Shipping & International Trade

Indonesia's Palm Oil Ban and PORAM Contracts

Introduction

Indonesia's month-long ban on the export of thermal coal in January 2022 to satisfy the demands of the domestic market; the Venezuelan oil strike of 2002-2003, which reduced Venezuela's export to almost nothing for several months; and, the nationalisation of Libyan oil assets in August 1973 resulting in oil companies turning to the more distant Middle East producers for oil supplies.

To these crises that have rocked commodity trade, we can now add Indonesia's 2022 palm oil export ban.

The ban by the world's biggest edible oils shipper has sparked concerns over global food prices, with palm oil being ubiquitous in food commodities such as cooking oil, ice cream, and spreads. The ban has also shocked global markets with the swiftness of its implementation and the breadth of its coverage.

This article will discuss the effect of the ban on parties who have contracted on standard-form Palm Oil Refiners Association of Malaysia ("**PORAM**")[1] contracts and the options available to them following the ban.

The Takeaway

Sellers in PORAM contracts should determine if their contracts include the "*prohibition*" or "*force majeure*" clauses, which are found in the standard-form contracts for overseas sales.

If these clauses are indeed included, sellers should take prompt steps to comply with them so that their performance under the contract may be excused.

Prompt action in this manner will not only preserve the commercial relationship between the parties, but also (potentially) avert substantial monetary claims by aggrieved buyers.

[1] See contracts at https://poram.org.my/contracts/list-of-contracts/ (accessed 10 May 2022).

The Ban and its Effect

What ban?

Indonesia banned the export of all palm oil derivatives, with effect from 28 April 2022. The ban, announced on 27 April 2022, prohibits the export of (amongst others) crude palm oil, refined, bleached and deodorised ("**RBD**") palm olein, palm oil effluent, and used cooking oil.

The ban is a reversal of an earlier decision to ban only the export of RBD palm olein.

Why?

The ban comes on the heels of a sharp rise in cooking oil prices in Indonesia caused by disruptions stemming from Russia's invasion of Ukraine, and the weaker production of corn and soybean in South America due to draught.

The Russian invasion (in particular) has caused shortages of supply of sunflower oil from Ukraine, driving up prices of palm oil, a key ingredient in cooking oil.

The price escalation caused Indonesia – ironically, the world's largest producer of palm oil – difficulties in acquiring palm oil for domestic consumption. As a result, cooking oil prices in Indonesia have risen 45% since February this year.

What is the effect?

The effect of the ban is that monthly supplies of 300,000 to 325,000 tonnes of palm oil (about 60% of global supply) will be taken off global markets. The ban on RBD palm oil in particular will increase the worldwide prices of cooking oil and a host of products from snacks to ice cream.

When will it end?

Indonesia has not spelt out the duration of the ban, saying only that exports will be restored once domestic needs are met.

How can palm oil industry players deal with the ban?

The downstream players in Indonesia might be able to circumvent the government's ruling by holding back their refined oil stocks to benefit from the higher prices, if and when the government lifts the ban. Refined oil can, industry experts say, be kept for as long as eight months with no impact on quality.

This move could, however, result in them incurring wrath from the Indonesian government.

Obligations under PORAM Contracts – An Overview

CIF Contracts

In a *Cost, Insurance and Freight ("**CIF**") Contract*, the seller can ship the goods itself or allocate to the sale contract goods which are already afloat. The option of which method to adopt usually rests with the seller. Consequently, if one method of performance becomes impossible, the contract is normally *not discharged* as the seller is usually under a duty to adopt the alternative.

So, for example, when the seller intends to ship the goods but cannot implement this due to events beyond his control (war, export prohibition, strikes, etc.), he is under an obligation to procure the goods afloat. The seller is excused from performance only when he is able to plead illegality as a defence or rely on *force majeure* or prohibition provisions (both explained below) to discharge the contract.[2]

The CIF buyer's chief duty is to pay the price of the goods and to nominate the destination of the goods (usually in a confirmation note).

FOB Contracts

In a *Free on Board ("**FOB**") Contract*, it is the buyer's duty to nominate the ship, and it is the seller's duty to put the goods on board for account of the buyer. Occasionally, the seller is asked to make the necessary shipping arrangements and to take the bill of lading in his own name and obtain payment against the transfer of the bill.

Just as in a CIF sale, the seller is excused from performance only if he is able to plead illegality or rely on *force majeure* or prohibition provisions.

The buyer's key duty under a FOB contract is to make an effective nomination of the vessel on which the seller is to place the goods and to pay the price of the goods.

The Prohibition Clause in PORAM Contracts

General considerations

The public policy consideration that underlies a discharge (of the seller's obligation under the contract) as a result of a supervening prohibition of export is not the physical impossibility of keeping to the terms of the contract.

Instead, the underlying policy is that parties should be given no incentive to perform contracts affected by supervening illegality (i.e. a breach of Indonesian law). Put another way, contracting parties should be deprived of the incentive to perform an illegal act in a friendly foreign country.

[2] Para 4-002, *Sassoon on CIF & FOB Contracts (2012)*.

The wording of the clause

Perhaps the clause most relevant in the PORAM contract to the present situation might be the clause titled "*Prohibition*". This clause is included in all PORAM standard-form contracts for overseas sales.[3]

It says, in summary, that a prohibition of export during the contract period by the Government of the country of origin where the port of shipment is situated shall be deemed by both parties to apply to the contract, and to the extent that the prohibition prevents fulfilment of the contract, the contract shall be extended by 30 days.

The clause goes on to say that if shipment proves impossible even during the extended period, the contract (or any unfulfilled part thereof) shall be cancelled.

The thinking behind the clause appears to be that export prohibitions in the palm oil industry are not unheard of, but that a temporary prohibition lasting less than 30 days should not *in itself* be allowed to derail the contract.

Practical Application of the Clause

In practical terms, sellers who are affected by the ban should, firstly, determine if the standard-form clause remains applicable to their contract and has not been otherwise amended or curtailed by the text of the contract (read as a whole) or by bespoke clauses added to the contract or the context within which the contract was agreed.

Secondly, if the clause remains standing, it seems likely that the ban will qualify as a prohibition of export that prevents performance of the contract. This is provided of course that it is a term of the contract that the palm oil should come from a source in Indonesia.

Thirdly, sellers should notify buyers as soon as possible that they intend to rely on the clause, providing reasons for doing so. Fourthly, sellers should mention when the 30-day extension expires.

Lastly, at the conclusion of the 30-day extension, sellers should re-assess the situation to determine if the contract can be fulfilled or if it should be cancelled.

If the prohibition clause cannot be relied on, sellers may attempt to argue that the ban constitutes a *force majeure* event (as understood within the *force majeure* clause[4]), and which also provides a mechanism for cancelling the contract. This mechanism, however, varies greatly depending on the version of the PORAM contract adopted by the parties.

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[3] Clause 21 of Contract No. 2; Clause 20 of Contract No. 4; Clause 18 of Contract No. 5; Clause 21 of Contract No. 7; Clause 19 of Contract No. 8; Clause 19 of Contract No. 9; Clause 26 of FOSFA 81.
[4] Clause 22 of Contract No. 2; Clause 17 of Contract No. 4; Clause 19 of Contract No. 5; Clause 22 of Contract No. 7; Clause 20 of Contract No. 8; Clause 20 of Contract No. 9; Clause 25 of FOSFA 81.

Conclusion

The PORAM contracts appear well-suited to deal with incidents of export prohibitions, and this is testimony to the far sightedness of the drafters of the contracts.

It remains, however, up to sellers to take timely steps to ensure compliance with the provisions of the contract to take advantage of the protection afforded by the “prohibition” clause.

Big-picture wise, there is unfortunately very little that parties can do to deal with the volatility in the palm oil trade except perhaps to remind ourselves that the next ice cream we purchase may cost us a pretty penny.

If you have any queries on the impact of the ban on PORAM contracts, please feel free to contact the writer of this update, Clive Navin Selvapandian, who is both a member of the Malaysian Bar's Shipping and Admiralty Law Committee and the Treasurer of the International Malaysian Society of Maritime Law.

Queries on disputes within the maritime sphere can also be referred to John Rolan. Queries on ship finance may be addressed to Por Chuei Ying and Evelyn Ch’ng.

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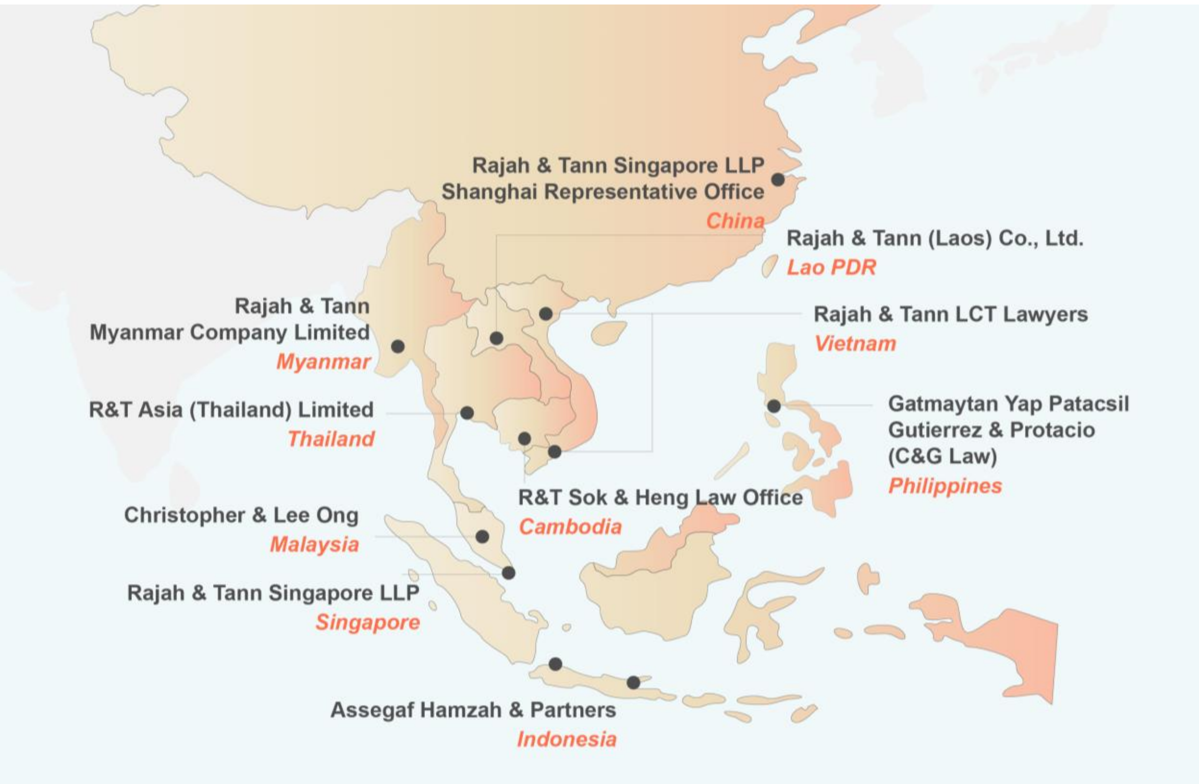

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