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To: Transport Industry Operators

Air cargo misdelivery

The Hong Kong Court of Appeal issued a Judgment on 17/7/2014 holding a Hong Kong forwarder liable to pay US\$852,339 plus costs and interest (as damages for conversion) to an Indian bank in an air cargo misdelivery case. [CACV 282/2012]

This was an appeal against the judgment of the High Court dated 4/12/2012 by which the High Court dismissed the claims of the Indian bank against the Hong Kong forwarder for damages for conversion (by misdelivery) of a cargo of diamonds, on the ground that the Indian bank did not have the requisite title to sue to enable it to maintain a claim in conversion.

The factual background to the claim can be summarised as follows:-

- (1) The Indian bank provided banking facilities in India to an Indian diamond supplier. Such facilities were evidenced by a Working Capital Consortium Agreement dated 23/10/2006, and a Joint Deed of Hypothecation of the same date.
- (2) Pursuant to the first of these agreements, the Indian bank made finance available to enable the diamond supplier to acquire diamonds and other raw materials for the manufacture of finished diamonds for export.
- (3) With the Indian bank's consent, the diamond supplier sold three batches of diamonds ("the Diamonds") to a buyer in Hong Kong. The payment terms were documents against acceptance 120 days after sight – i.e. the Indian bank (through its Hong Kong agent) would present drafts of 120 days' tenor (drawn by the diamond supplier on the buyer) to the buyer for acceptance, and that the buyer would only be entitled to take delivery of the goods after having accepted the drafts drawn on it.
- (4) The Diamonds were shipped to Hong Kong by air. The diamond supplier engaged an Indian freight forwarder to make arrangements for the shipment. The shipments were effected under three House Air Waybills issued by the Indian forwarder, respectively dated 28/7/2008, 6/11/2008 and 12/11/2008. The House Air Waybills recorded the diamond supplier as the shipper, the Bank of East Asia ("BEA") (the Indian bank's agent and receiving bank in Hong Kong) as the consignee and the buyer as the notify party.
- (5) The House Air Waybills were given by the Indian forwarder to the diamond supplier, who in turn handed them over to the Indian bank. The Indian bank sent them on to BEA, but later received them back, and remained in possession of them.
- (6) According to the House Air Waybills, the Hong Kong forwarder was the contracting party in respect of the contract for carriage of the goods covered by the House Air Waybills.
- (7) The diamonds were actually carried from India to Hong Kong by Jet Airways, under Master Air Waybills issued by Jet Airways showing the Indian forwarder as the shipper and the Hong Kong forwarder as the consignee.
- (8) When the Diamonds arrived in Hong Kong, they were collected from Jet Airways by the Hong Kong forwarder, who subsequently released them to the buyer without having first obtained the consent of the Indian bank or BEA, and without the buyer having accepted the drafts drawn on it. As a result, the buyer was able to obtain of the Diamonds without paying for them, resulting in the Indian bank losing such security as it had over the Diamonds.

In the High Court, the Indian bank sued the Hong Kong forwarder for conversion, claiming that:-

- (1) it was the pledgee of the Diamonds, and as such had the necessary proprietary, or at least possessory, interest in them to entitle it to bring the claim; and alternatively

(2) it was entitled to sue for misdelivery under the Warsaw Convention or Amended Warsaw Convention (relying in particular on Article 13 thereof).

The High Court rejected both of these arguments:-

- (1) In relation to the argument that the Indian bank was the pledgee of the Diamonds, the High Court concluded that in order to constitute the Indian bank a pledgee (or to perfect the pledge), it would be necessary for the Diamonds to have been delivered to the Indian bank (or for possession of the Diamonds to be transferred to the Indian bank), but that because the House Air Waybills (although naming the Indian bank's agent as consignee) were not negotiable documents of title – either as a matter of law or as the result of custom (none having been proved), the delivery of the House Air Waybills by the diamond supplier to the Indian bank did not amount to constructive delivery to the Indian bank of the Diamonds.
- (2) In relation to the claim based on the Warsaw Convention or Amended Warsaw Convention, the High Court held that this claim was not open to the Indian bank since it had not been pleaded. He also expressed doubt as to whether or not either Convention was applicable in this case, as the misdelivery took place after the completion of the carriage by air, and hence was not within the scope of either Convention.

Before the Court of Appeal, the Indian bank accepted that there could in this case be no claim under the Warsaw or Amended Warsaw Conventions, as the misdelivery had clearly taken place outside the aerodrome, so that the Conventions had ceased to be applicable by the time of the misdelivery. However, the Indian bank submitted that the High Court was in error in concluding that the Indian bank was not the pledgee of the Diamonds, contending that the case in question was indistinguishable from the decision of the Privy Council in *Kum v Wah Tat Bank Ltd* [1971] 1 Lloyd's Rep 439, in which it was held that the delivery of goods to a carrier, consigned to a bank, amounted to a constructive delivery of the goods to the bank, so as to perfect a pledge over the goods which it earlier had been agreed should be given to the bank. The Indian bank also submitted, as a fall back position, that even if it were held that the Indian bank's pledge had not been completed, the diamond supplier had, by naming the Indian bank's agent BEA as consignee on the House Air Waybills, parted with the immediate right of possession of the Diamonds in favour of the Indian bank, thus conferring upon the Indian bank a possessory title sufficient to sustain a claim for conversion. Finally, the Indian bank suggested that as the Warsaw and Amended Warsaw Conventions had the force of law in Hong Kong, the right of the consignee under Article 13(1) to have the cargo delivered to him also gave the Indian bank (through its agent, BEA) the necessary possessory title to mount a claim in conversion, and that this being a matter of law, it was not strictly necessary to plead it.

In the Court of Appeal's view, the Indian bank was correct in its contention that it had become the pledgee of the Diamonds, and as such, was entitled to bring its conversion claim against the Hong Kong forwarder.

Articles II.1 and II.5 of the Working Capital Consortium Agreement provide, so far as material, as follows:-

"1. The Borrower agrees that the said Facilities together with interest, compound interest, additional interest, liquidated damages, costs, charges, expenses and other moneys payable in respect thereof will be secured in favour of the said Banks by a first charge by way of hypothecation and/or pledge of the Borrower's Current Assets, namely, Stock of Raw Materials, Semi Finished and Finished Goods, Stores and Spares ... Bill Receivable and Book Debts and all other movables of the Borrower ..."

"5. In respect of the said Facilities granted to the Borrower against pledge of goods, movables and all other assets all such goods, movables and other assets shall be placed in the possession of the said Banks under their control and in such manner that such possession and control may be apparent and indisputable ..."

In the Court of Appeal's view, these provisions clearly amounted to an agreement on the part of the diamond supplier to pledge to the Indian bank its finished goods (in the case in question the Diamonds), although the pledge would not be complete until such time as the Diamonds were placed in the possession (actually or constructively) of the Indian bank.

It further seemed to the Court of Appeal that by delivering the Diamonds to the Indian forwarder for carriage to Hong Kong, under House Air Waybills that identified the Indian bank's agent, BEA, as the consignee, the diamond supplier were directing the Indian forwarder to deliver the Diamonds to BEA, so as to constructively deliver them to the Indian bank. That an arrangement by which the owner of goods delivers them to a carrier consigned to a bank to whom the owner has agreed to pledge the goods amounts to a constructive delivery to the bank so as to perfect the pledge is established by the decision of the Privy Council in the *Kum* case.

There, Lord Devlin, having observed that in a contract of sale, delivery would prima facie occur on shipment, went on to consider whether the position should be any different under a contract of pledge, and expressed the view that where the contract was silent as to the mode by which delivery was to be accomplished, it was difficult

to see why the same presumption should not apply, going on to say that the circumstances of the case in fact strongly supported the applicability of the presumption. Lord Devlin suggested that there were three possible occasions for delivery to a pledgee, these being on shipment, by attornment during the voyage, or by physically delivering the goods to the pledgee at the destination, and explained that of the three, the most sensible, particularly where money had already been advanced, was on shipment, since that would provide the bank with the security for which it had stipulated at the earliest point in time. By contrast, attornment during the voyage would be unnecessarily complicated, as it would involve a transfer of possession during the voyage, which would require fresh instructions to be given to the carrier, which the carrier would have to accept. Delivery by way of physical delivery at the destination made little sense, since in the normal case, where the buyer honoured his payment obligations, the bank itself would never take delivery of the goods, with the result that the contract of pledge would, in normal circumstances, never be completed, and would leave the bank with no security in the event that the customer obtained the goods without first paying for them.

The factual situation in the case in question was not materially different. The Indian bank had advanced funds to the shipper (the diamond supplier), and would have been concerned to obtain the security of a pledge at the earliest opportunity. There was therefore no reason to treat the delivery by the diamond supplier of the Diamonds to the Indian forwarder, consigned as they were to BEA, as other than a delivery to them as a bailee for the Indian bank.

Unfortunately, the High Court seemed to have led itself into error by focussing on the question of whether the House Air Waybill constituted a negotiable document of title, and concluding that it did not. It would seem that the High Court understood the effect of the *Kum* case to be that the pledge there was completed by the delivery to the bank of the mate's receipts which constituted the shipping documents in that case, on the basis that those documents were, by a custom which had been established on the evidence in that case, negotiable documents of title. This was indeed the basis on which the Malaysian Court of Appeal had found in favour of the bank in that case. But the Privy Council had in fact held that the custom contended for could not be established in the face of the fact that the mate's receipts were clearly marked "non-negotiable". The delivery of the mate's receipts to the bank therefore did not equate to delivery to it of the goods. However, notwithstanding that the Privy Council held that the mate's receipts were not negotiable documents of title, it had no difficulty in concluding that delivery to the carrier of goods consigned to the bank amounted to a delivery to the bank so as to complete the pledge. That this (and not the delivery of the mate's receipts) was the basis of the Privy Council's decision is clear from Lord Devlin's statement (at p. 446 of the judgment).

It seemed to the Court of Appeal that one of the main bases of the Indian bank's claim was that it had been constituted a pledgee of the goods and, as such, had the necessary possessory title to maintain its claim for conversion.

For the foregoing reasons, the Court of Appeal was satisfied that the Indian bank had established that it had become the pledgee of the Diamonds, so as to be able to claim damages for conversion as against the Hong Kong forwarder for its misdelivery of the Diamonds to the buyer, and that the High Court was in error in reaching the contrary conclusion. As to the amount of damages, there did not appear to have been any real dispute but that the value of the Diamonds was, as stated in the Statement of Claim, US\$852,339 (the first shipment being worth US\$248,500.50, the second shipment being worth US\$409,076 and the third shipment being worth US\$194,762.50) and that this represented the measure of the Indian bank's loss.

The Court of Appeal would therefore allow the appeal, set aside the judgment of the High Court, and substituted therefor orders that the Hong Kong forwarder to pay to the Indian bank the amount of US\$852,339 as damages for conversion, together with interest at the commercial rate on the value of each of the three shipments from the date of misdelivery. So far as costs were concerned, the Court of Appeal would make an order *nisi* that the Hong Kong forwarder was to pay the Indian bank's costs both of the Court of Appeal and the High Court.

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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