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To: Transport Industry Operators

Wrongful arrest

The High Court of Hong Kong on 26/8/2011 issued a Judgment about wrongful arrest of a vessel. [HCAJ 105/2011]

On 16/7/2011 the Owners of the vessel "Hong Ming" signed a Memorandum of Agreement (MOA) with a buyer for the sale of the vessel. By MOA cl. 2 the buyer was to pay a deposit of 20% (that is, US\$663,968) within 3 banking days of the MOA's signing. However, as at 26/7/2011, the buyer had only paid a deposit of US\$400,000. Later, the buyer requested a variation of the MOA to reduce the deposit payable to US\$400,000. The Owners rejected this request. Instead, the Owners cancelled the MOA on 27/7/2011. The cancellation was communicated to the buyer. The buyer sought to negotiate further with the Owners to keep the MOA alive. The buyer, for example, offered to guarantee that the balance of the deposit would be paid by 2/8/2011. The Owners rejected the buyer's proposals. The buyer then demanded a refund of the partial deposit which it had paid. But on 28/7/2011 the buyer suggested that the Owners "extend instead of refunding the amount". On 3/8/2011 at 1211 hours Hong Kong time the Owners proposed entering into a new agreement based on similar terms to the previous MOA. Under the proposal the balance of the deposit would be payable by 1000 hours on 5/8/2011. At 1311 hours the buyer countered with a variation relating to bunkers. That evening the buyer applied to Macrae J (the Duty Judge) for the Warrant of Arrest. The buyer filed its Writ on the following day. On 4/8/2011 at 0156 hours the buyer made a revised counter-offer. Among other things, it was proposed that the Vessel be delivered in Hong Kong rather than Singapore and that there be inspection of the vessel in Hong Kong. The buyer's offer stated:-

"[W]e are very very close to get the deal done. Buyers' asked for vessel's inspection because they need to be 100% sure that all machinery of the vessel are in working condition because place of delivery change and the distance to the place of beaching is almost double. Please try to provide me with position for inspection and agents asap in order to arrange immediately."

By email at 1012 hours the Owners replied that it would not be possible to bring the Vessel to Hong Kong. At 1712 hours the buyer insisted on inspection in Hong Kong. The buyer's email stated:-

"We are ready to all terms and price offered at Delivery Hong Kong At this stage we hereby confirm that our previous MOA stands Null and Void and please ask owners to return our deposit money urgent."

The Owners then changed their mind and agreed to inspection of the Vessel in Hong Kong. On 14/8/2011 the Vessel arrived in Hong Kong for inspection. It was arrested by the buyer at that point.

The Writ alleged a claim for possession or ownership of the Vessel arising out of the original MOA with the buyer. In the alternative, the Writ sought a refund of the buyer's deposit or damages.

High Court Ordinance (Cap. 4) (HCO) s. 12A(2) does not include claims arising from contracts for the sale of a ship or a claim by a buyer for breach of a contract for the sale of a ship as giving rise to a right to arrest the ship. The 1952 Arrest Convention does not include such claims either.

In the application for the Warrant of Arrest, it was asserted that the buyer's claim fell within HCO s. 12A(2)(a), namely, a claim to the possession or ownership of a ship or to the ownership of any share therein. The Judge did not think that the buyer could claim such possession or ownership. The original MOA with the buyer had been terminated as a result of the buyer's failure to pay the full deposit. It followed that property in the ship must be fully vested in the Owners. There could be no prospect of obtaining specific performance of a contract which had been terminated. It could not therefore be argued (even speculatively) that a right of specific performance gave rise to some sort of equitable interest in the vessel.

It was alleged by the buyer that the payment of part of the requisite deposit gave some sort of interest in the vessel. The Judge disagreed. The full deposit was not even paid. In that circumstance, the Judge did not understand how the payment of part of what should have been paid gave rise to any proprietary or possessory interest in the ship. Under the MOA, the deposit was expressly payable as security for the performance by the buyer of its obligations. Under the MOA, upon the buyer's failure to comply with the MOA, the deposit would be released to the Owners as sellers by way of compensation for the buyer's default. On the terms of the MOA alone, it could not be asserted that the retention by the Owners of the part deposit paid somehow enabled the buyer to assert a proprietary right in the ship to get the deposit back. The stark reality was that the buyer was the wrongdoer. It failed to do what it ought to have done under the MOA, namely, pay the full deposit. The buyer having failed to pay the full deposit within the stipulated time or

any reasonable period thereafter, the Owners were entitled to treat the original MOA as terminated. The Owners cancelled the MOA accordingly. The Owners in consequence were further entitled to treat the part deposit paid as forfeited.

The Owners and the buyer then entered into negotiations for the subsequent resurrection and variation of the MOA. Those negotiations might or might not have resulted in a concluded agreement. But there had been no breach by the Owners of the negotiation or any fresh agreement concluded as a result. It was understood by all as a result of the negotiations that there would be a sale and delivery of the Vessel in Hong Kong subject to inspection. The Owners were seeking to comply with that understanding by having the Vessel sail to Hong Kong for inspection. The Owners have not breached any stipulation in the negotiations. There could be no basis for a claim against them, much less a claim *in rem*, based on the breach of the negotiations or any concluded agreement made as a result.

The Judge added that he saw no basis for characterising any ensuing communications or negotiations between the buyer and the Owners (i.e. following the buyer's failure to pay the deposit) as amounting to a "waiver" of the Owners' cancellation of the original MOA.

It followed there was no basis for the buyer's claim. The warrant of arrest should not have been issued.

There were further difficulties with the buyer's case.

At the *ex parte* stage it was not drawn to Macrae J's attention that conventional wisdom was that the buyer's claim did not fall within the claims giving rise to a right of arrest. It was simply asserted that the buyer had a right or interest in the vessel. The judge was not provided with a fair, even-handed analysis of the authorities in connection with how such interest was alleged to arise. Nor was the Court informed (as it ought to have been) of the later negotiations which took place following the issue of the Warrant of Arrest. The duty of full and frank disclosure is a continuing one. The Court, however, was not informed that, on the day following issue of the Warrant, the buyer accepted that the original MOA had been terminated and was negotiating fresh terms with the Owners. That in the Judge's view was material as to whether the buyer had any cause of action. On material non-disclosure alone, the Judge would have set aside the Warrant of Arrest.

At the time when it applied for the Warrant, the buyer did not seem to have seriously addressed its mind to any of the considerations discussed above. It instead proceeded in what might be described as a "cavalier fashion". That, according to *The Maule* [1994] Civil Appeal No. 187 of 1994 (11 July 1995) could amount to "malicious negligence". The chronology of events gave rise to a strong inference that the inspection requested by the buyer was merely a ruse to bring the Vessel into Hong Kong waters so it could be arrested here. The arrest could then be used by the buyer as leverage or pressure in the negotiations with the Owners for a revised MOA on terms favourable to the buyer or for the return of the part deposit previously paid by the buyer. Such motive coupled with a cavalier attitude would amount to a misuse of the arrest process. It would at least constitute the "malicious negligence" to which the Court of Appeal has referred in *The Maule*. The buyer's tactic could not have been a sincere use of the arrest mechanism to enforce a genuine *in rem* claim. That conduct would, to the Judge's mind, justify an inquiry into the damages suffered by the Owners as a result of the wrongful arrest. In this connection, the buyer was aware, when applying for the Warrant, that the Owners were also negotiating with other parties for the sale of the Vessel. Arrest might well have affected the Owners' dealings with those other parties. The Owners had asked in their summons for an inquiry as to damages for wrongful arrest. In the Judge's judgment, they were entitled to such inquiry.

The Warrant of Arrest would be set aside. The Writ would also be struck out.

Please feel free to contact us if you have any questions or you would like to have a copy of the Judgment.

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