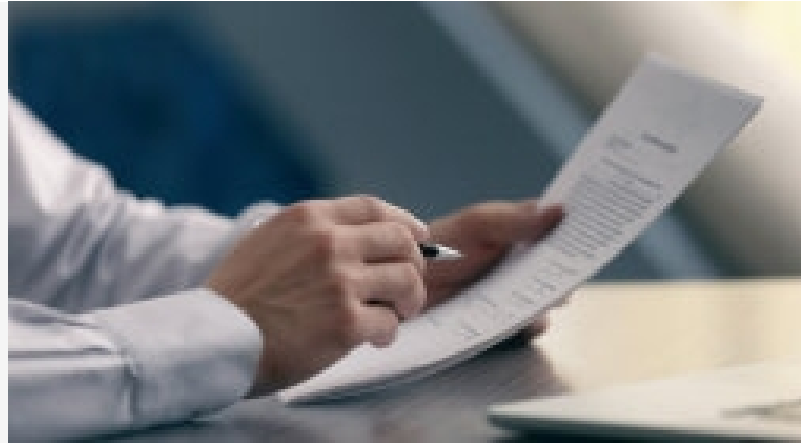


DO ARBITRATION AGREEMENTS IN BILLS OF LADING BIND THEIR HOLDERS?

14 AUGUST 2018 • ARTICLE



Bills of lading are a crucial part of the security package traditionally sought by trade finance providers. However, the nature and extent of the contractual rights and obligations transferred to a finance party holding bills of lading are complex. In addition to substantive rights, bills of lading commonly incorporate agreements to arbitrate all disputes. The English High Court decision in *Sea Master Shipping Inc. v Arab Bank (Switzerland) Limited*¹, which concerned the effect of arbitration agreements incorporated in a bill of lading on its holder(s), therefore provides useful guidance on how these rights and obligations operate in practice.

In this decision, the Court ruled that the holder of a bill of lading which includes or incorporates an arbitration agreement will be subject to the jurisdiction of a tribunal formed under that arbitration agreement. This will be the case regardless of whether they are seeking (or have sought) to exercise any rights under the bill of lading themselves, and even if they are no longer holders of the bill of lading.

BILLS OF LADING UNDER ENGLISH LAW

The rights obtained by and obligations imposed upon the holder of a bill of lading under English law are governed by the Carriage of Goods by Sea Act 1992 ("COGSA 1992").

Under section 2(1) of COGSA 1992, "the lawful holder of a bill of lading... shall (by virtue of becoming the holder of the bill...) have transferred to and vested in him all rights of suit under the contract of carriage as if he had been a party to that contract." Therefore the contractual rights contained in a bill of lading vest in the holder automatically.

In contrast, however, under section 3 of COGSA 1992, the obligations and liabilities contained in a bill of lading only vest in the holder upon them (or their predecessor) taking or demanding delivery of the goods under the contract of carriage.

These provisions make clear that there is, to some extent, a separation of the rights and obligations under the contract of carriage contained in a bill of lading, with rights accruing to the holder before, and separately from, the obligations (which may never vest in the holder at all).

THE SEA MASTER CASE

The *Sea Master* case related to a cargo of soyabeanmeal which was shipped from Argentina on the M.V. Sea Master. Financing for the purchase of this cargo by the charterer, Agribusiness United DMCC (“Agribusiness”), was provided by Arab Bank (Switzerland) Limited (the “Bank”), who took possession of the bills of lading as security. The bills of lading incorporated the terms of the contract of carriage, including an LMAA arbitration clause.

As a result of various complications with the onward sale of the cargo, the vessel was redirected to different ports of discharge on a number of occasions. In order to resolve the issues with the onward sale, the Bank agreed to the vessel owner (the “Owner”) issuing a “switch” bill of lading (the “Switch Bill”) to allow for delivery at a different port of discharge. The Bank surrendered the original bills of lading to the Owner for cancellation and took possession of the new Switch Bill (which was made out to the order of the Bank) as security.

During the time in which the complications with onward sales were being resolved Agribusiness became liable for substantial amounts of demurrage under the Charterparty, which it ultimately failed to pay.

The Bank later commenced arbitration proceedings against the Owner under other bills of lading in respect of other cargo on board the vessel. In response, the Owner counterclaimed under the Switch Bill for demurrage and/or damages for the detention of the vessel that had occurred due to the delays in delivery of the cargo.

The Bank objected to the tribunal’s jurisdiction to hear the counterclaim for demurrage under the Switch Bill. The Bank argued that it was not subject to the arbitration agreement in relation to the Switch Bill because (i) the Bank was not a party to the contract under the Switch Bill, and (ii) it had not made a demand in respect of the cargo, and therefore the liabilities under the underlying contract of carriage had not vested in it under section 3 of COGSA 1992.

The tribunal agreed with the Bank, and held that it did not have jurisdiction to hear the counterclaim. The Owner applied to the High Court to set aside that award as to jurisdiction under section 67 of the Arbitration Act 1996, arguing that the Bank was in fact a party to the Switch Bill, and therefore bound by the arbitration agreement in the contract of carriage in relation to disputes regarding the Switch Bill.

In the appeal additional submissions were made upon the suggestion of Mr Justice Popplewell that the Bank might in fact be party to the arbitration agreement under the contract of carriage by virtue of the fact that (on the Bank’s own case) it had acquired rights of suit under section 2 of COGSA 1992, notwithstanding section 3 of COGSA 1992.

The judge noted that the doctrine of separability² means that it cannot be assumed that a statute such as COGSA 1992 intends to treat rights and obligations under an arbitration agreement in precisely the same way as it treats the other rights and obligations under the contractual arrangements in which the arbitration agreement sits. On this basis, it is therefore possible that the effect of COGSA 1992 on rights and obligations under an arbitration agreement contained in or incorporated into a bill of lading would be different to its effect on the other rights and obligations under that bill of lading.

Mr Justice Popplewell then went on to hold that although the majority of the rights and obligations vested in the parties under an arbitration agreement arise only upon arbitration being commenced, there are other obligations which are not dependant on either party having exercised the option to commence arbitration. In particular, he noted that “irrespective of the exercise of that option [to commence arbitration] by either party, each party makes a promise not to seek to have an arbitral dispute resolved other than by arbitration.” He went on to say that “however one categorises the bundle of rights, obligations or options in an arbitration agreement, they are mutual and interdependent.” Accordingly, he said, “they must operate equally”.

On this basis, Mr Justice Popplewell concluded that he was:

“unable to accept that the intended effect of sections 2 and 3 of COGSA [1992] is to bifurcate an arbitration clause in the contract of carriage contained in or evidenced by the bill of lading into rights and obligations, such as to confer arbitration rights under section 2 and arbitration obligations under section 3.”

Accordingly, he held:

“the operation of section 2 of COGSA involves a lawful holder becoming a party to the arbitration clause in the contract of carriage... the holder is a party to that separate arbitration agreement, with all the consequences which flow from such agreement.”

The judge also held that the Bank’s argument that it divested itself of its rights and obligations under the Switch Bill upon it leaving the Bank’s possession was unsound because once the Bank became party to an agreement to arbitrate the extinguishment of rights under the contract of carriage does not affect the arbitration agreement.

Mr Justice Popplewell therefore concluded that the tribunal did, in fact, have jurisdiction to hear the dispute between the parties.

CONCLUSIONS

The *Sea Master* case contains a useful discussion on the nature of the rights and obligations obtained by a party which is the holder of a bill of lading, although it remains to be seen whether it will be subject to further examination on appeal.

In particular, it makes clear that, whilst the engagement of the substantive rights and obligations under the bill of lading (and attendant contract of carriage) may be split under COGSA 1992, this is not the case for rights and obligations in relation to any arbitration agreement contained within the bill of lading and/or contract of carriage.

Parties who regularly hold bills of lading as security should therefore be aware that doing so may well make them subject to the jurisdiction of a tribunal formed under an arbitration agreement contained therein, even if they are not themselves seeking to exercise any rights under the bills of lading.

WATSON FARLEY & WILLIAMS

It is worth noting that, having found that the tribunal did have jurisdiction to hear the dispute, Mr Justice Popplewell did not consider it appropriate for him to determine what he termed “the Substantive Issue”. The Substantive Issue was the question of whether the Bank was an original party to the Switch Bill, and therefore liable for demurrage under the contract of carriage. This is unfortunate, as it would have been useful to have court guidance on this point. Hopefully the courts will have the opportunity to consider this question in other proceedings in the future.

1 [2018] EWHC 1902 (Comm)

2 This states that an arbitration agreement is separable from any broader agreement in which it sits, meaning that an arbitration agreement can be valid notwithstanding debate as to the validity of the broader agreement.

KEY CONTACTS



ANDREW HUTCHEON
PARTNER • LONDON

T: +44 20 7814 8049

ahutcheon@wfw.com

DISCLAIMER

Watson Farley & Williams is a sector specialist international law firm with a focus on the energy, infrastructure and transport sectors. With offices in Athens, Bangkok, Dubai, Dusseldorf, Frankfurt, Hamburg, Hanoi, Hong Kong, London, Madrid, Milan, Munich, New York, Paris, Rome, Seoul, Singapore, Sydney and Tokyo our 700+ lawyers work as integrated teams to provide practical, commercially focussed advice to our clients around the world.

All references to ‘Watson Farley & Williams’, ‘WFW’ and ‘the firm’ in this document mean Watson Farley & Williams LLP and/or its affiliated entities. Any reference to a ‘partner’ means a member of Watson Farley & Williams LLP, or a member, partner, employee or consultant with equivalent standing and qualification in WFW Affiliated Entities. A list of members of Watson Farley & Williams LLP and their professional qualifications is open to inspection on request.

Watson Farley & Williams LLP is a limited liability partnership registered in England and Wales with registered number OC312252. It is authorised and regulated by the Solicitors Regulation Authority and its members are solicitors or registered foreign lawyers.

The information provided in this publication (the “Information”) is for general and illustrative purposes only and it is not intended to provide advice whether that advice is financial, legal, accounting, tax or any other type of advice, and should not be relied upon in that regard. While every reasonable effort is made to ensure that the Information provided is accurate at the time of publication, no representation or warranty, express or implied, is made as to the accuracy, timeliness, completeness, validity or currency of the Information and WFW assume no responsibility to you or any third party for the consequences of any errors or omissions. To the maximum extent permitted by law, WFW shall not be liable for indirect or consequential loss or damage, including without limitation any loss or damage whatsoever arising from any use of this publication or the Information.

This publication constitutes attorney advertising.