even integrated, contracts, such as those of carriage, marine insurance, and bankers' letters of credit.² A concrete illustration

¹ See para 1.03.

² For a useful survey article, see H Berman and C Kaufman, 'The Law of International Commercial Transactions (*Lex Mercatoria*)' (1978) 19 Harv Int Law J 221. See also J Ramberg, 'Synchronization of Contracts of Sale, Carriage, Insurance and Financing in International Trade' in P Sarcevic (ed), *International Contracts and Conflicts of Laws* (1990); E McKendrick (ed), *Goode's Commercial Law* (4th edn, 2010), ch 32.

of this will be given below after an outline discussion of the various delivery terms used in international sales. It will be seen that the delivery terms concerning the English courts are predominantly those with a maritime element, as opposed to delivery terms common in Europe that call for the carriage of goods by road or rail. In this book, the duplication of material that is more properly dealt with in a book on the domestic sale of goods³ will be avoided in order to allow greater concentration on material unique to international transactions. In consequence, for example, not all aspects of remedies will be considered, but some will be subjected to extended treatment. Again, detailed applications of the rules concerning the description, quality, and fitness of goods will be left to works dealing with the domestic law of sale.

1.02 Commodities The existing body of international sale contracts featuring in the reported decisions of the English courts has an homogeneous character, consisting as it does more or less exclusively of commodity agreements concluded on the terms of London-based commodity associations by major grain dealers or by oil companies on the standard terms of the multinational oil companies. A standard feature of contracts published by the London-based commodity associations is the selection of English law as the applicable law.⁴ This is true to a lesser extent of bulk oil contracts. The badge of an international sale, as displayed in these reported decisions, is the marine, cross-border character of the contractual performance that takes place. Sales between parties of the same nationality and residence may therefore qualify as international sales for the purpose of the larger part of this book.⁵ As the reported cases demonstrate, the connection between England and the contracting parties and performance in the commodities trade is usually slight or non-existent. The great majority of international sales litigated in England concern contracts between parties neither of whom is English, which are to be performed by physical or documentary means outside England. The long-settled practice of choosing English law as the applicable law in international commodities contracts in such cases is sanctioned by the Rome I Regulation on the Law Applicable to Contracts,⁶ which has effectively superseded a Rome Convention of the same name.⁷

1.03 UN Sale Convention It was stated above that this book consists of two unequal parts. The smaller part deals principally⁸ with the United Nations Convention on the International Sale of Goods 1980 (the CISG),⁹ sometimes known as the Vienna Convention, compares it to English law, and considers the impact it would have on the law of international sale in the event of its being applied in lieu of the existing English law. When the CISG is examined, it will be seen that the definition of an international sale used in connection with English law will no longer serve, since the CISG primarily defines internationality according to the place of residence of the contracting parties and not according to the place or type of performance. An international sale contract under the CISG may perfectly well be an ex works

³ See MG Bridge, *The Sale of Goods* (2nd edn, 2009).

⁴ See para 1.24.

⁵ As in the Convention on the International Sale of Goods (CISG) 1980.

⁶ Regulation 593/2008, applicable to contracts concluded on or after 17 December 2009.

⁷ The Rome Convention 1980 was implemented by and scheduled to the Contracts (Applicable Law) Act 1990 (see Sch 1). The Rome I Regulation 2008, as directly applicable legislation in the United Kingdom, needed no domestic measure to become law. See M Bridge (ed), *Benjamin's Sale of Goods* (8th edn, 2010), ch 26 (Harris).

⁸ Attention is also given to the Common European Sales Law (CESL) at Appendix 1.

⁹ Discussed in detail in chs 10–12.

contract. Even though the CISG has not been brought into force in England, it has long been the practice explicitly to exclude the operation of the CISG, along with a number of other international conventions, in the standard contract forms promulgated by commodity associations, such as the Grain and Feed Trade Association (GAFTA) and the Federation of Oils, Seeds and Fats Associations (FOSFA), which provide for arbitration in England and for the application of English law as the applicable law.¹⁰ The CISG is also excluded from trading forms sponsored by the major oil companies, such as Shell¹¹ and Total.¹² The CISG has almost nothing to say about the detailed problems that one sees in reported cases in England. It does not define delivery terms such as FOB and CIF, nor does it make mention of bills of lading,¹³ nor does it deal with payment through a letter of credit. Yet the same could equally be said about the Sale of Goods Act 1979. In the great majority of reported commodities decisions on English law terms, the Sale of Goods Act either receives a passing mention or no mention at all. More significant in the resistance of commodities traders to the CISG is the conservatism of commodities traders doing business on standard forms that have evolved in a symbiotic relationship with reported English cases, often over many decades. In addition, the CISG has certain features that are considered to be unsuitable in the commodities trades. For example, the CISG is less free than English law in conferring rights of contractual termination on buyers where the seller supplies non-conforming or late documents or goods.¹⁴ In addition, the application of the CISG would alter or cast doubt over established rules on the allocation of risk in both FOB and CIF contracts.¹⁵ A further consideration is the close relationship that has developed between the forward delivery and the derivative markets.¹⁶ In the latter case, the Financial Markets Law Committee of the Bank of England has drawn attention to the unsuitability of the CISG as a contract instrument and the desirability of its exclusion by market participants.¹⁷ One may therefore expect the practice of exclusion in the commodities markets to continue, for reasons that will emerge from the ensuing text.¹⁸ The practice accords with Article 6 of the CISG, which expressly permits the parties to exclude the Convention as well as to vary the effect of or derogate from its provisions.

Comparison with English law So far, the United Kingdom has not adopted the CISG, but in the long run it is questionable that the United Kingdom will remain outside a community of nearly eighty nations, including most of its major trading partners, that have

1.04

¹⁰ The CISG is excluded from other association standard forms, such as those of the International Cotton Association (formerly the Liverpool Cotton Association) (January 2011, bylaw 202).

¹¹ See, eg, cl 43(2) of the General Terms & Conditions for Sales and Purchases of Crude Oil (2010).

¹² See, eg, cl of the General Terms and Conditions for CFR/CIF/Delivered Ex Ship Sales of Crude Oil (2007).

¹³ See ch 8.

¹⁴ See chs 4 and 9.

¹⁵ See ch 7.

¹⁶ For hedging purposes: see para 1.59. For the importance of contractual certainty in hedging operations, see FMLC Issue No 97: Feasibility Study by the European Commission's Expert Group on European Contract Law (Letter to the European Commission of 13 June 2011), available at <<http://www.fmlc.org>>.

¹⁷ Issue No 130: Implementation of the Vienna Sales Convention (July 2008).

¹⁸ See further M Bridge, 'Uniformity and Diversity in the Law of International Sale' (2003) 15 Pace International Law Review 55. For the view that the CISG is apt to deal with international commodity sales, see P Schlechtriem, 'Interpretation, Gap-Filling and Further Development of the UN Sales Convention' (2004) 16 Pace International Law Review 279; I Schwenzer, 'The Danger of Pre-Conceived Views with Respect to the Uniform Interpretation of the CISG etc' (2005) 36 Victoria University of Wellington Law Review 795, 799. The question *why* the CISG has not been taken up by commodity traders is not addressed in the literature that considers it almost self-evidently good for them.

adopted it. The CISG provides traders with added choice and, for English importers at least, should be more accessible than a foreign seller's law.¹⁹ There is noticeably, however, a lack of enthusiasm for its adoption,²⁰ and indeed a measure of opposition, due to the belief that the international prominence of English law is under threat from uniform legislation of this kind. Parliamentary time, moreover, is itself a commodity in short supply, which suggests that some momentum in favour of the CISG will have to build up before it is adopted in the United Kingdom. The CISG, apart from its importance as positive law, is also a profoundly influential instrument in the development of international and regional (especially within the European Community) uniform law.²¹ Even though the CISG has not been adopted, English traders may find themselves adopting it by way of arbitral references and through the selection of a foreign applicable law whose state has adopted the CISG. It is therefore prudent to examine the CISG with particular reference to its points of departure from current English law. In the process, it will be necessary also to consider the territorial field of application of the CISG. The law to be applied to sales passing the test of internationality in the CISG will be the uniform law laid out therein, and not some national system of law selected as the applicable law by virtue of party choice or the distribution of connecting factors. Once the CISG applies in its own terms, no particular account need therefore be taken of the connection between any specific contract and England. There is an exception to this. The CISG does not cover all types of international sale contract²² or all aspects of sales law pertinent to international as well as domestic sales contracts.²³ English law, if it passes the test of the applicable law under the Rome I Regulation,²⁴ would continue to apply to sale contracts and aspects of sales law excluded from the CISG in the event of the United Kingdom adopting the CISG.²⁵ English law might also have a continuing role to play in filling gaps in the coverage of the CISG.²⁶ Finally, it might also be the law applicable to general contract issues not located in sales law.

Shipping terms

- 1.05 Defining delivery** A feature of contracts involving delivery across national frontiers is the range of different shipment terms available to the parties. These define variously the way in which the seller, with appropriate assistance from the buyer, is expected to prepare the goods for carriage or arrange for their carriage when placing the goods at the buyer's disposal. They therefore define the nature, extent, and cost of the seller's delivery responsibilities and, in so doing, depart more or less from the standard presumption in the Sale of Goods Act 1979 that delivery takes the form of (somewhat passively) placing the goods at the disposal of the buyer at the seller's premises.²⁷ Without attempting to be exhaustive, it is

¹⁹ Since sellers' standard terms tend to prevail over buyers' terms, the likelihood is that a seller's preferred law will prevail over the buyer's.

²⁰ See S Moss, 'Why the United Kingdom Has Not Ratified the CISG' (2005) 25 *J of Law and Commerce* 483.

²¹ Its influence is evident in the Consumer Sales Directive (Directive 1999/44/EC of the European Parliament and Council on the sale of consumer goods and associated guarantees), transposed into UK legislation in the form of Part 5A of the Sale of Goods Act 1979.

²² See Art 2.

²³ See Arts 4 (validity and passing of property excluded) and 5 (personal injuries excluded).

²⁴ See Arts 3–4 of the Regulation.

²⁵ Discussed further at para 1.24.

²⁶ See Art 7(2); discussed in ch 10.

²⁷ Ex works delivery: s 29(2) of the Sale of Goods Act.

useful to consider a broad range of physical delivery responsibilities of ascending onerousness from the seller's point of view. When an independent carrier is employed to transport the goods, the place of delivery may be anywhere between the seller's premises and the buyer's. It may occur at the seller's factory, at some inland collection point, at some point in the harbour where shipment occurs, alongside the ship, or on board the ship. If delivery is postponed to the port of discharge, it may take place on a lighter barge or over the ship's side, or it may be postponed to some inland collection point in the buyer's country or at the buyer's factory.

Excluding domestic sales As stated above, the prima facie rule in the Sale of Goods Act²⁸ is that delivery occurs at the seller's premises, but, since this may occur between parties of different nationalities, there is nothing to distinguish it from a conventional domestic sale. All arrangements for the export of the goods are left in the hands of the buyer. This book deals with those commodity sales where the seller assumes responsibility for at least some of the export arrangements.²⁹ It may therefore include contracts between parties, both of whom are English.³⁰ As stated above, it therefore excludes ex works contracts.³¹ The parties' departure from the rule in s 29(2) is expressed by means of special expressions and abbreviations, such as 'FAS (free alongside ship)', 'FOB', and 'ex ship'³² (at the port of discharge). These are economical statements of various instances of the seller's contractual duty to deliver. **1.06**

Documents instead of goods It is quite possible not just to vary the place of delivery, but to commute the delivery obligation so that the subject of the seller's delivery obligation is not the goods themselves but rather documents representing the goods. The expression 'CIF Rotterdam', for example, does not connote a place of delivery (since the expression alone does not inform us where, or to whom, the documents are to be delivered). Rather, it tells us that the seller's delivery duty has been substituted by a duty to deliver to the buyer a number of documents,³³ principally (for present purposes) the following. First, there will be a bill of lading, which establishes at the very least that the carrier is in receipt of the goods.³⁴ It may also have to show that the goods have actually been shipped, that is, loaded on board and not merely received for shipment by a carrier taking them in hand. The bill of lading is also supposed to evidence that the seller has entered into a proper contract of carriage to the agreed destination of Rotterdam. The buyer should be able to tell from the face of the bill of lading whether the CIF seller has performed its physical duties under the contract.³⁵ Secondly, the seller will have to tender an insurance document (classically, the policy itself but more often a certificate of insurance nowadays). Thirdly, there will be a commercial invoice identifying the goods shipped and separating the elements of basic price, freight, and insurance in the overall CIF price. The due performance of a CIF sale does not normally depend upon the date or fact of arrival of the goods, though the date of arrival is a common **1.07**

²⁸ S 29(2).

²⁹ The definition of an international sale for the purposes of the CISG is broader than this: see ch 11.

³⁰ eg *Re Anglo-Russian Merchant Traders Ltd* [1917] 2 KB 79, CA.

³¹ These are capable of being international sales pursuant to Art 1(1)(a) of the CISG.

³² Or DES according to Incoterms 2000. In the current 2010 edition of Incoterms, which are discussed at para 1.19, DES is deemed redundant and subsumed under DAP (delivery at a named place in the destination country). See ICC, *Incoterms®2010*, Introduction (p 6).

³³ See ch 4.

³⁴ For alternatives to the bill of lading under a CIF contract, see ch 4.

³⁵ See ch 4.

feature nowadays of bulk oil contracts. Instead, the buyer gets documents that, as will be seen, give the buyer rights against the carrier and against the insurance company.

1.08 CIF and FOB It would be impracticable to discuss each and every delivery term in a book of this length. The bulk of decided cases on commodity sales deal with CIF and FOB contracts, though there is a modern trend outside the commodities trade to move away from these types of sale in their pure form.³⁶ An understanding of these delivery terms will create a solid foundation for an understanding of the others. Besides the FOB sale, references will be made from time to time and by way of contrast to the similar FAS (free alongside ship) term. In addition to the CIF sale, mention will often be made of the very similar 'C&F' sale,³⁷ which is like a CIF sale except that the buyer takes care of the insurance. It is of course up to the parties to designate the delivery term of their choice. From time to time, however, when construing the whole of, for example, a 'CIF contract', it will become apparent that the contract is something else, such as an on-shore delivery contract, where the buyer pays not against documents but against the goods themselves when they are discharged from the ship. The use of the letters CIF is indicative of the nature of the seller's responsibilities and not a magic formula that fixes despite all else the character of the contract concluded by the parties. A contract for delivery on shore may be ex ship³⁸ or it may call for physical delivery at some other point in the country of destination.

A common transaction

1.09 General It is useful to put the shipment terms that are the focus of this book in context by taking a hypothetical transaction.³⁹ Suppose a contract of sale is concluded between a New York seller and an English buyer for the sale of a colour printing press. The machine is not yet in a deliverable state but will be ready for delivery in New York in three months' time. The buyer has the responsibility under the contract for finding a carrier to transport the press to England and engages a freight forwarding agent to book shipping space on a boat calling in New York at the relevant time. This is but one way in which a carrier's services may be employed. With large cargoes of oil or dry commodities, such as wheat, the buyer may charter an entire ship and will not make use of the services of a freight forwarder but instead employ the services of a ship's broker to fix the charter.⁴⁰ In agricultural commodities markets, ships are often chartered at short notice on the spot (or voyage charter) market, in contrast with other commodities manufactured in industrial conditions, where the availability of cargoes can more readily be plotted in advance and ships hired on time charter terms. In the above example involving manufactured goods, the buyer's agent has booked liner space by consulting shipping timetables and selecting a ship due to visit New York at the relevant time. In other cases, the services of a tramp may be employed, a tramp being a ship that puts into port in no particular rotation in the speculative hope of finding a cargo.

³⁶ See the availability of other terms in Incoterms 2010, most of which have had a negligible impact on the reported case law in England.

³⁷ C&F is known as CFR in Incoterms.

³⁸ See para 1.06 on the abandonment of the ex ship (or DES) term by Incoterms 2010.

³⁹ Because the focus of this book is on commodities contracts, the examples chosen are FOB and CIF delivery terms. This is not meant to assert that, in intra-European trade for example, these are commonly employed shipping terms.

⁴⁰ For a valuable discussion of the background to the bulk shipping markets, and to shipping markets in general, see M Stopford, *Maritime Economics* (3rd edn, 2009).

New York shipment Building on this example, suppose the parties have agreed that it is up to the New York seller to get the press to the harbour in New York. Where precisely the seller's responsibilities end will depend on the precise shipping term used. It may be that delivery is required FAS, or free alongside, so that the seller's duty is done when the goods are brought to the ship. Suppose, however, that the seller is bound to do more and that delivery is to take place on FOB terms. This means that the seller is responsible for seeing to it that the press is not merely received by the carrier but that it is actually loaded on board ship. The FOB buyer is usually responsible for selecting the carrier, and there is nothing in the present contract to indicate a contrary intention. Indeed, the contract might explicitly state that this is the buyer's duty. It is unlikely that New York or US federal law will require an export licence in the case of non-military manufactured goods (or that an import licence will be demanded by English law), but there will be customs clearance requirements to be adhered to at both ends. On the above facts, these will be down to the seller in New York and to the buyer in England.⁴¹ **1.10**

Variety of contracts It should be stressed that the ways in which an overseas sale may be conducted are almost infinitely variable and that the applicable rules are almost always drawn from a construction of the contract. Consequently, it is necessary to avoid dogmatism in dealing with overseas sales law. One cannot, for example, say that it is always the FOB buyer's responsibility to select and engage the carrier: sometimes the seller is explicitly, perhaps even implicitly, obliged under the contract to do this.⁴² Examples of this sort can be multiplied. **1.11**

Other contracts International sale contracts do not exist in a vacuum. As stated above, they are frequently associated with other contracts. For example, it would be most unwise not to insure the press whilst it is in transit. The press might be damaged or lost through an act of God, common in the case of marine transit. Even if the carrier is at fault, the carrier is likely to be, and will be in the above example, subject only to limited liability. In FOB cases, it is the buyer who arranges insurance, though this may be done by the seller, acting as the buyer's agent, on account of the buyer. The buyer may need certain information from the seller in order to be able to effect insurance. There is also the contract of carriage to consider. If the carrier is liable for breach of contract, a question that has caused great difficulty in the past is, 'Liable to whom?' In the present example, the carrier's contract will be concluded with the buyer, but this is not invariably the case in FOB transactions. This issue of the carrier's contractual liability, together with any possible liability in tort, has proved much more troublesome in the case of CIF contracts, where the buyer is not originally privy to the contract of carriage and will not usually have a proprietary interest in the goods at the time they are damaged by a negligent carrier.⁴³ Again, the significance of charter party contracts needs to be considered. Where goods are sold as bulk commodities, it is commonly the head seller (in string CIF contracts) and end buyer (in string FOB contracts) who will fix a charter party to carry the goods. Charter parties have a number of clauses in common with sale contracts and the interaction of the two types of contract is an important matter. **1.12**

Payment There is also the issue of payment to consider. Where the buyer and seller have a well-established business relationship, delivery will probably be made on terms giving the **1.13**

⁴¹ See ch 5.

⁴² See ch 3.

⁴³ See ch 8.

buyer thirty days' (or some other period of) credit. In the above example of a one-off contract, this is unlikely. The seller may reserve the right of disposal⁴⁴ until payment is made but this may not be sufficient security in the event of the buyer's default or insolvency: the seller may have to dispose of the press (perhaps customized for the buyer) at a loss in England if the buyer fails to pay. So it is not just the risk of the buyer's insolvency or repudiation of the contract that needs to be taken into account. If the buyer is not willing to pay cash and the seller not willing to extend credit, then a reliable paymaster must be sought. This will inevitably be a bank. The way in which the bank's services are likely to be engaged is through the letter of credit system.⁴⁵ Briefly, the buyer's bank in England will undertake directly to the seller to pay when the seller ships the press and tenders the stipulated shipping documents. Since the promise of an English bank alone is unlikely to satisfy the New York seller (what if the bank defaults?), this undertaking will usually be confirmed by a New York bank which will handle the shipping documents (for transmission to the buyer's bank) and make payment to the seller. Commonly, the buyer's bank will extend credit to the buyer and will take a security interest in the shipping documents and their proceeds⁴⁶ until the loan is repaid or some other security provided or extended to the press. An interest in the shipping documents might also be taken earlier in the process by the seller's bank, as security for a short-term loan to the seller pending the receipt of payment through the banks involved in the letter of credit.

- 1.14 After discharge** Once the press is discharged at the docks in England, it is of course up to the buyer to arrange for carriage to the buyer's premises or onward to some other destination of the buyer's choice. An FOB seller's involvement and continuing interest in the contract is usually exhausted once the goods have been loaded on board and payment has been made.
- 1.15 CIF** In the above example, the delivery term employed was FOB. It would not be at all unusual in such a case for the seller to ship the press on CIF terms.⁴⁷ Briefly, this involves a greater share of the responsibility by the seller. The seller will charge the buyer a price that includes the cost of insurance as well as the cost of carriage. The seller will also see to the transport and insurance arrangements. Besides the risks associated with fluctuating freight rates and insurance premiums, the seller who charters a ship also runs the risk, common in some trades, of congestion in the destination port when presenting the goods for discharge. An inability to quantify the risk of this may make FOB dealings more attractive to some sellers. The issues concerning payment, as well as the way the parties deal with those issues, will be just as relevant to CIF cases. Most of the reported cases on international sales that are governed by English law concern transactions in the commodities trades, where the goods will be carried under the terms of a charter party contract rather than an affreightment (or bill of lading) contract. These rarely involve payment difficulties and will not involve the letter of credit system unless they are oil contracts. The cases tend to be preoccupied with difficult issues of contractual construction as these bear on the contractual rights and duties of buyer and seller. As stated above, the buyer's rights against the carrier have long been a

⁴⁴ See ch 7.

⁴⁵ See ch 6.

⁴⁶ By way of a trust receipt: *Re David Allester Ltd* [1922] 2 Ch 211.

⁴⁷ Incoterms 2010 also provide a CIP (carriage and insurance paid to) term applicable to any mode of transport (whereas CIF is specifically designed for sea and inland waterway transport). On CIP, see *Geofizika DD v MMB International Ltd* [2009] EWHC 1675 (Comm).

subject of difficulty in CIF sales. The contract of carriage⁴⁸ could not with its rights and duties have been transferred in practical terms by seller to buyer without statutory intervention. Legislation was passed to permit the transfer of rights and duties under the contract of carriage⁴⁹ but it depended upon the passing of the property in the goods from seller to buyer in narrowly defined circumstances and worked poorly in the case of modern bulk cargo shipments.⁵⁰ It took more recent legislation⁵¹ to facilitate the transfer of rights and duties under the carriage contract to the buyer before satisfactory results were achieved to fit modern conditions of traffic in cargoes. Meanwhile, the CIF buyer could not turn to tort for comfort in proceedings against a negligent carrier. If the buyer lacked a property interest in the cargo at the time the goods were negligently damaged or destroyed, which he would not acquire before payment and, in the case of goods constituting an unascertained part of a larger bulk, would not acquire even upon payment,⁵² this meant that the buyer's action was seen as an attempt to impose upon the carrier liability for pure economic loss, against which the English courts have set their face in modern times.

The above example atypical The example of a common transaction involving a New York seller represents one distinctive type of overseas contract. The great bulk of the decided English cases deal with very different contracts, namely, the sale of large amounts of commodities, such as oil in bulk, and large amounts of agricultural commodities like grain or soya beans. These sales take place against a background of speculative trading. A consignment of wheat can be the subject of a large number of paper transactions before delivery is taken by the eventual buyer. Everyone else in the chain is dealing only with paper, namely the various shipping documents, such as the bill of lading. This speculative dimension has a profound effect upon the way in which the parties' responsibilities are defined and enforced and upon the character of English law as applied to such contracts. **1.16**

B. Organizations and Entities

UNCITRAL This is a book on the private law of international sale of goods. It is therefore not its concern to review all of the organizations, governmental and non-governmental, whose work bears upon international sales. It is nevertheless useful to review a few international organizations that play a particular role in introducing uniform substantive law to international trade. The United Nations Commission on International Trade Law (UNCITRAL) is a branch of the United Nations⁵³ that performs its work through **1.17**

⁴⁸ Where goods are carried under a charter party entered into by the seller, the charter party is not transferred to the buyer but the bill of lading, a receipt for the goods in the hands of the seller, becomes when transferred to the buyer, constitutive of a contract of carriage with the carrier: *Leduc & Co v Ward* (1888) 20 QBD 475, CA; *Hain Steamship Co v Tate & Lyle Ltd* (1936) 41 Com Cas 350, 356–57, HL. The same result is less easy to achieve under the language of the Carriage of Goods by Sea Act 1992, ss 2–3, 5(1).

⁴⁹ Bills of Lading Act 1855 (repealed by the Carriage of Goods by Sea Act 1992).

⁵⁰ See ch 7.

⁵¹ Carriage of Goods by Sea Act 1992.

⁵² Until the Sale of Goods (Amendment) Act 1995. The buyer of goods forming part of an agreed bulk who has made partial or full payment will now acquire to the extent of any payment made an undivided share in the bulk: Sale of Goods Act 1979, s 20A. The characteristics of this right, as it might affect the buyer's rights in tort against a negligent third party, have not yet been tested, but in principle this reform should overcome the long-standing objection to a buyer without a property interest pursuing the carrier in tort.

⁵³ Another branch of the United Nations is UNCTAD (United Nations Commission on Trade and Development), founded in 1964, which works as a forum for inter-governmental deliberations; conducts

diplomatic conferences, as well as through the formulation of model laws. In 1980, for example, a diplomatic conference in Vienna adopted the CISG. It is a blend of common law and civil law principles arranged to take account of the varied interests of manufacturing, producing, and consumer countries. Although there are other areas of concern, such as the rules on risk, it is probably because the CISG lacks the hard certainty that one finds in certain areas of English sales law that, as stated above, it is routinely excluded in the standard forms of trading associations. The primary purpose behind the CISG is the removal of barriers to free trade: legal pluralism is seen as a barrier and various methods have been adopted over the decades to tackle this problem of which the CISG is the latest. Besides the CISG, UNCITRAL has been responsible for the Convention on the Limitation Period in International Sale of Goods 1974.⁵⁴ It plays an active role in encouraging the adoption of conventions it has sponsored or for which it has accepted responsibility.⁵⁵ UNCITRAL is or has been heavily involved in other areas of international commercial transactions, such as secured transactions, the assignment of receivables, arbitration, standard form contracts, and electronic commerce.

1.18 Unidroit Unidroit, or the International Institute for the Unification of Private Law, is an intergovernmental organization based in Rome. Originally an organ of the League of Nations, it was reconstituted in 1940 by a multilateral agreement (the 'Unidroit statute') in its present form. At present, it has nearly 60 members, including the United Kingdom, and is maintained by contributions of the Italian Government and the other Member States. Its work consists of the preparation of conventions and model laws addressed to States. It was involved in the work that culminated in the 1954 Hague Conventions relating to the international sale of goods⁵⁶ and it prepared the 1983 Geneva Convention on Agency in the International Sale of Goods and the 1988 Ottawa Conventions on International Financial Leasing and on International Factoring. It is currently at work on leasing and international capital markets transactions and has successfully concluded a convention, the Cape Town Convention 2001, dealing with international security interests in certain types of mobile equipment. The work of Unidroit is not just addressed to States. The Unidroit Principles of International Commercial Contracts are proffered for adoption by private contracting parties as well as for use by arbitrators. The role that they might play in conjunction with the CISG could prove to be considerable.⁵⁷

1.19 International Chamber of Commerce The International Chamber of Commerce is a private Paris-based body, bringing together the various national chambers of commerce, whose varied activities include the issue of Incoterms⁵⁸ and of the Uniform Customs and Practice for Documentary Credits.⁵⁹ Incoterms are a collection of rules setting out the various contractual responsibilities of buyer and seller for the different types of overseas sale

research, collects data and carries out research analyses; and provides technical assistance to developing countries. Its activities are for the most part outside the scope of this book, but its report on Documentary Risk in Commodity Trade (1998), UNCTAD/ITCD/COM/Misc.31, repays careful reading.

⁵⁴ This has been adopted by 29 countries.

⁵⁵ An example of the latter is the New York Convention on the Recognition and Enforcement of Foreign. Arbitral Awards 1958.

⁵⁶ See ch 10.

⁵⁷ See ch 10.

⁵⁸ 2010 edition (first issued in 1936).

⁵⁹ The UCP 600 Rules, 2007.

(such as CIF and FOB). They are written in plain language for lay people and therefore lack the complexity one expects in detailed statutory rules or commercial contracts. To a significant extent, they work as a sort of checklist for business parties, identifying which of them has to take each of the necessary steps required to effectuate the contract. Incoterms apply to a contract of sale only if the contracting parties incorporate it into their agreement.⁶⁰ They are practically never incorporated in dry commodities transactions⁶¹ but may well be encountered in transactions like the one involving the press in the above example. The Uniform Customs and Practice for Documentary Credits⁶² are a more detailed collection of rules relating to letters of credit. Reference to them in the case law is very common indeed. Again, they apply to a contract created by a letter of credit only if they are incorporated therein, as they almost always expressly are. Whether they may be incorporated impliedly, and if so when, is an uncertain matter.⁶³

Trade associations Particular trade associations include the Grain and Feed Trade Association (GAFTA), the Refined Sugar Association, and the Federation of Oils, Seeds and Fats Associations (FOSFA). These bodies are all located in London. Besides providing an arbitration service, they issue standard contracts for particular adventures. FOSFA 24, for example, is an FOB contract for the sale of South American yellow soya beans to be shipped from a South American port. GAFTA 100 is a general feeding stuffs contract entered into on CIF terms: it dates from an early form issued more than a hundred years ago. The forms are very detailed and respond to problems arising in the case law. They therefore bear the encrustations of decades of case law. Problems can arise if the standard form is modified in the instant case. Over a hundred years ago, Grove J warned that it was ‘always dangerous to alter established printed forms, for these had been the subject of legal decisions and had had interpretations put upon them’.⁶⁴ The issue by trade associations in the dry commodities trade of standard form contracts assists in the creation of trading strings,⁶⁵ in which the various pairs of participants contract on terms that are equal save as to price. This results in a concatenation of nearly identical contracts, which assists in the creation of liquid markets. In the oil trade, standard forms are put out, not by independent trading associations, but by major oil companies whose terms are adopted in contracts concluded between other oil companies.⁶⁶

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⁶⁰ But note that a US court, applying the CISG, held that the use of the letters CIF without more was sufficient to incorporate also Incoterms pursuant to usage and in accordance with Art 9(2): *St Paul Guardian Assurance Co v Neuromed Medical Systems & Support* SDNY District Court 26 March 2002, available at <<http://cisgw3.law.pace.edu/cases/020326u1.html>>.

⁶¹ They are in fact explicitly excluded in GAFTA contracts in the ‘International Conventions’ clause but are nevertheless usually incorporated in oil transactions: see, eg *Shell, General Terms and Conditions for Sales and Purchases of Crude Oil* (1980), cl 27 and *Total, GENERAL TERMS AND CONDITIONS FOR CFR/CIF/DELIVERED EX SHIP SALES OF CRUDE OIL* (2007), Section 1; *Erg Petroli SpA v Vitol SA (The Ballenita and BP Energy)* [1992] 2 Lloyd’s Rep 455; *ERG Raffinerie Mediterranee v Chevron USA Inc (The Luxmar)* [2007] EWCA 494, [2007] 1 CLC 807, where however they are of little value in resolving the complex performance issues that arise in such contracts.

⁶² UCP 600 (2007) were preceded by UCP 500 (1993).

⁶³ See ch 6; M Bridge (ed), *Benjamin’s Sale of Goods*, (8th edn, 2010) (Bennett), para 23–008; cf *Harlow and Jones Ltd v American Express Bank Ltd* [1990] 2 Lloyd’s Rep 343 (setting an undemanding test for incorporating the Uniform Rules for Collections).

⁶⁴ *Cederburg v Borries Craig and Co* (1885) 2 TLR 201.

⁶⁵ See ch 5.

⁶⁶ See, eg *Sohio Supply Co v Gatoil (USA) Inc* [1989] 1 Lloyd’s Rep 588 and *Phibro Energy Inc v Coastal (Bermuda) Ltd (The Aragon)* (1987) [1991] 1 Lloyd’s Rep 61 (both involving BP terms).

- 1.21 Standard form contracts** It is common in the commodities trade for bulk contracts to be entered into very informally, by telephone, fax, or telex, with a brief reference to ‘GAFTA 100 terms’ or something similar. The traders will be fully familiar with GAFTA 100 and will not exchange the form between themselves. Frequently, however, special clauses are appended to the standard form. The reported decisions on commodity sales usually involve appeals from arbitrators’ decisions. In this connection, it should be noted that the construction of a contract is a matter of law. While deference will be paid by courts to arbitrators’ knowledge of the trade, courts do insist on retaining control over the construction of contract terms.⁶⁷ This allows for certainty and continuity in the use of standard form contracts, with the decisions of courts amounting to authoritative interpretations of what really constitute private legislation. Recent changes in the arbitral process, in particular the abolition of the case stated procedure, have limited the number of appeals from arbitrators’ decisions and have restricted the powers of the courts to deal with errors of law committed by the arbitrator.⁶⁸ These developments have substantially limited the number of cases on commodity sales coming through to the courts. This is plainly in accordance with the legislation which, in section 69 of the Arbitration Act 1996, places obstacles in the way of appeals on a point of law by permitting them only if the parties so agree or the court gives leave. For the court to give leave, it must be shown that the rights of one or more of the parties will be substantially affected, that the question is one that the tribunal was asked to determine, and either that the decision of the tribunal was ‘obviously wrong’, or that the question of law is one ‘of general public importance’ with the decision of the tribunal being ‘at least open to serious doubt’. Furthermore, it must be ‘just and proper’ for the court to intervene despite the parties’ agreement to submit their disputes to arbitration.
- 1.22 Traders** Subject to the following paragraph, the trade in commodities is predominately a private trade. The concentration of power in the hands of major oil companies has been a notorious fact for many decades. One of the earliest targets of American anti-trust legislation was Standard Oil. It is a less notorious fact that the trade in agricultural (or dry) commodities has long been dominated by a handful of well-resourced private companies who, in an industry subject to volatility of prices, are largely shielded from market entry by new competitors. Some thirty or so years ago, the market in dry commodities was dominated by five companies whose names (and the names of their subsidiaries) recurred at regular intervals in the reported case law: Cargill, André, Bunge, Continental Grain, and Louis Dreyfus.⁶⁹ More recently, it has been estimated that between 75 and 90 per cent of the global grain trade is conducted by the so-called ABCD companies: Archer Daniel Midland, Bunge, Cargill and (Louis) Dreyfus.⁷⁰ The names of the major participants may change from time to time but the phenomenon of market concentration remains the same.
- 1.23 State monopolies** In some countries, the export of grain is a state monopoly.⁷¹ This is still the case for western Canadian wheat and barley, where the export trade is controlled

⁶⁷ See, eg *Bunge Corp v Tradax Export SA* [1981] 1 WLR 711, HL; *Cargill Inc v Marpro Ltd (The Aegis Progress)* [1983] 2 Lloyd’s Rep 570.

⁶⁸ See now the Arbitration Act 1996, especially s 69.

⁶⁹ See D Morgan, *Merchants of Grain* (Penguin, 1980), 32–33.

⁷⁰ *The Guardian*, 1 June 2011.

⁷¹ The position in Australia, a complex one, shows a withdrawal of the State from domestic and export monopoly positions whilst retaining a significant degree of control of the market. In the case of wheat, controlled at the Commonwealth level, a Wheat Export Authority developed out of the Australian Wheat Board

by the Canadian Wheat Board, though it is expected to end soon.⁷² The Board operates so as to give the farmer the security of knowing his future price without his having to sell his crop forward or make an offsetting sale on the futures market. Crop prices are announced by the Board before the growing season; the farmer may therefore adjust his seeding plans. Farmers receive the same price whenever they sell their crops to the Board in the growing season but are subject to individual production quotas. The Board itself does not trade on the futures market.⁷³ It also sells mainly on an FOB basis leaving to private traders the risks associated with the charter, insurance, and currency markets.⁷⁴

C. Choice of Law

Sources Apart from the CISG, this book is confined to international sale contracts governed by English law.⁷⁵ So far as English law is the applicable law of the contract,⁷⁶ it becomes so by virtue of the choice of law rules of an English court, a foreign court, or an arbitral tribunal. In all cases appearing before the English courts, the choice of law rules for contracts concluded after 17 December 2009⁷⁷ are to be found in the Rome I Regulation.⁷⁸ Prior to the Regulation, those rules were located in the Contracts (Applicable Law) Act 1990, which introduced major changes to the antecedent common law rules. The 1990 Act, which still applies to contracts concluded before 18 December 2009,⁷⁹ gave effect to the Rome Convention on the Law Applicable to Contractual Obligations 1980,⁸⁰ the English language version of which is scheduled to it. Further, though less dramatic, changes were brought in by the Rome I Regulation. In the paragraphs that follow, the differences between the Convention and the Regulation will be brought out. The impact of the Regulation on case law decided under the Convention will also be considered. The Rome I Regulation was initiated by the European Commission in 2002,⁸¹ leading to a proposal to replace the

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in 1999 with regulatory functions. Other grains, controlled at the State level, have also been the subject of privatization. See Kronos Corporate, *A Review of Structural Issues in the Australian Grain Market* (September 2002), available at <<http://www.piagroup.com.au>>.

⁷² The Marketing Freedom for Grain Farmers Act (Bill C-18), which came into force on 1 August 2012, makes provision for the Canadian Wheat Board to become a privatized entity and therefore a marketing organization with which farmers might voluntarily deal in the free marketing of grain.

⁷³ cf (formerly) the Australian Wheat Board. See CC Carter, 'Canada' in D Blandford, CA Carter, and R Piggott (eds), *North-South Grain Policies and Trade Policies* (1993).

⁷⁴ See A Schmitz and others, *Grain Export Cartels* (1981), p 27 (Ch 2: 'The Nature of Grain Markets and Trade').

⁷⁵ If and when the CISG is adopted by the UK, it will of course be applied by English courts as part of English law.

⁷⁶ For reasons of convenience, choice of law issues concerning property are dealt with in ch 7.

⁷⁷ See Art 28 of the Rome I Regulation.

⁷⁸ See M Bridge (ed), *Benjamin's Sale of Goods* (8th edn, 2010), ch 26 (Harris). The Rome II Regulation on the law applicable to non-contractual obligations (Reg 864/2007) applies to *culpa in contrahendo* (Art 2(1)), an expression that is broad enough to encompass liability in damages for fraud and misrepresentation. The Rome II Regulation is considered only incidentally in this text. For a fuller treatment, see A Dickinson, *The Rome II Regulation* (2008); JJ Fawcett and JM Carrothers, *Cheshire, North and Fawcett[:] Private International Law* (14th edn, 2008). For a review of case law under the Private International Law (Miscellaneous Provisions) Act 1995, preceding Rome II, see *VTB Capital Plc v Nutritek International Corpn* [2011] EWHC 3107 (Ch) at [119]–[143]. The law applicable to the liability of a carrier in conversion for delivery without production of a bill of lading is referred to in ch 8.

⁷⁹ And also as regards the territory of any Member State to which, pursuant to Art 299 of the EC Treaty, the Rome I Regulation does not apply: Art 24(1) of the Regulation.

⁸⁰ See generally JJ Fawcett, JM Harris, and MG Bridge, *International Sale of Goods in the Conflict of Laws* (Oxford, 2005), ch 13.

⁸¹ Starting with a Green Paper (COM(2002) 654).

Rome Convention with a regulation.⁸² The proposed regulation was modified in a number of important respects in the course of negotiations before it was adopted as the Rome I Regulation in 2008. In accordance with the Maastricht Treaty 1992, the United Kingdom had an opt-out in respect of this measure but it played an active role in the negotiations. In the result, the United Kingdom decided to opt into the Regulation after concluding that its interests were adequately served by the new measure.⁸³ A regulation has an advantage over an international convention in so far as it will avoid the need for a new treaty securing the adherence of accession States, permit amendments to be made without convening a diplomatic conference, and enable the European Court of Justice to give authoritative interpretations of the instrument without there being any need to secure the agreement of Member States by means of a Protocol to a Convention.

1.25 Universal rules Unlike the case of jurisdiction and enforcement of judgments, the terms of the Rome Convention and Rome I Regulation are not confined to intra-EC contractual disputes but instead extend to all contract cases involving a foreign element. Pursuant to their choice of law rules, the applicable law may turn out to be the law of a non-EU State.⁸⁴ Before their provisions are considered in detail, a preliminary point about the two instruments needs to be addressed. It concerns the notion that foreign law is a fact that the parties are free to introduce or exclude from the litigation. In the case of the Rome Convention, the contracting parties are not free to exclude the Convention as such since s 2(1) of the 1990 Act provides that it 'shall have the force of law'.⁸⁵ On one view, the Convention directs the application of a particular law in the relevant circumstances, but this does not assist an English judge if the parties choose to root their dispute in English law. It is likely that in such a case English courts will continue to apply English law under their own procedural rules relating to the proof of foreign law as a fact, which they may also do if foreign law is pleaded but insufficiently proved to rebut the presumption that it is the same as English law. It is a truism of the conflict of laws process that courts regularly make mistakes when applying foreign law, so it may be that there will be no great support for mandating the application of the applicable law. In any case, it might be argued that, if the parties conduct their proceedings without reference to the applicable law as designated by the Rome Convention, then they are availing themselves of their entitlement to change the applicable law after the contract date.⁸⁶ In the case of the Rome I Regulation, it has direct effect in Member States⁸⁷ and 'shall apply, in situations involving a conflict of laws, to contractual obligations in civil and commercial matters'. Nevertheless, other considerations affecting the Rome Convention apply here too, in particular, the freedom of the parties subsequently to change the applicable law.⁸⁸ The outcome under the Regulation should therefore be the same as under the Rome Convention.

⁸² 2005 (COM(2005)).

⁸³ 'The Articles that were of greatest concern to UK stakeholders during negotiations have either been removed, substantially revised or returned to their Convention form subject to later review. In the case of those provisions subject to review, future amendments will not automatically bind the UK': Ministry of Justice Consultation Paper CP05/08 of 2 April 2008.

⁸⁴ Art 2.

⁸⁵ See *Halpern v Halpern* [2007] EWCA Civ 291, [2008] QB 195.

⁸⁶ Art 3(2): 'The parties may at any time agree to subject the contract to a law other than that which previously governed it, whether as a result of an earlier choice under this Article or of other provisions of this Convention.'

⁸⁷ See Art 110(2) of the EC Treaty; the Rome I Regulation (final part).

⁸⁸ Art 3(2).

Arbitration The Rome Convention⁸⁹ and the Rome I Regulation⁹⁰ do not apply to arbitration agreements. This exclusion applies also to arbitration and jurisdiction clauses in contracts that otherwise are governed by the two instruments. The law applied by the arbitrator to that contract is a different matter. Under English law, an arbitrator may, despite the exclusion of arbitration agreements, apply the provisions of either instrument to that contract. In the case of an arbitration with an English seat, the arbitrator is required under English law to act in accordance with s 46 of the Arbitration Act (since the notion of a delocalized arbitration is not accepted by English law).⁹¹ Section 46(1) requires the arbitrator to respect the parties' choice of applicable law. If there is no choice, the arbitrator applies 'the law determined by the conflict of laws rules that [he] considers applicable'.⁹² The arbitrator should therefore be at liberty to select his own choice of law rules and, should be open to the argument that the Rome Convention is a respected and widely accepted statement of applicable choice of law rules. This freedom given to arbitrators has implications for the application of the CISG under its Article 1(1)(b), which directs the application of the CISG when the choice of law rules of the forum point to the law of a Contracting State. An arbitrator, unlike the courts of a Contracting State, is not bound to apply the CISG but is likely nevertheless to be influenced by the provisions defining its scope and applicability. 1.26

Interpretation As an authoritative aid to interpreting the Rome Convention, there is the Giuliano-Lagarde Report,⁹³ whose use is permitted by s 3(3)(a) of the Contract (Applicable Law) Act in the interpretation of the Convention. There is no similar standing given to the Report in the interpretation of the Regulation, but, in those cases where the Regulation is very similar to the Convention, the Report may still play an influential part. Article 18 of the Rome Convention also exhorts courts to interpret the provisions of the Convention in an internationalist spirit⁹⁴—a similar provision is to be found in many international conventions—which thus encourages attention to be paid to the views of foreign courts, and also encourages a purposive rather than a literal approach to the Convention.⁹⁵ In addition, there is a protocol providing for the European Court of Justice to give binding rulings on the meaning of the provisions of the Convention.⁹⁶ Since, under the Rome I Regulation, its provisions have an autonomous meaning under Community law, and since the European Court of Justice is the final court of resort in determining that meaning,⁹⁷ there is no equivalent to Article 18 in the Regulation and no need for a protocol on its interpretation. 1.27

⁸⁹ Art 1(2)(d); see *Halpern v Halpern* [2007] EWCA Civ 291 at [24], [2008] QB 195.

⁹⁰ Art 1(2)(e).

⁹¹ See L Collins (ed), *Dicey and Morris on the Conflict of Laws* (14th edn, 2006), Vol 1, pp 723–24.

⁹² S 46(3)—a formula identical to Art 28(2) of the UNCITRAL Model Law on Arbitration and Art 33(2) of the UNCITRAL Arbitration Rules.

⁹³ [1980] OJ C282/1.

⁹⁴ See *Samcrete Egypt v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 35; *Iran Continental Shelf Oil Co v IRI International Corp* [2002] EWCA Civ 1024, [2004] 2 CLC 696.

⁹⁵ *Samcrete Egypt v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 353; *Egon Oldendorff v Libera Corp* [1996] 1 Lloyd's Rep 380, 387.

⁹⁶ The Brussels Protocol, Sch 3 to the Contracts (Applicable Law) Act 1990. In force in England as of 1 April 2005.

⁹⁷ For preliminary rulings on the interpretation of regulations, see Art 234(b) of the EC Treaty. See also Art 225(3).

- 1.28 Party autonomy** The Rome Convention⁹⁸ and the Rome I Regulation⁹⁹ both support the principle of party autonomy by stating the applicable law to be the law chosen by the parties. The choice may be an express one or it may be implied, ‘demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case’. An implied choice of a country’s law may be found in a clause providing for arbitration in that country, particularly where the contract contains standard clauses with well-known meanings according to the law of that country.¹⁰⁰ The implied agreement, however, must be a real implied choice and not an imputed choice.¹⁰¹ An English jurisdiction clause has been held to demonstrate, to the level of a good arguable case for jurisdiction purposes, an implied choice of English law as the applicable law in a guarantee case.¹⁰² The parties may after the contract date vary the choice of applicable law, but this will not lightly be inferred from conduct. In *Aeolian Shipping SA v ISS Machinery Services Ltd*,¹⁰³ a contract for the sale of a turbocharger, governed by Japanese law, was followed by a later contract between the same parties for the supply of replacement parts, which latter contract was made subject to English law. The buyer argued that this had the effect of rendering its counterclaim under the first contract subject to English law but the Court of Appeal ruled otherwise. Such a change had not been expressed and would also have severely prejudiced the supplier under its own contract with the Japanese manufacturer, also governed by Japanese law.
- 1.29 Split choice** The parties’ choice may extend to a part of the contract or the whole.¹⁰⁴ There is no reason why they may not choose more than one law to govern their relations. It is also possible that the applicable law will be split where the parties do not expressly or impliedly choose the applicable law.¹⁰⁵ Nevertheless, care must be taken when applying this *dépeçage* principle. Suppose the contract provides that matters of breach and matters of frustration are governed by different laws. That raises the possibility of one law holding that the defendant has committed a breach while the other holds that the contract is discharged for frustration. Judicial concern has been expressed about the possibility of an inconsistency of this sort,¹⁰⁶ though it is not so easy to see the solution. One possibility is that a court would identify one of the choices as the dominant one, for example, the law chosen to deal with a particular aspect of the contract,¹⁰⁷ and decline to recognize the other to the extent that it would otherwise produce an incoherent resolution of the problem.

⁹⁸ Art 3(1).

⁹⁹ Art 3(1). The case law on the Convention should support the interpretation of the Regulation.

¹⁰⁰ *Egon Oldendorff v Libera Corp* (NYPE time charter); see also *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd* [1999] 2 All ER (Comm) 54 (English non-marine insurance form); *Gard Marine & Energy Ltd v Lloyd Tunncliffe* [2009] EWHC 2388 (Comm), [2010] Lloyd’s Rep IR 62; Giuliano–Lagarde Report, comment 3 to Art 3.

¹⁰¹ *Aeolian Shipping SA v ISS Machinery Services Ltd* [2001] EWCA Civ 1162, [2001] CLC 1708; Giuliano–Lagarde Report (comment 3 to Art 3 ‘a real choice’—but cf *American Motorists Insurance Co v Cellstar Corp* [2002] 2 Lloyd’s Rep 216, affd [2003] EWCA Civ 206, [2003] 2 CLC 599, where the court relied upon a series of strong connecting factors to conclude that Texas law was the law of implied choice and not just the most closely connected law (though it reached the same conclusion that Texas law applied under the characteristic performance rule (see below))).

¹⁰² *Marubeni Hong Kong and South China Ltd v Ministry of Finance of Mongolia* [2002] 2 All ER (Comm) 873.

¹⁰³ [2001] EWCA Civ 1162, [2001] CLC 1708.

¹⁰⁴ Art 3(1) of both the Convention and the Regulation: *dépeçage*.

¹⁰⁵ *Intercontainer Interfrigo SC (ICF) v Balkenende Oosthuizen BV* [2010] QB 411, ECJ (Case C-133/08).

¹⁰⁶ See Ward LJ in *Centrax Ltd v Citibank NA* [1999] 1 All ER (Comm) 557, CA.

¹⁰⁷ On the principle of *lex specialis derogat legi generali*.

Applicable law and stateless contracts 1.30 Once the parties have chosen the applicable law, they are nevertheless free to change it at a later date.¹⁰⁸ This gives some support for the notion that a contract may be subject to a ‘floating’ applicable law, that law to be selected by one of the parties at a later date, possibly even on the commencement of legal proceedings. A ‘floating’ law clause is supported by the Giuliano-Lagarde Report.¹⁰⁹ This type of clause is not uncommon in bills of lading. Until the law in question is chosen, the contract would be subject to the law applicable in accordance with Article 4 of the Rome Convention and of the Regulation, which lays down the applicable law for those cases where the parties have not made a choice. Hence, it would be this law selected further to Article 4 that were changed by the parties in accordance with Article 3(2). Nevertheless, the notion of a contract subject to a floating applicable law has attracted adverse comment in an English case.¹¹⁰ Yet, if Article 4 is invoked at the outset, there is no need for the contract to be without an applicable law before the later choice is made by the parties. The court in the same case¹¹¹ also rejected the idea of a ‘harlequin proper law’, whereby under a global liability policy the insuring clause of the policy and the definition of the insured were to be subject to whatever was the law of the country of the person from time to time claiming under the policy.

Stateless applicable law 1.31 Although the contrary is the case for arbitration under the Arbitration Act 1996,¹¹² under the Rome Convention and the Regulation the choice of applicable law has to be the choice of a system of state law as opposed to a body of non-State-based rules of law.¹¹³ In the case of the Rome Convention, the former is clearly the case since the Convention applies ‘to contractual obligations in any situation involving a choice of law between different countries’.¹¹⁴ The position under the corresponding provision of the Rome I Regulation is slightly less clear, since it ‘shall apply, in situations involving a conflict of laws . . .’,¹¹⁵ but other provisions of the Regulation point overwhelmingly to the same conclusion as the Rome Convention in favour of State-based law.¹¹⁶ Furthermore, a draft provision would have permitted the application of a non-State-based system of rules, but this was rejected in the process leading up to the adoption of the Regulation.¹¹⁷ An English court, therefore, should not recognize the choice of the Unidroit Principles of

¹⁰⁸ Art 3(2) of both the Convention and the Regulation.

¹⁰⁹ Comment 5 to Art 3.

¹¹⁰ See Toulson J in *CGU International Insurance plc v Szabo* [2002] 1 All ER (Comm) 83 who is critical of attempts to give the contract no governing law until a later date (‘an impossible concept’, since parties’ rights and obligations crystallize at the contract date—see also *EI Du Pont de Nemours and Co v Agnew* [1987] 2 Lloyd’s Rep 585, 592, CA (Bingham LJ)). The application of Art 4 to the contract before this choice is made is a powerful rebuttal of this criticism.

¹¹¹ *CGU International Insurance plc v Szabo* [2002] 1 All ER (Comm) 83.

¹¹² Section 46(1)(b), requiring the tribunal to determine the dispute ‘if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal’.

¹¹³ See *Amin Rasheed Shipping Corp v Kuwait Insurance Co* [1984] AC 50, 60, 65, HL (Lord Diplock); *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals* [2004] 1 WLR 1784, CA; *Halpern v Halpern* [2007] EWC Civ 291, [2008] QB 195; Rome I Green Paper (COM(2002) 654 final), para 3.2.3.

¹¹⁴ Art 1(1) of the Convention.

¹¹⁵ Art 1(1) of the Regulation.

¹¹⁶ See, eg recitals 6, 15, 19–21 and Arts 3(3), 4–8, 9(3), 11, 12(2), 20–21.

¹¹⁷ Art 3(2)—‘the principles and rules of the substantive law of contract recognized internationally or in the Community’, an expression that was calculated to embrace instruments like the Principles of European Contract Law and the Unidroit Principles of International Commercial Contracts, though not something as vague and formless as the ‘*lex mercatoria*’.

International Contracts, or even of the CISG as a free-standing instrument (as opposed to the choice of the law of a State whose courts would apply the CISG).¹¹⁸

1.32 Mandatory law The old pre-Rome Convention restriction in English law, more apparent than real, that the choice had to be ‘bona fide and legal’,¹¹⁹ did not in fact hamper the parties’ choice. The relevant provision of the Rome Convention is Article 3(3), which prevents the parties to a contract of a domestic character from evading mandatory rules of the country to which the contract is connected ‘where all the other elements [apart from choice] relevant to the situation at the time of the choice are connected with one country only’¹²⁰ by selecting an unconnected applicable law. This means that the law they have chosen will still be applied but it will *pro tanto* be overridden by the mandatory provisions of the connected law.¹²¹ This provision would certainly be applicable to many international commodities contracts currently subject to English law, were it not for the absence in domestic legal systems of mandatory rules for contracts of this kind.¹²² The concept of mandatory rules is unknown to English law *eo nomine*, though at least some issues that would be classified in English domestic law as pertaining to illegality would appear to fall within the scope of ‘mandatory rules’. The expression was not defined by the Rome Convention, though the expression did seem to incorporate protective provisions for individuals who merit special treatment by the law, namely employees and consumers.¹²³ Article 3(3) of the Rome I Regulation is in terms almost identical to the Convention provision,¹²⁴ except that there is no explicit connection to the notion of mandatory rules. Article 3(3) may nevertheless be seen an implicitly referring to a new provision that defines what are now called overriding mandatory provisions as ‘provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation’.¹²⁵ The Rome Convention also has a provision permitting the forum to give effect to other countries’ mandatory rules with which ‘the situation has a close connection’,¹²⁶ but the United Kingdom entered a reservation to this provision. This uncertain and undefined notion of mandatory rules, rendering unattractive to international litigants any forum that might apply them, remained a source of concern for the United Kingdom in the proceedings leading to the

¹¹⁸ For a more extensive discussion of the CISG chosen as a free-standing instrument, see para 10.53.

¹¹⁹ *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277, PC.

¹²⁰ Like its Rome I successor, Art 3(3) would not allow all other elements of the contract to be gathered from more than one country outside the United Kingdom, a process that would in any case create significant difficulty in selecting mandatory rules.

¹²¹ See *Caterpillar Financial Services Corp v SNC Passion* [2004] EWHC 569 (Comm), [2004] 2 Lloyd’s Rep 99.

¹²² Supposing the provisions of the Unfair Contract Terms Act 1977 to be mandatory rules, a Dutch court, for example, facing Art 3(3) would not be troubled by them since they are disapplied (see ss 26–27) in the case of international supply contracts. United Kingdom regulatory legislation treating certain contracts as unenforceable (see *CR Sugar Trading Ltd v China National Sugar & Alcohol Group Corp* [2003] EWHC 79 (Comm), [2003] 1 Lloyd’s Rep 179, discussed at para 1.49) would seem not to qualify as mandatory rules.

¹²³ Arts 6–7 of the Convention.

¹²⁴ In the case of mandatory provisions of Community law, a new provision requires their application where all elements of the ‘situation’, apart from the chosen law, are within the EC: Art 3(4) of the Regulation.

¹²⁵ Art 9(1) of the Regulation.

¹²⁶ Art 7(1) of the Convention.

Rome I Regulation, and largely accounted for the provision that now defines what are called overriding mandatory provisions. No reservations, of course, are permitted in the case of the Regulation, where now there is substituted the place of performance for close connection and overriding mandatory provisions for mandatory rules.¹²⁷ A further provision in the Convention and the Rome I Regulation concerning mandatory provisions¹²⁸ permits the forum to apply its own mandatory provisions regardless of the law applicable to the contract (though English law in the Unfair Contract Terms Act 1977, ss 26–27, dispenses with mandatory rules when dealing with transnational and international contracts).¹²⁹

Presumptive applicable law If the parties have not chosen an applicable law, there are rules for determining it in both the Convention and the Regulation, with significant differences between the two sets of provisions. The provisions in the Convention work as follows. First of all, the presumptively applicable law is the law of the country with which the contract is most closely connected.¹³⁰ Secondly, there is a presumption that the country most closely connected to the contract is the country where the party effecting ‘characteristic performance’ under the contract has his habitual residence or central administration.¹³¹ The country of habitual residence or central administration gives way, where a contract is entered into in the course of a party’s trade or profession, to the country of that party’s place of business.¹³² Where a company enters into a contract through a place of business other than its principal place of business, it is the former that supplies the applicable law.¹³³ Thirdly, the characteristic performance rule is displaced if it appears from all the circumstances that the contract is more closely connected with some other country.¹³⁴ This has the clumsy consequence of introducing the notion of close connection at two stages of the inquiry. Finally, there are special presumptive rules for carriage of goods contracts and contracts for the sale of land.¹³⁵ The Rome I Regulation has somewhat simplified this structure but at the expense of some flexibility. First of all, the applicable law is explicitly stated for certain nominate contracts. For example, the applicable law of a sale of goods contract is the law of the country where the seller is habitually resident,¹³⁶ except in the case of auction contracts, where the law of

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¹²⁷ Art 9(3) of the Regulation.

¹²⁸ Art 7(2) of the Convention and the similarly worded Art 9(2) of the Regulation.

¹²⁹ The concept of mandatory law or rules is used in a number of places and in different ways in the Rome Convention.

¹³⁰ Art 4(1) of the Convention.

¹³¹ Art 4(2) of the Convention. The relationship in the Convention of the rules of close connection and characteristic performance was considered by the European Court of Justice in *Intercontainer Interfrigo SC (ICF) v Balkenende Oosthuizen BV* [2010] QB 411 (Case C-133/08). In concluding that a court should revert to the rule of closest connection, the court in a not especially helpful way concluded that the invocation of the rule of closest connection depended upon all of the circumstances of the case. This meant that, contrary to the European Commission’s contention, the characteristic performance rules did not first have to be addressed to see if they had no genuine connecting value, before a court’s attention could be drawn to other matters.

¹³² Art 4(2).

¹³³ Art 4(2). In one case, an Iranian company had very good reasons indeed (a US boycott) for doing business through its London office: *Iran Continental Shelf Oil Co v IRI International Corp* [2002] EWCA Civ 1024, [2004] 2 CLC 696. The existence of multiple ‘principal’ places of business of a reinsurer has been used as a ground for displacing the characteristic performance rule altogether (*Lincoln National Life Insurance Co v Employers Reinsurance Corp* [2002] Lloyd’s Rep IR 253), but this was a jurisdiction case and the only choice of law issue was whether there was an arguable case that the contract was governed by English law.

¹³⁴ Art 4(5) of the Convention.

¹³⁵ Art 4(3), (4) of the Convention.

¹³⁶ Art 4(1)(a) of the Regulation.

the country where the auction takes place is applicable instead.¹³⁷ Secondly, where the law is not a nominate contract, or where a hybrid contract may be identified as more than one nominate type, the applicable law is the law of the country of habitual residence of the party who is to effect characteristic performance.¹³⁸ Thirdly, where a contract is 'manifestly' more closely connected to a country other than the one identified in the first or second steps of this process, that other country's law shall apply.¹³⁹ Fourthly, in residual cases where no other law has been identified as applicable, the law of the country with closest connection to the contract is applicable.¹⁴⁰

1.34 Characteristic performance The doctrine of characteristic performance is less explicitly invoked under the Regulation than under the Convention. The rules in the Regulation that select the applicable law for nominate contracts in the absence of choice by the parties are nevertheless derived, if not explicitly, from the doctrine. Characteristic performance seems to have its origins in Swiss law.¹⁴¹ The Convention gives no assistance on its meaning but there is an extensive discussion of it, expressed as an idea that looks for the 'essence of the obligation', by Lord Brodie in the Scots case of *Re Atlantic Telecom Group GmbH*.¹⁴² It would be uncontroversial to say that the characteristic performer under a contract of sale of goods is the seller,¹⁴³ as implicitly confirmed by Article 4(1)(a) of the Regulation. A more difficult case is where goods are sold to a distributor, where it was held under the Convention that the characteristic performance is that of the seller to supply and not of the buyer to use best endeavours to expand sales in its territory.¹⁴⁴ The Regulation has in effect reversed this outcome by making the applicable law of distribution contracts the law of the country of habitual residence of the distributor.¹⁴⁵ It is therefore possible for a master distribution contract to be governed by one law while individual sale contracts concluded thereunder are governed by a different law. The characteristic performance of a reinsurance contract has been held under the Convention to be the reinsurer's duty to indemnify.¹⁴⁶ The characteristic performance of a guarantee is the guarantor's payment.¹⁴⁷ In the case of a bank account, the characteristic performer is the bank.¹⁴⁸ More cautiously, Lord Brodie has stated that a contract between a banker and customer in which the bank advances money

¹³⁷ Art 4(1)(g) of the Regulation.

¹³⁸ Art 4(2) of the Regulation.

¹³⁹ Art 4(3) of the Regulation. While this should make it more difficult to revert to a rule of closest connection, the approach of the European Court of Justice when dealing with the Rome Convention, calling for all the circumstances of the case to be considered, should still apply: *Intercontainer Interfrigo SC (ICF) v Balkenende Oosthuizen BV* [2010] QB 411 (Case C-133/08).

¹⁴⁰ Art 4(4) of the Regulation.

¹⁴¹ H D'Oliviera, "Characteristic Obligation" in the Draft EEC Obligation Convention' (1977) 25 *American Journal of Comparative Law* 303, cited by CGJ Morse in Current Law Statutes 1990.

¹⁴² [2004] ScotCS 152 (25 June 2004).

¹⁴³ See *Iran Continental Shelf Oil Co v IRI International Corp* [2002] EWCA Civ 1024, [2004] 2 CLC 696.

¹⁴⁴ *Print Concept GmbH v GEW (EC) Ltd* [2001] EWCA Civ 352, [2002] CLC 352.

¹⁴⁵ Art 4(1)(f) of the Regulation.

¹⁴⁶ *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd* [1998] CLC 1072; *Dornoch Ltd v Mauritius Union Assurance Co Ltd* [2005] EWHC 1887 (Comm). There is no rule in Art 4(1) of the Regulation for reinsurance contracts.

¹⁴⁷ *Samcrete Egypt v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 353. Again, there is no specific rule in Art 4(1) of the Regulation.

¹⁴⁸ *Sierra Leone Telecommunications Co Ltd v Barclays Bank Plc* [1998] CLC 501. Again, there is no specific rule in Art 4(1) of the Regulation.

to the customer will normally have the bank as the characteristic performer.¹⁴⁹ In a contract to provide consultancy services in connection with the staining of a building, the characteristic performance is the giving of advice.¹⁵⁰ The doctrine of characteristic performance is not helpful for contracts where both parties provide similar or near-identical performance. Under a currency swaps contract, each party would appear to effect characteristic performance. A similar difficulty arises with trade mark agreements where both parties assume matching negative obligations.¹⁵¹ Under the Regulation, the applicable law would therefore in such cases have to be the law of closest connection to the contract.¹⁵²

Displacing characteristic performance A displacement of the characteristic performance rule, pursuant to Article 4(5) of the Rome Convention, occurred in *Definitely Maybe (Touring) Ltd v Marek Lieberberg Konzertagentur GmbH*.¹⁵³ It concerned a contract between promoters of a pop group (Oasis) and German concert organizers and a claim for payment in full by the promoters though one of the members of the group declined to participate in the concerts. The ‘only’ connection with England was the ‘location’ of the group and the claimant promoters, who were treated as the supplier of services, and the place of payment. Germany, on the other hand, was the place where the characteristic performance occurred as well as the place where the defendants performed their organizational obligations in full. The governing law, given the strength of the connection between the contract and Germany, was held to be German law pursuant to the closest connection rule in Article 4(5) of the Convention. The court was insistent that the characteristic performance presumption in Article 4(2) flowed out of the closest connection rule in Article 4(1): the latter was not an exception to the former. In reaching its decision the court was conscious that the characteristic performance rule had to be seen as the ‘normal’ rule to apply, given its ease of application, and that simply to focus on Article 4(5) would be to reproduce the pre-Rome English choice of law rule. It tried to steer a path between the Dutch approach, which was to treat the rule in Article 4(2) as a hard rule of law, and the dictum of Hobhouse LJ in *Crédit Lyonnais v New Hampshire Insurance Co*,¹⁵⁴ that Article 4(2) creates a ‘very weak’ presumption. The court would have displaced the characteristic performance rule only if the circumstances of the case had ‘clearly demonstrate[d]’ that this was justified.¹⁵⁵ It is clear, nevertheless, that the court in *Definitely Maybe* rewrote the characteristic performance *residence* rule in terms of a characteristic performance *place* rule.¹⁵⁶ Under the Regulation,

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¹⁴⁹ *Re Atlantic Telecom Group GmbH* 2004 SLT 1031. The question of what is characteristic performance under various letter of credit contracts will be dealt with in para 6.91 et seq.

¹⁵⁰ *Ennstone Building Products Ltd v Stanger Ltd (No 2)* [2002] EWCA Civ 916, [2002] 1 WLR 3059. The same conclusion takes the shape of a specific rule in Art 4(1)(b) of the Regulation that the applicable law for services contracts is the law of habitual residence of the provider of the services.

¹⁵¹ See *Apple Corps Ltd v Apple Computer Ltd* [2004] EWHC 768 (Ch) at [51] et seq, [2004] 2 CLC 720.

¹⁵² Art 4(2) of the Regulation.

¹⁵³ [2001] 1 WLR 1745.

¹⁵⁴ [1997] 2 Lloyd’s Rep 1, 5.

¹⁵⁵ An approach supported by Keene LJ in *Ennstone Building Products Ltd v Stanger Ltd (No 2)* [2002] EWCA Civ 916, [2002] 1 WLR 3059, by Potter LJ in *Samcrete Egypt v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 353, and by Clarke LJ in *Iran Continental Shelf Oil Co v IRI International Corp* [2002] EWCA Civ 1024, [2004] 2 CLC 696—which however seem to show that the stricter Dutch approach was gaining ground with the aid of Art 18.

¹⁵⁶ A more clearly justified departure from the characteristic performance rule came where a German defendant breached its contractual undertaking not to communicate with persons in the United Kingdom to complain of a patent infringement: *Kenburn Waste Management Ltd v Bergmann* [2002] EWCA Civ 98, [2002] CLC 644.

the court, if seeking the same result, would have had to depart from the clear rule that the applicable law of a services contract is the law of the provider's habitual residence.¹⁵⁷ To do so, it would have had to conclude that Germany was 'manifestly' the country of closest connection.¹⁵⁸ This would be a debatable outcome and open to the same criticism that the rule in fact being applied in services cases is the law of the place where the service is being rendered.

1.36 Scope of the applicable law Under the Convention and the Regulation, the applicable law deals with matters of interpretation, performance, damages and the consequences of breach, extinction of obligations and limitations, and the consequences of nullity.¹⁵⁹ The consequences of breach test has been held to have quite deep roots in the law governing remedies: the applicable law has been said to apply to the currency of the award, the award of interest and the recovery of interest as damages.¹⁶⁰ It is important to note, however, that the United Kingdom entered a reservation under the Convention to this last item, the consequences of nullity.¹⁶¹ This had important implications for restitution. No such reservation was of course possible under the Regulation. Where the country of performance is not the country of the applicable law, the Convention and the Regulation delegate to the former issues concerning the manner of performance and the steps to be taken in the event of defective performance.¹⁶² These items should include, for example, what constitutes a working day and what is the currency of payment. They may also include notices of default if the relevant law requires these before a contract is terminated. The applicable law, namely, the law that 'would govern [the contract] ... if the contract or term were valid', also deals with matters concerning the 'existence and validity of a contract, or of any term of a contract'.¹⁶³ The reference to 'existence' shows that this provision certainly applies to matters of consent. The Convention and Regulation, nevertheless, go on to apply the law of a party's habitual residence to determine that party's lack of consent if it would 'not be reasonable' to apply the law dealing with the existence and validity of the contract.¹⁶⁴ The burden of establishing unreasonableness rests upon the party in question.¹⁶⁵ It is not clear what constitutes validity. It should include rules dealing with one-sided bargains, mistake and duress, for example. It ought to include the question of whether consideration is required for a contract

¹⁵⁷ Art 4(1)(b) of the Regulation.

¹⁵⁸ Art 4(3) of the Regulation.

¹⁵⁹ Art 10(1) of the Convention; Art 12(1) of the Regulation.

¹⁶⁰ See *Re Lesotho Highlands Development Authority* [2002] EWHC 2435 (Comm), [2003] 1 All ER (Comm) 232, applying Art 10(1)(c) of the Rome Convention; *Service Europe Atlantique Sud v Stockholms Rederiaktiebolag SVEA (The Folias)* [1979] AC 685, 700, HL (Lord Wilberforce). The starting point is whether the parties by contract have made provision for these matters: *ibid* 700–01 (Lord Wilberforce); *Re Lesotho Highlands Development Authority* [2003] EWCA Civ 1159, 2 Lloyd's Rep 497 at [34]). The *Lesotho* litigation concerned a challenge to the arbitrators' award, and the House of Lords (at [2005] UKHL 43, [2006] 1 AC 221) reversed the Court of Appeal which had affirmed the trial judgment that the award was open to challenge.

¹⁶¹ Art 10(1)(e).

¹⁶² Art 10(2) of the Convention; Art 12(2) of the Regulation.

¹⁶³ Art 8(1) of the Convention; Art 10(1) of the Regulation.

¹⁶⁴ Art 8(2) of the Convention; Art 10(2) of the Regulation. See *Welex AG v Rosa Maritime Ltd (The Epsilon Rosa) (No 2)* [2003] EWCA Civ 938, [2003] 2 CLC 307 (incorporation clause in bill of lading referring to charter party that in turn contained arbitration clause).

¹⁶⁵ See *Welex AG v Rosa Maritime Ltd (The Epsilon Rosa) (No 2)* [2003] EWCA Civ 938, [2003] 2 CLC 307.

to be duly concluded. It includes also illegality (though this subject raises additional questions). Penalty clauses are difficult to classify, but it hardly matters whether any special rules in this area fall to the applicable law under the relevant provisions of the Convention and Regulation.¹⁶⁶ The applicable law also applies to formal invalidity.¹⁶⁷ Alternatively, a contract is formally valid if it complies instead with either the law of the country in which it is concluded, where both parties are in the same country, or, where the parties are in different countries, the law of the country where either party happens to be. Finally, the legal capacity of companies falls outside the Convention and the Regulation,¹⁶⁸ so too that of natural persons except in so far as it is provided that, where contracts are concluded between parties in the same country, a party's incapacity under the law of another country may be invoked only if the other party knew, or was negligent in not knowing, of that incapacity.¹⁶⁹ Otherwise, English law, which has no clear rules on the matter, applies. It is likely to be a matter for the proper law objectively ascertained.¹⁷⁰

Illegality A contract may be affected by illegality from the outset; alternatively, it may be struck down for supervening illegality. Although the Convention and Regulation do not use the concept of illegality, it falls under the heading of 'material validity' so that it is subject to the applicable law.¹⁷¹ A contract, however, may be illegal under a law that is not the applicable law of the contract. Because the UK Government entered a reservation to Article 7(1) of the Convention, the English courts were in no position to accept the invitation to take account of 'the mandatory rules of the law of another country with which the situation has a close connection' within the limits stated in Article 7(1). They are now free under Article 9(3) of the Regulation to apply the 'overriding mandatory provisions' of the country where obligations are performed, so the following discussion is largely confined to the application of the Convention. Article 7(1) of the Convention *pro tanto* frees courts from the obligation to apply the applicable law under Articles 3–4. On the face of it, this reservation threatened the recognition of illegality under laws of other countries closely connected to the contract. The reason for this was that the Rome Convention superseded prior common law conflict rules in the area of contract, and not just those rules that corresponded to the provisions of the Convention applying in a Member State. Now, prior to the Rome Convention, there were well-established rules dealing with the recognition of illegality under a law other than the proper law of a contract. Might the English courts, when applying the Convention rules, turn to these in appropriate cases? On the face of it, the answer is no for the reason given above. According to one of these rules (the *Regazzoni* rule), English courts will not enforce a contract that would 'involve the doing of an act in a foreign and friendly State which violates the law of that State'.¹⁷² According to a similar rule (the *Ralli Bros* rule), it is an implied term of the contract that performance will not be illegal under the law of the place where performance is to be rendered.¹⁷³ If these rules are regarded as rules of domestic English contract law, they should survive the Rome Convention. If so,

¹⁶⁶ Arts 8 and 10 of the Convention; Arts 10 and 12 of the Regulation.

¹⁶⁷ Art 9 of the Convention; Art 11 of the Regulation.

¹⁶⁸ Art 1(2)(e) of the Convention; Art 1(2)(f) of the Regulation.

¹⁶⁹ Art 11 of the Convention; Art 13 of the Regulation.

¹⁷⁰ See *Bodley Head Ltd v Flegan* [1972] 1 WLR 680.

¹⁷¹ Art 8(1) of the Convention; Art 10(1) of the Regulation.

¹⁷² *Regazzoni v KC Sethia (1944) Ltd* [1958] AC 301, HL.

¹⁷³ *Ralli Bros v Cia Naviera Sota y Aznar* [1920] 2 KB 287, CA.

where the forum is an English court and English law is the applicable law, the same result as in these cases will be reached pursuant to Article 8(1) of the Convention. It is particularly debatable, however, that the *Regazzoni* rule can be regarded as a rule of English domestic law. That said, the court in a letter of credit case applied *Regazzoni* without displaying any concerns about its continuing validity.¹⁷⁴ Where the forum is English but English law is not the applicable law, the courts might still reach the same result to the extent that they apply domestic public policy, which they are entitled to do under Article 16 of the Convention and Article 21 of the Regulation, or the mandatory rules of the forum, which they are entitled to do under Article 7(2) of the Convention (to which the UK Government did not enter a reservation). If the forum is English and the illegality is recognized under a foreign applicable law, then that law deals with the matter of illegality pursuant to Article 8(1) of the Convention (and Article 10(1) of the Regulation) in the usual way. It may be that that law contains rules similar to those laid down in the *Regazzoni*¹⁷⁵ and *Ralli Bros*¹⁷⁶ cases.

1.38 The CISG In the event of the CISG being adopted by the United Kingdom and applying on its own terms, the applicable law arrived at according to the rules laid down in the Rome Convention and Regulation will give way to the uniform law contained in the CISG.¹⁷⁷ Since, however, the range of contract rules covered by the Rome Convention and Regulation will be broader than the range of the sale of goods rules contained in the CISG, a court will in some cases be called upon to apply the CISG together with the provisions of the applicable contract law. This is consistent with the tolerance afforded by the Rome Convention and the Regulation to a split applicable law (or *dépeçage*).¹⁷⁸ In so far as the contracting parties seek to exclude the application of the CISG and do so successfully,¹⁷⁹ it is useful to consider how such exclusion would intersect with the Rome Convention and the Regulation. If they exclude the CISG by stipulating an applicable national law, then the exclusion must pass the test of an exclusion under Article 6 of the CISG. A simple stipulation in favour of the law of a country that happens to be a CISG State may or may not pass that test.¹⁸⁰ To the extent that a court is satisfied that the parties have excluded the CISG, then the next question is to define the applicable law, which will be done pursuant to the terms of the Rome Convention or Regulation as the case may be. If such a law already applies to the general aspects of the contract, it should to the extent of the exclusion of the CISG simply carry over into the sale aspects of the contract.¹⁸¹ Finally, the exclusion of the CISG may be partial under Article 6, which again is consistent with the principle of *dépeçage*.

1.39 Contractual foreign elements As stated above, commodity trading organizations based in London state that English law governs the contract of sale. All GAFTA contracts, for example, contain a choice of law clause selecting English law as the applicable law. Reported cases contain many examples of contracts entered into by companies, neither of which is English, involving the shipment of goods in a country overseas and their discharge in a

¹⁷⁴ See *Mahonia Ltd v JP Morgan Chase Bank* [2003] 2 Lloyd's Rep 911.

¹⁷⁵ *Regazzoni v KC Sethia (1944) Ltd* [1958] AC 301, HL.

¹⁷⁶ *Ralli Bros v Cia Naviera Sota y Aznar* [1920] 2 KB 287, CA.

¹⁷⁷ See the discussion in ch 10.

¹⁷⁸ Art 3(1) of the Convention and Regulation.

¹⁷⁹ Under Art 6 of the CISG.

¹⁸⁰ See ch 2.

¹⁸¹ The contract of sale aspects, not the proprietary ones, which will be subject to the appropriate law selected by the conflict rules of the forum.

country that is not England, with payment being made abroad in a currency that is not sterling. Despite doubts expressed in the past as to whether English law may be chosen despite the absence of any real and substantial connection between the contract and England,¹⁸² the Rome Convention and the Rome I Regulation place no identical restriction on the parties choosing whichever applicable law they want¹⁸³ and therefore underwrite the practice in GAFTA and similar contracts. This facilitates the management of string contracts¹⁸⁴ since it permits all contracts in the string to be governed by the same law, regardless of matters such as the residence of the parties and the currency of the contract. Where the contract is governed by English law and incorporates the UCP rules¹⁸⁵ or Incoterms, it is still English law that governs the contract. Indeed, it is by virtue of the English law of contract that these supplementary terms are incorporated.

D. Speculation, Hedging, and String Trading

Market liquidity A striking feature of many of the reported cases on international sale of goods is that the contracts in question function as speculative instruments. Speculation is an activity that attracts a measure of opprobrium but is commonly justified by the way that it introduces liquidity into the market and hence stabilizes it. Besides the presence of speculators in these markets, there are those, such as farmers and manufacturers, with a practical interest in the future prices of commodities to plan their operations. **1.40**

Forward delivery The nineteenth century saw the development of forward delivery contracts, which are to be distinguished from spot transactions, namely, physical contracts performed immediately or nearly so. In a forward delivery contract, the parties may agree a price and other terms concerning agricultural commodities even before the crop is grown and reaped. They do not know what the spot market price will be at the future date when the rice, for example, is ready for shipment. The buyer and seller both take a chance as to the state of the market and the volume of the contract commodity in circulation at that time. If the spot price at the time of delivery is lower than the contract price, the seller has gained and, if higher, the buyer has gained.¹⁸⁶ This excessively simple statement suggests a zero sum game but the reality is that both parties gain from the forward delivery contract in so far as they receive the assurance they need to plan their future activities. In the normal case, where the market is in contango, the forward delivery price will be higher than the spot price prevailing at the date of the contract. This is because of the carrying costs over the interim period, or the cost of hedging activity that avoids carrying costs. In less usual **1.41**

¹⁸² See *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277, PC ('bona fide and legal').

¹⁸³ But there are provisions relating to the application of the forum's public policy and mandatory rules (Arts 7(2) and 16 of the Convention; Arts 9(2) and 21 of the Regulation). Furthermore, as seen above, where all the other relevant 'elements', apart from the choice of applicable law clause, point to the law of a country which has mandatory rules or provisions that have to be observed, that country's mandatory rules or provisions must be obeyed by the forum (Art 3(3) of the Convention and the Regulation), though otherwise the choice of applicable law remains unaffected. These various restrictions do not add up to striking down a choice of applicable law on the ground only that the contract has no material connection with the country whose law is chosen.

¹⁸⁴ Discussed at para 1.42.

¹⁸⁵ See para 1.19.

¹⁸⁶ See E Murray, 'UK Financial and Derivatives Markets', in M Blair and G Walker (eds), *Financial Markets and Exchanges Law* (2007), ch 6.

circumstances, the market is in backwardation, so that the present spot price is higher than the forward price for future delivery.¹⁸⁷

1.42 Wagers Cases in the early part of the nineteenth century had treated forward delivery contracts as illegal wagers on commodity prices since buyer and seller were treated as taking a bet on what the future market price would be.¹⁸⁸ When the Sale of Goods Act was first passed in 1893, it was made clear in s 5(1) that a contract of sale could be entered into for future goods.¹⁸⁹ Where contracting parties enter into a contract for the sale of goods on forward delivery terms with no intention that any delivery should occur, there is a possibility that the contract will be characterized as a wagering contract. For this conclusion to be reached, however, neither party may have an interest in the transaction going beyond the sum of money that is at risk and each party must be capable of winning or losing depending upon the outcome of future events.¹⁹⁰ Formerly, such a contract was ‘null and void’¹⁹¹ but the position now is that the ‘fact that a contract relates to gambling shall not prevent its enforcement’.¹⁹²

1.43 Need to plan ahead Rice, wheat, and other crops are seasonal and dependent upon the hazards of nature. That means that they are subject to price fluctuations as well as to famine and glut. If prices can be settled in advance under forward delivery contracts, prices are thus stabilized. Those participants in the trade with a physical interest in the commodity, such as millers, brewers, animal feed compounders, and pasta manufacturers, therefore welcome the interest of outside speculators since this increases the volume of trading. The farmer gets the assurance that his grain will have a market; the miller grinding wheat into flour ensures there will be supplies of wheat to be called forward from an importer’s warehouse as and when these are needed. This does not mean that opportunistic behaviour will not occur on the part of those with a physical interest in the trade. In *Sainsbury (HR & S) Ltd v Street*,¹⁹³ the crop was low because of poor harvesting conditions. The farmer, wishing to escape from the price clause in order to take advantage of the rise in the market that accompanies poor harvests, argued unsuccessfully that his inability to deliver the agreed amount in full because of the weather meant that the contract was frustrated. The conclusion of the court was that the buyer was entitled to call for delivery of the diminished crop at the contract price. In international markets involving intermediate traders, it is even more difficult to run the frustration argument because of poor harvests and similar supervening

¹⁸⁷ See N Schofield, *Commodity Derivatives* (2007), 8–11.

¹⁸⁸ See *Bryan v Lewis* (1826) Ry & Moo 386. See also invoicing back cases like *Lancaster v Turner (JF) & Co Ltd* [1924] 2 KB 222, CA (Scrutton LJ) and *Adair (JF) and Co Ltd v Birnbaum* [1939] 2 KB 149, CA (MacKinnon LJ) for the view that the transaction amounts to a wager. The practice of invoicing back, which leads to the closing out of a contract at the prevailing market rate so as to favour even a breaching party who is ‘in the money’, has attracted criticism over the years. See *Dunavant Enterprises Inc v Olympia Spinning & Weaving Mills Ltd* [2011] EWHC 2028 (Comm) at [2] and cases there cited.

¹⁸⁹ For a purely domestic example of a forward delivery contract, see *Sainsbury (HR & S) Ltd v Street* [1972] 1 WLR 834 (sale by farmer to supermarket chain of future barley crop of stated tonnage within a margin of tolerance).

¹⁹⁰ See *Kloeckner & Co AG v Gatoil Overseas Inc* [1999] 1 Lloyd’s Rep 177 (where these conditions were not fulfilled).

¹⁹¹ Gaming Act 1845, s 18.

¹⁹² Gambling Act 2005, s 335(1). See further H Beale (ed), *Chitty on Contracts* (30th edn, 2008), Vol I para 3–169.

¹⁹³ [1972] 1 WLR 834.

events affecting market price. Rises in commodity prices are invariably seen in English law as not giving rise to frustration. Traders, moreover, cannot trace back their sale obligations to a particular affected farm because the description of the goods in the sale contract is never so precise.

Sales strings It will be shown in ensuing chapters that a number of CIF and FOB cases involve sales strings stretching to many parties dealing with the same appropriated cargo.¹⁹⁴ Only the first seller physically delivers; only the last buyer takes physical delivery.¹⁹⁵ The intermediate parties dealing in the same goods are trading paper and will be brokers or speculators with no physical interest in the commodity at all, looking for a profitable opportunity.¹⁹⁶ Speculators will wish to take market risks by taking a 'long' or 'short' position¹⁹⁷ on a particular commodity; physical producers and consumers typically have a lesser appetite for risk. The risks that are taken and avoided will be demonstrated below. **1.44**

Closing out Forward delivery contracts as vehicles for speculation can be closed out in a way that shows this feature of the markets more prominently. '[T]here is nothing at all unusual in commodity dealers using contracts of sale and resale as a means of arriving at a position in which the true nature of the transaction is the settlement of a price difference.'¹⁹⁸ But forward delivery contracts do not lose their physical quality. According to Sellers LJ in *Garnac Grain Co Inc v Faure (HMF) & Fairclough Ltd*:¹⁹⁹ 'There may be many cases where the parties do not expect to complete the transaction but to trade on differences in the hope that the result will be a profit, but if there is an obligation to fulfil the contract according to its tenor if circumstances require it, then the contract is enforceable.' This case involved the deliberate creation of a circle by the head seller, which bought in the goods at the end of the string.²⁰⁰ The head seller would therefore also be the end buyer, in which case the contracts would be performed by financial settlements under circle clauses²⁰¹ that serve to prevent sellers from triggering default at later stages in the string by the expedient of not performing their own obligations further up the string.²⁰² **1.45**

Futures contracts From a paper-based forward delivery market, it is a short step to organizing dealings in futures on an exchange and to treating these futures like any other financial instrument, such as gilt.²⁰³ Next September's Pacific Coast wheat can be dealt with by **1.46**

¹⁹⁴ For a description of internal Canadian string (or track) trading, see *Louis Dreyfus Canada Ltd v Pulses Etc SA* [2007] SKCA 58.

¹⁹⁵ It is possible to have string arbitrations between the first seller and the last buyer in the string, eg GAFTA 125 (Arbitration Rules, July 2007), cl 7(1) ('between the first seller and the last buyer in the string as though they were parties who had contracted with each other').

¹⁹⁶ For a discussion whether the specification of jet fuel (containing an additive to inhibit electrical discharge which could be introduced into the fuel at any time) as a matter of contractual construction applied to intermediate buyers in the same way as it applied to the end buyer, see *Trasimex Holding SA of Panama v Addax BV of Geneva* (Rix J, 3 Mar 1996).

¹⁹⁷ See para 1.55.

¹⁹⁸ Kerr J in *Pagnan (R) & Fratelli v Schouten (NGJ) NV (The Filipinas I)* [1973] 1 Lloyd's Rep 349, 356.

¹⁹⁹ [1966] 1 QB 650, 674, CA.

²⁰⁰ See also the 'dry' circle in *Voest Alpine Intertrading GmbH v Chevron International Oil Co Ltd* [1987] 2 Lloyd's Rep 547, 552; *Kloekner & Co AG v Gatoil Overseas Inc* [1999] 1 Lloyd's Rep 177.

²⁰¹ See ch 9.

²⁰² See *Re Hall (R and H) Ltd and Pim (WH) (Jnr) and Co's Arbitration* (1928) 33 Com Cas 24, HL.

²⁰³ E Murray, 'UK Financial and Derivatives Markets', in M Blair and G Walker (eds), *Financial Markets and Exchanges Law* (2007), ch 6.

investors, professional or amateur, just like the shares in a major corporation.²⁰⁴ The investor's contracting partner, or counterparty, will be a broker on the exchange or the exchange itself.²⁰⁵ Investors' dealings operate according to the rules of an organized exchange, apart from those cases where over-the-counter derivatives are traded, often in response to the particular needs of a player in the market, seeking hedges that are responsive to its particular business requirements. The rules of an organized market will include, for example, rules dealing with margin calls and market manipulation. A margin call is the deposit by way of security with the exchange in cash or its equivalent of a stated percentage of an investor's market exposure (the gross amount of this will fluctuate with the state of the market).²⁰⁶ Variations in the margin will be required as the market moves, the amount to be paid or reimbursed depending upon a mark-to-market calculation conducted commonly at daily or even shorter intervals.²⁰⁷ Some exchanges may introduce particularly stringent margin requirements in the event of a trader taking a pronounced short position²⁰⁸ in the futures market.²⁰⁹ The degree of financial risk associated with the very large body of unregulated over-the-counter transactions, conducted outside exchanges, is cause for real concern when the stability of the world's capital markets comes into consideration, as is evident from the turmoil that invaded the financial markets from 2007 onwards. The forward delivery market also does not operate according to the rules of an exchange.²¹⁰ In the case of futures contracts, there are various ways in which these can be settled but typically 'delivery' will take place in the form of a closing out or settling of financial differences. Occasionally, in the event of settlement not occurring in this way, there will occur a physical performance. For example, the physical delivery of metals under London Metal Exchange (LME) contracts can be accomplished by means of the transfer of warehouse warrants.²¹¹ These warrants have themselves become the subject of a secondary market.²¹²

1.47 Financial services legislation Besides the operation of the rules of a commodity exchange, there is the question of the extent to which financial services legislation imposes a regulatory structure on futures or even forward delivery contracts. The Financial Services Act 1986 has been superseded by the Financial Services and Markets Act 2000, though the regulatory impact of the latter Act is essentially the same as the former in the area under consideration. For that reason, and because of case law under the Financial Services Act 1986 illustrating

²⁰⁴ These are treated as contracts for the sale of goods: see *Sucden Financial Ltd v Fluxo-Cane Overseas Ltd* [2010] EWHC 2133 (Comm) at [4], [2010] 2 CLC 216.

²⁰⁵ In contracts cleared through the London Clearing House, the LCH, as the buyer for every seller and the seller for every buyer, acts as the sole intermediary on some of the world's leading trade exchanges and over-the-counter market places. The same applies in the case of the ICE (Intercontinental Exchange).

²⁰⁶ *ED&F Man Commodity Advisers Ltd v Fluxo-Cane Overseas Ltd* [2009] EWCA Civ 406.

²⁰⁷ *Sucden Financial Ltd v Fluxo-Cane Overseas Ltd* [2010] EWHC 2133 (Comm) at [6], [2010] 2 CLC 216. See, eg London Metal Exchange (LME) Trading Regulations (October 2011), Rulebook rr 9.1.3, 9.1.5 (futures), 9.1.8 (swaps) (daily).

²⁰⁸ See para 1.55.

²⁰⁹ See *ED&F Man Commodity Advisers Ltd v Fluxo-Cane Overseas Ltd* [2009] EWCA Civ 406 (additional 20 per cent 'super margin' required by the ICE (Intercontinental Exchange)).

²¹⁰ See D Morgan, *Merchants of Grain* (Penguin, 1980), ch 9: 'Catch-22'.

²¹¹ London Metal Exchange (LME) Trading Regulations (October 2011), Rulebook Part 9 (can take place by offsetting or delivery of warrants); ICE Sugar No 11 Futures Contract (allowing for physical delivery FOB receiver's vessel). See also *Nissho Iwai Petroleum Co Inc v Cargill International SA* [1993] 1 Lloyd's Rep 80, discussed at para 1.54.

²¹² They can be converted into electronic form under NYMEX (New York Mercantile Exchange) Rules, r7A04.

the reach of regulatory legislation in relation to forward delivery contracts, it is convenient to start with the 1986 Act before proceeding to the 2000 Act. The Financial Services Act regulated investment business,²¹³ the pivotal question being whether forward delivery and futures contracts were investments as defined in Pt I of Sch 1 to the Act. Listed in para 8 of Pt I, entitled 'FUTURES', was: 'Rights under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed when the contract is made.' The language was certainly wide, which gave rise to some concern to those dealing in the forward delivery markets or engaging in hedging activity in complementary futures markets. By s 3 of the Act, a person engaging in regulated activity had to be authorized under the Act, or be an exempted person. Any investment contract entered into in breach of s 3 was unenforceable against the other party to the transaction, who was entitled to recover property or money transferred under the investment contract.²¹⁴ A discretion allowed the benefit of a contract unlawfully concluded to be retained if the person in question reasonably believed that, in entering into the contract, he did not breach s 3, where it was just and equitable that he retain the benefit of the contract.

Exceptions The notes accompanying para 8,²¹⁵ which had authoritative status, however, went some way towards allaying the concern of commodities traders. First of all, the paragraph did not apply if the contract was made for commercial rather than investment purposes.²¹⁶ A contract was indicatively made for commercial purposes when at least one party was a producer of the commodity or used it in his business. Alternatively, it was indicatively commercial if either the seller intended to or did deliver the commodity, or the buyer intended to or did take delivery of it.²¹⁷ These cases were apt to cover cases of futures dealings where either party had a general physical interest in the commodity. That interest did not have to be in the very subject matter of the particular contract, which meant that a compounder of animal feeds using a futures contract as a hedging mechanism had no need to envisage the taking of physical delivery under the particular futures contract in order for regulation to be avoided. It might, however, have been the case that an intermediate contract involved traders, neither of whom had a physical interest at all, in which case the contract could be a regulated investment.²¹⁸ In addition, the language of para 8 was just as apt to embrace a forward delivery as a futures contract. If delivery of the commodity were equated with delivery of documents representing the commodity, which it is submitted should have been the case, the risk of regulation was greatly reduced. This exit from the regulatory scheme would apply to those contracts settled pursuant to circle and book-out clauses only because of the intention of the parties, prior to the invocation of the book-out

1.48

²¹³ S 1.

²¹⁴ S 5(1). There is no reason why one unauthorized, etc person might not take advantage of this provision as against another unauthorized person.

²¹⁵ In Sch 1 to the 1986 Act.

²¹⁶ Note 1.

²¹⁷ Note 4. This indicative note had the capacity to pull in a contrary direction to indicative notes 5 and 6. According to the former, a contract was indicatively commercial when it was traded ad hoc and not by reference to standard lots, terms, or delivery dates. According to note 6, the contract was indicatively one of investment if it was traded on an exchange or its performance was ensured by an exchange or clearing house or there was provision made for margin.

²¹⁸ The chances of regulation were therefore greater where the exchange was a necessary counterparty to each trade.

or circle clauses, was that there be a delivery of the property. Nevertheless, the use of English contract forms would not of itself have subjected overseas parties doing business overseas to regulation under the Financial Services Act.

1.49 CR Sugar Trading The application of the Financial Services Act 1986 to futures contracts in sugar was considered in *CR Sugar Trading Ltd v China National Sugar & Alcohol Group Corp.*²¹⁹ where David Steel J upheld the decision of an arbitral tribunal below that the parties were carrying on an investment business. The case concerned a business relationship between an English sugar trader, CR, and a Chinese company, CNS. Neither was an authorized or exempt person under the 1986 Act. CNS granted to CR, in return for premiums, certain put options, the effect of which was that CR could at a future date require CNS to take delivery of physical sugar. A New York affiliate of CR was then able to use these options to open hedging positions on the New York futures market. While the market price of sugar continued to rise, both CR and CNS made money from the transaction, CR in the form of margin gains on futures trading made by its New York affiliate, and CNS, in the form of premiums paid by CR. CR never contemplated delivering sugar to CNS: the price of the physical sugar in the options was deliberately pitched below the market price. The trouble emerged when the optimistic expectations entertained by the parties in a state of 'myopic euphoria' were defeated by a downward plunge in the sugar market, the consequence of which was that CR decided to exercise its options under two contracts. These were for large quantities of raw sugar on C&F free out, one main safe South China port, terms. At the time the put options were granted, the parties' expectation that they would not be exercised was explicitly recognized in the option agreements, as sellers and buyers agreed to work towards the postponement of the exercise of the options at no cost to the buyer. At all relevant times, moreover, CNS did not conduct the physical business of importing raw sugar into China and refining it. The reasons given by the arbitral tribunal and the court for the conclusion that the parties were carrying on an investment business were as follows. Neither party was a person using the sugar in its business:²²⁰ mere traders like CR did not use sugar and CNS was no longer active in the physical importing and refining business in China. The parties were buying and selling sugar in a speculative way. Moreover, there was no intention for delivery to be made,²²¹ intention having to be judged at the date the put options were granted and not the date when they were exercised.

1.50 The Financial Services and Markets Act 2000 The Act prohibits any person from carrying on of a regulated activity in the United Kingdom unless that person is authorized to do so or exempted from the prohibition.²²² A regulated activity is one that relates to an investment of a specified kind,²²³ investment being defined in the widest terms as 'any asset, right or interest'.²²⁴ Regulated activities specifically include options²²⁵ and futures, the latter being defined, so as to include also forward delivery contracts, as '[r]ights under a contract for the sale of a commodity or property of any other description under which delivery is to

²¹⁹ [2003] EWHC 79 (Comm), [2003] 1 Lloyd's Rep 179.

²²⁰ See note 4(a).

²²¹ See note 4(b).

²²² S 19. The grant of exemptions is authorized by s 38. See also Financial Investments and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544, especially reg 68 (exclusions concerning sale of goods and supply of services transactions).

²²³ S 22.

²²⁴ Sch 2 to the Act.

²²⁵ Para 17 of Sch 2.

be made at a future date'.²²⁶ The sanction of unenforceability for acting in an unauthorized way is the same as under the 1986 Act²²⁷ and there is a very similar discretion to permit an unauthorized benefit to be retained.²²⁸ The outcome of the *CR Sugar* case²²⁹ would in all probability be the same under the Financial Services and Markets Act 2000.

Oil trade The oil trade presents an interesting case study of the way that market in commodities operate.²³⁰ In the world of stable oil prices that existed prior to 1973,²³¹ it was common for oil to be bought in spot sales on the international oil market and for it to be the subject of long-term fixed price domestic contracts. One of the problems of spot markets is their inflexibility and the risks they pose to sellers, taking a speculative position in the market, who are faced with a range of possible products on the market and a consequent difficulty in covering any short²³² position they have taken.²³³ The world of stable oil prices changed after the Arab–Israeli war of 1973 when the oil producers' cartel, OPEC, introduced huge price increases.²³⁴ A number of cases have illustrated the development of forward trading in oil to produce commercial activity that in its informality and lack of regulation resembles forward delivery sales in the GAFTA and FOSFA systems. It would seem that this type of activity filled a gap not yet filled by a still-developing futures market in oil products.²³⁵ Certainly, the development of forward trading in oil is a relatively recent one.²³⁶ Activity of this kind needs a standard product that can be used to create strings (or daisy chains) of activity on identical terms save as to price. This prevents market activity from being spread across too wide a range of products: concentrated activity promotes the efficient and reliable hedging of risks. Standardized forward trading gives, at one end of the distribution chain, oil producers an incentive to maximize production and, at the other, refiners the assurance that their future feedstock requirements will be met.

Standard oil contracts Commonly traded products are Brent crude oil,²³⁷ West Texas Intermediate crude²³⁸ and Dubai crude. Even highly specific products can be the subject of

²²⁶ Para 18 of Sch 2.

²²⁷ S 26(1).

²²⁸ S 28(3)–(6).

²²⁹ [2003] EWHC 79 (Comm), [2003] 1 Lloyd's Rep 179.

²³⁰ For a useful description of the oil trade and its various futures markets, see S Mankabady, *Oil Trading Law* (1997), ch 1. See also EJ Swan, 'Derivatives and the Control of Oil', in EJ Swan (ed), *Derivative Instruments Law* (1995).

²³¹ For instability in the iron ore market attributed to expanding Chinese demand, see the Financial Times, 30 March 2010.

²³² For short and long positions, see para 1.55.

²³³ *Voest Alpine Intertrading GmbH v Chevron International Oil Co Ltd* [1987] 2 Lloyd's Rep 547, 550.

²³⁴ Similar developments have arisen in recent years (2007–09 in particular) in the iron ore trade, driven by increasing Chinese demands for iron ore. Annual contracts based on a benchmark price have given way to short-term activity with the release of iron ore on the international spot markets and the intervention of price assessors like Platts. See ICE Product Guide to Iron Ore, available at <<http://www.theice.com>>; Financial Times (Commodities), 30 March 2010.

²³⁵ *Voest Alpine Intertrading GmbH v Chevron International Oil Co Ltd* [1987] 2 Lloyd's Rep 547.

²³⁶ *Transpetrol Ltd v Transol Olieprodukten Nederland BV* [1989] 1 Lloyd's Rep 309, 310 ('a relatively new and highly sophisticated trade').

²³⁷ 'Brent is by far the most widely traded crude oil in the international market... despite the fact that Brent has never accounted for more than 3 percent of crude oil in international trade. Roughly two-thirds of internationally traded crude oil is sold at Brent-related prices': R Weiner, 'Do Crises Tear the Fabric of Oil Trade?' (March 2006), 4 (Discussion Paper for Resources for the Future (<<http://www.rff.org>>)).

²³⁸ The underlying oil commodity for NYMEX dealing.

multiple trading activity. For example, the needs of a power station situated at Littlebrook on the Thames were the subject of forward delivery activity in *Vitol SA v Phibro Energy AG (The Mathraki)*.²³⁹ Trading in the former product is the subject of a most helpful expert's report incorporated in the judgment of Hirst J in *Voest Alpine Intertrading GmbH v Chevron International Oil Co Ltd*.²⁴⁰ The problem in that case concerned a circle settlement (or 'book-out') procedure that was not as fully developed as those in the GAFTA and FOSFA contractual systems.²⁴¹ This produced problems of contractual uncertainty that need not be dealt with here except to say that the court was satisfied with a loose arrangement whose purport was the payment of financial differences.

1.53 Daisy chains It appears from the *Voest Alpine* case²⁴² that the standard quantity of FOB Sullom Voe Brent crude was 600,000 bbls (barrels) +/- 5 per cent. Approximately 400 contracts were struck each month in respect of 45 physical cargoes. The delivery requirement was that the seller would give fifteen days' notice of a three-day lifting range.²⁴³ Nevertheless, the limited number of participants in this market ensured that their involvement would be confined to a settlement of financial differences as circles (or 'daisy chains') were taken out of the physical delivery chain by the book-out procedure. This reduced costs, sparing the parties thus taken out the expense of opening letters of credit for multi-million dollar figures.

1.54 Converting to physical delivery The FOB Sullom Voe contract for Brent crude was again the subject matter of the decision in *Nissho Iwai Petroleum Co Inc v Cargill International SA*.²⁴⁴ That contract formed the basis of two different types of transactional activity. First, there was the physical market, where, as in *Voest Alpine*,²⁴⁵ fifteen days' notice of readiness had to be given by the seller with a three-day lifting range. There was also a forward paper market used for speculative and hedging activities, where the normal procedure was, as the due date approached, for contracts to be settled as a 'book-out' by the payment of financial differences. In this case, the distinction between those paper contracts that retained their paper character, to be closed out in the way of futures contracts, and those that were converted into 'wet' contracts, with a physical delivery, was highly significant for the following reason. The two markets traded at different prices, so that, if wet cargoes were trading at a discount in relation to paper cargoes, it was in the interest of a seller holding a wet cargo to convert the paper contract into a wet contract, which sellers were entitled to do under the terms of the paper contract. A buyer chosen by a seller in this way to receive a nomination converting a paper into a wet contract would suffer a substantial loss if the wet market price fell significantly below the paper price. As the physical delivery date approached, one would normally expect a convergence of the two market prices since the earlier, and higher, physical price would include (diminishing) holding costs not associated with the abstract futures market.²⁴⁶ In this case, however, the difference was substantial. A buyer receiving a

²³⁹ [1990] 2 Lloyd's Rep 84.

²⁴⁰ [1987] 2 Lloyd's Rep 547.

²⁴¹ For the workings of circle clauses, see ch 10.

²⁴² [1987] 2 Lloyd's Rep 547.

²⁴³ Note that in this trade it is the FOB *seller* who controls the timetable, a departure from the position in sales of dry commodities.

²⁴⁴ [1993] 1 Lloyd's Rep 80.

²⁴⁵ [1987] 2 Lloyd's Rep 547.

²⁴⁶ cf the relationship between current spot prices and forward delivery prices in the physical market discussed at para 1.41.

nomination in these circumstances, besides suffering a financial loss, might also find as a result of the seller's nomination that its paper and its wet books were no longer balanced. That buyer, if able to do so, would wish to pass on, in the same way, that same nomination to a sub-buyer, and so on. It amounted to a game of passing the parcel that had to be stopped at the above fifteen-day deadline. More precisely, the game came to an end at '17 00 hours London time on the 15th day prior to the first day of the laydays [the three-day lifting range]' The unlucky buyer at the end of the line was said in the jargon of the trade to be '5 o'clocked'.

Availability for nominations It was therefore necessary in these paper contracts to establish a protocol for the giving and receiving of these nominations. The practice was for this nomination process to be started a day before the expiry of the fifteen-day deadline, with a chain of forty or fifty contracts developing over a twenty-four hour period. Each nomination took about ten seconds to deliver and all participants in the trade were required to declare a telephone number and appoint a named person to receive nominations in this way. The dispute centred on the last nomination in the chain. After meticulously reviewing the facts, which included counting the number of rings (timed at two seconds each followed by a four-second interval), Hobhouse J in the *Nissho Iwai* case²⁴⁷ found that the seller, from its New York office, had placed a call to the Boston office of the buyer so that the buyer's telephone began to ring at least twenty seconds before the deadline. If the buyer's nominee had picked up the instrument promptly, there would have been ample time for the seller to complete (as it had to) its ten-second nomination within the deadline. But the buyer's nominee was unwilling to trust the Boston speaking clock and took her cue from a Geneva colleague, in whose offices the Geneva speaking clock was relayed by tannoy. The ensuing delay resulted in her picking up the telephone receiver outside the 17.00 hours deadline. She then informed the seller that it was out of time. **1.55**

Seller's option? The buyer in the *Nissho Iwai* case²⁴⁸ contended that it had not timeously been '5 o'clocked'. Since the seller was exercising an option to convert a paper contract into a wet contract, there was no room for any generosity at all when time is in issue in the exercise of an option. But Hobhouse J held that, in failing to respond promptly to the seller's call, the buyer had acted in breach of an implied contractual obligation not to impede the seller in its attempts to perform the contract (more accurately, to exercise an option under the paper contract). Consequently, the buyer was left holding the parcel, which involved a loss of a little more than \$1 million. **1.56**

Balancing commitments On futures and forward delivery markets, investors and traders can equalize their buying and selling commitments. Alternatively, if they anticipate a fall in the market they can go 'short', which means that their sale commitments exceed their purchase commitments. If they anticipate a rise in the market, they can go 'long' by entering into purchase commitments that exceed their sale commitments. On a futures market, depending upon its rules, these 'open' positions can be closed either by a physical delivery or by a cash settlement.²⁴⁹ It is important to realize that there is a close correlation between **1.57**

²⁴⁷ [1993] 1 Lloyd's Rep 80.

²⁴⁸ [1993] 1 Lloyd's Rep 80.

²⁴⁹ This is what occurred in *Nissho Iwai Petroleum Co Inc v Cargill International SA* [1993] 1 Lloyd's Rep 80. See also the ICE Exchange of Futures for Physical (EFP) mechanism at <<http://www.theice.org>>. For a case involving futures contracts where the buyer of physical cereals paid by surrendering an equivalent quantity of futures contracts, see *Soules CAF v ADM Agri-Industries Ltd* 2001 WL 676681.

the physical market price of a commodity and its futures market price.²⁵⁰ A discussion of the relation between the physical and futures (or terminal) markets for sugar is to be found in *Gebrüder Metelmann GmbH & Co KG v NBR (London) Ltd.*²⁵¹ The two sets of prices generally track each other but the sugar futures market can be extremely volatile within the course of a single day.

1.58 Example S, who has taken a short position, has agreed to sell September futures to B at \$240 per tonne. When September arrives, the market price has fallen to \$220. On a cash settlement, S will receive from B \$20 (\$240–\$220) per tonne. On a delivery basis, S will make up the shortfall by acquiring a cargo at \$220 from another seller and tendering it to B under the contract at \$240. Either way, S captures a profit of \$20 per tonne. This example can be reversed to the benefit of B if the market is a rising one. Investors have been known to misread the market.

1.59 Hedging Dealers on the physical, forward delivery market can ‘hedge’ against future market movement by parallel and opposite dealings on a futures market.²⁵² Those who both buy and sell—middlemen—are engaged in a double hedging operation. If they sell forward, they go short and may choose to buy an equivalent amount in the futures market if they wish, which they may not want to do in full or at all, to lay off the risk. As and when they eventually enter into a forward physical purchase²⁵³ to ‘close down’ their ‘open’ position and balance their books, they sell an equivalent amount in the futures market. Hedging operations—and they can come in different forms—are especially vital in the oil trade. It was once observed that oil had been known to move by \$7 per barrel in the space of ten minutes.²⁵⁴ Market volatility has not disappeared since that observation was made. End sellers (farmers) and end buyers (millers) do not need to go through this double hedging. A farmer hedging against the risk arising from the future sale of his crop when it is reaped can hedge now by selling the equivalent (estimated crop yield) amount on a futures market. This is an alternative to making a forward sale of his crop to a particular buyer, such as a supermarket chain. Unlike the intermediate trader, the farmer at no time needs to buy in either market. Similarly, the end user, a feed mill for example, can enter into a hedge purchase on the futures market and buy on the spot market when the crop is ready for delivery. Apart from hedging, the futures market can also be used to protect participants in the physical market against the price risk associated with the failure of a commodity market to create consistent and transparent prices.²⁵⁵

²⁵⁰ See the examples in A Slabotsky, *Grain Contracts and Arbitration* (1984), pp 49–54.

²⁵¹ [1984] 1 Lloyd’s Rep 614, CA (Mustill J at 623, Donaldson MR at 630).

²⁵² See A Slabotsky, *Grain Contracts and Arbitration* (Lloyd’s of London, 1984); *Socomex Ltd v Banque Bruxelles Lambert SA* [1996] 1 Lloyd’s Rep 156; *ED&F Man Commodity Advisers Ltd v Fluxo-Cane Overseas Ltd* [2009] EWCA Civ 406. A trader’s bank may require it to conduct hedging operations: see *Choil Trading SA v Sahara Energy Resources Ltd* [2010] EWHC 374 (Comm) at [156], which also contains a useful description of hedging activity at para [156] et seq (on which also see *Glencore Energy UK Ltd v Transworld Oil Ltd* [2010] EWHC 141 (Comm) at [14]).

²⁵³ Any delay in so doing is a speculative activity in itself since the market will be moving in the meantime.

²⁵⁴ See J Gray, *Shipping Futures* (2nd edn, 1990), ch 2. On the volatility of freight markets, which will affect CIF prices, see *Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 2 AC 694, 703, HL.

²⁵⁵ N Schofield, *Commodity Derivatives* (2007), 75.

Standard products Just as the activities of string traders are assisted by the way that government-controlled and other inspection agencies standardize a commodity by quality classification—for example, the Canadian Grain Commission and its classification of wheat according to the season's overall quality and taking into account origin, type, and protein content²⁵⁶—so the fluidity of futures markets is assisted by the standard commodity contracts invented by the exchanges. For example, the standard unit on the sugar terminal markets of London and Paris is '50 tonne lots of a standard grade of sugar on standard terms as to delivery at various standardised future periods'.²⁵⁷ Another example is the ICE Gas Oil Futures contract where the amounts traded are in units of 100 tonnes.²⁵⁸ The use in oil contracts of basis clauses,²⁵⁹ which provisionally standardize the destination of the oil, is a useful tool in the manufacture of a standard product to suit string trading in physical cargoes. It should not much matter if the gas oil or other oil product so specified is highly individualized with few buyers and sellers. Nevertheless, when there is hedging between the physical and futures markets, and the commodities dealt with in the two markets are not quite identical, there is a 'basis risk' that the two price trends will not be identical. Traders 'aim off' the physical (or forward) commodity for its nearest futures equivalent.²⁶⁰ The two price trends may be sympathetic, since the two commodities are very similar, but the risk of differential movement can produce significant losses. For example, soya bean meal in the physical market may diverge from soya beans in the futures market, though the two price trends should remain close.

Physical production The very considerable expansion of futures trading in commodities is matched by increases in physical production. Apart from the increasing appetite for oil, growing world prosperity and technological improvements have been responsible for substantial increases in the volume of dry commodities such as rice and wheat. The world production of wheat increased by 150 per cent in the period between the 1960s and 1980s.²⁶¹ Statistics maintained by the United Nations Food and Agricultural Organisation²⁶² show that, over a nine-year period ending in 2008, the value of world agricultural imports and exports increased by more than 200 per cent. In broadly the same period, there was a significant increase in world production. In the case, for example, of sugar, the increase in the volume of production was close to 25 per cent; for cereals generally, it was about 20 per cent. The law relating to commodity sales applies to strategically important goods whose importance will not diminish in the years to come.

²⁵⁶ See Canada Grain Regulations, CRC c 889, Sch 3 (Grades of Grain), available at <<http://www.grain-scanada.gc.ca>>. In the United States, standards are applied to grain under the terms of the Grain Standards Act 1916 (PL 64–190) (as amended).

²⁵⁷ *Gebrüder Metelmann GmbH & Co KG v NBR (London) Ltd* [1984] 1 Lloyd's Rep 614, 630. On the ICE US market, the quantity is 50 tons (see ICE Sugar No 11 Futures).

²⁵⁸ The former International Petroleum Exchange was acquired by ICE in 2001. See J Gray *Shipping Futures* (2nd edn, 1990), p 20. In the case of Brent Crude Futures, the standard ICE amount is 1,000 barrels (or 42,000 US gallons). For the reason why a barrel consists of 42 (US) gallons, see B Bryson, *At Home* (2010), 181.

²⁵⁹ See ch 5.

²⁶⁰ See, eg *Choi Trading SA v Sahara Energy Resources Ltd* [2010] EWHC 374 (Comm) at [157].

²⁶¹ See D Blandford, 'An Overview of the World Grain Economy', in D Blandford, CA Carter, and R Piggott (eds), *North-South Grain Policies and Trade Policies* (1993).

²⁶² See <<http://www.fao.org>>.

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