

# Dispute hits Uzbeki trade

*Arguments between an Uzbeki company and a Swiss grain trading company relating to an international arbitration ruling could ultimately lead to a credit re-assessment of that market and ultimately more expensive trade finance. Jonathan Bell analyzes a wheat supply deal that turned sour.*

When there is a dispute related to a trade transaction, it is normally within the interests of most parties to ensure that the matter is resolved as quickly as possible. In practice however, this rarely happens as there are so many issues to be discussed, argued, and if necessary resolved through arbitration or the courts - as stated in the contract - and any subsequent ruling implemented. So, it comes as great concern for Romak, a Swiss grain trading company, that one year after an arbitration ruling in its favour from the London-based Grain and Feed Trade Association (Gafta), the Uzbekistan company Uzdon has still not paid the \$10.8 million it was ordered to. The case, which could affect Uzbekistan's trade profile, is perhaps a lesson to all commodity traders and exporters in the caution that is required in dealing with trading partners in many of the emerging markets.

## **A complex case**

The case is a complex one, and begins in 1995 when Romak held negotiations on the supply of wheat with the Uzbeki state company Uzkhleboprodukt and representatives of the council of ministers. Following this, Romak (the seller) signed a contract with Uzdon (the buyer), the foreign trade subsidiary of Uzkhleboprodukt, for the supply of up to 50,000 tonnes of wheat with delivery by the end of 1996 with a price of \$235 per tonne. The contract states that the railway bills have to specify the final receiver GAK Uzkhleboprodukt. The four page contract also states very clearly under the heading 'arbitration': "The parties will endeavour to settle any disputes in a friendly way. But in case it should be impossible to reach a mutually acceptable solution of any such disputes the case to be submitted for arbitration to Gafta, London, for final and binding arbitration as per rules of Gafta no.125." The contract was issued in Russian and in English, both having equal legal value. The final clause above the signatures on the contract specifies: "The present contract is in force from the moment of its signing by both parties and is valid until complete execution of their obligations by both parties." The contract is signed by Dan Pletscher, general director of Romak, and Bakhtiyar M Kadyrov, general director of FTC Uzdon. A letter of July 10, 1996, the buyers addressed a 'Letter of Guarantee to Sellers' which was signed by Uzdon and countersigned by Uzkhleboprodukt - and all the details of this are specified in the Gafta award of arbitration.

The contract was duly implemented by Romak with instructions from Uzkhleboprodukt to deliver at least 40,000 tonnes of wheat in July/August 1996 against a guarantee that the appropriate letter of credit, payable in January 1997, would be opened by 10 October 1996, at the latest. Romak delivered 40,600 tonnes of Kazakh wheat to the Uzbeki border as agreed, with the original documentation, including railway bills, showing that the wheat was shipped by Romak to Uzkhleboprodukt. There then followed a number of communications from Uzkhleboprodukt/ Uzdon to Romak explaining that delays in the opening of the letter of credit were due to administrative reasons and giving assurances that these would soon be resolved. The delays persisted leaving Romak with no choice but to have its bankers, Credit Suisse, present documents in January 1997 to the National Bank of Uzbekistan for payment. The payment was never made.

Despite numerous communications between the two parties to try and resolve the dispute, Romak felt it was left with no alternative but to take the case to arbitration with Gafta. Uzdon's chief legal adviser R Tulyaganov, made two written submissions to the arbitration panel presenting their case. In the award of arbitration it states the buyers submitted that: "The state is not responsible for the obligations and debts of the state shareholding corporation Uzkhleboprodukt, and vice versa. The government of Uzbekistan had not guaranteed payment and had no obligations towards Romak for the delivery of 40,000 tonnes of grain." The Uzbeks also argued that they had paid a private Uzbeki company called Odil for the wheat which had

been delivered by Romak; and as such Romak should seek payment from Odil instead of Uzdon/Uzkhleboprodukt. Uzdon also claimed that Romak's contract with Uzdon had not been properly registered by the Uzbeki side, and as such had never come into force. It was also argued by the Uzbekis that the registration of the contract was not possible because the necessary quotas were never obtained and such a situation qualified as force majeure, thus negating the contract. The Gafta award of arbitration actually states that: "The contract... was not subject to the issuance of quotas."

However, the Gafta arbitration panel, stated that the contract fell under English law and ruled in Romak's favour and ordered Uzdon to pay \$10.8 million for the delivered. As this has not been paid additional interest has been accruing, and as of August 1998, this figure totalled \$11.6 million; based on an annual interest rate of 8%. But the arbitration panel did reject a penalty clause which was in the initial contract as invalid under English law. Enforcement of this clause would have led to penalties of around \$30,000 each day, meaning that Romak would be due well in excess of \$20 million to date. Gafta declared that Romak had delivered 40,581 tonnes of wheat to Uzdon/Uzkhleboprodukt based on a contract valid under UK law, and should, therefore, be paid by the buyers for the goods delivered.

With any such arbitration there is a standard period allowed for appeals to be made by either side. In this case, as no appeal was made within a 30-day period, the arbitration award became final and binding on 22 September 1997. The Uzbekis have yet to pay (see Euromoney's Project Finance, December 1997, p48), despite the fact that Uzbekistan has signed the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Because of this stance, in January 1998 Uzdon was blacklisted by Gafta for non-payment of the arbitration award. Then in March 1998, some six months after the time limit for an appeal had expired, Uzdon gave notice of appeal through its London lawyers requesting the arbitration panel to exercise its absolute discretion to waive the expired time limit for appeal against the award. Gafta rejected this request for a time extension on the appeal. The Gafta rules allow for the exercise of discretion to waive or extend conditions for appeal, but state that any decision on a question such as this is final, conclusive and binding.

The next event took place on 23 June 1998, when the Economic Court of Tashkent City issued a ruling in a case brought by Uzkhleboprodukt against Odil. Romak was not informed that the court proceeding was taking place. The ruling stated that Uzkhleboprodukt had turned to the court because "Odil had not honoured their payment obligations for the grain delivered by Romak". The court decided that Romak had acted as an agent on behalf of Odil and that payment should be settled between them as Odil had argued "without participation of the State Bodies". To impartial observers it will seem strange that this court case took place without any notification to Romak.

A Romak spokesman in Geneva believes that this latest event in Tashkent is irrelevant. "This was an international contract under UK law for delivery to the Uzbek border. Neither the Uzbek legal system nor the economic court of Tashkent city should have anything to do with it. The basic facts are quite simple: Romak delivered grain under a valid contract to an Uzbek state company yet has not received payment. Both sides submitted their arguments to an independent international arbitration panel, which then reached this inescapable conclusion and ordered the Uzbeks to pay for the wheat they have received," says the Romak spokesman.

The general manager of Uzdon, Bakhtiyar Kadyrov, describes this case as an "unpleasant dispute", and says that the award of arbitration "turned out to be a surprise" for Uzdon. He also stresses that: "To our regret, the arbitrators pronounced their verdict on the base of the invalid contract without considering the matter in the proper way."

He adds that the following points serve as evidence to this. "The contract concluded between Uzdon and Romak provided for deliveries of wheat on CIP terms (freight, carriage and insurance paid to) and the documents, which were submitted to arbitration by Romak evidenced that the wheat had been delivered on

CPT terms (carriage paid). Goods accompanying documents evidence that the deliveries of wheat were made under the contract unknown to Uzdon. Shipping documents such as railway bills and certificates of quality were made out for several receivers and other firms. Meanwhile the contract with Uzdon clearly specified only one receiver," claims Kadyrov.

In addition, says Kadyrov, "According to shipping documents and invoices represented to the arbitration by Romak, the deliveries of wheat had been made since the beginning of February under at least five contracts which had nothing to do with the contract between Romak and Uzdon." He goes on to state: "The volume of wheat claiming by Romak also gives rise to doubts, because they represented documents for only 39,700 tonnes." Having stated these points, Kadyrov adds: "For these reasons we can consider that Romak did not make any deliveries of wheat under the contract with Uzdon. It is very strange that the arbitrators did not take into consideration Romak's written confirmation of making the deliveries under the other contracts, but at the same time they easily counted the deliveries of wheat made by Romak under the contract No.305 of March 26, 1996 and No.413 of June 14, 1996, towards the contract with Uzdon."

But beyond these claims, there are also a number of events which would prompt some questions. In particular, the payment made to Odil from the National Bank of Uzbekistan. "The wheat delivered by Romak was applied by Uzkhleboprodukt to Odil's debt on October 24th 1996, but on precisely that same date we were sent a fax from them apologizing for the late opening of our LC due to late allocation of funds and promising to do so by November 10th of that year," reveals the Romak spokesman.

The latest development in this case has taken place on August 28, 1998, when Uzdon instructed its lawyers to file an application in the London high court to challenge the Gafta award. This application also sets out explanations as to why Uzdon was unable to make an appeal on the Gafta ruling within the specified time period. Among other things the application states that Uzdon had had no previous experience of London arbitration, particularly under Gafta terms. In addition it states that Uzdon did not appreciate the legal effect and consequences of arbitration proceedings, nor that the effect of an arbitration award was finally and conclusively to determine the parties' legal rights. In essence the application states that the Uzbekis wholly misunderstood the nature, significance, course and effect of the arbitration proceedings. On the arbitration and appeal proceedings, Bakhtiyar Kadyrov at Uzdon informs Trade Finance that: "It was our first experience and we had to learn a great deal of shipping documents which had nothing to do with our contract. By appealing the award of arbitration we are seeking for a just award in order not to lose prestige of our young firm and to clear up the essence of the dispute."

### **The implications**

There are a number of important issues which arise from this dispute, not least of which is will there ever be a solution? This is impossible to answer at this stage. For commodity traders and bankers alike, disputes such as this leave a very bitter taste - and colour any future business activities. In hindsight, some casual observers may say that Romak was naive in getting into such an exposed situation in Uzbekistan. In particular, the movement by rail of a soft commodity between Kazakhstan and Uzbekistan is something that needs frequent supervision and inspection of both documents and cargo, as well as constant guarding. On the other hand, Romak firmly believed that in supplying state-owned entities that the trade was backed by the state and carried sovereign guarantees.

Kadyrov at Uzdon stresses to Trade Finance that: "We would like to draw your attention to the fact that Romak at their risk made the deliveries under the other contract and did not want to claim against the due respondent. Instead of settling the dispute in accordance with the actual responsibility of the parties they have been claiming against the company which had not received any wheat and thereby, give the due debtor a chance to avoid the punishment, and the due debtor was clearly determined in the award of the Tashkent economic court on June 23, 1998."

Part of the Uzbeki argument has been that Uzkhleboprodukt is not a state company, and therefore the government of Uzbekistan is not responsible for the debts of Uzkhleboprodukt or its subsidiary Uzdon. This claim has been made by several Uzbeki officials, including Ronald Kennedy, senior adviser to the National Bank of Uzbekistan, in a letter to the Wall Street Journal Europe published December 16, 1997. However, Uzkhleboprodukt was established by a decree of president Islom Karimov of Uzbekistan, as a successor to the former state grain ministry, and its charter states clearly that the government retains majority ownership.

In the early stages of this dispute, Romak hired a lawyer registered with the Uzbeki ministry of justice in Tashkent, who gave a legal opinion stating: "GAK Uzkhleboprodukt enters the composition of the council of ministers of the republic and is accountable to the council. Uzdon is a constituent part of GAK Uzkhleboprodukt." Knowledge of corporate ownership is crucial in any trade deal, and this is an area which is likely to be closely scrutinized by companies in any future dealings with Uzbeki companies. "For the government of Uzbekistan to try to claim that this is a purely commercial dispute between private companies stretches the bounds of credibility. These are state companies, owned and controlled by the government and directly accountable to the council of ministers of Uzbekistan," stresses the Romak spokesman.

On a much wider frame, it has to be asked just what sort of image a dispute like this throws up for others involved in trade and investment with Uzbekistan. Certainly, a good deal of damage has already been done to reputations, and some of the commodity traders are likely to be much more wary of entering into deals without much more highly specified transactional details and risk coverage. Ultimately, these factors could make deals more expensive to arrange, bringing in additional due diligence and lawyer involvement leading to additional contractual detail. Beyond this, there is the potential for the credit rating agencies to look closely at Uzbekistan.

The commercial banks will look to see if there is any announcement from the credit rating agencies, but independently the principal western commercial banks dealing with Uzbekistan are likely to take a dim view of the current situation given that the arbitration ruling is in Romak's favour and that the various Uzbeki parties concerned are not abiding by this ruling. As the spokesman for Romak remarks. As Romak is Swiss-based, it is known that the company approached the Swiss government to try to reason with the government in Uzbekistan. A letter from president Cotti of Switzerland on the dispute and the non-payment of the arbitration award was delivered to president Karimov of Uzbekistan in early March of this year. To date there has been no response to this letter. It is highly likely that further high-level international representation will be sought by Romak to support its case.

### **Key players in the dispute**

**ROMAK** Swiss based grain trading company.

**UZKHLEBOPRODUKT** Uzbekistan state share holding corporation responsible for ensuring grain purchased for the needs of the state. Formerly the State Grain Ministry. Established by a decree of the president of Uzbekistan supported by a resolution of the council of ministers. The government retains a 51% ownership stake, approves management, and directs the activities of the company. Directly accountable to the council of ministers of Uzbekistan.

**UZDON** Foreign trade subsidiary of Uzkhleboprodukt. Uzdon's charter is signed: "approved" by the first deputy chairman of state share holding corporation Uzkhleboprodukt, S.U. Mukhamedzanov. At the time Uzdon's charter was signed (November 20, 1995), the chairman of Uzkhleboprodukt was also the prime minister of Uzbekistan (PM Mulatov).

**ODIL** Uzbekistan-based private trading company with the same ownership as Adil.

**ADIL** Kazakhstan-based private trading company with the same ownership as Odil.

*Note: In the compiling of this report, Trade Finance has also separately asked Uzkhleboprodukt, and the office of the prime minister for their comments on the case. At the time of going to press no response had been forthcoming from these entities.*