WATSON FARLEY
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WILLIAMS

BRIEFING

NO CROSS-UNDERTAKINGS IN DAMAGES FOR SHIP ARRESTS

AUGUST 2018

- ENGLISH COURT CONFIRMS THAT COUNTER SECURITY IS NOT REQUIRED WHEN ARRESTING A VESSEL
- DAMAGES FOR WRONGFUL ARREST REMAIN LIMITED TO CASES OF BAD FAITH OR GROSS NEGLIGENCE
- IF A SHIPOWNER WISHES TO PLEAD POVERTY THE BURDEN IS ON THEM TO PROVE THAT THIS IS THE CASE

In a recent important decision of the Admiralty Court in London, *NatWest Markets Plc v Stallion Eight Shipping Co. S.A.*,[1] in which Watson Farley & Williams acted for the successful party, the Court upheld the longstanding practice of not ordering counter security following a vessel's arrest, and further confirmed that wrongful arrest damages will only be ordered in the event of an arrest in bad faith or through gross negligence.

This decision provides certainty and clarity on an issue which has been the subject of some academic debate, and confirms the attractiveness of England as a jurisdiction for the arrest of ships.

"THIS DECISION … CONFIRMS THE ATTRACTIVENESS OF ENGLAND AS A JURISDICTION FOR THE ARREST OF SHIPS."

Background

Historically, one of the attractive features of England as a jurisdiction in which to arrest ships is that the arresting creditor does not have to provide counter security for the shipowner's losses in the event that the arrest is shown to be wrongful. Further, even if an arrest is later shown to have been wrongful, the arresting creditor will only be liable in damages in the event that it can be demonstrated that the arrest was made either in bad faith or through gross negligence.

This is in contrast to the many jurisdictions in which it is obligatory to provide counter security, usually in the form of a local bank guarantee or a payment into court, and/or liability to pay damages for wrongful arrest is strict. The obligation to provide

[1] [2018] EWHC 2033 (Admlty)

counter security in particular can make it very inconvenient to arrest a vessel in such jurisdictions, especially at short notice. The formalities for providing counter security can lose the arresting creditor precious time.

The Case

NatWest v Stallion concerned the arrest by a mortgagee bank of a mortgaged ship.

Usually in ship mortgage enforcement cases there is no serious dispute on the merits. However, in this case the shipowner challenged the bank's calling of an event of default and resulting acceleration, and took steps to have the arrest released.

The Application

As a preliminary procedural point, the shipowner sought an order that the vessel be released from arrest unless the bank gave an undertaking to pay the shipowner's damages for earnings during the period of the arrest. Further, they asked that this undertaking be in a form that would cover any loss suffered by the shipowner, irrespective of whether bad faith or gross negligence were later proved.

"THE SHIPOWNER SOUGHT AN ORDER THAT THE VESSEL BE RELEASED FROM ARREST UNLESS THE BANK GAVE AN UNDERTAKING TO PAY THE SHIPOWNER'S DAMAGES FOR EARNINGS DURING THE PERIOD OF THE ARREST."

In doing so, the shipowner relied on a number of articles by commentators, including a former judge, Sir Bernard Eder, criticising the Admiralty Court's long standing practice in this regard. This commentary, they argued, demonstrated that Admiralty Court practice should be changed to bring it in line with court practice when granting freezing (or Mareva) injunctions, where a cross-undertaking in damages is invariably required.

The shipowner argued that this was a just and reasonable order for the court to make because they were not in a position to provide alternative security in exchange for the release of the vessel. This, the shipowner said, put them in an unfair position as, in the absence of such an order, they would be forced to incur considerable losses in order to challenge the arrest with little prospect of recovering those losses if the challenge succeeded. As a result, they argued, they would be at a significant disadvantage to the bank in the proceedings if the order was not made.

The shipowner claimed that the proposed order would resolve this imbalance. They also submitted that such an order would represent a mere "tweak" to the court's existing practice, and that, as the arresting party was a bank, there would be no prejudice to the arrestor in making such an order. Accordingly, the shipowner argued that justice required that the order be made.

The Decision

Giving judgment on the application, Mr Justice Teare accepted that the court had a discretion to order the release of the vessel and/or to place conditions on its continued arrest. He also accepted that as part of this discretion it was, in principle, open to the court to make the order sought.

However, Mr Justice Teare considered that such discretion "must be exercised in a principled manner". In light of this, Mr Justice Teare ultimately rejected the application on the following grounds:

Contra to the entitlement to arrest as of right
Mr Justice Teare noted that, following the decision in *The Vasso*,[2] procedural rules regarding arrest had been specifically changed to expressly state that a party seeking to bring a claim against a vessel may arrest the vessel as of right. It is for this reason that no cross-undertaking is required to be given in exchange for the arrest.

Accordingly, he held that the order sought "would… cut across and negate the principle that a claimant may obtain the issue of a warrant of arrest without providing a cross-undertaking in damages". He went on to say that "that would appear to me to be, in a relevant sense, an unprincipled exercise of [the court's] discretion".

Inconsistent with established practice
Mr Justice Teare also noted that if such an order were made in this case it would undoubtedly be equally appropriate to make a similar order in a great many other cases.

"THE RESULT OF GIVING SUCH AN ORDER WOULD BE 'A VERY SUBSTANTIAL CHANGE AS TO THE CIRCUMSTANCES IN WHICH AN ARREST CAN BE OBTAINED AND MAINTAINED... OVERNIGHT'."

He held that there was nothing "unusual or exceptional" in this case. Accordingly, the result of giving such an order would be "a very substantial change as to the circumstances in which an arrest can be obtained and maintained... overnight… not, as it seems to me, a modest development or a 'tweak'".

Mr Justice Teare also commented that such a change would have significant implications for the shipping industry. In particular, he suggested that it might discourage parties with valid claims from arresting vessels, and that it might also discourage P&I Clubs and hull underwriters from issuing undertakings to avoid the arrest or secure the release of vessels.

Contrary to prior authority
Mr Justice Teare then went on to discuss what he considered to be the relevant authorities on this issue.

In *The Bazias 3 and 4,*[3] the Court of Appeal held that a cross-undertaking in damages would not be given in circumstances where a vessel was to remain under arrest in support of arbitration proceedings where the *in rem* proceedings against the ship had been stayed. In that case Lord Justice Lloyd held that "this has never been the practice in Admiralty actions and I do not regard this case as being one in which we can introduce so far reaching a change in the practice for the first time".

In *Willers v Joyce*[4], although not itself a shipping case, Lord Clarke commented on the appropriateness of comparisons between the arrest of ships and freezing orders. He said that such comparisons were not helpful because "a person who arrests a ship does not have to provide security to the defendant in respect of any loss which he might incur".

In light of these (higher) authorities, Mr Justice Teare commented it would be "a particularly bold step for a first instance judge to … require a cross-undertaking in

[2] [1984] 1 Lloyd's Reports 235, in which it was held that the granting of an arrest was a discretionary power of the court
[3] [1993] 1 Lloyd's Reports 101
[4] [2016] 1 WLR 477

damages". More importantly, he stated that "I do not consider that such a course is open to me at first instance".

Pleading Poverty

Although not part of his reasons for refusing the application, Mr Justice Teare also gave some useful commentary on the shipowner's argument that the order was just because it was not financially able to provide alternative security in exchange for the release of the vessel.

Mr Justice Teare commented that "where a shipowner wishes to show that he is unable to avail himself of the remedy usually adopted to avoid loss caused by arrest he ought, it seems to me, condescend to particulars… the evidence ought to deal not merely with the shipowner's own resources, but also with the shipowner's ability to provide security by calling on the resources of its shareholders, direct and indirect."

He went on to conclude that "the evidential burden lies upon the shipowner" to prove its poverty, not the arresting creditor, and that in this case the shipowner had not satisfied that burden.

"IF A SHIPOWNER WISHES TO ARGUE THAT IT IS UNABLE TO PROVIDE ALTERNATIVE SECURITY THEN THE BURDEN IS ON THEM TO PROVE THAT THIS IS THE CASE."

This judgment therefore makes clear that if a shipowner wishes to argue that it is unable to provide alternative security then the burden is on them to prove that this is the case.

Further, and perhaps more importantly, it indicates that the assets of any broader shipping group within which the shipowner sits will be relevant to this consideration, and not just the assets of the shipowner themselves.

Conclusions

This is an important decision, which preserves the attractiveness of England as a jurisdiction for both ship arrest and ship mortgage enforcement.

Mr Justice Teare acknowledged that the Admiralty Court's practice in relation to counter security for arrests represents the striking of a balance between "on the one hand, the interests of the claimant *in rem* and, on the other, the interests of the shipowner". However, he did not comment as to whether the current approach struck the right balance or "remains appropriate and sufficiently 'responsive to modern realities'". This, he held, was "not a matter for the court to judge but a matter for either the legislature or the Rules Committee to consider".

Whilst it may appear that the ability to arrest a vessel without giving any cross-undertaking in damages is draconian, and operates harshly on the shipowner, it should be borne in mind that shipowners who find themselves in breach of a loan always have the option of either refinancing their debt with another bank, or making the payments required to cure the default. In the ordinary course, a shipowner ought to be in a position to do this.

The decision potentially leaves open the possibility that the court may be persuaded to order that a bank provide appropriate counter security in rare cases where an owner and its shareholders can genuinely satisfy the court of their poverty. However, it makes clear that any argument on this basis will need to be supported by clear evidence as to the financial circumstances of not just the shipowner but also any broader shipping group of which it is a member.

FOR MORE INFORMATION

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