Arbitration Issues in the International Vegetable Oil Trade

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ABSTRACT

This paper concerns settling commercial disputes in the oils and fats trade. The usual method is litigation before the courts and commercial settlements. However, between these two extremes are arbitration, coordination and mediations. The FOSFA system of arbitration offers the best for obtaining commercial justice, swiftly and at a reasonable price.

INTRODUCTION

Arbitration as Compared with Other Forms of Dispute Resolution

In Malaysia and, indeed, throughout the Far East, commercial partners largely prefer to settle their differences in an amicable rather than a litigious manner. However, the reality is that in an international trade, parties will be dealing and contracting with people and companies from all over the world, not all of whom will share a consensual approach to the settlement of commercial disputes. Thus, geographical diversity also means cultural and social diversity and in the field of dispute resolution, one may go from one extreme, the U.S.A., where lawyers and litigation are part of everyday life, to Malaysia and the Far East, where the submission of differences to a third party is something to be avoided.

There are many different ways of settling commercial conflicts and any one of these methods may be appropriate to the case. At one end of the scale, there is litigation before the courts and at the other, commercial settlement between the parties. In between these two extremes, lie arbitration, conciliation, and mediation. The advantages of conciliation and mediation are that they are not adversarial, but their problem lies in the fact that they do not guarantee a decision.

Arbitration has the advantage of providing the parties with a decision in the form of an award which can be enforced, like a judgment, against the other side. Unlike litigation, it is not public and so avoids the washing of one's dirty linen in public and possible

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loss of face by one of the parties. To this extent, it is more consonant with eastern cultural and social values than litigation. Where, in addition, it forms part of an overall system for carrying out the trade in a particular commodity or commodities – the oils and fats trade – it has a further advantage of dispute decision by fellow members of the trade on the basis of contracts which have been designed by commercial men specifically to meet the needs of our trade.

Thus, if one contracts on FOSFA terms with any disputes subject to arbitration under the rules of those respective organizations, one has the advantage of knowing that any decision which is reached will have been reached by one's peers in the trade and any failure to honour an award will be brought to the attention of the trade. In addition to the pressure that can be brought at a commercial level to ensure the honouring of the awards, one also has the advantage of being able to enforce an award in the courts of any country which, like Malaysia, has ratified the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

THE FOSFA SYSTEM

The rules governing FOSFA arbitration are complex and rigorously applied. Their essential purpose is to ensure the efficient and definitive resolution of trade disputes and the final settlement of accounts between the parties.

Nowhere is this rigour more apparent than in the complex and imperative rules on validly claiming and proceeding with an arbitration and a considerable number of cases which have come before the writer have, in part, been argued on the basis that the claimants' claim should not be admitted as it was not introduced in accordance with the rules.

In particular, to avoid the risk of losing one's right to claim, the time-limits and requirements for validly initiating FOSFA arbitration proceedings must be followed to the letter. Generally speaking, the time-limit starts to run from the end of the respective contract shipment periods or from the delivery of the goods. It follows that as soon as a problem arises, either with the goods themselves or with the execution of payment, one should check within which particular category one's claim falls so as to be sure to claim arbitration and nominate an arbitrator within time. While the arbitrators have a residual power to allow claims that are prima facie out of time, this power is a discretionary power and one on which it would be unwise to rely.

Once arbitration has been properly claimed and an arbitrator appointed and his name and details advised by telex or courier to the other side, one will be called upon under the rules to submit one's claim and supporting documents in the case of quality and conditions disputes within 10 consecutive days and, in the case of other disputes, without delay. The requirements applicable to claiming arbitration and nominating an arbitrator in respect of disputes other than quality/condition disputes are, generally speaking, not more than 120 days from the end of the contract period of shipment/delivery.

As far as the proceedings are concerned, generally, the arbitrators will decide the case on the basis of the written submissions and documents put in by the parties. One can, however, as a party, request an oral hearing and call witnesses on one's behalf. Such requests are rarely refused by the arbitrators.

As FOSFA follows the old English system, it is possible and, indeed, often the case, that the two arbitrators appointed by the parties agree and issue a joint award. However, where they do not agree, they will together decide on and appoint an umpire to whom all the documents and submissions shall be sent and he will then decide the case and issue his Umpire's Award.

Should one be dissatisfied with any award rendered at first instance, one has the right to appeal to the Board of Appeal. But again, one must be very vigilant with respect to the time-limits within which this right to appeal may be exercised. Here, one must comply with two time-limits: (1) one must pay (if the other side has not paid) the fees and expenses of the arbitrators within 42 days of the issuance of the award and (2) notice of appeal must be received by the Federation not later than 12.00 noon on the 28th consecutive day after the award has been sent to the parties.

The appeal is a totally new hearing of the case and, subject to the directions of the Appeal Board, one may bring any new arguments, evidence, witness statements or witnesses before the Board of Appeal, which, in contradistinction to cases heard at first instance will invariably be in the form of a formal oral hearing. At the hearing, one may present one's case in person or by a trade representative member of the Federation but, in the absence of the express agreement of the Board, one may not be represented by counsel or solicitors.

The advantage of having important or difficult cases reviewed by an Appeal Board consisting of five senior members of the trade is considerable and ensures that every case is thoroughly examined and, where necessary, errors at first instance corrected.

Finally, a word on costs. While FOSFA arbitration comes at a price, compared with the courts or certain other institutional form of arbitration, such as ICC, it is very fair value for money. While it is not possible to give precise indications of the costs of an arbitration without knowing the full extent of the issues involved, it has been the writer's experience that, at first instance, even complex and difficult cases rarely exceed GBP 5000 and straight forward defaults, *e.g.* an inexcusable failure to ship or to pay for the goods will usually cost no more than GBP 2000. On appeal, the costs will be higher because instead of two or three arbitrators, there are five members of the Appeal Board and such cases invariably involve an oral hearing and require a considerable amount of administrative and supervisory work by the FOSFA secretariat. The costs here will be closer to GBP 10 000 and GBP 3500 respectively. These indicative costs, moreover, only cover the fees and costs of the arbitrators and the Federation but not those of the parties' representatives or advisers in preparing or presenting (at oral hearings) the parties' submissions.

One of the great advantages of the FOSFA system is that representation by lawyers is generally not admitted. Lawyers are expensive. Accordingly, when one judges the time, expense, speed and convenience involved in definitively resolving a commercial dispute in one's particular trade, there can be little doubt that FOSFA arbitration is infinitely preferable to submitting such disputes before national tribunals where, with a few noteworthy exceptions, the judges know nothing of the oils and fats trade.

A TRUE LIFE STORY

The most recent real-life arbitrations concerning oils have been a series of cases provoked by the wilful contamination of palm oil with diesel fuel at origin. The palm oil in question was not of Malaysian origin.

While most of the claims were settled amicably between the several parties in each string, nonetheless, a number of cases went to arbitration and even appeal at FOSFA. And the questions which these cases raised, while relating to palm oil, are not atypical of the kind of questions that come before arbitrators under CIF contracts in general. The contracts in question were all on the FOSFA 80 Form, providing for London arbitration and with English law as the applicable law.

The questions of fact and law which had to be answered by the arbitrators in these cases included the following:

- how did the contamination occur?
- where, how and when was the contamination ascertained?
- were the sellers liable to the buyers for having supplied the contaminated oils?
- if so, could the buyers refuse to pay for the oil and reject it and hold the sellers in default under the Default Clause of the contract?
- if so, when was the date of default?
- what was the relevant market price at the date of default for the purpose of assessing damages and how was it to be ascertained?

The arbitrators found that the contamination had occurred prior to shipment as the result of criminal acts of person unknown. There was no suggestion that any of the sellers in string were aware that the oil had been contaminated when appropriating it under the contract to their buyers.

Once it had been ascertained that the contamination had occurred prior to loading, it was clear that these cases did not involve any liability on the part of the vessel or cargo underwriters. Further, the provisions of the contract requiring the buyers to take delivery of the goods against paying allowances for admixture were inapplicable. The nature of the contamination was such that it was found by the arbitrators that the oil did not meet the contractual and legal requirements of *good merchantable quality*. Under these circumstances, the buyers were entitled to refuse to pay for the goods and to reject them in their entirety. It was also found that the buyers were entitled to hold their sellers in default and, under the provisions of the FOSFA Default Clause, to claim damages based on the difference between the contract price and the market price at the date of the default.

The questions which caused the greatest difficulty to the arbitrators were those of the correct date of default and the correct market price on that date.

The problem of the correct date of default was one for which the contract provided no guidance. Of the several possible dates, one could have taken the date on which the contaminated goods were appropriated under the contract or the date on which the contaminated goods were shipped under the contract or the date on which the buyers first learned that contaminated goods were being or had been shipped to them. The arbitrators took the common sense view that the buyers could have done nothing to cover their positions until they were advised or learnt that the goods were contaminated.

Accordingly, the date on which this information was formally communicated was taken as the prima facie date of default but where the buyers had preferred to check for themselves the veracity

of this information, it was considered that this date would be the appropriate date provided they did not take an unreasonable amount of time in carrying out their checks.

However, at this point, there still remained another thorny problem to resolve, namely, that of the correct measure of damages. The problem arose from the fact that the law and sound commercial practice require evidence of actual trades at the date of default in goods of the contract description to provide a *market price* against which to measure the differential with the original contract price. By the time the various default dates had crystallized and the buyers were looking around for goods to buy in, there was virtually no trading of any kind in goods of the contract description and, more particularly, of the contract origin. The reason for this was, of course, because goods of that origin had become highly suspect and virtually untradable. So, what were the arbitrators to do? Were they simply to say *no trades in goods of the contract description at the date of default; therefore no available market from which to establish a market price; therefore no damages proved; therefore none awarded?*

This was an option open to them which they rejected on the ground that even if no goods of the exact contract description and origin were traded in sufficient quantities to constitute a market on the respective date of default, nonetheless, other palm oil of other origins but similar quality was being traded and, if the buyers had to find a substitute for the goods which they could not use, the price that they would have had to pay for these similar but different origin goods served to set a standard by which to assess their actual loss.

The common sense decision taken by the arbitrators in fixing damages in these cases is also the way in which the law and the courts approach this problem. The authority for this proposition is the relatively recent case of the *Athenian Harmony* (2 LLR 1998 at pp. 410 et seq.) where a cargo of jet kerosene was contaminated by fuel oil from a previous cargo. It was argued by the vessel owner that there was no loss because there was no market for jet fuel in Iran (the country of destination) at the time and there was thus no available market against which to measure the damages. The court held that where there is no available market the value must be ascertained as best as possible by comparing similar if not identical goods available elsewhere and awarded substantial damages against the owners on that basis.

In citing these two examples, the purpose is two-fold. First to illustrate the fact that the courts and the arbitrators live in the same world and that commercial and legal sense should be, and here are, one and the same and, secondly, to show that the principles underlying such decisions do not depend on the particular commodity or trade but are of general application.

ENFORCING AN AWARD

There is no point in being held to be right by arbitrators and succeeding in a large claim for damages if, at the end of the day, one cannot collect the sum awarded. It is here that the FOSFA system and, indeed, arbitration in general has certain distinct advantages over litigation. Thus, one of the great advantages of obtaining a FOSFA award is that it will be recognized by the vast majority of the courts in the countries with which one trades. The reason for this is that it will be an English award and England, or rather the United Kingdom, is, together with the majority of the world trading nations, a signatory to the New York Convention referred to earlier. Without going into the details of the Convention, in essence, any state that is a signatory to that Convention will enforce and give legal effect to an award validly issued under the law of any other contracting state. As of today, no fewer than 120 states have ratified the Convention. It is clear that a FOSFA award will be prima facie enforceable in most jurisdictions. The same is not true for national judgments where no such widely-ratified unifying Convention providing for the enforcement of foreign judgments exists.

To conclude on this issue of enforcement, it should not be forgotten that the trade is, in some respects, a gentleman's club. It follows from this that were a member of that trade to fail to honour his obligations, either under a contract or in respect of a binding award issued against it, the rest of the trade will soon know. Thus, in practice, that trading member will find it progressively more difficult to carry out his business, as his dishonourable conduct becomes known. But in addition to this unofficial sanction, the FOSFA system provides an official sanction. Thus, where upon application by a member of the FOSFA Council, the Council considers that it is appropriate to advise all its members that a given trading company has failed to honour a FOSFA award, this company will be *posted* as a *defaulter*.

In conclusion, the combination of formal legal enforcement remedies together with those unofficial and official remedies open to members of the trade does a great deal to ensure a very high level of compliance with FOSFA awards (currently estimated at around 95%).

CONCLUSION

In concentrating on the FOSFA system of arbitration, it has not been the writer's intention to suggest that other systems are not equally good in their own right.

The Palm Oil Refiners' Association of Malaysia (PORAM) system of arbitration and the PORAM Rules, in many respects, operate very similarly to FOSFA arbitration with the consequence that much of what has been said about the FOSFA system will be equally applicable to the PORAM system.

Thus, this paper should not be taken as a general call to submit all commercial disputes to arbitration because commercial differences are always better resolved in fair and amicable negotiation between the parties (and here, I am more in harmony with eastern than the western approach, though the west is learning from the east as we see from the enormous interest currently being shown in the west for *Alternative Dispute Resolution* or ADR and the encouragement being given to potential litigants by the English courts to mediate).

However, if you have a dispute which you cannot resolve amicably, the FOSFA system offers you the best prospect of obtaining commercial justice, swiftly and at a reasonable price.

REFERENCE

NEW YORK CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS (1958).