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Cross-Border Insolvency and International Trade

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Foreword: Cross-Border Insolvency and International Trade

Luke Parsons QC, Head of Chambers, Quadrant Chambers, London, UK

I am delighted to welcome you to the special Quadrant Chambers' edition of International Corporate Rescue, which aims to focus a spotlight on some of the cutting edge cross-border insolvency issues with a particular emphasis on the commodities and shipping markets. The contents and width of the articles in this special edition evidences the increasing expertise of Quadrant Chambers in matters of cross-border insolvency as it impacts on our other traditional core practice areas such as international trade, commodities and shipping.

Cross-border insolvency issues seldom arise in isolation. More often than not they raise complex issues of the laws of contract, property and bailment not to mention issues of maritime and private international law. Given its pedigree, Quadrant Chambers is perhaps uniquely well placed to deal with many cross-border insolvency issues that require expertise across all of these areas.

OW Bunkers has possibly given rise to the most high profile commodities/insolvency litigation since the 'Glencore' saga of the late 1990s. It is no coincidence that Quadrant Chambers has been at the forefront of this litigation with Counsel from here representing Owners at all stages of the test case litigation '*the Res Cogitans*' from the first arbitration all the way up to the Supreme Court. In addition, several members of Chambers have acted for physical suppliers in the myriad arbitrations that have arisen since the collapse of OW Bunkers in the Autumn of 2014.

Quadrant Chambers' expertise in cross-border insolvency does not, however, stop at the OW Bunkers litigation. Members of Chambers have appeared in some of the leading cases on the Cross-Border Insolvency Regulations 2006 and the EU Insolvency Regulation 2000. Others have penned learned articles or authored books addressing these areas.

I do hope you enjoy these articles and we, as a Chambers, look forward to advising and/or representing you in the future in this increasingly important and complex area.

Res Cogitans: A Sale Is Not Always a Sale, Says the Supreme Court

Turlough Stone, Barrister, Quadrant Chambers, London, UK

On 11 May 2016, the Supreme Court handed down its much-anticipated judgment in the case of *PST Energy 7 Shipping LLC & Product Shipping and Trading S.A. v OW Bunker Malta Ltd & ING Bank N.V.* [2016] UKSC 23 (the '*Res Cogitans*'). The Supreme Court unanimously rejected the appeal of PST Energy (*Owners*) from the decision of the Court of Appeal – see [2015] EWCA Civ 1058 – that bunker supply contracts, in which marine fuels (*bunkers*) are sold upon credit terms, with the seller retaining title until payment and the parties contemplating that the goods will (or are likely to) be consensually consumed prior to the time at which property is meant to pass under the contract, are not contracts for the sale of goods within the meaning of s.2(1) of the British Sale of Goods Act 1979 (*SOGA 1979*).

The Supreme Court went further, however. It rejected the Court of Appeal's conclusion that a bunker supply contract would or might be a contract of sale to the extent that, at the expiry of the relevant credit period, any bunkers remained unconsumed. It also held that, even if the contract had been a contract of sale, the shipowner would still have been liable for an action on the price, notwithstanding s.49 SOGA 1979.

Background

The facts are well-known and have been rehearsed in a number of forums. There would be little profit in setting them out at length here. Those seeking a detailed narrative are referred to the article entitled 'Sale or No Sale? An Update on O.W. Bunkers',[1] which appeared in an earlier issue of this journal (and in the Quadrant Chambers Special Edition of this journal), and of which the present writer was a co-author together with Stephen Cogley Q.C. (who appeared for the Owners at all stages of the litigation).

On 4 November 2014, OW Bunker Malta Ltd (*OWBM*) supplied bunkers to the vessel *Res Cogitans*, pursuant to a contract under the OW Bunker Group's standard terms (*the OWB Terms*). OWBM acquired the bunkers from its Danish parent company, OW Bunkers & Trading A/S (*OWBAS*). In December 2013, OWBAS had entered into a revolving credit facility with a syndicated loan, as security for which it assigned and charged all its rights to intercompany and third party receivables to ING Bank N.V. (*ING*), the lead bank and security agent. OWBAS did not supply the bunkers directly, but obtained them from another bunker supplier, Rosneft Marine (UK) Ltd (*RMUK*). RMUK in its turn acquired the bunkers from one of its associated companies, RN-Bunker Ltd (*RNB*), which was the actual physical supplier.

The contracts between the Owners and OWBM and between OWBM and OWBAS were on the OWB Terms. These provided for payment 60 days after delivery and included a retention of title clause under which property in the bunkers was not to pass until the bunkers had been paid for in full. They also contained an express bailment clause, to the effect that until payment of the full amount due to the seller, the purchaser would hold the bunkers solely as bailee for the seller, and would not be entitled to use them for any purpose other than propulsion of the vessel.

In November 2014, the OW Bunker Group became insolvent and defaulted on its obligations to ING. The result was that, whilst RMUK paid RNB, it was not paid by OWBAS, which in turn was not paid by OWBM. The Owners were content to pay for the fuel delivered. However, there were competing claims for payment of the price of the bunkers from RMUK and ING (the latter as OWBM's assignee).

The litigation

The Owners commenced arbitration under its sale contract with OWBM, with OWBM and ING as respondents, seeking declarations that as a matter of English law they were not required to pay OWBM (and hence ING), thus leaving them free to pay RMUK and forestall the arrest of the Vessel. The Owners contended amongst other arguments that: (a) the contract was an agreement to sell within s. 2(1) SOGA 1979 (and thus OWBM was in breach of s.12 SOGA 1979 because it

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1 (2016) 13:3 *International Corporate Rescue* 185-188.

was never able to pass property in the bunkers); (b) even if the contract was not one for sale, OWBM/ING had no claim for the price under s.49 SOGA 1979, because neither of the conditions for bringing such a claim were satisfied; and (c) terms equivalent to those contained in s.12 SOGA 1979 had to be implied into the contract, with the result that the Owners had a defence to a claim for the price, because OWBM was in breach of the obligation to pass property in the bunkers to the Owners at the time of payment.

The arbitrators found, in respect of each of these issues that: (a) the contract was not an agreement to sell within the meaning of s.2(1) SOGA, because the essence of the contract was the delivery of fuel with a right to consume the same; (b) OWBM's claim to payment was a straightforward claim in debt which was not subject to any requirement as to the passing of property in the bunkers at the time of payment; and (c) if the contract had been one for sale to which SOGA 1979 applied, a claim for the price could not be maintained, as none of the relevant conditions in s.49 were satisfied.

The Owners' appeal to the Commercial Court was dismissed by Males J, who upheld the arbitrators' conclusion, and considered that the contract was properly characterised as one containing a condition whereby OWBM undertook that the Owners would have the lawful right to use any bunkers which they in fact used pursuant to the bailment clause. In a similar vein, he held that whilst there was a residual obligation to transfer property in relation to unconsumed bunkers at the expiry of the credit period, that obligation was not subject to SOGA 1979. However, he also found that it was an implied condition of the contract between the Owners and OWBM that the latter was obliged to comply with its obligations to suppliers higher up the chain. Although the s.49 point did not arise for determination, Males J stated that he disagreed with the arbitrators and would have held that OWBM/ING was entitled to bring a claim for the price, because the provision for payment to be made within a fixed period after delivery was sufficient to satisfy the requirements of s.49(2) SOGA 1979.

On the Owners' appeal before the Court of Appeal (Moore-Bick, Longmore and McCombe LJJ), the issues were effectively limited to the questions of (a) whether the contract was a contract of sale within the meaning of SOGA 1979, and (b) if not, whether it was subject to an implied term that OWBM would perform or had performed its obligations to its supplier. The Court of Appeal answered both questions in the negative. On the second question, the Court of Appeal did not accept that there could be an implied term, as it was uncertain in its scope, and there was no need to imply such a term, as it did not accurately reflect the essential nature of the contract.

On the first question, whilst the language of the contract suggested that it was one for the sale of goods, the terms of the contract – particularly the fact that the supply was on credit terms and that owners had the right to use the bunkers from the moment of delivery – meant that Owners had not contracted for the transfer of property in the whole of the bunkers, but rather for the delivery of bunkers, which they could use immediately and pay for when the credit period expired. From the supplier's point of view, the consumption of bunkers before payment would result in an ever diminishing form of security provided by the retention of title clause. In reaching that conclusion, the Court of Appeal distinguished the long line of cases in which the courts had regarded contracts with retention of title clauses as contracts for the sale of goods under SOGA 1979, on the basis that none of those cases had expressly addressed the issue of whether property could pass retrospectively when the goods had ceased to exist (in this case, when the bunkers had been consumed). However, unlike Males J, the Court of Appeal held further that the contract would or might be a contract for the sale of goods in respect of any part of the bunkers that remained unconsumed as at the date for payment.

The Supreme Court gave permission to appeal in February 2016, with the appeal being heard in late March 2016. The two central questions before it were those before the Court of Appeal, namely whether the bunker supply contract fell within the scope of s.2(1) SOGA 1979, and if not, whether it was an implied condition of the contract that OWBM would perform its obligations to parties higher up the supply chain, in particular by paying for the goods timeously. In response to an attempt by OWBM/ING to revive an argument that s.49 SOGA 1979 did not preclude it bringing a claim for the price, the Supreme Court also took the opportunity to consider whether the Court of Appeal decision in *F G Wilson (Engineering) Ltd v. John Holt & Co (Liverpool) Ltd* [2014] 1 WLR 2365 ('*Caterpillar*') should be overruled. By that decision, the Court of Appeal had held that, where goods are delivered under a contract of sale, but title is reserved pending payment of the price, the seller cannot enforce payment of the price by an action.

The only judgment was given by Lord Mance, with whom Lords Neuberger, Clarke, Hughes and Toulson agreed. On the first question, his Lordship held that bunker sale agreements are not straightforward agreements to transfer property in bunkers (to which s.2(1) SOGA 1979 would apply). Rather, they are *'sui generis'* (a fact which permitted his Lordship to side-step the authorities involving retention of title clauses) with two distinct aspects: (i) an agreement to permit consumption of the bunkers prior to payment (and without any property passing) and (ii) to transfer property in any remaining bunkers at the end of the credit period. His Lordship took the view that an agreement of this type could not be categorised as a contract for sale because: (i) in its essential nature, it was different from a contract for sale of goods, because it conferred the liberty to consume all or any part of the bunkers without acquiring property in them (there was no condition governing the transfer of property in the bunkers used before payment) and (ii) the agreement was a single contract to pay a single 'price' for all the bunkers sold not later than 60 days after delivery, whatever had happened to such bunkers in the meantime, and was not one that could sensibly be treated as divisible. He cited with approval the arbitrators' conclusion that, when in the ordinary course an owner or manager has paid for bunkers at the end of the credit period:

> 'it would not have crossed anyone's mind to enquire what bunkers had been consumed meanwhile in order to determine whether the invoice was being paid wholly or in part under a contract of sale (in respect of unconsumed bunkers), or otherwise (in respect of consumed bunkers).'

For similar reasons, Lord Mance rejected the Court of Appeal's suggestion that the contract could be analysed as a contract of sale to the extent that it provided for the transfer of property in any part of the bunkers remaining at the time of payment. Whilst a transaction relating to unconsumed bunkers might be closely analogous to a sale (in that, for instance, it would contain similar implied terms as to description, quality and the like to those implied in any conventional sale), one could not divide up a single agreement covering the supply of all the bunkers at a single price, irrespective of what happened to them.

The Supreme Court also determined the second question in ING's favour, finding that there was no basis or need for any implied term relating to performance of obligations in the contractual chain through which OWBM had obtained the bunkers eventually supplied to the Owners. The only implied duty on OWBM in respect of the bunkers was that OWBM had a legal entitlement to give permission to the Owners to use the bunkers for propulsion prior to payment. As Lord Mance put it:

> 'In order to be so entitled, OWBM did not need to have or acquire title to the bunkers. It merely needed to have acquired the right to authorise such use under the chain of contracts by virtue of which it had obtained the bunkers.'

That sufficed to determine the appeal. However, the Supreme Court went on to consider (albeit *obiter*) the question of whether, if the contract was one of sale, s.49 SOGA 1979 would preclude any claim for the price of bunkers used. This required consideration of the decision of the Court of Appeal in *Caterpillar* that held that where goods are delivered under a contract of sale, but title is reserved pending payment of the price, the seller cannot sue for the price. In essence, in *Caterpillar*, the Court of Appeal had concluded that s.49 SOGA 1979 constitutes a complete code for situations in which the price might be recoverable and that, as a matter of principle, it excluded any claim to recovery of a price outside of the terms of the section. After a detailed consideration of the authorities, in the course of which he noted that s.49 does not focus on the position where delivery has been made and title reserved pending payment, and the buyer is permitted by the contract under which supply is made to dispose of or consume the goods, Lord Mance rejected that conclusion and said that, had it been necessary to do so, he would have overruled *Caterpillar* on that point. On that basis, in circumstances where it had been assumed for the purposes of the appeal that the bunkers had been completely consumed, s.49 SOGA 1979 would not have been a bar to a claim by OWBM to payment of the agreed price.

Observations

In an earlier article in this journal on this case – see Volume 13, Issue 3, pp. 185-188 – the author and Stephen Cogley Q.C. set out a number of criticisms of the Court of Appeal's decision. To the extent that these were advanced by the Owners before the Supreme Court and rejected, it would be impertinent to maintain them here. However, the Supreme Court's analysis is surprising for a number of reasons. The first is that it is questionable whether it is appropriate for the nature of a contract (and thus the remedies available to the parties thereunder) to be determined by reference to ex post facto events such as consumption, rather than at the point at which it is entered into. The second is that it offends against commercial reality. In this case, the parties constructed their bargain as if it were a contract of sale, with payment of the price to be made at the end of the credit period, albeit that both parties knew that the goods would be consumed prior to the payment date. Put another way, they had contracted on the basis that property was to be treated as if it would still exist at the point of payment. Why should the Court not give effect to that commercial reality, particularly when the purchase price is frequently used along a string of supply agreements to feed title? Third, it is arguable that the Supreme Court placed undue weight upon the bailment clause in the OWB Terms. That clause simply sought to regulate what the buyer could do with the seller's property during the credit period: it was not directed towards the passing of property.

Those criticisms aside, the Supreme Court decision has finally clarified that, at least within the context of bunker supply contracts, owners and charterers cannot rely upon the previously well-established assumption that contracts containing retention of title clauses in which goods are consumed prior to expiry of the credit period or where such consumption is expressly permitted under the contract are sale contracts within SOGA 1979. That is, of course, bad news for those who acquired bunkers from companies in the OW Bunkers Group. The risk of double jeopardy, of having to pay both ING/OWB and also the unpaid physical suppliers in respect of the same bunker supply, is now very real and – given the risk of arrest – likely to be of pressing concern.

The question remains of whether the decision has a broader application. In attempting to classify bunker supply contracts as *sui generis*, the Supreme Court was clearly attempting to confine its decision as narrowly as possible. However, such contracts are no different in their essentials from other contracts where the retention of title clause in the contract permits consensual use of the goods (such as contracts for the sale of foodstuffs, chemicals and raw components for incorporation into other products). That being the case, the ramifications of the decision are potentially very wide indeed. Given Lord Mance's criticisms of the decision in *Caterpillar*, it can also reasonably be expected that the scope of s.49 SOGA 1979 will be subjected to further judicial scrutiny in the future.

Whose Goods Are They Anyway?

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The recent decision of the Court of Appeal in *The Res Cogitans*[1] as to the ineffectiveness, if not the complete irrelevance, of a standard species of retention of title provision under a contract for the supply of marine bunkers where the bunkers are subsequently consumed by physical use in the vessel's main engines prompts a reconsideration of some basic principles of the law of personal property in the context of such provisions. The simple principle that if goods are supplied to another and are then used so as to cease to exist, then no question of title in the goods (whether purportedly 'retained' or otherwise) can thereafter arise seems to have come as a surprise to some. The ramifications of that principle go further than mere retention of title, and as the decision shows, lead to the difficulty of characterising a contract in which title (if any) in the goods supplied by 'seller' to 'buyer' is not to pass until some time after their prior consumption and simultaneous destruction by the 'buyer' as a contract for the sale of goods at all. These questions are considered elsewhere in this issue.

The simple molecular destruction of the goods owned by A and sold to B subject to a retention of title clause by their outright consumption or other destruction by B (or by a third party or some external event) and the subsequent impossibility of the existence of any title to the goods on the part of either A or B is, despite the apparent surprise, a straightforward situation. One cannot retain what no longer exists; crude, boilerplate type, retention of title clauses cannot circumvent the ineluctable, however much a 'commercial' construction is resorted to. The lesson should have been learnt much earlier from cases such as *Borden (U.K.) Ltd. v Scottish Timber Products Ltd.*[2]

More difficult (and hence analytically more interesting) is the situation where the goods of A are combined in some way with the goods of B and continue to exist in some molecular form but now exist in some altered physical state or one in which they have become indissolubly merged with B's goods: this was the situation considered in part in *Borden*. In what circumstances will the retention of title provision stipulated for by A operate? How are the goods and title of A to be regarded for the purposes of the insolvency of A (or, for that matter, of the insolvency of B)? Does it make a difference to the result if the combination or merger was performed by A or by B? Or, if performed by B, does the result depend on whether it was carried out with A's consent or wrongfully by B?

These questions give rise to the fascinating and virtually unique resort by English common lawyers in the context of judgment enforcement, freezing order relief and insolvency, to principles of Roman law to assist in the task of working out who has title (and title to what) in such a case.

Mixing and joinder

It is convenient first to distinguish two broad classes of combination or merger: (i) the first are the *mixing* cases where goods belonging to different owners are mixed together; (ii) the second are the *joinder* cases where the goods of one owner are joined with or to the goods of another owner so as either to incorporate those other goods or to be incorporated within them.

The mixing cases

Roman law in this context distinguished between two types of intermixture: *commixtio* (the mixing together of separable but indistinguishable constituents such as sheep, bales or coins) and *confusio* (the mixing together of inseparable constituents such as the same or different wines). English law has broadly (although not always consistently) adopted the same distinction: see e.g. *Indian Oil Corporation Ltd. v Greenstone Shipping S.A. (The 'Ypatianna')*[3] and *Glencore International AG v Metro Trading International*,[4] both summarising the earlier cases (going back to 1594[5]).

Notes

1 [2015] EWCA Civ 1058; currently on appeal to the Supreme Court (hearing fixed for 22 March 2016).
2 [1981] 1 Ch. 25.
3 [1987] 2 Lloyd's Rep. 286; [1988] 1 Q.B. 345.
4 [2001] 1 Ll. Rep. 284.
5 A case described as *Anon* Pop. 28, or sometimes as *Stock v Stock*: wrongful mixing up of parcels of hay.

(i) Commixtio

In the case of *commixtio* of separable but indistinguishable goods, while it is not possible to identify any longer the separate contributing elements owned by A and B, there is no sense in which A's goods have ceased to exist. In such a case a retention of title clause would be likely to be effective, a fortiori where the mixing was done by B wrongfully such that it was B's fault that A's separate goods could no longer be identified. See per Staughton J. in *Indian Oil*[6] where he stated: 'If the wrongdoer prevents the innocent party proving how much of his property has been taken, then the wrongdoer is liable to the greatest extent that is possible in the circumstances'.

Indeed, based on the older cases, where it is not possible for A to identify its own goods at all, A may (but cf. *Indian Oil*, discussed below) have a good claim to the whole of the intermixed quantity and B cannot be heard to say that some of the quantity must be his; see e.g. Moore-Bick J. in *Metro* at [183]: 'They [the older cases] start from the proposition that where one person wrongfully mixes his goods with those of another so that they cannot be separated, the innocent party is entitled to recover the whole of the mixture.'

Even where B's mixing was carried out innocently, the default position would in any event be regarded as one of co-ownership of the mixed whole by A and B. In the event of either A's or B's insolvency, the interest of A or B in the co-owned bulk would be available to the creditor. A's property, not having ceased to exist but merely having been mixed up with another's, can be retained pursuant to the retention of title clause. In *Sandeman & Sons v Tyzack & Branfoot Steamship Co. Ltd.*[7] a consignee of bales of jute claimed that six of his bales were missing. It was found that 14 bales, belonging either to that consignee or to others, were missing; and that 11 bales were available without any marks. It was held that the consignee was entitled to claim for his six bales not delivered, and was not obliged to accept that any of the unmarked bales belonged to him. The obiter dictum of Lord Moulton at p. 694 is frequently cited:

> 'My Lords, if we proceed upon the principles of English law, I do not think it is a matter of difficulty to define the legal consequences of the goods of "A" becoming indistinguishably and inseparably mixed with the goods of "B". If the mixing has arisen from the fault of "B", "A" can claim the goods. He is guilty of no wrongful act, and therefore the possession by him of his own goods cannot be interfered with, and if by the wrongful act of "B" that possession necessarily implies the possession of the intruding goods of "B", he is entitled to it (2 Kent's Commentaries, 10th ed., 465). But if the mixing has taken place by accident or other cause for which neither of the owners is responsible, a different state of things arises. Neither owner has done anything to forfeit his right to the possession of his own property, and if neither party is willing to abandon that right the only equitable solution of the difficulty, and the one accepted by the law, is that "A" and "B" become owners in common of the mixed property.'

(ii) Confusio

In the different case of *confusio*, the Courts have distinguished between two cases, that of the mere commingling together of parcels of identical substances or products (i.e. two parcels of the same refined crude owned separately by A and B put together in one bulk tank) and that of the blending of different grades or qualities of product with the result that a different and new material is created by that blending (e.g. the deliberate blending of two or more oils of different grades or specifications in order to produce oil of a grade or specification commercially different from any of its ingredients; cf. the Roman law example of honey blended with rough wine to make mead).

Commingling. In the commingling situation, where A's parcel of oil of a specific quality is mixed with another of identical quality owned by B so as to make up one larger bulk, the molecular identity of the separate parcels remains and the case is one very close to that of ordinary *commixtio* (as the passage cited above from Lord Moulton with its reference in the context of unmarked bales to 'indistinguishably and inseparably mixed' demonstrates: if two parcels of identical oil are mixed together the position is effectively the same). The retention of title clause cannot be defeated on the basis that the goods covered by it have ceased to exist as they have not: they have simply been indistinguishably mixed and A's title supports its co-ownership of the whole pro rata to its contribution and its right 'to receive out of it a quantity equal to that of his goods which went into the mixture, any doubt as to that quantity being resolved in favour of A'. While it is arguable, in the case of wrongful commingling, that A may assert its ownership potentially of the greater whole, the modern approach eschews the 'punitive' and 'primitive rule' of complete cession of the whole to A in favour of co-ownership: see *Indian Oil.*[8] Accordingly co-ownership by A of the whole with B is the solution

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6 At 293.
7 [1913] A.C. 680
8 At p. 298.

adopted for both innocent and wrongful commingling by B of its goods with A's.

Blending. The blending situation is different. Here A's goods will have ceased to exist upon the mixing together of A's and B's goods (as will B's) and a new product will have been created.

Once again the retention of title clause will be ineffective, essentially for the same reason as it was in *The Res Cogitans*: the goods owned by A and which were transferred to B subject to a clause retaining A's title have ceased to exist by reason of the blending process and A's title and further possibility of title in the goods has been extinguished.

Borden (U.K.) Ltd. v Scottish Timber Products Ltd [1981] 1 Ch. 25 is a simple example of this. The plaintiffs in that case supplied resin to the defendants for use in the manufacture of chipboard. The contract provided that property in the resin was to pass to the defendants only when all the goods supplied by the plaintiffs had been paid for, although it also contemplated that the resin would be used in the manufacturing process before payment had in fact been made: no question of wrongful 'blending' therefore arose. In the course of that process, the resin was mixed with other materials in such a way as to lose its separate identity. On the appointment of a receiver of the defendants the plaintiffs brought an action for money still owing to them in respect of the price of the resin. They contended that any chipboard manufactured using the resin was charged with the payment of the outstanding amount. The Court of Appeal rejected that argument, holding that once the resin had been used in the manufacture of chipboard it had ceased to exist and with it the plaintiffs' title: 'there is no doubt that as soon as the resin was used in the manufacturing process it ceased to exist as resin, and accordingly the title to the resin simply disappeared' per Bridge LJ at 35.

The chipboard was a wholly new product, property in which vested in the defendants as the manufacturers of it. The Court of Appeal rejected the argument that the retention of title could take effect so as to give the plaintiffs a charge over the resultant end-product into which their resin had disappeared or to trace or follow their interest into the new product. Templeman LJ with characteristic terseness stated at 44:

> 'When the resin was incorporated in the chipboard, the resin ceased to exist, the plaintiffs' title to the resin became meaningless and their security vanished. There was no provision in the contract for the defendants to provide substituted or additional security. The chipboard belonged to the defendants.'

It will be noted that no argument was advanced in *Borden* that the chipboard resulting from the use of the resin was subject to co-ownership, or that the rule of co-ownership as applied in the commingling class of case should equally be applied in a blending case. As Buckley LJ pointed out at 46:

> 'Common ownership of the chipboard at law is not asserted by the defendants; so the plaintiffs must either have the entire ownership of the chipboard, which is not suggested, or they must have some equitable interest in the chipboard or an equitable charge of some kind upon the chipboard. For my part, I find it quite impossible to spell out of this condition [i.e. the retention of title clause] any provision properly to be implied to that effect. It was impossible for the plaintiffs to reserve any property in the manufactured chipboard, because they never had any property in it; the property in that product originates in the defendants when the chipboard is manufactured.'

This omission to argue for co-ownership is explicable on two bases.

First, it being a case of consensual destruction by blending / manufacture under a contract between the parties, the parties' intended result of ownership of the newly created product would have to be inferred by reference to the contract terms agreed between the parties: hence the plaintiffs' attempt to seek to build from the simple retention of title provision an implied charge over the new product. That clause, given its (typically) limited wording, could hardly support co-ownership by the plaintiffs of a wholly different item to be manufactured by the defendants. Hence no argument was advanced on this basis.

As Moore-Bick J. pointed out in *Glencore v Metro*,[9] if A allows B to use and destroy his goods in the manufacture by B of B's new goods, the default assumption will be, irrespective of mere retention of title provision which does not provide for what is to happen when A's goods cease to exist, that A intended B to have property in its goods and, in any event, that B had sole property in B's newly created goods.

> 'In most cases where there is agreement to the use of goods in a manufacturing process the parties will have made specific provision for these matters, but even if they have not, it will usually be possible to determine from the terms of the contract as a whole what their intention was. In the absence of agreement to the contrary, the likelihood is that property will pass on delivery because the supplier intends to give the manufacturer complete dominion over the goods.'

Secondly, the failure to argue for co-ownership may also have reflected an uncritical acceptance by counsel for the plaintiffs in *Borden* of the Roman law principle

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9 *Supra*; at [157].

of *specificatio* that, where a wholly new product or thing is created by B out of the materials or goods of A, either in combination with B's own goods or, possibly, using A's goods alone, title to the newly created product or thing is solely in B. This principle was concerned with the alteration of a raw material or subject matter by some process so as irreducibly to create an entirely new thing (*nova species*).[10] While all things made can, in one sense, be described as being a new thing, the Roman law concept was, and its modern application has been, narrowly confined to the conversion of materials from one species into a new one. As it is put by Professor Bridge,[11] specification is 'where a raw material is altered by labour to produce something of a different identity. The Romans gave examples of grapes converted into wine and silver fashioned into a jug. We may cite the more recent example of leather that is cut, shaped and stitched to make handbags.'[12]

That principle certainly forms part, at least, of Scots law. By way of example, in *International Banking Corporation v Ferguson, Shaw & Sons*[13] the defendant buyer bought in good faith a quantity of oil to which the seller did not have title and used it for the manufacture of lard compound by blending it with materials of his own. The true owners of the oil brought an action to recover the oil or damages in lieu, although by that time the lard had already been sold. Lord Low, who delivered the leading judgment, pointed out[14] that in this case a new substance had been created to which the doctrine of *specificatio* applied by which 'the mixer, whether he be one of the proprietors or a third party, must, as the maker of the new species, become the sole proprietor of the subjects mixed.' Similarly, Lord Dundas[15] considered that the case was a pure type for the application of the Roman doctrine of specificatio which he considered to be undoubtedly part of the law of Scotland. It is to be noted that the purchaser in this case, although acting wrongfully, was acting in good faith

In *Glencore v Metro*, the English Court had to consider this issue in the context of blending by another major bunker supplier whose business also collapsed. Apart from ordinary commingling issues, the Court had to consider a variety of different blending cases where different grades of fuel had been blended to create various types of marine bunker fuel. It was argued for Metro that the creation of the new fuels was an instance of *specificatio*: i.e. that the effect of the blending was to produce a new commodity different in kind from either of its constituents and that where the original goods ceased to exist altogether and new goods were created in their place, title to them vested in the person who produced them, being Metro as blender.

Moore-Bick J. held that there was no support for a similar approach in English law at least where (a) the blending came about by wrongdoing on the part of the blender and (b) the new product created, although entirely different from the constituent elements (made up of A's and B's goods or simply A's goods or the goods of different innocent parties A1, A2 etc), could be divided up pro rata between the contributors to it without destroying the new product (cf. a single manufactured item such as a coat made up of individual furs[16]). As he put it:[17]

> 'I have therefore reached the conclusion that when one person wrongfully blends his own oil with oil of a different grade or specification belonging to another person with the result that a new product is produced, that new product is owned by them in common. In my view justice also requires in a case of this kind that the proportions in which the contributors own the new blend should reflect both the quantity and the value of the oil which each has contributed. As in other cases of mixing, any doubts about the quantity or value of the oil contributed by the innocent party should be resolved against the wrongdoer.'

The joinder cases

Less commonly encountered are the cases where A's goods are physically incorporated by a process of further manufacture into B's goods (or vice versa). The typical example is of an engine or machine part supplied by A fitted by B into B's vehicle or larger machine or plant.[18]

Notes

10 Thomas, *Handbook of Roman Law*, p. 174; Buckland, *Textbook of Roman Law* (3rd edn ed. Stein), p. 215.
11 *Personal Property Law* (2002), p 107.
12 The 'recent example' is a reference to *Re Peachdart Ltd* [1984] Ch 131.
13 1910 S.C. 182.
14 At p. 192, Lord Ardwall concurring.
15 At p. 194.
16 As considered in *Jones v De Marchant*, (1916) 28 D.L.R. 561
17 At [185].
18 Mixture of liquids can give rise to the *accessio* principle rather than that of *confusio* or *specificatio*: as explained by Moore-Bick J in *Glencore v Metro* at [177]: 'the addition of a small quantity of one type of material to a large bulk in order to make a slight adjustment to one of its characteristics without changing its essential nature (e.g. the addition of sugar to tea or anti-knock compounds to petrol)' and [179]: 'the work carried out on the goods by the wrongdoer, as well as additions of small amounts of the his own materials, are treated as attaching to the goods by accession'

For perhaps the most recent example (in which the author was involved), see *International Finance Corporation v DSNL Offshore Limited*, where accession was argued to defeat a third party's continued ownership of a pump unit which was fitted consensually by a manufacturer into a drilling rig's topside unit (and an equitable lien imposed upon the same in favour of the party who funded the manufacturer's purchase of the pump).[19]

Joinder raises the separate Roman law doctrine of *accessio*[20] or accession. It has been summarised in English law as follows by Professor Palmer[21] 'if one entity (the accessory) is firmly attached to another, in some sense, superior entity (the principal) then ownership of the accessory passes to the owner of the principal' and is described by Professor Bridge in these terms: '*accessio* is the joining of a subordinate thing to a dominant one, so that the identity of the subordinate becomes submerged in the dominant ....For accession, the rule is that the owner of the dominant or superior thing retains the thing in its new and enlarged state'.[22]

In Roman law, the test was based on the degree of permanency of joinder and the ease of separation coupled with regard to whether the detachment of the accessory would effectively destroy the article which had been produced by joinder. However some form of permanent fusion appears to have been required,[23] with mere loose joinder insufficient. However, there has been greater consideration of this second issue on accession in the modern cases in both the US and the Commonwealth.[24]

Whether the physical incorporation is irreversible or can simply give rise to a disconnection or cutting out of the structure will raise a factual question. In *McKeown v Cavalier Yachts P/L*[25] a hull of a yacht belonging to P had work done on it by D with D fitting it out with floors, stringers to complete the hull, installing an engine and then fitting on the deck. It was held that the hull was the principal to which the other items and materials fitted by D were the accessory or merely accretions to the dominant chattel and that title in all of the materials added to the laminated hull passed to P as owner of the hull. An argument by D that the relative values of the materials contributed by D (Aus$ 24,409) and of the laminated hull owned by P (Aus$ 1,777) meant that the hull acceded to the added items rather than the other way around was rejected. Young J. held that:

> 'Quite clearly the work was done gradually and the true position was that some work was done to the laminated hull making it more valuable, at that stage that work acceded to the laminated hull, and the whole of the product belonged to the plaintiff. A little further work was done, and that little further work acceded to the hull and again the hull became the plaintiff's property and this was the result as each extra bit of work was gradually done to the hull. In my view that is the correct view of looking at the case.'[26]

Contrast the only modern English case to consider accession of chattels to chattels of *Hendy Lennox (Industrial Engines) Ltd v Graham Puttick Ltd*,[27] a case concerning the incorporation of engines into generating sets which were parts which were capable of being 'changed out' from time to time in case of need and were secured in place in the generator sets by bolting and other connections. It was held by Staughton J. that there was no accession: 'They just remained engines, albeit connected to other things.'[28]

The importance of accession is that where the joinder attains the requisite factual threshold, the accessory item is treated as if it has ceased to exist, having been subsumed in another thing. Accordingly a simple retention of title provision will be ineffective.[29]

Further, under Roman law, no co-ownership arose of the principal to which the accessory had been joined and in which it had become merged. Even in cases of wrongful joinder, the property in the accessory was lost to the owner of the principal and the owner of the accessory was left to his remedy in damages. 'In all cases of genuine *accessio*, the owner of the principal element became the owner of what was incorporated into it, regardless of whether the incorporation was effected

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19 [2005] EWHC 1844 (Comm). The accession point having been fully argued, the Judge (Colman J.) touched on only one aspect of it, given that the case was being heard on an urgent basis in vacation and dealt principally with issue of title and the application in English law of the vendor's equitable lien to sales of chattels and whether the Australian decision in *Hewett v Court* [1982] 149 CLR 639 was to be followed. The parties agreed to re-argue the points before the Court of Appeal but the case settled shortly before the six-day appeal was due to be heard.

20 *Accessorium principale sequitur* or *accessio cedit principali*: [ownership of] the accessory item follows or yields to that of the principal item.

21 Palmer and McKendrick (eds), *Interests in Goods* (2nd edn 1998), p. 931.

22 *Personal Property Law* (2002), at 106 and 107.

23 See the consideration in Thomas, *Textbook of Roman Law*, *op. cit*, p. 169. Hence the jurists' distinction in terms of attachment between welding something to another object (: *ferruminatio*) which gave accession and mere soldering of two things together (:*plumbatura*) which did not. As Thomas points out 'separability naturally was dependant on current technology', *ibid*. fn. 60

24 See the extensive compilation by Professor Guest at (1964) 27 *Modern Law Review* 505 at 507.

25 (1988) 13 NSWLR 303.

26 At 311G-312A.

27 [1984] 1 WLR 485.

28 At p 494F-G.

29 See e.g. *Lewis v Andrews & Rowley Pty Ltd* (1956) 73 WN (NSW) 670 and cf. *Rendell v Associated Finance Pty Ltd* [1957] VR 604 at p. 610.

bona fide or mala fide, whether it was effected with or without the consent of the former owner of what was incorporated or whether the incorporation was effected by himself or by another. These factors were however relevant to the issue of possible.'[30]

Unfortunately, there is no clear modern English authority on this aspect (and the point although it arose for decision in *IFC v DSNL* was not addressed). The textbooks all support the adoption of the Roman law approach[31] as apparently does Scots law.[32] The large number of cases collected together by Professor Guest and other reported cases in other Common Law jurisdictions[33] all appear to proceed upon the basis that *if* accession were shown to have taken place, then title would pass to the owner of the principal item. The only doubt in the cases was over the difficult factual issue, resolved for the purposes of this appeal by the assumption made by the Judge, of whether or not there had been that degree of attachment and that resultant difficulty of separation as to give rise to accession in the first place.

In *IFC*, Colman J. in upholding the existence of an equitable lien in respect of the accessory distinguished, for the purposes of *accessio*, between the survival of this lien (over the whole, i.e. the principal) and the extinction of any property in the accessory by accessio to the principal. He stated at [65] and [66]:

> 'I further assume, without presently deciding the point, that the nature and degree of attachment was such that if Chevron had legal title to that equipment, that title would have passed to DSNL by accession. In those circumstances, and on that assumption, what happened to the equitable lien?
>
> DSNL having received delivery of the equipment subject to the equitable lien were thereafter trustees of Chevron's equitable interest and were, as such, precluded from disposing of that interest without Chevron's consent as beneficiary. If they attached the equipment subject to Chevron's lien to their own property they could not in my view thereby divest Chevron of its beneficial interest in the equipment if severable or, if not severable, in the composite structure. Although, even if because of the nature of attachment there would have been a passing of property by accession if Chevron had had legal title to the equipment, there would be no breach of trust by DSNL in those circumstances making the attachment because it was done with the beneficiary's consent. Nevertheless, in the present case where legal title remained in DSNL throughout, there was no conduct on the part of Chevron which amounted to its consent to the extinguishing of its equity in the equipment. Indeed, the only purpose of its acquisition of the lien in the first place was that the equipment should be designed, built and deployed in the construction of the modules. It would be absurd for the beneficiary to be deprived of its lien by the performance by the trustee of the very function which the lien was intended to facilitate. The composite would in those circumstances be subject to the equitable lien.'

Conclusions: the need for tailored drafting

The overriding conclusion to be drawn is that where goods are sold or supplied for use in manufacture it is necessary to adopt a bespoke approach to what might loosely be called 'retention of title'. Crude boilerplate retention clauses will work only so long as the goods themselves exist (a truism). Where it is anticipated that they will cease to exist either because of blending, consumption in a process of manufacture or by incorporation in a greater whole, then a tailored provision dealing with the consequences of non-payment should always be employed.

While English law has arrived at a fairly settled approach as to when co-ownership will result from intermixture, including the creation of a *nova species*, there remain less certain contexts, such as accession. All these (for lawyers, fascinating) questions can be side-stepped by contractually providing in advance for title to the manufacturer's product or a charge or other security interest in respect of it pending full payment.

Parties are free to decide for themselves at what stage, if any, in the process to which the goods being supplied or sold are being subjected, property in the original goods shall pass to the blender and on what terms. This includes the right to decide who is to own the resultant blend or created item. In *Clough Mill Ltd. v Martin*[34] the plaintiff supplied yarn to a manufacturer of fabric under a contract which provided that if any of the yarn were incorporated into other goods the property in those goods should remain in the plaintiff until all the yarn supplied had been paid for. Lord Justice Robert Goff described the effect of a term of that kind as follows:[35]

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30 Thomas, *Text-book of Roman Law* (1976) at 171.
31 Professors Guest; Bridge; Palmer and Hudson (all cited above) and Halsbury, *Laws of England*, vol. 35, para. 1238.
32 Stair, *Encyclopaedia of the Laws of Scotland*, vol. 18; paras 574 and 588
33 *Supra*. See also Rendell; *McKeown v Cavalier Yachts*; in New Zealand: *Thomas v Robinson*; in Canada: *Firestone Tire & Rubber v Industrial Acceptance Corporation* (1970) 75 WWR 621; in England: *Hendy Lennox v Graham Puttick*; in the US: *Davy v State* (1928) 265 Pac. 626
34 [1985] 1 W.L.R. 111.
35 At p. 119G.

> 'Now it is no doubt true that, where A's material is lawfully used by B to create new goods, whether or not B incorporates other material of his own, the property in the new goods will generally vest in B, at least where the goods are not reducible to the original materials… But it is difficult to see why, if the parties agree that the property in the goods shall vest in A, that agreement should not be given effect to. On this analysis, under the last sentence of the condition as under the first, the buyer does not *confer* on the seller an interest in the property defeasible upon payment of the debt; on the contrary, when the new goods come into existence the property in them ipso facto vests in the plaintiff, and the plaintiff thereafter retains its ownership in them.'

Put more simply by Moore-Bick J. in Glencore v Metro.[36]

> 'in a case where title to newly manufactured goods would otherwise vest solely in the manufacturer, there is no reason in principle why the manufacturer and a supplier should not by agreement cause title to vest originally in the supplier rather than the manufacturer.'

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36 At [157].

Sale or No Sale? An Update on O.W. Bunkers

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Introduction and summary

It is often the case that contracts for the sale of goods provide for credit to be extended to the buyer, but with the seller retaining title until payment. As a result of the decision of the Court of Appeal in *PST Energy 7 Shipping LLC & Product Shipping and Trading S.A. v OW Bunker Malta Ltd & ING Bank N.V.* [2015] EWCA Civ 1058 (the '*Res Cogitans*'), which was handed down on 22 October 2015, if the goods forming the subject matter of such a contract are consensually consumed during the credit period, then the contract will not be classified as one of sale.

The appeal was heard on an urgent basis, reflecting the fact that its implications, already far-reaching in the shipping industry, extended far beyond. In essence, the Court of Appeal upheld the conclusion of the Judge below in the Commercial Court (Males J.), who had in turn upheld some of the conclusions of the arbitrators who first heard the matter. Each concluded that a written contract, described as a sale contract and containing all the indicia of a sale contract, would not be a sale contract if the parties contemplated that the goods would physically cease to exist before the time at which property was meant to pass under the contract.

The authors submit that this is a surprising conclusion. In contracts for the sale of pharmaceuticals, foodstuffs, chemicals, raw components for incorporation into other objects, and fuel, it is often the case that the retention of title clause in the contract permits consensual use of the goods. The result of the Court of Appeal's decision in *Res Cogitans* is that the numerous cases that have come before the Court concerning the extent to which aspects of such retention of title clauses are enforceable or not, which have proceeded on the basis that the consumption of the goods has no impact upon the nature of the contract (indeed in those cases it has been assumed that contracts permitting consensual use were and remain contracts of sale within the Sale of Goods Act 1979, or its predecessor, the 1893 Act), have all proceeded on an incorrect assumption. The authors believe that this is unlikely. The decision is also open to criticism on a number of other grounds.

The facts

The OW Bunker Group, consisting of a Danish parent company, OW Bunkers & Trading A/S (*OWBAS*), and different subsidiaries in different jurisdictions, was one of (if not the) largest supplier of marine fuels, known as bunkers, in the world. In December 2013 OWBAS entered into a revolving credit facility under a syndicated loan, with ING Bank N.V. (*ING*) as lead bank. As security for the loan, the OW Bunker Group entered into an Omnibus Security Agreement, whereby it assigned and charged to ING, as Security Agent, all rights, title and interest in its third party and intercompany receivables.

The bunker supply industry generally uses standard form contracts, and there is usually a string of participants, and thus a string of contracts. Thus when the owner/operator of a ship orders fuel, which may be delivered (*stemmed*) to the vessel in port, or offshore from a bunker supply vessel, the immediate seller places an order with another party further up the chain, and so on. There may be four or five such participants in the chain, with only one of them physically delivering the fuel. Invariably each participant in the chain regards itself as having entered into a sale contract with the parties immediately below (and above). These contracts are frequently, although not invariably, governed by English Law, are frequently on or adaptions of BIMCO (Baltic and International Maritime Council) standard terms, and more often than not contain a retention of title provision of some description. It is also usual, although not inevitable, that each contract restricts use of the fuel, but permits the same to be consumed for a limited purpose only, namely propulsion of the vessel. Whilst not invariable, it is often the case that the parcel of fuel delivered may have been consumed in whole or in part before the expiry of the credit period. Of course, the more creditworthy the seller, the longer the credit period, and the greater the likelihood of consumption.

The facts of this case followed this well-established pattern. On 4 November 2014, OW Bunker Malta Ltd (*OWBM*) supplied 1,000 metric tons of fuel oil and 100 metric tons of gasoil (*the bunkers*) to the vessel *Res Cogitans*, pursuant to a contract which incorporated and was subject to the OW Bunker Group's 2013 Terms and Conditions of Sale for Marine Bunkers (*the OWB Terms*). Those terms provided for payment 60 days after delivery and included a retention of title clause under which property in the bunkers was not to pass to the vessel's owners or managers until the bunkers had been paid for in full. However, the contract also expressly provided that the vessel was entitled, from the moment of delivery, to use the bunkers for the purposes of propulsion.

OWBM acquired the bunkers under a contract with OWBAS, which in its turn obtained them from another bunker supplier, Rosneft Marine (UK) Ltd (*RMUK*), which obtained the bunkers from one its associated companies, RN-Bunker Ltd (*RNB*), the company which effected delivery to the vessel. The contract between OWBAS and RMUK incorporated RMUK's standard terms. These provided for payment to be made 30 days after delivery and included a retention of title clause. However, they did not expressly allow the owners to use the bunkers for the purpose of propulsion of the vessel pending payment.

The contract between OWBAS and OWBM was on the OWB Terms. It was accepted at all stages of the litigation, and could not have been argued to the contrary, that the OWB Terms are drafted as an agreement to sell. This appears not only from the language of the agreement, which refers to 'Buyer' and 'Seller', but also from the structure of the agreement. The retention of title clause in the OWB Terms provided as follows:

> H.1 Title in and to the Bunkers delivered and/or property rights in and to such Bunkers shall remain vested in the Seller until full payment has been received by the Seller of all amounts due in connection with the respective delivery. The provisions in this section are without prejudice to such other rights as the Seller may have under the laws of the governing jurisdiction against the Buyer or the Vessel in the event of non-payment.

The 'carve-out' to permit use for propulsion of the vessel, was not in fact a carve out from the sale/retention provisions of the agreement, but rather an express bailment that was entered into to cater for the capacity in which the buyer (the Owners) held the stemmed parcel of fuel pending payment. It provided:

> H.2 Until full payment of the full amount due to the Seller has been made and subject to Article G.14 hereof, the Buyer agreed that it is in possession of the Bunkers solely as Bailee for the Seller, and shall not be entitled to use the Bunkers other than for the propulsion of the Vessel, nor mix, blend, sell, encumber, pledge, alienate, or surrender the Bunkers to any third party or other Vessel.

The litigation

In November 2014, the OW Bunker Group became insolvent and defaulted on its obligations to ING. Serially, the various OW subsidiaries that had accepted orders for fuel did not pay the party next above them. Thus, in *Res Cogitans*, whilst RMUK paid RMB, it was not paid by OWBAS, which in turn was not paid by OWBM. The Owners (*PST*) were content to pay for the fuel delivered. However, there were competing claims from Rosneft, the intermediate supplier (which relied upon its English law contract with a retention of title clause, and was threatening to arrest the vessel to obtain security) and from ING, as OWBM's assignee, which was claiming payment of the price, and again threatened to arrest the vessel.

PST commenced arbitration under its sale contract with OWBM, with OWBM and ING (as assignee) as respondents, seeking declarations that as a matter of English law it was not required to pay OWBM (and hence ING), thus leaving it free to pay Rosneft and preclude an arrest of the vessel by ING. PST's arguments were that: (i) the contract was an agreement to sell within Section 2(1) of SOGA 1979; (ii) OWBM was in breach of condition in that it never had, and never would have, property in the goods to pass to PST; and (iii) in any event, OWBM/ING had no claim for the price under Section 49 SOGA, and no other claims.

In response, ING's primary arguments were that: (i) the contract *was* an agreement to sell; and (ii) property had passed on consumption (all along the chain) and thus had passed to PST already, so that OWBM (and hence ING as assignee) had a claim for the price under Section 49 SOGA, alternatively property had passed along the chain via Section 25 SOGA. ING alternatively sought specific performance of the sale contract and/or remedies in bailment or restitution.

The arbitrators found against ING on most of the preliminary issues, but concluded that the contract was not an agreement to sell within the meaning of Section 2(1) SOGA, because notwithstanding its language, its essence was the delivery of fuel with a right to consume the same. On appeal to the Commercial Court, Males J. ultimately agreed with the arbitrators' conclusion. However, he also found that it was an implied condition of the contract between PST and OWBM (to be implied of necessity) that OWBM was obliged to ensure that the licence which it gave PST to use the bunkers immediately upon delivery was or became binding on whichever entity in the supply chain was or would become the owner of the goods.

Interestingly ING's argument in the Commercial Court did not, initially, seek to support the logic and reasoning of the arbitrators in relation to the question of whether the contract was one of sale or not. ING argued in front of Males J. that the contract was, in principle, a contract of sale within Section 2(1) SOGA, but that incrementally the content of the sale was removed upon consumption. In the face of scepticism from the Judge when he directed questions to ING's Counsel, that argument was abandoned and instead ING contended that the contract was not a contract of sale at all. The Judge accepted this but, recognising that this was breaking new ground and had significant commercial ramifications extending far beyond the maritime community, he granted permission to appeal to the Court of Appeal.

The decision of the Court of Appeal

The Court of Appeal agreed to hear the case on an expedited and urgent basis. In its reserved Judgment, the Court of Appeal (Moore-Bick, Longmore and McCombe LJJ) decided that the true nature of the agreement was:

> 'a contract under which goods are to be delivered to the owners as bailees with a licence to consume them for the propulsion of the vessel, coupled with an agreement to sell any quantity remaining at the date of payment, in return for a money consideration which in commercial terms can properly be described as the price.'

This conclusion was driven by the well-established principle that consumption of goods destroys property in them (as a matter of English law, if the very act of consensual use results in the physical destruction of the goods, they cease to exist: *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25). From that, the Court of Appeal concluded that it is no longer possible to transfer property in goods once they have ceased to exist.

However, in contrast to Males J. in the Commercial Court (who concluded that there was a residual obligation to transfer property in relation to unconsumed bunkers at the expiry of the credit period, *but* that obligation was not pursuant to a sale contract within SOGA), the Court of Appeal held further that:

> 'Since the contract provided for the transfer to the owners of property in any part of the bunkers remaining at the time of payment, it was to that extent a contract for the sale of goods to which the Act, including the implied conditions in Section 12, applied. A failure to pass title to any residue remaining at the time of payment would therefore involve a breach of contract, but it would not be one which entitled the owners to treat the contract as a whole as discharged, unless (contrary to all expectations) it represented such a large proportion of the quantity originally delivered that there could be said to have been a total failure of consideration.'

Observations

The Court of Appeal accepted that the many cases to which it had been referred in argument concerning retention of title provisions, had all proceeded on the assumption that the contracts were sale contracts within SOGA, notwithstanding the fact that the goods had either been consumed prior to the credit period (as in, for example, *Borden, q.v.*; and *Chaigley Farms Ltd. v Crawford* [1996] BCC 957) or that such consumption was expressly permitted and contemplated (as in the House of Lords case of *Armour v Thyssen Edelstahlwerke AG* [1991] 2 AC 339). It might be thought surprising, in view of the number of retention of title cases that have come before the Court in England over the last 50 years that, in those where a right to consume was given expressly or by implication, it had never occurred to any of the numerous Counsel involved, or to Judges at the highest echelons of the judiciary, to raise the question as to whether SOGA applied.

True it is that this point was never argued, but that is equally consistent with everybody proceeding on the basis that the nature of the contract was to be determined at the point at which it was entered into, rather than by reference to ex post facto events such as consumption. It might also be said that even if not *expressly* raised, the point was raised by implication, because most of the cases involving retention of title clauses (or '*Romalpa* clauses', so named after *Aluminium Industrie Vaassen BV v Romalpa Aluminium Limited* [1976] 1 WLR 676) concerned competing arguments in relation to whether the contract was a sale contract with a postponement of the passing of property, or whether it was in reality a charge, under which property passed to the buyer, but was then subject to an equitable charge in favour of the seller by way of security, and hence (usually) void for want of registration under the Companies Acts. The other broad species of retention of title dispute concerns whether, and the extent to which, a reservation of property transfers into new products manufactured using or incorporating the subject matter of the original sale, or whether and the extent to which there is a right to trace into the proceeds of sale of the new products. The arguments marshalled in relation to such cases inevitably involve a consideration of the nature of the contract, its proprietary content and effect, and the passing of property.

In the circumstances, the Court of Appeal's determination that all these cases had little utility in determining the issue before it is perhaps surprising. It does, however, illustrate the fact that this decision certainly constitutes 'new law' in that it clarifies, by removing, the well-established prior assumption.

A number of problems arise in relation to the Court of Appeal's judgment. At the date of the contract (or a day or so thereafter) the goods forming the subject matter of the same (the bunkers) were delivered to the buyer. They were ascertained goods appropriated to the contract. If the credit period had been three days, and the goods accordingly not consumed, according to the Court of Appeal it would have been a sale contract within SOGA because the obligation to transfer property in the unconsumed bulk at the time of payment constitutes a sale within SOGA (see paragraph 33 of the judgment of Moore-Bick LJ). This raises the question as to what the source is of that obligation to transfer property. It is obviously the contract - the agreement entered into a few days earlier. It must follow that the contract is an agreement to sell, not least because it fulfils the definition of such a contract contained in Section 2(1) SOGA: 'A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price'.

Thus, even on the Court of Appeal's reasoning, when entered into, the contract was an agreement to sell within SOGA, at least in relation to those bunkers that had not been consumed at the time of payment. On this analysis, therefore, although not expressed in such terms by the Court of Appeal, the contract must have been an agreement to sell at the date it was entered into, but the *obligation* in relation to transferring property was confined only to the goods that physically existed at the date of payment. On that basis, OWBM was in breach of condition under Section 12 SOGA, because this obligation to pass property applies as much to an agreement to sell as it does to an outright sale.

Next, if (as the Court of Appeal found) there was an obligation to transfer property 'in any part of the bunkers remaining at the time of payment' (again, see paragraph 33 of the judgment of Moore-Bick LJ), what happens if the buyer chooses to pay early, and does not take the benefit of the credit period? Why should it be, further, that the nature of the agreement when entered into is determined by such circumstances, which are entirely within the gift of the buyer? Moreover, why should the length of the credit period determine the nature of the contract when entered into?

The Court of Appeal rejected the contention (only one of the arguments advanced by PST) that, in any event, certainly as a matter of contract, property could pass retrospectively. The essence of that argument was that: (i) the parties are free to contract in whatever way they so choose; (ii) it is well established as a matter of English law that parties can contract upon an agreed basis, even if it does not represent the factual reality (see *Springwell Navigation Corp v JPMorgan Chase Bank (formerly Chase Manhattan Bank) & Ors* [2010] EWCA Civ 1221); (iii) if the parties contract on the basis that the price is to be paid at day 60, both in the knowledge that the goods may well have been consumed prior to that period, but nevertheless expressly structure the bargain as if it is a contract of sale; then (iv) neither party can set up and assert the fact of consumption as changing the nature of the obligations they have assumed, or invoke the physical act of consumption to re-categorise the nature of the contract, and by dint thereof, remove the implied conditions contained under SOGA. The parties, in other words, can be said to have contracted on the basis that property is treated as if it still existed as at the point of payment. This also reflects commercial reality, because the purchase price is frequently used along a string of such agreements to sell, to feed title. Providing title has been obtained at or immediately consequent upon payment, then as a matter of commercial reality, no party has any complaint. The bargain works and takes effect according to its contractual terms. In the present case, for example, there was a string of agreements to sell, although doubtless each party contemplated that the bunkers would be used as fuel to propel the vessel. Each supplier granted credit for a period. Each sought to retain property until full payment of the bunkers supplied. Each contract used the language of a contract of sale, and every aspect thereof contained the indicia of such a contract.

Why then was the contract between PST and OWBM not a contract for sale? Whilst it might be said (as indeed the Court of Appeal observed) that the contract contained an express bailment with a right to consume, this was hardly the 'hallmark' or 'defining feature' of the contract; even more so as the right to consume was not accompanied by any obligation to pay upon consumption, either in whole or in part, and neither were any terms in relation to payment contained within the bailment. The bailment is better regarded as reinforcing the fact that property remained in the seller until payment, but possession passed to the buyer. The bailment provisions in clause H2 of the OWB Terms sought to regulate what the buyer could do with the seller's property in the meantime. That clause was not addressing passing of property, payment, or somehow reclassifying the genus of the agreement consequent upon consumption.

Conclusions

The ramifications of this decision are extreme and far-reaching. Even though the degree of contemplation of consumption that determines the nature of the agreement has not been addressed, if the state of the law in England rests with the Court of Appeal's decision, a number of further issues are going to have to be determined. Is it enough that the contract contemplates consumption by permitting it? What degree or extent of consumption gives rise to a breach of Section 12 SOGA if the seller never actually owns the goods supplied under the contract? It will be remembered in the present case, that OWBM did not own the bunkers: yet according to each decision, at each level, OWBM was nevertheless able to maintain a claim for the contract sum.

On 11 February 2015, the Supreme Court granted PST permission to appeal against the decision of the Court of Appeal. These knotty and important issues will be further explored in that forum.

Admiralty *in rem* Claims and Insolvency Law

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The problem stated

In his eponymous work on maritime liens (Stevens & Sons, 1980), D.R. Thomas remarked acidly (at para. 99) that –

> 'The law of [insolvency] seems to have developed with little regard to the Admiralty proceeding *in rem*. Certainly it is difficult to fit the Admiralty proceeding into the legislative language of the relevant statutes which regulate [insolvency proceedings]. Yet the need for the latter to accommodate the action *in rem* and the potential conflict between the two processes is plain.'

This article seeks to provide some insight into the Admiralty action *in rem* for the benefit of those who, unlike Thomas, are not steeped in the Admiralty tradition.

In rem claims outlined

Admiralty jurisdiction in England and Wales (with siblings in Australia, New Zealand, Hong Kong, Singapore, Canada and South Africa) dates back to the early middle ages. Nowadays, however, it is derived in the first instance from the provisions of ss 20-22 of the Senior Courts Act 1981 ('SCA'). Those sections set out four broad areas of jurisdiction, of which the principally relevant one for present purposes is that of maritime claims. With the sole exception of claims for damages received by a ship, maritime claims may all be brought *in rem*.

The action *in rem* is the Admiralty Court's defining feature, even though maritime claims can in most instances be brought *in personam* (i.e., against a named natural or legal person). In the action *in rem*, the claim is brought against a named ship, and the parties to the action are not named but are described (e.g., as 'The Owners of the Ship XYZ').

The action *in rem* enables property (usually a ship) to be arrested. Arrest contributes in some circumstances to the founding of jurisdiction, but that is not the concern of this article. It also compels the vessel's owner to provide security for the underlying claim, failing which the vessel can be sold, even before trial, with the sum realised from the sale standing in place of the ship. The fund is then available to anyone with a judgment against the ship or its owner. For this reason, judicial sale removes all encumbrances from the vessel's title.

If the fund is insufficient to meet all judgments against it, then it will be distributed following the relative priority accorded to the claims by the Admiralty Court. The ranking of claims is ultimately within the discretion of the Court, which may adjust it in order to reflect the justice of the case. The starting point, however, is the following prima facie order:

(1) The Admiralty Marshal's costs and expenses connected with the arrest of the vessel and its appraisement and sale. (The Admiralty Marshal is the court official who effects arrest and administers vessels under arrest.)

(2) (i) The costs of the arresting party up to and including the arrest of the vessel concerned, and

(ii) The costs of the party who obtained the order for the appraisement and sale of the vessel, for the period up to and including the order itself.

(3) Maritime liens.

(4) Possessory liens.

(5) Mortgages.

(6) Other statutory actions *in rem*.

(7) *In personam* claims.

If there is anything left in the fund once the above claims have been satisfied, the (former) owner is entitled to the balance. In an insolvency context, that will usually mean that the balance will be available for the non-Admiralty creditors of the owner.

The correct classification of the claim can therefore be make-or-break in terms of recovery. What, then, are these 'maritime liens' which rank ahead of classic real security such as mortgages? What are other statutory *in rem* claims? And what is it about them that they rank ahead of *in personam* claims?

Statutory claims *in rem* and maritime liens

The answer to the last question is that statutory *in rem* claims also give rise to a lien on the vessel against which the claim is made. So-called statutory liens have in common with maritime liens that, once they have arisen, a subsequent change in the ownership of the vessel will not defeat the lien, so the vessel can still be arrested and sold as outlined above. They also have in common that neither requires possession of the ship and that effect can only be given to them through the *in rem* process.

In addition to their different priorities ranking, there are three principal differences between them:

(1) Their history. Until 1840, the jurisdiction of the Admiralty Court was coterminous with the availability of the maritime lien. With one exception (claims for masters' wages and disbursements), all maritime lien claims are thus non-statutory in origin. (They cannot be called 'common law', however, because the Admiralty Court was never a common law court.) The statutory claims, as the label implies, were added by a succession of Acts, most notably in 1840 and 1861. Most claims giving rise to maritime liens were included in those statutes, so that they can also be brought as statutory *in rem* claims.

(2) The time at which they arise: whereas the maritime lien arises at the same time as the underlying cause of action, the so-called 'statutory lien' arises only when the proceedings are commenced, i.e., upon the issue of the *in rem* claim form.

(3) The identity of the vessel which may be proceeded against, and the connection between that vessel and the person who would be liable on an action *in personam*:

  (a) Maritime liens may only be 'enforced' (i.e., the claim giving rise to them may only be brought) against the vessel in respect of which the cause of action arose, but can be brought whether or not the current owner was ever liable *in personam*.

  (b) A statutory *in rem* claim, on the other hand, can be brought only where –

    (i) the personal liability of the owner, charterer, or person in possession or control of the ship can be established at the time when the cause of action arose *and*

    (ii) such person is the beneficial owner of the 'wrongdoing ship' or of another ship, or the demise charterer of the 'wrongdoing ship'.

  In other words – and broad terms – it may be possible to proceed against more vessels than just the 'wrongdoing ship' (i.e., against its so-called 'sister-ships), but a change of ownership before the proceedings are commenced will make *in rem* proceedings against that ship impossible.

Because statutory claims *in rem* give rise to a security right against the vessel, it is only natural that they should rank ahead of purely *in personam* claims. Justification for the prior ranking afforded to maritime lien claims even above those of mortgagees is elusive. The classes of claim which give rise to maritime liens and remain relevant today number only four:

(1) Damage done by a ship;

(2) Salvage;

(3) Crew wages; and

(4) Master's wages and disbursements.

> '[I]t may be noted that those whose claims fall into the categories of maritime lien have provided fundamental services to the ship or are victims of a maritime wrong which must be compensated. The fact that ships were highly mobile and could flee the jurisdiction of the court, coupled with the additional fact that their owners could continue to incur liabilities to the detriment of existing creditors, may have resulted in special protection being given to those who fell within the various categories mentioned. That special protection took the form of the artifice of the maritime lien, which survived transfers of ownership, and was given effect to by the action *in rem*.' Derrington & Turner, *Admiralty Matters*, 2nd edition OUP 2016, para. 2.21.

For present purposes the justification for the priority enjoyed by maritime lien claims is less relevant than its existence. It is also important to note that the law is currently in a state of uncertainty as regards the choice of the law governing maritime liens. This is potentially of real significance in the post-OW Bunkers world, as English law does not, but US (and, in some cases, Canadian) law does, recognise a maritime lien for bunker suppliers. The orthodox English law position, albeit on the authority of the Privy Council on appeal from Singapore, is that the law of the forum governs: *The Halcyon Isle* [1981] AC 221. However, recent Australian authority (*The Sam Hawk* [2015] FCA 1005) dissents from that view, albeit without identifying which law should govern. It is also at least arguable that the effect of the Rome I and II Regulations, under which the *lex causae* governs remedies, is that the traditional English view is no longer good law.

Possessory liens

This may be taken shortly: the high ranking accorded to possessory lienors reflects the power that they have to retain the vessel until their claim is met. The price of 'buying out' that power is the priority afforded to their claim.

Insolvency issues

The potential for interaction between Admiralty and insolvency procedure is as obvious as it is – currently – somewhat underdeveloped. Unexpectedly, perhaps, the effect of that interaction does not differ markedly whether the two sets of proceedings are in the same or different jurisdictions.

Proceedings both in same jurisdiction

Where both Admiralty and insolvency proceedings are brought in the same jurisdiction (i.e., for present purposes, England & Wales), much will depend upon which was commenced first.

Where *in rem* proceedings are commenced before presentation of the winding-up petition, they will initially be stayed once the winding-up order is granted, so that an application to the court seised with the winding-up will be necessary for the Admiralty action to proceed. That permission should ordinarily be forthcoming, because the *in rem* creditor had by definition acquired the status of a secured creditor by issuing its *in rem* claim before the winding-up petition was presented (*In re Aro Co Ltd* [1980] Ch 196).

The same result will only follow in cases where the petition precedes the issue of *in rem* process in cases involving maritime liens (as well as proprietary claims, such as a mortgagee's). The position is less certain in relation to statutory claims *in rem*. Here, two potential problems arise: the requirement of beneficial ownership and the consideration that the security interest had not arisen before the winding-up petition was presented.

Beneficial ownership

The required connection of beneficial ownership at the time when the proceedings are commenced (see above) is potentially problematic because of the dictum of Lord Diplock in Ayerst v C&K (Construction) Ltd [1976] AC 167 that: 'The authority of [In re Oriental Inland Steam Co (1874) 9 Ch App 557] for the proposition that the property of the company ceases upon the winding up to belong beneficially to the company has now stood unchallenged for a hundred years'.

If that *dictum* were applied blindly, it would follow that a company subject to winding-up proceedings could never be the beneficial owner of its ship and, by extension, that the ship could not be the subject of statutory *in rem* proceedings in respect of a claim for which the company was liable *in personam*. Happily (for Admiralty claimants at least), the High Court of Australia and the Court of Appeal of Hong Kong have refused, respectively, to adopt and to apply Lord Diplock's reasoning (in *Linter* [2005] HCA 20 and *The Convenience Container* [2007] HKCA 305). Of the two, the Hong Kong approach, which was to confine *Ayerst* to its proper context (revenue law), seems preferable. The requirement of beneficial ownership ought not, therefore, to be an obstacle to the commencement of *in rem* proceedings after the presentation of a winding-up petition.

In the only reported English case to have addressed this problem, *Re Lineas Bolivianas SAM* [1995] BCC 666, Arden J was led astray by the fact that the ship had been sold and the fund paid into Court:

> 'The effect of the order for sale ... on the assets of the company must have been to convert the company's interest in the ship into a right to receive the balance of the proceeds of sale remaining after satisfaction of the prior claimants. As a result of conversion [sic] it would appear that the ... applicants do not in fact require leave under s 130(2) because they are not proceeding against either the company or the company's property.'

That reasoning is flawed: there is no reason in principle or practice to treat the sale (or the order for sale) as transferring the beneficial ownership of the ship away from the owner (query to whom), thus making it impossible for a statutory *in rem* action to be commenced (not, as the judge appeared to think, having the opposite effect). To the contrary, the Court recognises the fund in Court as taking the place of the vessel for the purpose of new proceedings: *The Sanko Mineral* [2015] 1 Lloyd's Rep 248.

No security before winding-up

The more formidable obstacle to the grant of permission under s. 130(2) of the Insolvency Act 1986 is that the security bestowed by the issue of *in rem* process would only arise *after* the presentation of the winding-up petition. Arden J's decision in *In Re Lineas Bolivianas*, to allow the latecomers' claim to proceed, might perhaps have been justified on the basis of the direction under s. 130(2) of the Insolvency Act 1986 to do 'what is right and fair according to the circumstances of each case'. If, for example, a claimant issued *in rem* proceedings and then presented a winding-up petition (to secure a higher ranking than other statutory *in rem* claimants), then a court might well think it fair to take measures to prevent it, as Arden J put it, 'scooping the pool'.

Another reason for allowing a claim *in rem* to proceed – with appropriate safeguards – might be to ensure that the maximum sale price of the vessel is achieved, to the benefit of all creditors. The Admiralty Court is well placed to do this, not least because of the title-cleansing effect of judicial sale.

Absent circumstances of that sort, however, an *in rem* claimant is likely to have an uphill struggle to persuade the Companies Court that it should be able to commence proceedings in order to gain a higher priority than other unsecured creditors.

Foreign insolvency proceedings

Overseas insolvency proceedings may affect an English Admiralty action through one or more of the EU Insolvency Regulation (or, in due course, its 'recast' successor), the Cross-Border Insolvency Regulations 2006 (CBIR), s. 426 of the 1986 Act and the common law. The first two and last of these are considered briefly here.

Both the EU Regulation (art. 5; art. 8 in the recast version) and the CBIR (art. 32) employ the expression 'rights *in rem*'. In neither case, however, is it clear whether this expression encompasses those rights *in rem* which the Admiralty Court recognises and gives effect to by its process. The Virgos-Schmidt report on the former (at paras 102-104) sheds only a pale light on this question.

Under the EU Regulation (arts 3.2-3.3), *in rem* proceedings commenced before the insolvency will, in the first instance at least, be unaffected by them. The effect of insolvency proceedings on subsequent *in rem* proceedings will be for the law of the main insolvency proceedings to resolve.

In the context of the CBIR and Admiralty proceedings, the principal area of interest is the operation of art. 20(2). As enacted in Great Britain, it provides, broadly, that any stay or suspension shall be of the same scope and effect as under British insolvency law and subject to the same powers of the court and the same prohibitions, limitations, exceptions, and conditions as would apply under British law. It has been the subject of scrutiny in an Admiralty context in England, New Zealand and Australia: *Cosco Bulk Carrier Co Ltd v Armada Shipping SA* [2011] EWHC 216 (Ch); *Kim v STX Pan Ocean Co Ltd* [2014] NZHC 845; *Atlasnavios Navegacao LDA v The Ship Xin Tai Hai (No 2)* (2012) 215 FCR 265; *Yu v STX Pan Ocean Co Ltd* (2013) 223 FCR 189; *Kim v Daebo International Shipping Co Ltd* [2015] FCA 684.

The common approach to pre-existing Admiralty proceedings (and claims giving rise to maritime liens) has so far effectively been to follow the approach of *In re Aro* (above). Where, however, no right *in rem* has been obtained over a ship at the time a foreign winding- up order is made, the result is likely to be that the maritime claimant will be unable to bring *in rem* proceedings, and – unless the foreign court grants permission to sue *in rem* – it will be limited to proving in the foreign liquidation (see, e.g., *Harms Offshore AHT 'Taurus' GmbH & Co KG v Bloom* [2009] EWCA Civ 632).

The position at common law is likely in substance to follow the same pattern. See, e.g., *Turners & Growers Exporters Ltd v The Ship Cornelis Verolme* [1997] 2 NZLR 110. All will depend, in short, on which came first: the right *in rem* or the winding-up petition.

Conclusion

It is hoped that this short overview of Admiralty practice and its intersection with insolvency law will provide some clarity and food for thought in the ongoing development of both.

Insolvency and Anticipatory Breach of Bunker Supply Contracts: The 'STX Mumbai'

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Introduction

Fuel (known as 'bunkers') is commonly supplied to ships on credit, and with a retention of title clause. If the price for the bunkers is not paid on time by the shipowner, the supplier may be entitled to arrest the vessel and obtain security for his claim. Where the shipowner is part of a group of companies which appear to have become insolvent, but the time for payment has not yet arrived, can the supplier nevertheless terminate the supply contract for 'anticipatory' breach and arrest the ship? That was the question considered by the Singapore Court of Appeal in the recent case of *The 'STX Mumbai'* [2015] SGCA 35. The Assistant Registrar and the Judge held that the claim of the bunker suppliers was premature and legally unsustainable and the arrest wrongful. The Court of Appeal reversed that decision.

The facts

On 15 May 2013, Transocean received an order from STX Corporation for the supply of bunkers to the vessel 'STX Mumbai'. For the purposes of the issue before the court, it was assumed by agreement that STX Corporation had contracted as the owner of the vessel, though it was not the registered owner. Otherwise the vessel could not have been arrested under Singapore law, which requires the shipowner to be the person liable for the claim in order for an arrest to be permissible.

Transocean had also dealt with STX Corporation for the supply of bunkers to four other vessels. Transocean's case was that all these vessels were 'part of a conglomerate of related companies' such that defaults in payment by any of them would cause it to fear that there would be a default in payment in respect of the 'STX Mumbai'. It was common ground that STX Pan Ocean, STX Corporation, and the shipowners were part of the same group of companies.

The bunkers were supplied on terms which required payment to be made within 30 days, namely by Sunday 16 June 2013. On 10 June 2013 payment fell due for the supply of bunkers to one of the other vessels. Then, on 12 June 2013, there was a news report that one of STX Pan Ocean's chartered vessels had been arrested for unpaid bunkers in excess of US$1m. The same source also reported that STX Pan Ocean had filed for bankruptcy in South Korea. In fact, STX Pan Ocean had obtained the bankruptcy order some days earlier.

As a result of these developments, on 13 June 2013 Transocean sent an email to STX Corporation, demanding payment by close of the same business day of the sum of nearly US$3 million, an aggregation of the contract prices for all the five vessels in respect of which STX Corporation had placed orders for bunkers. Payment was in fact only overdue for one vessel. The email concluded by stating that if payment was not received as demanded, Transocean would treat the various bunker supply contracts as having been repudiated on the ground of the respective owners' 'anticipatory breaches'. No payment was received pursuant to the letter of demand and so Transocean proceeded to commence in rem proceedings and arrested the vessel the next day, Friday 14 June 2013. The shipowner eventually put up security on 22 July 2013 and the vessel was released.

As already noted, the Assistant Registrar and the High Court Judge struck out the claim as unsustainable in law, even assuming the facts to be as alleged. There were two grounds for this decision. First, not only is insolvency not a repudiatory breach, but the insolvency relied on was that of STX Pan Ocean and not STX Corporation, a separate corporate entity. Second, that the doctrine of anticipatory breach did not apply to 'executed' contracts.

Anticipatory breach: insolvency

The Singapore Court of Appeal confirmed that insolvency cannot, in and of itself, amount to an anticipatory breach. Indeed, in the absence of an express term to that effect, insolvency is not even a breach, let alone a repudiatory breach. It is not a renunciation of the contract, nor does it follow in every case that the defendant will be unable to perform. Much will depend on the nature and extent of the insolvency, how onerous it will be to perform the particular contract, and the attitude of the liquidator or administrator to the benefit to be obtained by performance. These factors will almost certainly involve considerations largely, if not entirely, outside the knowledge of the other party to the contract, at least in the early stages of the insolvency.

In the case of insolvency within a shipowning group, the scale of the difficulties may become rapidly apparent as vessels are arrested (and remain under arrest) in various jurisdictions. The time available to a supplier to take action to secure its position may be extremely limited, since not only must the vessel be within the jurisdiction of a State in order to be arrested, but that State should preferably be one in which the supplier is content to litigate his claim. The fortuities of the trading pattern of the ship may heavily influence where and when action is taken.

One of the central questions in the context of anticipatory breach by reason of insolvency is the standard by which the court considers the prospect of non-performance. Just because a party is unable to pay all of his debts on time, it does not follow that he will pay none of his debts on time, still less that he will fail to pay any particular debt on time. What does the terminating party have to prove in order to justify terminating the contract?

Liu, *Anticipatory Breach* (Hart Publishing, 2011), pp.73-79, argues that the test is whether it can reasonably be inferred from the circumstances existing at the time of the anticipatory breach that a future breach is likely to occur on the balance of probabilities. This test is criticised as 'unattractively wide and hazardous' in Andrews, Clarke, Tettenborn & Virgo, *Contractual Duties: Performance, Breach, Termination and Remedies* (Sweet & Maxwell, 2011), §7-074. Their alternative test is whether it can be responsibly and convincingly said that a party was definitely destined to fail to perform.

Neither formulation of the test can be said to mirror the expressions found in the authorities. In *British & Benningtons Ltd v North West Cachar Tea Co Ltd* [1923] AC 48, Lord Sumner referred to a party being 'wholly and finally disabled from performing essential terms of the contract'. In *Universal Cargo Carriers Corp v Citati* [1957] 2 QB 401, Devlin J applied the same test to anticipatory breach, clearly regarding it as reflecting impossibility of performance. Similarly, in *Alfred Toepfer International GmbH v Itex Itagrani Export SA* [1993] 1 Lloyd's Rep 360, Saville J held that what must be established was that on the balance of probabilities the party in question 'cannot perform' his obligations.

In the shipping context, there is little authority on the effect of insolvency in itself, notwithstanding the impact of the recent financial crisis. In *Fibria Celulose S/A v Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch), it was common ground that a clause permitting termination in the event of insolvency was valid under English law (the law governing the contract of affreightment) and Morgan J held that there was no power to prevent the service of such a notice under the Cross Border Insolvency Regulations where the clause was arguably void under the law of the foreign insolvency proceedings. As for the effect of insolvency in the absence of such as clause there is the Canadian decision of the Supreme Court of British Columbia in *The 'Sanko Iris' And 'Sanko Venus'* [1987] 1 Lloyd's Rep 487. Sanko had entered corporate rehabilitation in Japan and a charterer reasonably concluded that Sanko would be unable to perform. The conclusion, though reasonable, was in fact wrong: Sanko was in due course able to perform 29 other long term contracts of affreightment under the rehabilitation process, the majority of its arrested ships were released, and credit was once again extended to the vessels by stevedores and others. Macdonald J held that the charterers succeeded on the basis of renunciation, since on that basis subsequent events (which showed the Sanko could perform) were not relevant. Whilst correct in principle, it is not easy to see how the court had in fact concluded that there was a renunciation of the contract. The decision therefore provides little by way of useful guidance.

Returning to the 'STX Mumbai', the Singapore Court of Appeal referred to a line of cases, in particular *Jennings' Trustee v King* [1952] 1 Ch 899 and *In re Agra Bank; Ex parte Tondeur* (1867) LR 5 Eq 160, in which it had been held that insolvency was not an anticipatory breach because the liquidator might adopt the contract and perform. The Singapore court held that that the circumstances of the case before it were different in that the contract was for the one-off supply of a stated quantity of bunkers and those bunkers had already been supplied, with only payment outstanding. Performance by the liquidator on this analysis would therefore be wholly detrimental.

The answer may be different, however, if the correct starting point (considered below) is that the ship was continuing to consume bunkers belonging to the supplier, earning hire or freight from so doing, and its ability to do so depended on a continuing (contractual) permission from the supplier to use the bunkers. In that case, the fact that the supplier may be entitled to terminate the contract, bring the permission to an end and arrest the ship, would provide the administrator or liquidator with an incentive to pay for the bunkers. Such analysis may lead to something of a Catch-22 situation: the liquidator only has an incentive to pay if the supplier is able to terminate the contract, but the ability to terminate depends on the liquidator having no incentive to pay.

The Singapore Court of Appeal noted that the liquidator may feel restrained from paying if to do so would not be treating the creditors even-handedly, and might be dissipating the assets for no good reason. However, this assumes that the vessel can simply sail away with bunkers belonging to the supplier and continue to consume them without being arrested. That assumption cannot always be made, and payment for bunkers to allow the vessel to continue to earn hire or freight may well be in the interests of all creditors. This is particularly the case if the vessel is laden, since an arrest may well produce a significant increase in the liabilities of the shipowner as a result of claims brought by cargo owners for a failure to complete the voyage.

Nevertheless, it is not clear how the motivation of the liquidator can properly feature within the test for anticipatory breach. Considering his motive to pay a particular debt assumes that he has the ability to pay, but may choose not to do so. Insolvency makes it more likely, perhaps even probable that a debt will not be paid, but it does not necessarily mean that a particular debt cannot be paid, that the shipowner is 'wholly and finally disabled' from performing his obligations. The question is surely not whether the liquidator is likely to adopt the contract but whether he is able to do so. This is a far simpler question and avoids speculation as to the conduct of the liquidator.

The conclusion of the Singapore Court of Appeal was that a proper appreciation of the factual matrix within which the insolvency occurred would ultimately be determinative of whether the contract had become impossible to perform. This conclusion was undoubtedly correct, and the court was understandably cautious as to the facts on a strike out application. However, it is far from clear that one can safely arrest a vessel on basis of an assertion that the shipowner cannot pay, without showing more than that it is part of a group of companies where insolvency has arisen. If a court were to take a robust attitude to such an arrest, the arresting party may find itself in difficulty in justifying its assertion that the shipowner was unable to pay rather than simply unlikely to pay.

Anticipatory breach and executed contracts

In considering the further question whether the doctrine of anticipatory breach applies to executed contracts at all, the Singapore Court of Appeal considered in detail the rationale for allowing a party to terminate a contract on the basis that he 'anticipates' a repudiatory breach by the other party at some future time. This has long been something of a theoretical puzzle.

An 'executed' contract is one where the innocent party has already performed all of its obligations. It appears to have been common ground in the Singapore courts that the bunker supply contract was indeed executed in nature, in that the only further performance required was payment for the bunkers. There may be reason to doubt whether this was correct, as will be considered later.

In the converse situation of an 'executory' contract, the innocent party still has obligations to perform. In this case, it is readily understandable that the innocent party should be entitled to say that because the other party will not or cannot perform, he (the innocent party) should not be required to continue performing; to do so would be futile, and he should therefore be entitled to end the contract there and then. The argument that the doctrine of anticipatory breach only applies to executory contracts proceeds on the basis that there is no rationale for the innocent party to be able to terminate in advance of actual breach where the innocent party has no further obligations to perform.

In common law jurisdictions, the authorities differ. In England, in *Moschi v Lep Air Services Ltd* [1973] AC 331, the doctrine of anticipatory breach was applied to an executed contract but without discussion of the point. In Australia the position apparently remains uncertain. In the USA some state jurisdictions do not apply the doctrine to executed contracts, whereas others do. In Canada, Baxter J expressed the view in *Melanson v Dominion of Canada General Insurance Co* [1934] 2 DLR 459 that 'in the case of an executed contract where the defendant simply says that he will not, under any circumstances, pay a sum of money when it falls due there is no possible reason for accelerating the payment and no hardship upon the plaintiff in not doing so.'

The Singapore court was therefore faced with a question as to the proper justification for the doctrine, a matter of general importance. It has long been recognised that there are theoretical difficulties in allowing a party to terminate the contract and claim damages in advance of the time when performance would even become due. However, assuming that the doctrine was justifiable, the Singapore Court of Appeal observed that it was not obvious why a party who has yet to perform all of his obligations should be entitled to bring a contract to an end as soon as it is apparent that the other party will not perform, but a party who has already performed should not be so entitled: see J W Carter, *Carter's Breach of Contract* (LexisNexis Butterworths Australia, 3rd Ed, 2011), §7-80; and Liu, *supra*, pp.164–167.

If there is a reason to distinguish executory and executed contracts, it could only be found in the supposed justification for the doctrine of anticipatory breach. One justification considered by the court is that there is a promise implied in a contract not to hinder or prevent the innocent party from performing, where that performance is a condition precedent to his own right to claim counter-performance from the other party. The court observed that this was effectively seeking to ensure that the contract is not rendered an exercise in futility. If this were indeed the justification for the doctrine, then it can be seen at once that the justification may not arise in the case of an executed contract.

However, the basic idea underlying the doctrine seems to be wider than this justification would allow. The basic idea is that if one party can show that the other will in due course repudiate, it is unjust (all other things being equal) that he should be forced to wait for the inevitable (non) performance before being entitled to draw a line under the contract. Whilst it may be difficult to explain in orthodox terms, the doctrine is intuitively just, and any practical difficulties can be avoided. Whilst there might be an objection to the innocent party being able to accelerate his cause of action and claim damages before the time of payment, the advanced payment can, if necessary, be adjusted by way of a discount for accelerated receipt.

The Singapore Court of Appeal noted that the use of implied promises is somewhat strained and artificial, reminiscent of the techniques used by the courts in the 19th century. It therefore sought an alternative and more modern way of explaining the basis of the doctrine. It preferred the view that where the defendant has evinced a clear intention that it will not perform its obligations under the contract, then 'in principle and logic, an actual breach has, in substance, occurred – notwithstanding the fact that the time for the defendant's performance has yet to arrive under the contract' Understood this way, the court concluded that there was no reason to distinguish executed from executory contracts in the context of the doctrine of anticipatory breach.

In stating that an actual breach has 'in substance' occurred, the court was implicitly recognising that although in truth there was no breach, the situation was such that the defendant should be treated 'as if' an actual breach had occurred. This is, with respect, still somewhat artificial. It may be simpler just to accept that the doctrine reflects practical justice, but defies a universal theoretical justification. In *Moschi v Lep Air Services Ltd* [1973] AC 331 at p.356, Lord Simon of Glaisdale observed that logical objections had been advanced against the doctrine, but the rule was firmly established in the law and is really the only one which is practicable.

More recently, in *Bunge SA v Nidera BV* [2015] UKSC 43; [2015] 2 Lloyd's Rep 469, Lord Sumption JSC described the doctrine in similar terms, as 'a response to the pragmatic concern of Victorian judges to avoid the waste of economic resources implicit in any inflexible rule which required the parties to go through the motions of performing a contract which was for practical purposes dead'.

The nature of bunker supply contracts

Although the court held that the doctrine of anticipatory breach applied to contracts that were executed as well as those that were executory, the assumption (agreed between the parties) that the contract was executed in nature may have been mistaken, at least in the context in which it was considered.

The judgment does not identify whether there was a retention of title clause in the supply contract, but it is likely that there was one. In English law, as recently held by the English Court of Appeal, the nature of such an agreement is not a contract for the sale of the bunkers within the meaning of the Sale of Goods Act 1979: *PST Energy 7 Shipping LLC v O.W. Bunker Malta Ltd (The 'Res Cogitans')* [2015] EWCA Civ 1058. Whether or not the Court of Appeal and Males J at first instance were correct to conclude that the contract was not a contract for the sale of goods within the meaning of the 1979 Act (permission to appeal to the Supreme Court is being sought), the basic nature of such contracts is clear: the bunkers supplied to the vessel remain the property of the supplier, but the shipowner has permission to consume them during the period of credit.

Given that during the period of credit the ship was continuing to consume bunkers belonging to the supplier, it is suggested that (subject to the effect of any relevant insolvency regime) there is the clearest justification for the supplier to be able terminate the contract and to revoke his permission to consume the bunkers, if (and this may be a big if) he can show that the shipowner would in due course repudiate the contract because he was unable to pay. Although the Singapore Court of Appeal's analysis of the basis for anticipatory breach is of valuable, asking whether the contract is strictly speaking executed or executory in nature would not seem to be particularly helpful in this context. The correct approach to reliance on group insolvency was a considerably more important issue, but the answer given by the court was preliminary in nature and therefore left this question unresolved.

The Hong Kong Court Looks at the 'Sufficient Connection' Test to Liquidate Foreign Registered Company

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Introduction

On 13 November 2015, the Hong Kong Court of Final Appeal (*CFA*) delivered its judgment in the long-running saga of *Kam Leung Sui Kwan v Kaw Kwan Lai & Ors* FACV No. 4 of 2015. Overturning the decisions of the Court of First Instance (*CFI*) and the Court of Appeal (*CA*), the CFA ordered the winding up of Yung Kee Holdings Limited (the *Company*), a company incorporated in the British Virgin Islands, which was the ultimate holding company of a world-famous goose restaurant in Hong Kong, the Yung Kee (the *Restaurant*), and other group companies incorporated and operating in Hong Kong. It did so on the basis that there was a sufficient connection between the Company and Hong Kong to wind up the Company on the just and equitable basis.

The CFA's judgment provides important guidance on the approach to be taken when a court is called upon to exercise its discretion to make a winding up order against a foreign company on the just and equitable ground. It obviously has great significance in Hong Kong, where it is standard practice for family-owned companies to structure themselves so that assets and businesses in Hong Kong are held by a foreign parent company in jurisdictions such as the Cayman Islands or the BVI. Its impact may well be wider, however. The CFA rejected the suggestion that it is only in very exceptional cases that the court should be willing to exercise its statutory jurisdiction to wind up a foreign company on the just and equitable ground. Moreover, it emphasised the importance of substance over form, and the need to have regard to the nature of the dispute and the purpose for which the proceedings are brought: namely a shareholder's intention to wind up a company in order to realise the value of the assets directly or indirectly held by its subsidiaries.

Background

In the 1930s, Kam Shui Fai (*Kam Senior*) established a cooked food stall in the Sheung Wan district of Hong Kong. Many decades of hard graft by Kam Senior bore fruit, such that by the time of Kam Senior's death in 2004, his family's business and assets included the Restaurant, a nightclub, and various properties, including the Yung Kee Building. All of the underlying assets were situated in Hong Kong. The businesses of the group were carried out by companies incorporated in Hong Kong, which carried out their activities exclusively in that jurisdiction.

These companies were subsidiaries of a company incorporated in the BVI, Long Yau Limited (*Long Yau*). Long Yau in its turn was a wholly-owned subsidiary (and indeed the only asset) of the Company. Kam Senior's two sons, Kam Kwan Sing (*Kwan Sing*) and Kam Kwan Lai (*Kwan Lai*) each directly or indirectly held 45% of the shares in the Company. Although their sister indirectly held the remaining 10%, the votes they conferred were effectively at Kwan Lai's disposal, giving him majority control of the Company.

The two brothers fell out, and Kwan Sing brought proceedings seeking an order pursuant to s.168A of the then Hong Kong Companies Ordinance (now superseded) for Kwan Lai to buy his shares out on the grounds that the affairs of the Company were being conducted in a manner that was unfairly prejudicial towards him; alternatively an order that the Company be wound up on the just and equitable ground under s.327(3)(c) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

First instance decision

At first instance, Harris J found that a quasi-partnership existed between the two brothers and that Kwan Lai had used his majority shareholding to implement changes to the Company's board of directors that unfairly prejudiced Kwan Sing's interests. However, there was to be no relief for Kwan Sing because he could not get across the jurisdictional thresholds necessary for the Court to grant a remedy. Specifically Harris J found that:

– The Court did not have jurisdiction to make an order under s.168A, as the Company did not satisfy the requirement to have 'establish[ed] a place of business' in Hong Kong. Whilst its indirectly held subsidiaries were all operating in Hong Kong, the

Company was itself no more than a passive investor in Long Yau.

- The Court could not exercise its statutory jurisdiction under s.327(3)(c) because one of the three essential preconditions to the granting of such relief – a 'sufficient connection' with Hong Kong – was missing.

The appeal

Kwan Sing died shortly before judgment was handed down, and his estate, represented by his widow, brought an appeal against Harris J's jurisdictional findings.

On the s.168A point, the appellant contended that because (a) the Company was an investment holding company, (b) the 'business' of the Company was accordingly confined to internal corporate decisions and administration, and (c) all corporate decisions and administration (such as they were) took place in Hong Kong, Harris J had been wrong to conclude that the Company had not established a place of business in Hong Kong.

The CA rejected that contention, holding that internal corporate activities and administration were not, without more, sufficient to demonstrate the establishment of a place of business, particularly given that the Company – as a holding company – did not play any substantial role in the operation of its indirect subsidiaries.

When it came to the jurisdiction under s.327(3)(c), the CA rejected the appellant's argument that Harris J should have taken into account, when determining whether there was a 'sufficient connection' with Hong Kong to justify a winding up order, the fact that the Company's indirect subsidiaries were incorporated and operated in Hong Kong.

In so doing, the CA noted that:

- The business of the subsidiaries was to be disregarded, by operation of the doctrine of separate legal personality.
- The jurisdiction under s.327(3)(c) was an 'exorbitant' one, and as a result the Court could not adopt a loose interpretation of what constituted a 'sufficient connection' with Hong Kong. Accordingly, it would take a 'very exceptional case' to grant a winding-up petition. This was not such a case: the mere fact that the subsidiaries operated extensive businesses or had significant assets in Hong Kong did not suffice.
- It was a relevant consideration against the granting of relief in Hong Kong that the same remedy was available in the BVI, which was where the assets of the Company – namely the shares in Long Yay – were located. Primacy was to be given to the principle that the court of the country of incorporation should be the principal court to govern a liquidation, particularly because there was no suggestion that a winding-up order made in the BVI would not be recognised or enforceable in Hong Kong.

The Court of Final Appeal

For the reasons given both by the CFI and the CA, the CFA also found that the Company had not established a place of business within Hong Kong sufficient to engage the s.168A jurisdiction and affirmed the decisions of both inferior courts on that point.

The case turned on the question of jurisdiction under s.327(3)(c). Here, the CFA reversed the decisions of the inferior courts, holding that the Hong Kong courts did have jurisdiction to order a winding up on the just and equitable ground.

The CFA held that the test for winding-up a foreign company upon a shareholder's petition was the same as that of a creditor's petition, and required a focus on three 'core requirements'. Specifically:

> 'the question in the case of a creditor's petition is whether there is a sufficient connection between the company and this jurisdiction to justify the court in ordering a company to be wound up despite the fact that it is incorporated elsewhere; and that in deciding that question the fact that there is a reasonable prospect that the petitioner will derive a sufficient benefit from the making of a winding up order, whether by the distribution of its assets or otherwise, will always be necessary and will often be sufficient'.

The first requirement was the focus of the CFA's judgment (it readily found in the appellant's favour on the other two). Here, the court found that there was a distinction to be drawn between:

- a creditor's petition, where the creditor is seeking the winding up of the company in order to obtain payment of (or towards) their debts; and
- a shareholder's petition, where the parties are different – the dispute is between the petitioner and the other shareholders and the company is the subject of the dispute rather than a party to it – and the object is not to obtain payment of a debt, but to realise the petitioner's investment in the company.

On that basis, the Court rejected the inferior courts' emphasis on the requirement for a 'more stringent' connection in the case of a shareholder's petition, holding that 'shareholders, no less than creditors, are entitled to bring winding up proceedings in Hong Kong in respect of a foreign company'.

The CFA found that there were a number of factors pointing towards a 'sufficient connection'. Two were of particular importance. First, the presence of the other shareholders within the jurisdiction was 'an extremely weighty factor' in establishing sufficiency of connection with Hong Kong. In determining that sufficiency, the court would always have to determine whether there was a reasonable prospect that the petitioner would derive a sufficient benefit from the making of a winding up order, whether by the distribution of the company's assets or otherwise. If that was the case, that in itself would often be sufficient to establish a connection, but no more stringent connection was required.

Second, the Court placed great emphasis on the fact that all of the underlying assets and businesses of the Company's indirectly held subsidiaries were located in Hong Kong. The CFA took the view that although (a) the assets of the Company were wholly owned through Long Yau, incorporated in the BVI, and (b) a company and its shareholders were separate legal personalities, there was an 'obvious and close connection' between the Company and its subsidiaries or shareholders, there was no 'doctrinal' reason to disregard their different personalities when considering the discretionary core requirements necessary to open the jurisdictional gateway. The question the court should ask itself was whether a shareholder had sufficient locus standi to bring a minority shareholders' action to recover money not from the company of which he was a shareholder, but from a subsidiary of that company.

Conscious, perhaps, that this conclusion was perilously close to 'lifting the corporate veil' and breaching the fundamental principle of separate corporate personality, the CFA noted that the Hong Kong courts had previously overcome questions about piercing the corporate veil and the apparent elision of the distinction between the different corporate personalities by finding that any depletion of a subsidiary's assets caused indirect but real loss to the parent company and its shareholders, thereby vesting the parent with a right to bring proceedings in respect of those assets: *Waddington Ltd v Chan Chun Hoo* [2008] 11 HKCFAR 370.

For those worried about culinary rather than legal matters all is not quite lost yet: although the court considered that this was a proper case in which to make a winding-up order, the order was stayed for 28 days for the parties to attempt to agree the terms of a buy-out deal. If the parties did not agree a deal then this particular goose would have been well and truly cooked and the winding-up order would take effect automatically thereafter. At the time of writing this article the restaurant was still taking bookings for tables!

Discussion and implications

In some ways, this is a very conventional judgment, squarely in the line of authorities stretching back to the judgment of Knox J in *Re Real Estate Development* [1991] BCLC 210. Any applicant in a shareholder's petition seeking to persuade the court to exercise its jurisdiction over an overseas company will not only have to satisfy the court that the petition should be granted on its merits (that is, that it is just and equitable to wind up the company). It will also have to convince the court that:

- there is a sufficient connection with the jurisdiction;
- there must be a reasonable prospect that the petitioner will derive a sufficient benefit from the making of a winding up order; and
- the court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

However, the judgment is significant for a number of reasons. First, for the purposes of establishing 'sufficient connection', the CFA has established that the presence of shareholders (and possibly directors) within Hong Kong may be highly relevant, and even persuasive. Similarly, whilst it is not necessary for there to be assets within the jurisdiction, this too may be a factor to which the court will accord weight. The authors have some misgivings about this: the implication is that setting up an offshore company to run a Hong Kong Business operation may not achieve its obvious object, namely removal of that operation from the jurisdiction of the Hong Kong courts.

Second, the CFA has extended the jurisdiction of the Hong Kong courts well beyond its borders to encompass separate and distinct legal personalities. Although the court was at pains to emphasise that it was not lifting the corporate veil of the separate and distinct legal entities within the Yung Kee group, but merely giving effect to the close connection between the Company and its directly and indirectly held subsidiaries, it is difficult to see this is as anything other than a lifting of the veil. Even if that is not right, to the extent that the court may now be required to consider the corporate structure and business architectonically to determine whether it has jurisdiction to wind up a foreign company on the just and equitable ground, an unwelcome degree of uncertainty has been introduced. At what point does the court conclude that the place of incorporation is no longer the natural or appropriate forum for a winding-up petition?

Third, the Court has drawn a clear distinction between a creditor's petition to wind up a company and shareholder's petition. The authors query whether such a distinction can justifiably be drawn in the context of a winding-up on the just and equitable ground. Whilst it is the case that the reasons why a shareholder might petition for a winding up are different from those of a creditor – the former seeks to extract the value of its investment in the company, whereas the latter wants a winding up order in order to obtain payment in or towards satisfaction of its debts – the end result is the same: the assets of the company are realised by the liquidator and then distributed to those who have a claim against those assets. In both cases the remedy sought is the liquidation of the company (whether solvent or insolvent) and the distribution of the resulting 'pot' of cash either to an investor or to a creditor. There seems to be little justification in those circumstances for the court to examine the class of person requiring the company's liquidation or the reason for the petitioner's desire to wind up the company.

Whilst the potential effect of this judgment is significant, it must be remembered that, as the CFA acknowledged, there are very few petitions to wind up companies on the grounds that it is just and equitable to do so, and fewer instances still where there will be such complicated holding structures for what was, on any basis, a family company run as a quasi-partnership.

Recognition Applications under the Cross-Border Insolvency Regulations 2006: The Importance of Being Full and Frank

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1. Introduction

In the recent case of *Nordic Trustee A.S.A. et. al. v. OGX Petróleo E Gás S.A. et. al.*[1] the English court considered the question of whether an applicant for recognition of a foreign insolvency proceeding under the UNCITRAL Model Law on Cross-Border Insolvency ('the Model Law') as incorporated under the GB Cross Border Insolvency Regulations 2006 ('CBIR') must make full and frank disclosure to the Court in relation to the effect such recognition might have on third parties.

2. Background facts

OSX 3 Leasing BV ('Leasing') was a company incorporated in the Netherlands. In July 2011, Leasing contracted with a Japanese shipyard for a floating production, storage and off-loading vessel, known as the OSX 3. Construction was in part financed by a USD 500M secured bond issue in favour of the First Claimant, a Norwegian company ('Nordic'). On 6 March 2013, Leasing concluded a bareboat charter agreement in relation to the OSX 3 with the First Respondent ('OGX'), an oil and gas company incorporated in Brazil, for a period of 20 years. On 26 March 2013, Leasing assigned its rights under the bareboat charter to Nordic. On 30 October 2013 OGX and its parent company petitioned for judicial reorganisation under Chapter III (Articles 47 et seq.) of the Brazilian bankruptcy law. Pursuant to this insolvency proceeding, OGX prepared a reorganisation plan for submission to the Brazilian courts. While the plan was being prepared, OGX and Leasing entered into negotiations for a reduction in the daily charter rates payable under the bareboat charter. Eventually, OGX's reorganisation plan was approved by creditors on 3 June 2014 and by the Brazilian Bankruptcy Court on 13 June 2014. The plan provided that 'all claims existing on the date of the petition are subject to the judicial reorganisation, even if not yet due.' However, OGX's claims under the bareboat charter were carved out of the reorganisation plan to reflect the fact that the parties were still in negotiation as to rates payable under the bareboat charter. On 12 September 2014 the parties successfully concluded the re-negotiation of the bareboat charter. The old bareboat charter was expressly substituted by the new bareboat charter. The new bareboat charter incorporated LCIA arbitration provisions. Importantly, OGX provided warranties to Leasing relating to the enforceability of the obligations assumed by OGX under the new bareboat charter, notwithstanding the bankruptcy proceedings in Brazil. The obvious purpose of those warranties was that claims under the new bareboat charter would not be subject to restructuring of debts under the Brazilian reorganisation plan. OGX subsequently fell into arrears under the new bareboat charter.

On 18 December 2014, without notice, OGX sought and obtained a provisional injunction from the Bankruptcy Court in Rio de Janeiro unilaterally reducing the daily charter rate under the new bareboat charter by USD 120,000 under the provisions of the Brazilian Civil Code, which, OGX contended, empowered the Bankruptcy Court to revise the new bareboat charter on the basis that there had been an 'alteration in the objective basis of the business deal.' The Court of Appeal in Rio de Janeiro overturned the provisional injunction on the basis that the Bankruptcy Court only had jurisdiction over claims subject to the effect of the reorganisation plan by reason of Article 49 of the Brazilian bankruptcy law. Claims under the new bareboat charter were not subject to the reorganisation plan since they arose after the approval of the reorganisation plan. In those circumstances, the Brazilian Bankruptcy Court had no power to vary unilaterally the terms of the new bareboat charter. The Rio de Janeiro Court of Appeal remitted the matter back to a different civil court for determination, subject to (among other things) OGX 's application for permission to appeal. On 22 June 2015 Nordic and Leasing submitted a request for LCIA arbitration under the new bareboat charter seeking (among other things) to restrain OGX from pursuing its claim for relief in Brazil.

Notes

1 [2016] EWHC 25 (Ch).

On 28 July 2015 OGX applied without notice to Nordic or Leasing for an order for recognition in England of the Brazilian reorganisation plan as a foreign main proceeding. The application if successful would have had the effect of staying the pending LCIA arbitration. The evidence in support did not mention that the Rio de Janeiro Court of Appeal had specifically determined that as against OGX the Brazilian Bankruptcy Court had no jurisdiction to vary the charter rates under the new bareboat charter. During the hearing for the recognition of the Brazilian reorganisation plan in England, Counsel for OGX did not inform the Judge (Mann J) that Nordic/Leasing's claims in the LCIA arbitration were not subject to the Brazilian reorganisation plan. The Judge granted the recognition order ('the Recognition Order') spelling out the consequences of recognition including the stay of all pending arbitrations in England, including of course the pending LCIA arbitration.

Upon being served with the Recognition Order, Nordic and Leasing immediately protested and made an urgent application to the English court pursuant to the inherent jurisdiction of the court and Article 20(6) of the CBIR to set aside in part or partially vary the Recognition Order so as to permit the LCIA arbitration to continue. Nordic and Leasing said that Mann J had been misled or at the very least that the Recognition Order should be set aside on the basis that it had been obtained by material non-disclosure of the fact that the Brazilian reorganisation plan did not apply to the claims in the LCIA arbitration under the new bareboat charter.

Before Nordic and Leasing's application came on for final hearing before Snowden J, the Brazilian Superior Court of Justice had dismissed OGX's appeal and the parties had entered into a consent order in which it was agreed that the LCIA arbitration could proceed notwithstanding the Recognition Order. Also following an interim order of the English court the parties had filed evidence in the LCIA arbitration. In its evidence, OGX accepted that the claims of Nordic and Leasing under the new bareboat charter arose after the approval of the Brazilian reorganisation plan and were not subject to its terms under Article 49 of the Brazilian bankruptcy law. In those circumstances the parties had agreed to a consent order in which the arbitration would continue to final determination and OGX would pay the costs of Nordic/Leasing of their application to set aside the Recognition Order.

The Judge (Snowden J) was, however, not satisfied with the explanation provided by OGX for its deficient evidence in support of its initial application for the Recognition Order. In those circumstances, the Judge gave a full judgment because of the wider importance of these issues in applications for recognition of foreign insolvency proceedings under the CBIR.

3. The decision

Snowden J initially noted that in the ordinary case, the recognition of a foreign proceeding is intended to follow if the applicant can satisfy the requirements of Articles 15 and 17 of the Model Law. In brief Article 15 concerns the filing of certain documents in relation to the decision commencing the foreign proceedings and the appointment of the foreign representative. Article 17 concerns the question (among others) of whether the foreign proceeding in question is a collective judicial or administrative proceeding. If such conditions are met, then Article 17 provides that the foreign proceedings 'shall' be granted recognition in England. Article 17 is subject to Article 6, which provides that the court can refuse to take any action which would be 'manifestly contrary to the public policy of Great Britain or any part of it" but the public policy exception is to be restrictively interpreted. If a foreign proceeding is recognized as a foreign main proceeding under Article 17, the stay under Article 20(1) operates automatically. The Judge observed, however, that the powers of stay under the Model Law were intended to operate upon recognition of a collective foreign proceeding on claims that were subject to such collective foreign proceedings. As such, it would not be appropriate to stay, upon recognition, claims that stood outside the foreign collective proceedings such as Nordic/Leasing's claims against OGX.

The Judge made a number of important observations arising from this analysis. Firstly, where the purpose of the application for recognition was nothing to do with protecting the foreign insolvency proceedings as such, the application for recognition would represent an abuse of the process for the recognition of a foreign proceeding.

Secondly, it would be incorrect for applicants for the recognition of a foreign proceeding to proceed on the basis that it was only required to inform the English court of the matters necessary to obtain recognition so that the foreign representative could simply rely upon the stay coming into effect automatically under Article 20(1) irrespective of whether or not the stay might be upheld if subsequently challenged. The court hearing such an application has a discretion under Article 20(6) of the Model Law to modify from the outset the stay which will come into effect upon making the order. Accordingly, a foreign representative who seeks recognition of a foreign proceeding without notice ought to place before the court 'any material of which he is aware which is relevant to the exercise of that discretion.'[2]

Thirdly, the court has a residual discretion, notwithstanding the fact the public policy exception in Article 6 should be interpreted restrictively, to refuse recognition

Notes

2 At paragraph 58 of the decision.

if satisfied that the applicant is abusing the process for an illegitimate purpose. On the exceptional facts of this case, Mann J might well have been justified in rejecting the application for recognition altogether.

Fourthly, Snowden J also observed that it is well understood that the duty of full and frank disclosure requires disclosure of all matters that might reasonably be raised by an opposing party, whether or not the party appearing before the court considers that such argument might be well founded. Snowden J observed[3] that:

> '…for the future, however, I think that it must be made clear that foreign representatives and their advisers must ensure that the valuable process for recognition under the Model Law and the CBIR is not misused. When seeking recognition, full and frank disclosure must be made to the court in relation to the consequences that recognition of the foreign proceedings may have upon third parties who are not before the court. In particular, the court should be told of any points that could be raised in relation to the modification or termination of the automatic stay and suspension which will come into effect upon recognition.'

4. Conclusions

Snowden J has re-emphasised the duty of legal advisers to be full and frank when making without notice applications for the recognition of foreign proceedings. The case is significant, however, because it will require foreign representatives (and their legal advisers) when making without notice applications for recognition (a) to identify clearly those creditors who will be effected by the stay upon recognition; and (b) to consider in each case whether there are points that each such creditor might raise in objecting to such a stay. While in this case the consideration of these issues should have been relatively straightforward, in complex cases involving a number of creditor claims and/or security holder claims that consideration might well prove more complex and subtle. Decisions regarding disclosure are critical since recognition orders obtained without notice and on the basis of inadequate disclosure will be vulnerable to being set aside in their entirety. At present the category of persons on whom an application for recognition must be served is relatively narrow (per Article 21(2) of Schedule 2, CBIR) and does not generally include creditors (other than petitioning creditors and holders of qualified floating charges) unless the court otherwise directs. Whether this recent case will lead to an increase in the number of applications for the recognition of foreign proceedings on notice to creditors remains to be seen.

Notes

3 At paragraph 64 of the decision.

In *Ras Al Khaimah Investment Authority and others v Bestfort Development Limited LLP (and 13 others)* [2015] EWHC 3383 (Ch)

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The applicant entities (collectively 'RAK') formed part of the arrangements for investing the sovereign wealth of the state of Ras Al Khaimah. They applied to the English court for a freezing order and various ancillary relief, including the appointment of receivers over the assets of 14 respondent LLPs registered in England and Wales. The respondent companies were said to be connected to a Mr Mikadze, a Georgian national, who had been director of the 4th – 6th applicants between 2008 and 2013, and held senior management positions within those applicants. The application was made in support of claims issued by RAK in both the Republic of Georgia and the UAE, pursuant to s.25 of the Civil Jurisdiction and Judgements Act 1982 ('CJJA'). No relief was sought against Mr Mikadze personally, because (a) he was not present in the jurisdiction; and (b) he was not thought to have any assets in the jurisdiction, other than his interests in the Respondent LLPs.

The application was not successful.

Whilst the case did not establish any new principles, it provides a useful illustration of the possible breadth of the Court's jurisdiction to grant ancillary relief, including the power to appoint receivers; and guidance as to the circumstances in which such relief will be granted, and the evidence that may be required if an application is to succeed.

Background

The substantive proceedings

A Dr Massaad was put in charge of Ras Al Khaimah's decision to pursue investment opportunities in Georgia. He was given wide powers to pursue investments, including the power to appoint whomever he considered fit to assist him meet the state's objectives. He appointed Mr Mikadze to become the emirate's partner in developing investment opportunities in Georgia.

RAK asserted that Mr Mikadze and Dr Massaad both abused the trust placed in them, and acted in serious breach of fiduciary duties. Mr Mikadze was alleged to have, *inter alia*, diverted moneys to his personal bank accounts, and caused the Ras Al Khaimah companies for whom he was supposed to be working to enter into lucrative contracts with contractors that were in fact his creatures, and which did not in fact provide any services in return for the substantial remuneration paid.

Mr Mikadze vigorously disputed the claims. The English Court took the view that he had *prima facie* defence which would require the trial court to thoroughly examine all the facts, but concluded that there were good arguable claims against him.

The English application

There were two groups of respondents:

- The 1st, 3rd, 5th and 9th Respondents were defendants to some of the claims brought by RAK in Georgia or the UA.
- The remaining Respondents were not parties to any claims. Relief was sought against them on the basis that they were beneficially owned by Mr Mikadze, such that their assets would be available to satisfy any judgment against Mr Mikadze in those countries. In *TSB Private Bank International v Chabra* [1992] 1 WLR 231 Mummery J held that, although the court had no jurisdiction to grant an interlocutory injunction in favour of an applicant who had no good arguable cause of action against a sole defendant, it had power to grant such an injunction against a co-defendant against whom no cause of action lay, provided that the claim for the injunction was incidental and ancillary to the cause of action against the other co-defendant. RAK relied on this jurisdiction in bringing its claim against these Respondents.
- RAK also relied on the *Chabra* jurisdiction against the Respondents who were defendants in the foreign proceedings, on the basis that their assets were beneficially owned by Mr Mikadze. The freezing order was thus sought up to the total amount of damages claimed against Mr Mikadze, irrespective of the Respondents' status as defendants to any proceedings (or not).

Relief sought

S.25(1) of the CJJA provides that the Court may grant interim relief in support of substantive proceedings brought in another jurisdiction. In considering this provision the judge cited the test as described by Dicey, Morris and Collins *On the Conflict of Laws* 15th ed. Par 8-034:

On an application for interim relief under section 25, the court should first consider whether the facts would warrant the relief sought if the substantive proceedings had been brought in England.

Secondly, the court may refuse to grant the relief if, in the opinion of the court, the fact that the court has no independent jurisdiction in relation to the subject matter of the proceedings makes it inexpedient for the court to grant it.

Tests applied and relevant findings

S.25 CJJA

In order to establish that the Court would grant relief if substantive proceedings had been brought here, RAK had to show that (1) they had a good arguable claim against the defendants in the overseas proceedings; and (2) that the Respondents' assets were beneficially owned by Mr Mikadze.

Good arguable case

Perhaps unsurprisingly, in circumstances where detailed witness statements had been produced on either side, but the English Court was not the court seised, Rose J concluded that the claims 'clearly' raised arguable issues.

Good arguable case that the Respondent's assets were Mr Mikadze's assets

RAK also had to show a good arguable case that the Respondents' assets were Mr Mikadze's assets, or were under his control.

It was accepted that the first 2 Respondents were set up by Mr Mikadze. RAK identified the registered addresses, corporate members, and originally designated corporate members of these two Mikadze companies. The other 12 Respondents were all companies that shared registered addresses and membership (whether then current, or originally designated members) with the first 2 Respondents. RAK further relied on documents in respect of some of the LLCs showing that Mr Mikadze had been the beneficial owner of the companies, or had held powers of attorney for them. A single person had signed the accounts of many of the LLCs. RAK relied on these shared aspects to argue that if Mr Mikadze accepted beneficial ownership of the first 2 respondents, he was likely to own the others too.

Mr Mikadze's evidence was that he acquired the 1st and 2nd Respondents from a company, Hornberg, which runs a business of providing LLCs for a small fee, and then provides the service of making sure that the LLC files whatever documents are needed each year to maintain the LLC in being on the register. Given this, the judge recognised that the other LLCs may simply be others set up and run by Hornberg, or similar service providers. If so, the shared registered address, members, and account signatories would be unsurprising. There was no evidence as to what business was run from these shared registered addresses: there may have been hundreds of LLCs registered there. This was identified to be a real difficulty with RAK's case.

Rose J thought the evidence to be 'rather thin in relation to some of the LLPs'. However, on balance she was prepared to accept that there was a sufficiently arguable case that they were all beneficially owned by Mr Mikadze: significantly no one had come forward to assert that the LLCs were unconnected to Mr Mikadze. Given the identified paucity of evidence that he was in fact connected to some of the LLCs, this may well have been determinative to Rose J's assessment.

Whether the Respondents had assets to be caught by the order

In order to establish a right to relief, an applicant must show that he has grounds to believe that the defendant has assets that will be caught by the order: *A v C* [1981] 1 QB 956. Further, unless the assets are substantial enough to ensure that the enforcement process itself would not swallow up any sums that did exist, the order would be pointless.

It was not suggested that there were any assets in England. RAK relied the following:

– Past financial statements recorded the LLCs as holding a cash balance. However, these were not current; and recorded only small sums (well under GBP 20,000 in each case).

– Evidence of past payments by Ras Al Khaimah entities into the Latvian bank accounts of some of the named Respondents. Again, however, this was not evidence that those entities currently held cash. The way in which Mr Mikadze carried on business was adjudged to be equally consistent with the LLCs now being empty shells.

– The fact that the application was opposed was said to justify the inference that there was some money that Mr Mikadze was trying to hide. This argument was rejected: parties are entitled to defend proceedings without any inferences being drawn from that fact.

In short, RAK failed to satisfy the Judge that there were assets anywhere in the world that would be caught by the order. This was one of the determinative factors in Rose J's decision to refuse relief.

Whether the Order would be effective to freeze any assets that did exist: requested ancillary relief

It was common ground that the Latvian court would not recognise an order made by the English court freezing assets in Latvia in support of substantive proceedings brought in a third jurisdiction. For this reason, RAK asked also for:

– An order appointing receivers over all 14 of the Respondents pursuant to s.37 of the Senior Courts Act 1981, which provides that the High Court may by order (whether interlocutory or final) grant an injunction or appoint a receiver in all cases in which it appears to the court to be just and convenient to do so. This order was sought so that the receivers could then try to obtain payment of all sums standing to the credit of any bank accounts held anywhere in the world in the name of any of the Respondents; gather details of all transactions on the Latvian bank accounts; request information; and to bring or defend any action or other legal proceedings anywhere in the world. The receivers would then make all documents and information received available to the legal representatives of RAK.

– A power of attorney to the receivers to act on behalf of the LLP, empowering the receivers to give all such instructions and execute all documents on the LLP's behalf as may be necessary to obtain payment by the Latvian or any other bank of all moneys standing to the credit of identified bank accounts, and to gather details of all transactions on the account and payment of all moneys standing to the Respondent's credit at any bank account anywhere in the world. This was necessary because it was accepted that Latvia does not have a concept of receivership, and its courts would not recognise a English court order appointing receivers.

The problem for RAK, however, was that the Latvian law evidence suggested that even with the aid of these orders, the Latvian banks were unlikely to give effect to the freezing order.

Risk of dissipation

There must be solid evidence of the risk of dissipation. Mere reliance on the alleged dishonesty of the defendant is not enough. The court must scrutinise whether the alleged dishonesty is sufficient to found an inference that there is a real risk of dissipation.

RAK relied primarily on the serious allegations of fraud; Mr Mikadze's use of off-shore vehicles to keep his assets; and a guilty plea in Georgian criminal proceedings regarding misappropriation of shares. Rose J did not consider the case against Mr Mikadze to be as clear-cut as the Applicants alleged. Further, given that he was working in a politically uncertain country, his use of corporate structures controlled by offshore entities was adjudged to be understandable, and did not give rise to any inference that Mr Mikadze would seek to defeat the judgment.

The transfer of Georgian subsidiary companies of some of the Respondents to an associate of Mr Mikadze's shortly after service of the application was held to have been a move that may well have been motivated by a desire to put assets out of the reach of the court. However, this was not enough for the judge to find that there was a real risk of dissipation.

Particularly significant was the delay between the complaints arising and proceedings being commenced. This had given Mr Mikadze ample opportunity to squirrel away his assets: if there was a dissipation risk, it had already materialised, and any order would likely come too late. Further, neither Mr Mikadze nor any of the Respondents had failed to comply with any order of any court, and Mr Mikadze's compliance with his disclosure undertakings re the Respondent's bank accounts had not been criticised. In these circumstances, the risk of dissipation was not sufficient to justify the intrusive relief sought.

The exercise of the Court's discretion

In light of the conclusion on the above points, the Court's consideration as to whether it should exercise any discretion that it may have had to make the Order sought was *obiter*. Nonetheless, it does provide some guidance as to the factors that the Court will take into account when consideration whether to exercise its discretion in an appropriate case. The following were all said to weigh against the Court's exercise of its discretion to grant the relief sought:

– The order departed substantially from the standard form: it significantly broadened the scope of information that the Respondents were required to provide. Rose J stressed that a party restrained by a freezing order should not be treated like a judgment debtor, and it would not be right to make use of the power to enable claimants to discover where the defendant may have assets (citing *AJ Behkor & Co v Bilton* [1981] 1 QB 923(CA)). Nor was the substantive claim a proprietary one, where the fact that relief is designed to identify assets which the claimant allege to beneficially own is thought to justify broader disclosure (*A v C* [1981] 1 QB 956.)

- The appointment of a receiver in respect of respondents who were not defendants in proceedings was unprecedented, all the more so when the substantive proceedings were overseas. The appointment of a receiver is a very intrusive remedy, it is expensive, and not easily reversible.
- The ancillary remedies were sought to get around the fact that Latvia had chosen not to recognise interim measures ordered by courts of Member States that do not have jurisdiction over the substantive proceedings. Whilst Rose J did not go so far as to hold that it would in all cases be inappropriate for a court to grant additional relief in support of a freezing order with the sole purpose of avoiding the limitations set out in the Regulations, this was a factor weighing against the exercise of a discretion to grant such remedies. In her judgment it would require circumstances 'much more extreme and unusual' than those before her to justify such steps.
- There was held to be a serious risk that the appointment of receivers and grant of the power of attorney would stifle the Georgian litigation being brought by two of the LLPs to recover the shareholdings transferred as part of Mr Mikadze's plea bargain in criminal proceedings.
- Rose J concluded that, whilst there was only sparse authority in support of that power, 'in an appropriate case' the grant of such a power may be permissible. No real guidance was given as to the circumstances in which it may be appropriate, it was held not to be a power that should be used in the circumstances of the case.

RAK therefore failed on the first limb of the test: relief would not be granted even if the substantive proceedings had been brought in this jurisdiction.

Expediency

The Court nonetheless considered the question of expediency. It was thought that the main issue raised was whether the Georgian court had the power to freeze assets outside Georgia, such that it could have made the order sought. The position as to the approach taken by the Georgian courts was not clear. However, if it did have such a power, it applied a self-denying ordinance not to do so. Given this, it was said that it would have been inexpedient to grant relief in the particular case in any event.

Applications to Modify Recognition Orders under Art. 20(6) of Sch. 1 to the Cross-Border Insolvency Regulations 2006

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Introduction

Section 130(2) Insolvency Act 1986 provides that '[w]hen a winding-up order has been made or a provisional liquidator has been appointed, no action or proceeding shall be proceeded with or commenced against the company or its property, except by leave of the court and subject to such terms as the court may impose.'

However, section 130(2) did not apply to foreign insolvency proceedings, and, prior to the Cross-Border Insolvency Regulations 2006, SI 2006/1030 ('the CBIR') coming into force, there was no equivalent to section 130(2) that applied in the cross-border context, save to the extent that the English Courts have an inherent discretion, reinforced by s. 49(3) Supreme Court Act 1981, to stay proceedings whenever necessary to prevent injustice. See *Mazur Media Limited v Mazur Media GmbH* [2004] EWHC 1566 (Ch), [2005] 1 Lloyd's Rep 41, in which Lawrence Collins J. (as he then was) held that it would require 'exceptionally strong grounds' (at 54 rhc) for an English Court to stay English proceedings in favour of insolvency proceedings in a Council Regulation (EC) 44/2001 state, particularly where an exclusive jurisdiction clause had conferred jurisdiction on the English Courts.

The landscape of this area of the law has changed dramatically since 4 April 2006, when the CBIR ushered in a new order under which the UNCITRAL Model Law acquired the force of law in Great Britain to the extent that it was adopted and modified in Sch. 1 to the CBIR. A foreign representative may now apply to the Court for recognition of a foreign (insolvency) proceeding in which he has been appointed pursuant to Art. 15 of Sch. 1, and the exercise of recognition is treated by the Court as 'something of a "tick-box" exercise' (*Transfield ER Cape Limited* [2010] EWHC 2851 (Ch), para. 1, *per* Warren J.). If that foreign proceeding be a foreign 'main' proceeding (being a proceeding taking place in the state where the debtor has the centre of its main interests (Art. 17.2 of Sch. 1)), then an automatic stay on the 'commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities' obtains (Art. 20.1 of Sch. 1).

The result is that practitioners in England now regularly encounter instances where parties are precluded by recognition orders from litigating or arbitrating disputes in the *forum* that, but for the recognition order, would have jurisdiction over the dispute. The object of this article is to review some of the more recent cases that demonstrate how such a recognition order may be modified to enable the efficient determination of a dispute before an appropriate Court or tribunal.

Art. 20(6) of Sch. 1 to the CBIR

Art. 20(6) of Sch. 1 provides (*inter alia*) that 'the court may, on the application of the foreign representative or a person affected by the stay and suspension…, or of its own motion, modify or terminate such stay and suspension or any part of it, either altogether or for a limited time, on such terms and conditions as the court thinks fit.'

The correct approach is that the Court has a 'free hand to do what is right and fair according to the circumstances of each case' (*Re Aro Co Limited* [1980] Ch 196 at 209, *per* Brightman L.J. (in relation to a domestic case); applied by analogy to the CBIR in *Cosco Bulk Carrier Co. Limited v Armada Shipping SA* [2011] 2 All ER (Comm) 481).

A discussion of how this test applies to foreign insolvency proceedings that are analogous to administrations (as distinct from windings-up) is outwith the scope of this article, and on that point readers are referred to *VTB Bank (Austria) AG v Kombinat Aluminijuma Podgorica AD* [2015] EWHC 750 (Ch) and *Seawolf Tankers Inc. v Pan Ocean Co. Limited* [2015] EWHC 1500 (Ch) and Stephen Cogley QC, 'Stay of Proceedings under the Cross-Border Insolvency Regulations 2006: Seawolf Tanks Inc. v Pan Ocean Co. Limited', *International Corporate Rescue*, 2015, p. 295. Broadly: the test is sufficiently wide to take into account the interests of the debtor company where the interests of justice require this.

'Bum Chin' orders

Ordinarily, applications under Art. 20(6) of Sch. 1 (insofar as such applications relate to a stay on the commencement or continuation of individual proceedings) will be directed at terminating or lifting a stay.

However, *Heroic Warrior Incorporated v STX Pan Ocean Co. Limited* (*'The Bum Chin'*), Companies Court, no. 04446 of 2013 (6 September 2013, unrep.) illustrates a more unusual application of the Court's discretion, albeit as a provisional measure pending determination of the applicant's application to lift the stay.

The case concerned a charter of the vessel *'Bum Chin'*, on the terms of a charterparty that contained an arbitration clause providing for London arbitration. The applicant ('Heroic Warrior') asserted a claim against the respondent ('STX'), and had been provided with a letter of undertaking by STX's P&I club that responded to the award of a London tribunal on condition that Heroic Warrior refrained from commencing and/or prosecuting legal or arbitration proceedings other than before an arbitration tribunal in London, applying English law.

Thereafter, STX entered into rehabilitation proceedings in South Korea and Heroic Warrior registered its claim with the Seoul Central District Court. That claim was rejected by the receivers on the basis that it was 'uncertain' – in other words, it would need to be considered and determined before it could be accepted.

In the meantime, STX's representative had obtained a recognition order in England that proscribed the commencement or continuation of arbitrations concerning STX's assets, rights, obligations and liabilities. Accordingly, Heroic Warrior applied to the English Court to modify the recognition order to enable its dispute with STX to be arbitrated.

However, before that application could be determined, Heroic Warrior faced a dilemma (which is of a type that will be familiar to and will have been encountered by many practitioners). In order to contest the rejection within the rehabilitation, Heroic Warrior would need to commence 'Confirmatory Proceedings' in South Korea by 9 September 2013. If it did so, it faced the potential argument that it had submitted to the jurisdiction of the South Korean Court to the exclusion of its rights under the charterparty, with the result that it might be precluded from enforcing its security under the LoU. On the other hand, if it 'missed the boat' in South Korea, it potentially faced the contrary argument that its rights of recourse under the LoU were prejudiced by its inaction (in failing to take reasonable steps) in South Korea; in the event that the English Court ultimately refused to lift the stay, it risked being unable to assert its claim in any jurisdiction.

The solution favoured by the Court in *'The Bum Chin'* was to modify the recognition order as follows:

> 'That until the final determination of the Applicant's application for leave to arbitrate and to exercise ancillary rights, it be a condition of the stay on the commencement or continuance of arbitration contained in the [recognition order] as against the Applicant that (a) steps taken by the Applicant in the Republic of Korea in or associated with the rehabilitation proceedings in respect of the Respondent shall not be deemed to constitute submission to the jurisdiction of the Courts of the Republic of Korea to the exclusion of the Applicant's rights under the charterparty between the Applicant (as owners) and the Respondent (as charterers) ... to refer all disputes arising under the Charterparty to arbitration in London, and that (b), if or insofar as the Courts of the Republic of Korea give any judgment in the rehabilitation proceedings or in associated proceedings as to the Respondent's liability in respect of the Applicant's claims under or in connexion with the Charterparty, or make any determination of the quantum thereof, no estoppel otherwise arising by reason of steps taken by the Applicant in the Republic of Korea in or associated with the rehabilitation proceedings of the Respondent shall operate to preclude the Applicant from denying that such decision should be given effect to in England.'

This approach recommends itself as a practical modification of recognition orders to maintain the 'status quo' pending determination of an application to lift a stay. On the particular facts of that case, it is suggested that the Court was plainly right to take steps that would avoid Heroic Warrior falling between two stools that could potentially result in the dispute not being amenable to determination in any jurisdiction.

A very similar case (*Wren Shipping LLC v STX Pan Ocean Co. Limited* (Companies Court, 6 September, unrep.)) was heard by Registrar Jones on the same day with a similar result.

Factors relevant to the Court's discretion under Art. 20(6) of Sch. 1 to the CBIR

It is not possible to provide an exhaustive list of factors that the Court will take into consideration in deciding whether to modify a recognition order to terminate or lift a stay on the continuation or commencement of Court or arbitration proceedings. By its nature, the Court's discretion, in this regard, is a broad one that will depend upon the particular circumstances of the case before it.

As a general rule (and focussing only on the case of foreign insolvency proceedings that are analogous to a winding-up as opposed to an administration), the object that the Court must bear in mind is the orderly resolution of all matters arising in the winding-up for the benefit of the creditors as a whole. Moreover, the expectation of the Court is that the resolution of disputes within the machinery of a liquidation is likely to be cheaper and quicker than if left to ordinary proceedings, and, therefore, the Court will be cautious not to expose the often limited resources of the office-holder to the burdens of difficult and time-consuming litigation (see *Bourne v Charit-Email Technology Partnership LLP* [2010] 1 BCLC 201 at 212-213, *per* Proudman J.).

Recent cases provide useful guidance both as to the nature of the factors that the Court is likely to consider and the weight that it is likely to place on them (albeit that, particularly as regards the question of weight, the application of this guidance will vary according to the specific facts of the case).

The merits of the claim. The Court will not investigate the merits of the claim in favour of which it is asked to lift the stay (see *Cosco Bulk Carrier Company Limited v Armada Shipping SA* [2011] EWHC 216 (Ch) at para. 48, *per* Briggs J (as he then was)). However, the Court will investigate, in appropriate cases, whether there is any purpose or need for the dispute to be determined (see *VTB Bank (Austria) AG v Kombinat Aluminijuma Podgorica AD* [2015] EWHC 750 (Ch)). There are cases, as in the *VTB Bank* case (where the claims were pursued in order to support third party claims that had been inadequately particularised), where the merits and the purpose/need may shade into one another, but generally it should be clear which side of the line a case is on. Obviously, the fact that there is no sufficiently identified purpose or need for a dispute to be determined will be a factor that weighs heavily on a Court's determination of whether the dispute can be dealt with most efficiently in the context of the foreign insolvency proceedings.

The existence of a counter-claim. It appears from the *VTB Bank* case that this will most likely be an over-riding factor (see paras. 83-84). As explained in *Seawolf Tankers Inc. v Pan Ocean Co. Limited* [2015] EWHC 1500 (Ch), the fact that the insolvent company seeks to have its own disputes determined in English proceedings (while simultaneously seeking to preclude the applicant for modification from having its disputes determined in the very same proceedings) is a factor that weighs on the Court's discretion. There are a number of obvious reasons why this is the case. In particular, it may be unfair for related claims and counterclaims to be determined in different processes (where one of them will be determined on a summary basis); the result could be that the applicant for modification is deprived of a defence in the English proceedings; there is the risk that (if the unfairness that arises is sufficient) the insolvent party's claims cannot be determined at all in any jurisdiction.

Disputes that raise questions of English law. In order for a foreign Court to determine questions of English law, it will need to hear expert evidence on those questions, whereas an English Court or tribunal could proceed on the basis of submissions (which would, ordinarily, be a fairer and more satisfactory process). The more complex the issues, the more likely it is that the Court will consider that the fairest and most appropriate way forwards is for the dispute to be determined in England. As Registrar Jones commented in the *Seawolf Tankers* case (at para. 59.6), the complexity of the English law issues in that case 'mean[t] that a final determination, which will allow for oral evidence, by those qualified in English law will be the most efficient, effective and best method of resolving the disputes.'

Proportionality/means of the insolvent company. Where determination in England would be disproportionate, because of the relative costs of litigation/arbitration as against the sums (and/or issues) in dispute and the relative costs of proceeding in the foreign insolvency process, the Court will be unlikely to lift the stay. Where the line should be drawn is necessarily case specific. For a discussion, see the *Seawolf Tankers* case at paras. 63-71; see also *VTB Bank* at paras. 51-53.

Delay by the insolvent company in obtaining a recognition order. In the *VTB Bank* case, Registrar Jones described this as an 'important factor' in favour of lifting the stay (para. 55). However, it is clear from the judgment that the question of delay needs to be understood in the context of the underlying litigation/arbitration: where parties have reached an advanced stage in those proceedings (and even if some form of estoppel does not obtain to preclude the insolvent company from applying for a recognition order), it becomes more difficult for the insolvent company to oppose the lifting of the stay. To maintain the stay would result in the costs of the arbitration being (on some measure) wasted, and the closer the litigation/arbitration is to reaching a final determination the less weight the Court will be able to place on the assumed efficiency of the foreign insolvency process.

Conclusion

The English Courts are very often amenable to applications to modify recognition orders by allowing litigation/arbitration to continue in order to enable determination of disputes that are subject to English law and jurisdiction, particularly where the insolvent company has its own related claims and/or where the issues are of sufficient complexity that it would be unfair or inappropriate for these to be decided on the basis of expert evidence of English law or on a summary basis in a foreign insolvency proceeding. The overriding consideration is what is 'right and fair' in the particular circumstances of the case, and this means that the Courts are astute to avoid foreign representatives abusing the recognition process and are sympathetic to requests to modify recognition orders to avoid unfair advantage being taken of them.


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