QUALITY

Case No. 48 – 2002

Claimants:	Buyers
Respondents:	Sellers
Product:	Indonesian Origin CPO
Contract:	PORAM Contract No. 2 – Joint PORAM / MEOMA FOB Contract for Processed Palm Oil and Palm Kernel Oil Products in Bulk
Year of Award:	2002

ARBITRATORS' FINDINGS

A. Submissions of Claimants

The submissions of the Claimants are dated 6th October 2001 and 10th November 2001.

B. Submissions of Respondents

The submissions of the Respondents are dated 23rd October 2001 and 5th December 2001.

C. Findings

> *"The law has two great objects: to preserve order and to do justice. The two do not always coincide".*

To strike a proper balance between the two is a difficult task. That is the reason to defer our decision on damages and issue our direction of 25th September 2001.

Following this, the Claimants file their claims for damages by adopting, mutatis, mutandis, a submission by their Buyers the third party dated 22nd August 2001.

The present submission is technically wrong and the following are the reasons:

1. Firstly, we are not given the complete submission of the third party. We have this incomplete and partial snap shot dated 22nd August 2001.
2. Secondly, the Claimants bought on PORAM Contract No. 2, which is different from the purchase of the third party. In the present case, arguments on time limit must be based on PORAM rules and not FOSFA International. Pleadings on discretion to override the time bar must also be based on PORAM. Moreover, discretion if given is an individual and not a general judgment. In our case, the appeal for discretion must be based on the Claimants own accentuating circumstances.

   The third party bought FOSFA CIF Europe-delivered, weight and quality. The contract is dated 2nd September 2001 and shipment is afloat. Our responsibility is to consider pleading based on PORAM FOB terms. There are three major considerations.

a. Firstly, the first opportunity of inspection the goods by the Claimants, is during loading Port A, Indonesia. The Claimants did inspect the goods. The surveyors, XYZ say they represent the Claimants. The sampling and analysis certificate reads "Grade of sample: Indonesian CPO". It is dated 30th August 2001. The third party first opportunity to inspect the goods is very different. It is at a far later date and at a different place.

b. Following the above is the second consideration. The third party's arguments of mitigation of damages are based on the arrival of the vessel MV XYZ. The third party's immediate Sellers are TYU Ltd. If MV XYZ were to be used, it might be peculiar to the third party and its immediate Sellers and their CIF delivered quality contract. Why should the basis automatically apply to our FOB shipped quality contract?

c. Lastly is the third consideration. The Claimants could not assume that "the same value would apply" and pass the third party's calculated damages to the Respondents. The string is Respondents / Claimants / Immediate Sellers / third party. However, there are no uniform terms and conditions and no string arbitration. The Respondents did not sell CIF delivered quality to the third party. The Respondents sold FOB shipped quality and are only liable with the four corners of their PORAM contract.

D. Award

Accordingly, we dismiss the claims and the Claimants shall bear the cost of this arbitration as assessed by PORAM.

The Claimants not satisfied with the Award of Arbitration filed an appeal. The Award of Appeal is given below.

OBSERVATIONS AND FINDINGS

Having considered the documentary evidence submitted and the oral submissions during an Oral Hearing on 8th August 2002 at the PORAM Secretariat, and on the basis of the facts presented before us, our observations and findings are as follows:

1. The crux of the matter is whether the cargo was of GMQ (Good Merchantable Quality) at time of loading at the Indonesian port. Ships tank samples taken at the time of loading showed that the normally tested parameters of Free Fatty Acids (FFA), Moisture and Impurities (M&I) were within contractual limits. However the GMQ description of the cargo was not met, as subsequent tests on shipment samples at load port by recognized laboratories showed high levels of hydrocarbons (diesel) not normally found in customarily traded standard crude palm oil. The laboratory reports showed that levels up to 2200ppm of hydrocarbons (diesel) were present in the cargo prior to shipments.

2. There was no concrete proof that the contaminants were not present nor were there any denials by the Respondents that the diesel admixture was not present at time of loading.

3. The Respondents' Surveyor certified that the ship's allocated tanks were clean and suitable prior to the loading of the cargo. Therefore, it must be concluded that the cargo was already contaminated prior to loading into the vessel tanks on 28th August 2001.

4. This is not a case of quality deterioration due to passage of time. It was shown beyond reasonable doubt that prior to loading into the performing vessel's tanks' the cargo of crude palm oil was not of the quality and characteristics of normal crude palm oil in accordance with the terms of contract entered into between the Appellants and the Respondents.

5. The Appeal Board does not suggest there was a deliberate attempt by the Respondents to supply a cargo not conforming to contractual specification including GMQ. It was also clear that the Appellants accepted the cargo good faith under the impression that the cargo was fully in conformity with GMQ before the discovery of the presence of abnormally high levels hydrocarbons (diesel).

6. At this juncture, we would like elaborate on arguments pertaining what is standard crude palm oil and the issue of GMQ.

   a. Standard Crude Palm Oil (CPO)

   CPO that is currently commonly traded is the Standard CPO (MS814:1994) where there are 2 categories:

   - Special quality (SQ)
   - Standard quality (STD)

   Special Quality (SQ) is specific quality CPO where the quality parameters are more stringent and prices higher reflecting exclusive quality. In trading there also more grades, namely:

   - High FFA CPO, and
   - Industrial (Non-Edible purpose) CPO

   High FFA and Industrial CPO are not Standard CPO. Standard Quality CPO, the commonly traded is:

   - Fit for edible and non-edible purposes
   - GMQ and is immediately saleable

   The trade specifications are FFA (as Palmatic) 5% max and M&I 0.5% max.

   The standard CPO must comply with quality specifications and be packed or shipped under hygienic conditions in accordance with public health regulations. This is due to the fact that standard CPO is the raw material for edible products. When CPO is refined or further processed, the bulk is used for human consumption; only the residual by-products are used for non- edible purposes. Among the characteristics, MS 814 specifies the oil to be free from foreign matter, rancid odour and taste. To preserve the quality of CPO, the PORAM / MEOMA FOB contract stipulated under Clause 3 that the CPO is to be shipped in clean,

fit and suitable ship tanks for the carriage / voyage. During voyage, the oil must be kept at temperatures according to specific (IASC/PORAM) Heating Instructions. Heat should be applied gradually. The instructions stipulate, among others, that "A sudden increase in temperature must be avoided as it will almost certainly result in damage to the oil".

b. Good Merchantable Quality (GMQ)

From the foregoing, though Standard CPO is not warranted to be suitable for any specific end use or to conform to any particular analytical criteria extracted from Clause 2 of the PORAM Contract No. 2, Sellers and Buyers commonly trade CPO within standard quality specifications fit for the purpose or purposes for which goods of that kind are commonly transacted at the market price. If Buyers intend to buy CPO for non-edible use, CPO of inferior specifications is available at a lower/discount and price to Standard CPO. GMQ, therefore, engulfs certain aspects to which the goods must comply which in the case of standard CPO the common usage as raw materials for the production of edible grades and the residuals as non- dibble graded. In no instances, contamination with foreign matter as in this case diesel, allowed and render the goods still in its original character and suitable for its normal use.

7. Circumstantial evidence was strong as there were many instances of shipments where diesel contaminations of crude palm oil were reported at the material time. Admission of such practices by the Indonesian Authorities was also widely publicized during the period in question.

8. The question of whether the contract is FOB or CIF is irrelevant, and the Sellers must accept responsibility for its condition at time of shipment, unless proof can be tendered that subsequent deterioration had taken place after the cargo have passed over the ship's rail or during the journey.

9. Waiver of time limit on quality claim was exercised by the Appeal Board due to the special and unusual circumstance pertaining to the case. The Appeal Board would have invoked the 21 calendar days' time limit had the quality dispute only concerned the specifications of FFA and moisture. The presence of hydrocarbon (diesel) is not normally tested for and visual detection is not possible. Only specific analysis can be relied upon to detect it and was accordingly carried out within reasonable time.

10. Based on the evidence and the circumstance of the case, we find the Respondents to be at fault and we accordingly set aside the Arbitration Award dated 18th January and award the case in favour of the Appellants.

THE MEASURES OF DAMAGES AND COMPENSATIONS

1. The Appellants cannot reject the cargo as the cargo has been resold and even partly consumed. In our opinion there is no basis for claims on the cargo that has been consumed by end receivers. The total consignment shipped was 7,140 MT of which 2,677 MT (inclusive of 341 MT processed into Refined Hardened Palm Oil) were delivered to end receivers.

2. Consideration for damages can only be based on the transaction between the Appellants and the Respondents as subsequent sales terms were not similar. The Respondents sold the cargo on PORAM FOB terms whereas the subsequent sales by the Appellants were on CIF EU-1 FOSFA terms. Therefore, the extent of the claims would not take into consideration of damages suffered by the sub Buyers. The sub-Buyers had also in this case consumed the oil who in all probability did not notice any form of contamination at first .Subsequently, the Respondents cannot be liable for goods accepted and consumed. Damages shall, therefore, be limited only to the 4463 MT unutilized quantity still bulked in the tanks at the time when the contamination was discovered.

3. The salvage value of the contaminated cargo would be based on down grading the cargo to the next best use. In this respect, the Appeal Board is of the opinion that the CPO falls under industrial (non- edible purposes) CPO. Taking into account the fact that industrial CPO is not commonly traded and to also account for mitigation of losses, we have arrived at the following calculation to determine the price of industrial CPO pertaining to this case:

   Average of FOB Prices of CPO 7th – 13th October (5 trading days)
   Minus

   Average of FOB Prices of PFAD 7th – 13th October (5 trading days)
   Divide by 2

   Result - US$62.20 PMT

   The value of the industrial grade CPO is taken to be at a discount of US$62.20 PMT over Standard CPO.

4. The prices determined above are from the PORAM Price Settlement Committee from the 7th October 2001 onwards which is the next trading day upon completion of discharge of the cargo on the 6th October 2001. We are of the opinion that the Appellants should exercise care to determine acceptability of the cargo within reasonable time, i.e. upon completion of discharge and to mitigate losses, determination of the cargo value is reasonable within the next trading week i.e. 5 trading days. As there were no exact values of industrial CPO at any material time (trade value very much depends on the specific quality character of individual cargo) we have concluded that a fair discount value would be half- way between standard CPO and PFAD which is the by-product of CPO refining and of the lowest value / grade.

5. We stressed that in mitigating losses, both parties should be allowed reasonable conditions. Contractually the parameters are FOB contracts on PORAM Contract No. 2 terms. Time is of the essence and it is not fair to parties involved to delay actions due to ignorance or any other reason beyond normal and customary practice. The receiving party cannot take for granted that the cargo received is of normal standard conditions and as routine cases. The onus is on the receivers to determine acceptability and once accepted, there is no recourse. Hence our opinion on the portion handed down to sub-Buyers. It is also proper to dispose the balance cargoes within reasonable time and in all urgency in order to mitigate losses. After all, in the

order of the transactions either partly did not demonstrate any inclination towards bad intentions.

6. Based on the above, we also disallow the claims on ancillary costs as the contract is on FOB basis.

THE AWARD

Accordingly, we vary the Award of the Arbitral Tribunal and order that the Respondents pay the Appellants within fourteen (14) calendar days the following sum:

Damages arising from breach of contract:

US$62.20 PMT x 4,463 MT = US$277,598.60

We further Award that the costs of this Appeal as assessed by PORAM including the fees of the Appeal Board be shared equally between the Appellants and the Respondents.

If payment is not made within fourteen (14) calendar days from the date of this Award, interest at 8% per annum is to accrue from the day immediately after the Award date till the date of actual payment.