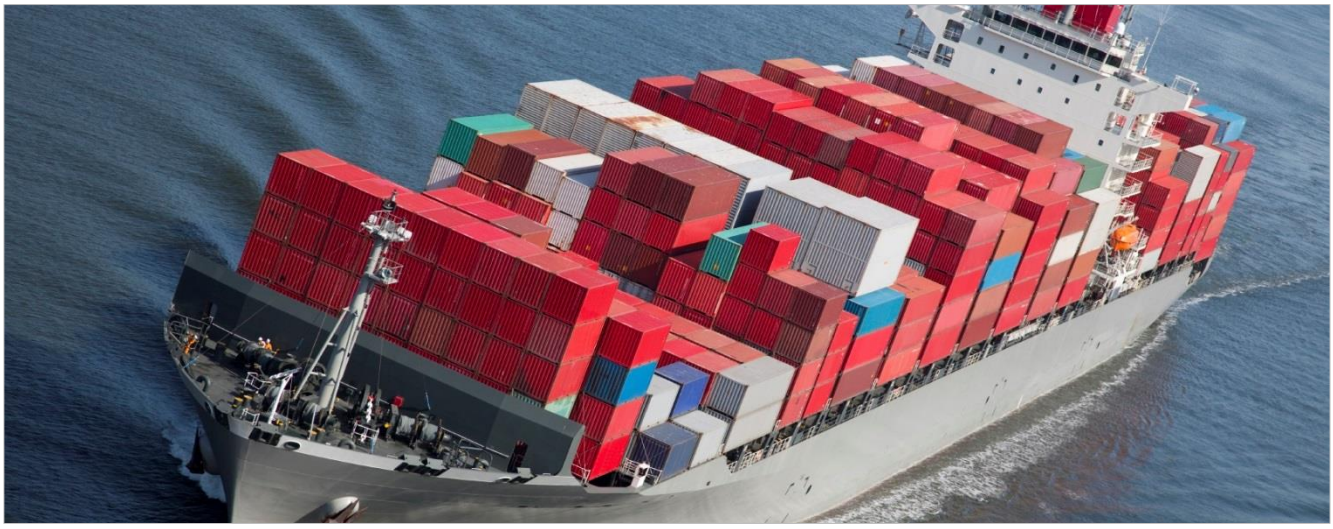
ONC The Voyager
March 2016



## Cover Story

# OW Bunker Crisis Saga – Nature of Bunker Supply Contract Reinforced

### Introduction

As discussed in our previous newsletter "*The Aftermath of the OW Bunker Crisis – Is Bunker Supply Contract a Sale of Goods Contract?*", the ruling of the English Commercial Court on the OW Bunker Crisis was not the end of the story. The case was subsequently brought to the English Court of Appeal in *PST Energy 7 Shipping LLC, Product Shipping & Trading S.A. v. O.W. Bunker Malta Ltd and ING Bank N.V.* [2015] EWCA Civ 1058, which upheld the Commercial Court's decision. This newsletter will look at the decision of the English Court of Appeal and discuss its possible implication.

### Background

To recap, OW Bunker was once the world's largest supplier of bunkers until its liquidation in late 2014. OW Bunker used sub-contractors to deliver bunkers to its customers' vessels. One of OW Bunker's customers was the owner (the "**Owner**") of a vessel called *Res Cogitans*, who entered into a contract with OW Bunker Malta Limited ("**OWBM**"), a company which is part of the OW Bunker group, for the supply of bunkers (the "**Contract**"). The Contract incorporated OW Bunker's standard terms and conditions which included a retention of title clause stating that ownership of the bunkers do not pass to the Owner until full payment has been made. However, the Contract did expressly contain the right for the Owner to use the bunkers for vessel's propulsion from the moment of delivery. A credit period of 60 days was also provided in the Contract.

OWBM then contracted with its Danish parent company, which in turn contracted with Rosneft Marine (UK), which further contracted with RN-Bunker. Ultimately, RN-Bunker was the physical supplier who actually delivered the bunkers to *Res Cogitans*. Except that Rosneft Marine (UK) had paid RN-Bunker for the bunkers, no other payments were made by any party in the chain.

Subsequently, OW Bunker suffered financial difficulties and ING Bank N.V. ("**ING**") became the

assignee of the debt. Since the Owner had not yet paid OWBM for the bunkers, which had all been consumed by the end of the 60-day credit period, dispute arose as to whether ING was entitled to demand payments on behalf of OWBM from the Owner. Potentially, the Owner had a defence to ING's claim if the Contract was within the definition of a contract of sale of goods under the Sale of Goods Act 1979 (the "**SOGA**").

The dispute was first heard before the arbitral tribunal which held that, since the Contract was not a contract of sale within the scope of the SOGA, ING had a good claim for payment against the Owner. Being dissatisfied with the tribunal's decision, the Owner brought the dispute to the English Commercial Court.

## At First Instance

At the hearing, the key issue to be determined remained whether, at the time it was entered into, the Contract fell within the definition of a contract of sale of goods under the SOGA. Having considered the features of the Contract, in particular the retention of title clause, the period of credit before payment fell due, the permission for the Owner to consume the bunkers in the meantime, and the fact that a portion of the bunkers were likely to have been consumed upon the expiry of the credit period, the Commercial Court found that parties to the Contract had understood that title to the bunkers might never be transferred to the Owner. Therefore, the Commercial Court affirmed the arbitrator's decision and held that the Contract was merely a "bunker supply contract" but not a contract of sale of goods under the SOGA. Accordingly, the Commercial Court held that ING was entitled to recover payments from the Owner notwithstanding the defect in title.

## On Appeal

As mentioned earlier, the Owner did not give up and appealed to the English Court of Appeal. However, the Commercial Court did restrict the Owner's appeal to the question whether the Contract was a contract of the sales of goods within the meaning of the SOGA, and whether ING, stepping into OWBM's shoes, could sue for the price under the Contract. These had formed the main issues on which parties had disputed before the Court of Appeal.

Owner's Arguments

The Owner as the appellant argued that the language used by parties to express their agreement made it clear that that they intended the Contract to be one of sale of goods and their relationship to be that of buyer and seller. It followed that they intended the Contract to be governed by the SOGA. The Owners further submitted that the Contract should be understood as an agreement to sell under which title to the bunkers was to pass to the Owner at a future date, in this case on payment. The fact that by that time the bunkers might have ceased to exist did not matter at all, since the effect of the Contract was that title passed retrospectively. The Owner therefore contended that since OWBM, having never paid its supplier, was unable to transfer title to the bunkers to the Owner, the sale price never became due. As such, any claim by OWBM for the price under the Contract doomed to fail.

Court of Appeal's Ruling

Although the Court did realize that the language of the Contract seemed to suggest that parties were thinking in terms of a sale and purchase of bunkers, the Court did not accept the Owner's arguments. In ascertaining the nature of the Contract, the Court opined that the starting point must be an objective analysis of what the parties had actually undertaken to do. In the present case, the Court found that parties had not undertaken to transfer title to another in return for a money payment. Instead, in light of the commercial backgrounds and the particular features of the Contract as mentioned above, parties had undertaken for delivery of the bunkers.

The Court also rejected the Owner's argument regarding the retrospective transfer of title and

held that it was not possible to transfer property in goods once the same had ceased to exist. Even if the bunkers had only been partly consumed, the Court opined that it was still not possible to transfer title to the whole of the bunkers covered by the Contract. In the circumstances, the Court held that OWBM (and hence ING) was entitled to payment for the bunkers that had been supplied to the Owner and, since the Contract was not one of sale of goods, it did not matter that OWBM was never in a position to transfer title to the bunkers to the Owner.

Splitting the Contract?

As to the nature of the Contract, the Court of Appeal did not merely stop at ruling that the Contract was not a contract of sale of goods; rather, the Court went further and held that the Contract is one under which bunkers were to be delivered to the Owner as bailee with a licence to consume them for propulsion of vessel, coupled with an agreement to sell any quantity remaining at the date of payment in return for money consideration. It is interesting to note that this approach of "splitting" the Contract was not first considered by the Court of Appeal, for it had been previously rejected by both the tribunal and the Commercial Court.

## Implications

With the Court of Appeal affirming the decisions of the tribunal and the Commercial Court, the position that the Contract in the present case is not a contract of sale of goods is further reinforced. Given the possibility that the majority of bunker supply contracts are drafted in a way similar to the Contract in the present case, it would mean that many ship owners will not enjoy the protection provided under the SOGA. What's more, ship owners might be forced to pay twice for the bunkers, on the basis that both the bunker seller and its subcontractor, being the physical supplier, might have a good claim against them. It is therefore not surprising that the Court of Appeal's decision has attracted criticism from ship owners as being uncommercial and harsh to bunker buyers.

In addition, under the "split contract" analysis, the bunker supply contract might be treated as one of sale of goods as far as the remaining bunkers at the time of payment are concerned. It therefore creates uncertainty as to the extent to which and the time from which the SOGA is applicable to those bunker supply contracts.

Furthermore, as mentioned in our previous newsletter, the Sale of Goods Ordinance (Cap. 26) in Hong Kong closely resembles the SOGA. As such, this decision would affect ship owners which have dealings in Hong Kong and legal advice should be sought if they have concerns over the nature of the bunker supply contracts they enter into.

We shall wait and see whether the Owners will further appeal against the Court of Appeal's decision to the English Supreme Court.

### Container throughput growth in China falls to record low

According to China Ports & Harbours Association, China's container ports throughput, weighed down by dismal export and import results, was up by only 0.3% compared with the level a year ago, which is the lowest growth rate since 2010. Analyst explained that the reasons are two-fold (1) the softening economy in China's largest trade partner the US dampened demand for Chinese export cargoes; and (2) a murky world economy has fuelled more protectionism, and hence hit global trade growth.

The slow growth casted shadows over the industry prospects this year. Generally ports in China was hit by drop in box handling, though some still managed to improve their performance substantially against the difficult market. For example, the port of Ningbo-Zhoushan has replaced Hong Kong as the world's fourth-busiest box port in 2015.

### Maersk Line picks Hong Kong for Asia region HQ

The world's largest container shipping line, MAERSK Line, has planned to reduce the regional offices by merging its Asia Pacific (Southeast Asia and Oceania) and North Asia (China, Korea and Japan) regions. The newly combined Asia Pacific region's head office will be in Hong Kong. The act is to enable simpler and more standardised processes, resulting in a leaner organisation with increased transparency and alignment. Since last year, the company has announced its plan to reduce land-based workforce and to postpone investments in new capacity.

### JES to sell shipbuilding business to Hong Kong investor

The China-based shipbuilder, JES International, is to dispose of its debt-ridden shipbuilding business for just USD$500,000 to Hong Kong Victo International, a private-owned asset and equity restructuring firm. The sale will lead to an estimated loss of RMB850.2m (USD$130m), yet all interested investors of the company are willing to invest only if the disposal subsidiaries are no longer part of the company. If the company is unable to obtain a viable new business, it may be delisted by the Singapore Exchange.

Amid a depressed shipbuilding market, restructuring or bankruptcy of Chinese yards is increasing. Hong Kong-listed Rongsheng, currently known as Huarong Energy, is also trying to dispose of its shipbuilding business.

### China Cosco Shipping Group eyes top tier in global container shipping

The new state-owned giant, China Cosco Shipping Group, which is a new entity created by the merger of China's two largest shipping conglomerates Cosco and China Shipping, announced that they will create a Chinese fleet that can match its western rivals and hold greater sway over the world container shipping arena.

According to its general manager Wan Min, their containership fleet currently ranks fourth in capacity term and it is expected that it will increase to 2m teu in 2018, with upcoming newly build ultra large containerships, and by then, it will jump from the second tier to the top tier. The new chairman of the Group is ambitious enough to aim at outing the power imbalance in the shipping world between the Eastern and Western hemispheres as the current three largest carriers are all western companies and control 40% of the shipping capacity. The merger has paved the way for a true global expansion for the Group.

### *Nolan and 42 others v Tui Uk Ltd*

Central London County Court, HHJ D Mitchell, 15 October 2015

On 2 May 2009 Mrs Nolan and 1,699 other passengers headed for Thomson Spirit which would arrive at Newcastle on 16 May 2009. During the course of the cruise at least 217 people, including crew members, were affected by gastroenteritis. Some passengers thus sued for personal injury while others sued for damage and disappointment as a result of an alleged breach of contract. In order to succeed, the plaintiff passengers must prove fault by the contractual carrier or the performing carrier and the defendant would be vicariously liable under the Athens Convention.

The Athens Convention of 1974 provides that fault or neglect of the carrier shall be presumed if personal injury arose from or in connection with a defect in the ship. The judge held that a presence of the gastroenteritis virus due to insufficient cleaning could not trigger the presumption of fault or neglect of the carrier under the Athens Convention because "defect of a ship" in the Convention was to be interpreted as referring to only the navigational and structural aspects of the ship, such as malfunction or failure in equipment, steering or mooring etc. As a result, the claims were dismissed.

***Glencore International AG v PT Tera Logistic Indonesia, PT Arpeni Pra***

[2016] EWHC 82 (Comm), Queen's Bench Division, Commercial Court, Mr Justice Knowles, 29 January 2016

The parties entered into four separate contracts for the charter of floating cranes to enable the Appellant to load coal on vessels at anchorages. The contracts imposed money obligations on each party and disputes arose on such obligations which led to two arbitrations. The owners gave written notice of the commencement of arbitrations "in respect of their claims under this contract" and "in respect of claims under this contract" (without the word "their") in the first and second arbitration respectively, while the charterers appointed a second arbitrator "in relation to all disputes arising under the [contract]" in both arbitrations. When the charterers served its defence and counterclaim, the limitation period for bringing their claims under the contract had expired. The majority of the tribunal found that the counterclaims were time-barred.

The charterers appealed. The issue is, whether a reference to "claims" or "all disputes arising under the contract" in a notice of appointment of an arbitrator suffice to interrupt the running of time in respect of a counterclaim for the purpose of s.14(4) of the Arbitration Act 1996 (the "**Act**"). The Court held that in the circumstances where a claim and counterclaim arise from the same set of facts giving rise to a balance of accounts or netting-off under a contract, references in the notices of appointment of arbitrator to "claims" and to "all disputes arising under the contract" will ordinarily suffice to interrupt the running of time in respect of a counterclaim for the purpose of s.14(4) of the Act. In this case, under the contract, delay was capable of giving rise to money obligations on either side of an account, so any claim was likely to be in the nature of an account with a net sum falling for payment, and it was not commercially likely that the parties intended that claims and counterclaims would be separate and determined by different tribunals. Therefore, the appeal was allowed.

***Fulton Shipping Inc of Panama v Globalia Business Travel SAU (formerly Travelplan SAU) of Spain (The New Flamenco)***

[2015] EWCA Civ 1299, Court of Appeal (Civil Division), Lord Justice Longmore, Lord Justice Christopher Clarke and Lord Justice Sales, 21 December 2015

The claimant owners time-chartered the cruise ship New Flamenco to the defendants. The defendants had disputed an agreement extending the charter by two years and redelivered the vessel. Owners treated charterers as in anticipatory repudiatory breach and accepted the breach as terminating the charterparty. Shortly after the redelivery, owners sold the vessel for US$23.7 million. As the economy was not good at the time, there was a significant fall of the value of the vessel from the sale date to the original redelivery date (around US$7 million difference). The owners claimed damages for loss of profits during the additional two-year charter.

The issue before the Court of Appeal is that whether that difference constituted a benefit which, on principles of mitigation and avoidance of loss, should be brought into account in the owners' claim for the charterers' breach of contract by making an early redelivery. The Court held that it should, if the acquisition of the benefit arose out of the consequences of the breach in the ordinary course of business and by way of mitigation of the claimant's loss. It is not a universal rule that market fluctuations over the period of a time charter should never be taken into account.

### *The "Chem Orchid"*

[2016] SGCA 04, Singapore Court of Appeal, Sundaresh Menon CJ, Chao Hick Tin JA, Andrew Phang Boon Leong JA, Judith Prakash J and Quentin Loh J, 20 January 2016

The case concerns a vessel *Chem Orchid* which was leased by the owners HKC to Sejin on a demise charter. The lease agreement is governed by South Korean Law. Due to unpaid debts by Sejin, the respondent creditors arrested the vessel. HKC sought to set aside the respondents' in rem writs by arguing that the admiralty jurisdiction was not properly invoked because the demise charter had been terminated before the writs were issued. The lower court decided to set aside the arrest but it was overturned by the High Court. HKC further appealed.

The Court of Appeal held that in relation to the issue of the Court's jurisdiction, the plaintiff must establish on the facts that it has a prima facie case and the issue would be subject to consideration in subsequent proceedings with full evidence, but if full evidence was heard and the standard of the balance of probabilities was met, the decision would be final. In the present case, HKC's jurisdictional challenge had only been based on affidavit evidence, that is, on a non-conclusive prima facie basis, so HKC was actually attempting to appeal against an order refusing to strike out the action. Therefore, the appeal by HKC was dismissed.

# Arresting Vessels – When and How?

## Can one arrest a vessel in Hong Kong?

Yes, it is possible.

## When can a vessel be arrested?

A vessel can be arrested if the claim gives the plaintiff a right of arrest and an in rem writ has been issued. The ship to be arrested has to be available in Hong Kong waters and there has to be no caveat against arrest has been entered.

It is also possible to arrest a sister vessel if at the time of the application, the owner of the vessel in which the cause of action arose also owns another sister vessel.

## What type of claims can lead to a vessel being arrested?

As mentioned above, not all claims give the claimant a right of arrest. In order to arrest a vessel, the claim must be a maritime claim. The High Court Ordinance (Cap 4) contains a full list of maritime claims which a vessel may be arrested, some examples are:

- a claim as to the possession or ownership of a ship;
- a claim in respect of a mortgage of or charge on a ship;
- a claim for damage done or received by a ship;
- a claim for loss of life or personal injury due to defect in a ship;
- a claim for loss of or damage to goods carried in a ship;
- a claim arising out of any agreement relating to the carriage of goods in a ship or to the use or hire of a ship;
- a claim in the nature of salvage or towage or pilotage;
- a claim in respect of goods or materials supplied to a ship for her operation or maintenance;
- a claim in respect of the construction, repair or equipment of a ship;
- a claim by the crews for outstanding wages;
- a claim arising out of bottomry; etc.

## How to arrest a vessel in Hong Kong?

The procedures for applying for the issue of a warrant of arrest (in Form 3) are in Order 75 of Rules of High Court (Cap 4A).

The applicant has to search the caveat book to see if there is any caveat against arrest of that vessel and file a supporting affidavit / affirmation. The affidavit / affirmation must set out the nature of the claim and nature of the property to be arrested (if it is a ship, states its name and port of registry). Depending on the nature of the claim, the affidavit / affirmation may also need to state the name of the person who would be liable for an *in personam* claim or the owner / beneficial owner / those in control or possession of the ship in which the cause of action arose.

One should also note that if the ship is a foreign ship belonging to a port of a State having a consulate in Hong Kong and the arrest is for possession of the ship or in respect of outstanding crew wages, a notice must be sent to the consul and annexed to the affidavit / affirmation. Leave of the Court is necessary before a warrant of arrest can be issued in these cases.

For enquiries, please contact our Litigation & Dispute Resolution Department:

E: shipping@onc.hk
W: www.onc.hk
T: (852) 2810 1212
F: (852) 2804 6311
19th Floor, Three Exchange Square, 8 Connaught Place, Central, Hong Kong