WATSON FARLEY & WILLIAMS

BRIEFING

LANDMARK COURT OF APPEAL DECISION ON SHIP ARREST COUNTER-SECURITY AND WRONGFUL ARREST DAMAGES

DECEMBER 2018

- ENGLISH COURT OF APPEAL CONFIRMS FIRST INSTANCE DECISION THAT COUNTER SECURITY IS NOT REQUIRED WHEN ARRESTING A VESSEL
- COUNTER SECURITY WILL ONLY BE ORDERED IN EXTREMELY RARE CASES
- MALICE / GROSS NEGLIGENCE TEST FOR WRONGFUL ARREST DAMAGES CONFIRMED

"THE JUDGMENT ON APPEAL HAS, IT IS HOPED, FINALLY DISPELLED PREVIOUS DOUBTS AS TO WHETHER A PARTY WHO ARRESTS A SHIP IN ENGLAND MAY BE ORDERED TO GIVE A CROSS-UNDERTAKING IN DAMAGES."

In a landmark ruling that has brought welcome clarity to a legal 'hot topic' that has been debated for many years, the English Court of Appeal has now upheld[1] the first instance decision of the Admiralty Court in *The Alkyon*[2]. WFW acted for the successful mortgagee bank on both occasions and produced a briefing note in August this year on the Admiralty Court's ruling.

The judgment on appeal has, it is hoped, finally dispelled previous doubts as to whether a party who arrests a ship in England may be ordered to give a cross-undertaking in damages (and, if so, on what terms, including provision of counter-security) and, if not, in what circumstances, if any, the court might exercise its discretion to require such counter-security following a ship's arrest, on an application by the shipowner for the ship's release.

This briefing addresses the key issues upon which the case turned and looks at the ramifications of the decision for shipowners and those wishing to arrest ships.

Background

The settled practice of the English courts for many years has been not to require the provision of counter-security (or indeed any 'cross-undertaking in damages') to obtain a ship arrest. A claimant may apply for the issuance of a ship arrest warrant 'as of right'[3], i.e. without needing to cross-secure such loss or damage that the arrest

[1] *Stallion Eight Shipping v NatWest Capital Markets* [2018] EWCA Civ 2760
[2] *Stallion Eight Shipping v NatWest Capital Markets* [2018] EWHC 2033 (Admlty)
[3] CPR 61.5(1)

may cause the owner. This practice mirrors and complements the high bar to be cleared under English law by an owner seeking to recover damages for wrongful arrest. For over 150 years, English law has required shipowners to show malice (*mala fides*) or gross negligence (*crassa negligentia*) on the part of the arrestor in order for liability to be imposed in the tort of wrongful arrest. Maritime lawyers refer to this as *The Evangelismos* test, after the case that established it[4].

These two related principles have made England an attractive jurisdiction in which to arrest ships, not only because the costs, delays and formalities of arranging counter-security can be avoided, but also because the procedure encourages shipowners to bond or to settle disputed claims.

"... SOME LEGAL COMMENTATORS HAVE SEIZED UPON THE APPARENT INCONSISTENCY BETWEEN ENGLISH SHIP ARREST LAW AND THE ENGLISH COURT'S PRACTICE WHEN GRANTING FREEZING INJUNCTIONS."

However, some legal commentators have seized upon the apparent inconsistency between English ship arrest law and the English court's practice when granting freezing injunctions (previously known as *Mareva* injunctions) over a defendant's assets, where the applicant must give a 'cross-undertaking' in damages (which he may also be ordered to fortify with security). Such cross-undertakings expose a claimant to damages if he subsequently loses the case, even a case brought in good faith. Those commentators have therefore suggested that ship arrests should be aligned with the practice on freezing injunctions. This argument has drawn support from the fact that, in the mid-19th century, when *The Evangelismos* test was laid down, a party was obliged to arrest a ship in order to commence an action *in rem*, and so could hardly be condemned in damages merely for bringing an action unless the party had committed the tort of malicious prosecution. However, since the end of the 19th century, parties have been able to commence actions *in rem* without arresting and, so the argument runs, they should be liable in damages when they arrest a ship, that they are no longer obliged to do, but their action *in rem* is then dismissed.

In the ship arrest context, maritime claims brought by third parties against shipowners will, in many cases (e.g. salvage, collision damage, and loss or damage to cargo), be covered by marine insurance, so the owner may turn to his insurers to bond the arrest. By contrast, arrests for unpaid ship OPEX will not normally be insured but will usually be within an owner's means to bond, even where disputed. Arrests by mortgagee banks for unpaid loans will not be insured but are rarely disputed and, even if they are, will usually prompt a sale or refinancing of the ship. Probably for these reasons, no owner had previously sought to re-open the law on this issue. But, in this case, the claim against the ship was both very substantial (over US$15m) and founded on a breach of a 'loan to value' ratio covenant supported by broker's valuation evidence that the owner disputed. Further, the ship was losing US$11,350 per day in charter hire, unlike in many cases where a bank arrest detains a ship that is not profitably employed.

The owner's original application

The shipowner, a Marshall Islands incorporated, one-ship owning company, applied to the Admiralty Court for the ship to be released from arrest unless the mortgagee bank gave a cross-undertaking in damages in a form that would apply whether or not the court later made a finding of bad faith or gross negligence against the bank.

[4] *The Evangelismos* (1858) 12 Moo PC 352; 14 ER 945

The shipowner reasoned that if the bank were ordered to give such a cross-undertaking it would be caused no prejudice whereas great injustice would result to the owner if the court later dismissed the bank's claim without going on to find that the bank had acted in bad faith or with gross negligence.

The first instance judgment

The judge (Mr Justice Teare) dismissed the shipowner's application. In finding for the bank, the judge held that the shipowner's application for a cross-undertaking would "cut across and negate" well-established procedural rules and case law[5] entitling parties to arrest ships as of right.

He also held that there was nothing on the facts of this case which made it sufficiently exceptional to justify departing from long-established case law and the usual practice of the courts. He noted that, were he to grant the order sought, the floodgates would be opened to the seeking of similar orders in a large number of other cases. Not only would this represent more than a 'tweak' to court practice, as the shipowner suggested, but it would also have significant implications for the shipping industry as a whole. For example, the judge observed that such a practice might discourage valid arrest claims and might even dissuade P&I Clubs and hull underwriters from arresting ships for insured claims.

The owner's appeal

The shipowner appealed on grounds that the judge had erred, both in holding that the order sought was incompatible with the right to obtain a warrant of arrest 'as of right' and in exercising his discretion by reference to an overly restrictive reading of the authorities. The owner also submitted that the judge had failed sufficiently (i) to weigh the injustice to the owner and absence of prejudice to the bank; and (ii) to consider the analogous nature of ship arrests and freezing injunctions, placing too much weight on the wider impact on the shipping industry and practice.

"THE COURT OF APPEAL … DISMISSED THE APPEAL AND FOLLOWED AND UPHELD THE JUDGE'S REASONING IN ALMOST ALL RESPECTS."

The Court of Appeal's ruling

The Court of Appeal (Sir Terence Etherington MR, Lord Justice Gross and Lord Justice Flaux) dismissed the appeal and followed and upheld the judge's reasoning in almost all respects. The decision confirms that, except in very unusual circumstances, the courts will not order the provision of counter-security, whether on an arrest or on a later application by a shipowner for his ship's release.

The Court of Appeal began by confirming that a party may arrest a ship as of right, with no judicial discretion being involved or counter-security required. Whilst recognising that *The Evangelismos* test can be harsh on shipowners where bad faith or gross negligence cannot be made out against the arrestor, the Court of Appeal went on to confirm the test.

Next, the Court of Appeal confirmed that, once a ship is arrested, the court has a discretion to release her, but will usually only do so on provision of security by the shipowner, and will only require the arrestor to provide security in exceptional or unusual cases.

The Court of Appeal reviewed the academic debate over *The Evangelismos* test and whether a cross-undertaking should be provided either on an arrest or, thereafter,

[5] *The Vasso* [1984] 1 Lloyd's Reports 235

on the owner's application for release of a ship, which has been conducted in legal journals over the past 20 or more years. This encompassed a review of relevant Singaporean, Australian and Canadian cases on the issue and a global survey conducted by the CMI (Comite Maritime International). The Court of Appeal concluded there to be no unified approach or practice either within Commonwealth countries or around the world in relation to either counter-security or wrongful arrest damages.

"THE COURT OF APPEAL CONCLUDED THERE TO BE NO UNIFIED APPROACH OR PRACTICE EITHER WITHIN COMMONWEALTH COUNTRIES OR AROUND THE WORLD IN RELATION TO EITHER COUNTER-SECURITY OR WRONGFUL ARREST DAMAGES."

Whilst agreeing with the judge that the *The Evangelismos* test could "no longer be defended by reliance on its original rationale", the Court of Appeal considered there to be "formidable" considerations to support the status quo and to militate against departing from existing law and practice in this case. These considerations were as follows:

1. The right of arrest is a "unique feature" of the action *in rem* and, as such, caution should be exercised before "unnecessarily restricting or hindering access to an Admiralty arrest";
2. Were the Court of Appeal to order a cross-undertaking in this case, about which the Court of Appeal agreed with the first instance judge there was "nothing unusual", such a requirement would become routine which, in turn, would ultimately deter parties from exercising their right of arrest;
3. Arrest, or even the mere threat of arrest, was an effective way of obtaining security, such that the Admiralty Court's practice ensures that few arrests are necessary;
4. Unlike a freezing injunction, whose effect is to freeze all of the defendant's assets, a ship arrest is "asset specific", and would only paralyse the owner's business if structured as a single ship company;
5. As the first instance judge had held, in a number of reported cases "judges of great authority" had not been persuaded that freezing injunctions and ship arrests were truly analogous procedures, such that a cross-undertaking should be required for an arrest;
6. Whilst it was no longer necessary to arrest a ship in order to start a claim *in rem*, the settled practice in relation to ship arrests, in terms of counter-security and wrongful arrest, has remained constant since 1883[6], giving ample time to reconsider the law, were that appropriate;
7. There has been no significant pressure from the maritime industry to change the law in this respect. Nor is there any international consensus on the approach to be adopted. Nor has the UK ratified the 1999 Ship Arrest Convention, which provides for counter-security to be given when arresting a ship; and
8. Commercial arrangements in the maritime industry are in place, without apparent discontent, to deal with arrests, in terms of undertakings of P&I Clubs and hull underwriters commonly given to secure releases, and the system of cautions against arrest contained in the Civil Procedure Rules by which an arrest can be avoided by shipowners. Disturbance of these settled arrangements ought not lightly to be embarked upon.

To conclude, the Court of Appeal robustly endorsed Mr Justice Teare's first instance judgment, disagreeing with him only insofar as his view was that Parliament or the court's Rules Committee were the appropriate bodies to make such a change. The

[6] *The Burns* [1907] P 137

Court of Appeal instead held that the courts themselves may reconsider the position, albeit should only do so with the input of the maritime community so as to be sure of the ramifications of a change to the status quo.

Risk of injustice: the owner's pleas of poverty

The Court of Appeal finally referred to a discrete issue, which has wider implications to the exercise of any discretion.

At first instance, the shipowner had contended that the non-provision of the cross-undertaking sought would cause injustice, as the ship owning company was unable to put up security to have the ship released. In this regard, the shipowner's stance was to assert that the resources of its direct and indirect shareholders to inject the capital required for this purpose were irrelevant, and the courts should look no further than the one shipowning company itself.

"A SHIPOWNER SEEKING TO PLEAD POVERTY MUST ADDUCE EVIDENCE OF THE FUNDS TO WHICH IT HAS ACCESS."

The first instance judge and the Court of Appeal disagreed and made clear that a shipowner seeking to plead poverty must adduce evidence of the funds to which it has access. It is clear, therefore, that any shipowner seeking a cross-undertaking in the context of a ship arrest would need, in future, to adduce evidence, which many shipowners would find overly intrusive, as to the wealth and resources of its principals and 'ultimate beneficial owners' (UBOs).

Conclusions

In a clear and well-reasoned judgment, the Court of Appeal has decisively confirmed the pre-existing position under English law and, whilst acknowledging the body of legal commentary supporting a change in the law in this area, has avoided the temptation to interfere with long-standing and settled law well-known to practitioners for over a century.

Although the Court of Appeal acknowledged that, in extreme circumstances, counter-security may be appropriate (for example, where the unpaid crew of a ship applies for her arrest or to give effect to the legal position in another country from which the ship had broken arrest (as happened in *The Tjaskemolen*[7])), the Court has decisively rejected any standard practice of cross-undertakings in damages for ship arrests.

This is a welcome decision for banks and other parties seeking to enforce their claims or to obtain security through ship arrest, which of course may include shipowners themselves, who may wish to arrest, for example, sister ships of defaulting charterers. The decision also provides welcome clarity to marine insurers. From the perspective of shipowners, whilst the decision highlights the fact that they cannot simply turn to their marine insurers in every case to assist them to bond an arrest, and may face arrests in an amount they cannot easily bond, they at least know that, where they face substantial claims, they may either raise the necessary equity from shareholders to bond the claim or, in the case of a bank arrest, to agree terms for the ship to be sold or the loan to be refinanced.

Probably this decision will be the last word on the matter, although the Court of Appeal noted that there "may be a case for revisiting existing law and practice as to the release of property from maritime arrests". If the maritime industry wishes further to harmonise global practice on ship arrests, then of course, it may do so. The

[7] [1997] 2 Lloyd's Rep 476

limited success of the 1999 Arrest Convention, which is only currently in force in ten signatory states[8], indicates that this may not happen for some time, if at all.

[8] Including Algeria, Spain, Estonia, Liberia, Latvia and Bulgaria.

FOR MORE INFORMATION

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