

# THE ARREST

## news

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### IN THIS QUARTERLY ISSUE

- **Insolvency and Ship Arrest in France, by Henri R. Najjar (Richemont Nicolas & Associés)**
- **Landmark Judgments of the High Court of Bombay, by V. K. Ramabahdran (Advocate High Court)**
- **New Rules for the Arrest of Ships in Spain, by Dr. Felipe Arizon (Arizon Abogados SLP)**
- **Gibraltar Ship Arrest Update, by Christian C. Hernandez (ISOLAS)**

### INSOLVENCY AND SHIP ARREST IN FRANCE

It is no secret that the international economic crisis, which has been shaking the world for the last years, did not spare the maritime industry. Numerous ship owners, charterers and operators have been unable to meet their undertakings and have been led to the edge of collapse, sagging under the weight of accumulated mounting debts. As a result, their creditors, bank mortgagees, bunker suppliers, crewmembers, have found themselves lumped together with all other creditors with little chance to recover all or part of their claims from the available estate. It was then legitimate to seek to circumvent this risk by trying to arrest ships owned by their debtors or their affiliated companies. Some avenues may be explored when a ship is spotted in a French port.

#### Laws applicable to the arrest of ships in France

It is first reminded that under French law, a ship flying the flag of a State party to the 1952 Brussels Convention can only be arrested as per the provisions of the Convention, while a ship that does not fly the flag of a Contracting State could also be arrested on the basis of the French domestic law, namely the Code of Transport.

Under the regime of the Brussels Convention, a ship may be arrested for any maritime claim alleged against the ship, irrespective of the identity of the debtor, save when the ship has been transferred to another entity by reason of the seizure of the vessel for infringement of customs, police or security laws, for judicial sale or for an amicable sale regularly published (in this latter case, after the expiry of a period of 2 months) (cf. art. 3 and 9 of the 1952 Convention read with art. L.5114-19 of the Code of Transport). One can also arrest any other ship than the one to which the claim is attached, so long as it is owned by the same debtor.

Under French domestic law, it is absolutely necessary to prove that the owner of the ship is indeed the debtor of the claim.

#### Arrest of a ship belonging to an insolvent debtor

As a matter of principle, it is prohibited to start any judicial action against a national entity declared insolvent or to attach any of its assets located in France. When the insolvent debtor is located abroad, outside the

European Union, its assets in France can still be attached if the judgement ordering the insolvency or winding-up of the debtor has still not been declared enforceable in France. Indeed, France did not tailor any legislation on the basis of the 1997 UNCITRAL Model law on Cross-Border Insolvency and does not recognize automatically foreign bankruptcy proceedings.

If the insolvent debtor is located within the European Union, then the Council (EC) Regulation no. 1346/2000 of 29 May 2000 on insolvency proceedings applies. According to this regulation, any judgment opening insolvency proceedings handed down by a competent court of a Member State shall be recognised in all the other EU States from the time that it becomes effective in the State of the opening of proceedings. Hence, a creditor would not be authorized to arrest a ship calling at a French port for a claim against a debtor party to insolvency proceedings started in another EU State. Yet, this does not apply to creditors holding rights in rem in connection with the ship. Indeed article 5 of the EC Regulation highlights that the opening of insolvency proceedings does not affect the rights in rem of creditors and defines as follows what may be held as a right *in rem*: "(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage; (b) the exclusive right to have a claim met, in particular a right guarantee by a lien in respect of the claim or by assignment of the claim by way of a guarantee; (c) the right to demand the assets from and/or to require restitution by anyone having possession or use of them contrary to the wishes of the party so entitled; and (d) a right in rem to the beneficial use of assets."

Likewise, the opening of insolvency proceedings against the purchaser of an asset shall not affect the seller's rights based on a reservation of title where at the time of the opening of proceedings the asset is situated within the territory of a Member State other than the State of opening of proceedings.

In France, a ministerial circular no.2006-19 enacted on 15 December 2006, with a view to clarifying further the EC Regulation, confirmed that the provisions of article 5 were not restrictive and that the same applied to rights deemed as a right *in rem*, by the law governing the said right - which would be the law of the underlying contract (*lex contractus*) or the

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law of the place where the asset is located (*lex rei sitae*). In practice, registered mortgages and liens acknowledged by law or by the applicable international conventions should therefore authorize the arrest of a vessel in France where insolvency proceedings are started in another EU State.

### Arrest of a ship belonging to a company affiliated to an insolvent debtor

If the debtor does not own a ship, creditors may want to arrest the assets, including ships, of an affiliated (sister or parent) company. French judges allow the arrest of sister ships whenever it is established that the affiliated company is fictitious. For this, claimants must pierce the corporate veil of the debtor and its affiliated company not only to prove a community of interests or management but more particularly the want of a “company life” of the entity said to be a sham: same head office, same telephone and fax numbers, no employees, no specific revenues, no other assets, no working structure, no general assemblies, straw men nominated as shareholders etc...

Claimants can also try to demonstrate that the affiliated company was involved in management decisions with the debtor or was directly or indirectly associated with the debt, or did participate in creating the wrongful impression that it was acting jointly with the debtor.

When the debtor is insolvent, the proof of its fictitiousness could lead to the extension of the insolvency proceedings to any affiliated company. Such extension is also allowed when it is proven that there is a “confusion of the patrimonies” of the debtor and the affiliated company. This concept, similar to the “substantive consolidation” known under US law, supposes that the patrimonies of both companies are entangled in a way that is difficult to determine their reciprocal assets and liabilities. It can be inferred from an excessive dependency of one company on the other and from unusual financial movements between them (ex. floating charges, unjustified want of consideration or compensation, extortionate credits, etc). The court ruling on an insolvency could also hold that the insufficiency of assets should be borne by any and all legal or actual managers or directors of the debtor, if their mismanagement or misfeasance contributed to the insufficiency. While a parent company is rarely designated as legal manager, French judges have often considered that it may be deemed as an actual manager, whenever it concurs to the management or carrying out of the business of the debtor.

Finally, proceedings could also be started against any creditor of the debtor that may have aggravated the situation of the debtor through any act, financial support or interference in the management of the debtor. It is important to note that the foregoing actions must benefit all creditors and are therefore to be initiated by the receiver.

Where the extension may be decided against the affiliated company, or where it may be deemed liable to contribute to the assets of the debtor, as the case may be, claimants should be entitled to proceed to the arrest of any of its ships in France, subject to the above.

In sum, creditors aiming at arresting a ship to secure their claims should not give up when their debtor is insolvent and should bear in mind that some jurisdictions, as France, could offer a way-out. The paths could happen to be easier to take than expected whenever the surrounding circumstances are tainted with fraud: French judges are prone to loosen their views on the independence and separateness between companies of a same group and to blot out entity borders whenever the debtor and/or its affiliated company are involved in acts meant to defraud creditors or dissipate assets. For French justice *Fraus omnia corrumpit* is not a mere adage. Fraud does indeed unravel all.

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## LANDMARK JUDGMENTS OF THE HIGH COURT OF BOMBAY

1. The Admiralty Jurisdiction prior to 15<sup>th</sup> August, 1947 when India became independent, vested only with three Presidency Courts being Bombay, Madras and Calcutta. These three Courts were conferred with unlimited Civil Jurisdiction and extended to the territorial waters of India by the Colonial Courts of Admiralty Act, 1891. Subsequent to the independence, States were reorganized by virtue of which several territories which were originally part of the aforesaid three Presidency States became independent States by themselves. A question arose in the year 2002 whether High Court of Bombay would have jurisdiction over the territorial waters of India or whether its jurisdiction would be confined and restricted to the territorial waters of respective States alone. The High Court of Bombay in the case of *m. v. Umang* (1) held that “power to arrest ship lies in the Sovereignty of State and said Sovereignty resides in whole of country and not any of the States”. The Court further held that provisions of “Constitution and Territorial Waters Act makes it clear that Union of India exercise sovereignty over the territorial waters and the law underneath it” and therefore the contention that the Admiralty law Jurisdiction of arrest of a ship could be exercised only by High Court within the limits of its territorial jurisdiction was rejected. The upshot of this judgment is that High Court of Bombay continues to exercise jurisdiction over the territorial waters of India and thus no matter where the ship is, as long as it is within the territorial waters of India the Admiralty jurisdiction of High Court of Bombay could be invoked seeking arrest of the ship.

2. In India there is no specific law or statute which enables the Admiralty Court to arrest a ship and retain security in the event of agreement between the parties which mandates dispute to be referred to Arbitration in a foreign country. The problem became more complex after the Arbitration and Conciliation Act, 1996 was enacted. Application for interim security could be made only before that Court within whose jurisdiction the cause of action arose or the property is situated, with the result, if the ship is outside the Port of Mumbai, difficulty arose as to whether Bombay High Court could exercise Admiralty Jurisdiction. The Full Bench of the High Court of Bombay in the case of *m. v. Golden Progress* (2) held that even if such an agreement exists to refer the dispute to Arbitration in a foreign country, the Court would be empowered to arrest the ship. Thus the Claimants would be secured of their claim but at the same time their remedy to proceed with the Arbitration against the ship owner for adjudication of dispute would not be jeopardized.

3. The High Court of Bombay had occasion to consider in the case of *m. v. ATAIR* (3) wherein claim of the Claimants far exceed the value of the ship, a question arose whether the security to be furnished by the owners

of *m. v. ATAIR* should be restricted to the value of the ship or the entire amount claimed by the Claimants. The High Court after considering the Rules framed by the High Court of Bombay and also decision of the English Court held that the owner of the arrested ship was not entitled to secure release of the ship unless and until security in the form of Bank Guarantee is furnished towards satisfaction of the entire claim.

4. The High Court of Bombay in the case of *m. v. Bunga Mas Taga* (4) held that if the order for supply of bunkers is not placed by the owner of the ship or anyone on behalf of the owner, the ship is not liable to be arrested. Frequently when the vessel is on time-charter, it is the charterer who places the order for the supply of bunkers. In such a case the supplier could look forward only to the charterers and/or any intermediary person who had placed the order for supply of the bunkers. The High Court of Bombay held that merely because supply was made to the ship neither the owner nor the vessel would be liable if the invoice of the bunker supplier remained outstanding. The Court held if there is no privity of contract between the Claimants and the ship and its owner, even if it is claimed that there is maritime lien, such rights cannot be enforced against the ship. The Court held that existence of an enforceable right against the ship is a must.

5. However, in the case of *m. v. Nuevik* (5) the High Court of Bombay held that in so far as a claim based on "use or hire" of the ship is concerned, the privity of contract with the owner may not be necessary to seek arrest of the vessel. In that case the ship owner had given the vessel on bareboat charter to one M/s. Nuevik Shipping Company who in turn entered into a sub-charter agreement with the Claimants for the use of the vessel *m. v. Nuevik*. The Court in its Judgment while dismissing the application for vacating the order of arrest held that expression "use or hire" of a ship is broad enough to include any agreement in respect of the ship.

6. At the time of making application seeking arrest of the ship, under the High Court Rules the Claimants has to execute an undertaking to pay damages in case any party sustains loss as a result of the order of arrest. However, it is rarely the Court enforces such undertaking even if it is found that the order of the arrest was not sustainable. However, the Division Bench of the High Court of Bombay in the case of *m. v. A.R.A. 25 D.e Mayo* (6) had directed the Claimants in that case to pay damages to the party who has sustained loss as a result of the wrongful arrest. By virtue of the Judgment it would appear that in case the arrest is wrongful and the Court finds that the application for the arrest was mala fide, the Court is entitled to order damages in the very same proceedings without directing the party who sustained the loss to initiate separate legal proceedings for the purpose of claiming damages.

List of cases:

- 1) *Kamala Kanth Dube & Anr. v/s. m. v. Umang & Ors* (2002 suppl.2) BOM.CR.864
- 2) *J S Ocean Liner LLC v/s. m. v. Golden Progress 2007(2)ARBLR104 BOM*
- 3) *Unigem Traders Ltd. Inc. v/s. m. v. Atair & Ors*
- 4) *Raj Shipping Agents v/s. m. v. Bunga Mas Taga* (2001) VOL 1 103 (4) BOM LR124.
- 5) *Flotech Maritime S.D.R.L. v/s. m. v. Nuevik*
- 6) *Gem Star Trading v/s. A.R.A. 25 DE Mayo & Anr.*

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## NEW RULES FOR THE ARREST OF SHIPS IN SPAIN

The International Convention on the Arrest of Ships 1999 will come into force on 14 September 2011. So far only ten States have ratified the 1999 Arrest Convention: Albania, Algeria, Benin, Bulgaria, Ecuador, Estonia, Latvia, Liberia, the Syrian Arab Republic and Spain. The 14.03.2011 signature of Albania has triggered the application of the Convention.

As a result a new set of rules will apply in Spain to arrest a ship. The certainty gained under the 1952 Arrest Convention is now to be tested under different rules of law. Spain has reserved his right to exclude the application of the Convention to ships not flying the flag of a State Party.

Some changes introduced by the 1999 Arrest Convention include; (i) a wider list of maritime claims; for instance under the 1999 Arrest Convention P & I Clubs, insurance companies and insurance brokers will be able to apply for the arrest of ships against their debtors. I have to say that under the 1952 Arrest Convention I have successfully arrested ships to collect unpaid P&I premiums in Spain, eg Arrest of MV Nestor at La Coruña; *Nestor gives fighting power to P&I*, Lloyds' List 2003 by Felipe Arizon. The Spanish Courts of Appeal had issued decisions in pro and against this practice. Elsewhere the positions varied while the *The Sea Friends* [1991] 2 Lloyd's Rep 322 set the rule against such wide construction.

(ii) The amount of the guarantee to release the ship from the arrest cannot exceed the value of the arrested ship. This will lead to more rational behaviours and to the running of arguments in respect to ships' valuations.

(iii) The countersecurity to be provided by the arrestor is no longer a mandatory condition to obtain the arrest of the ship. The Commercial Courts have now the discretion to request the arrestor countersecurity for the arrest. This discretionary power can be exercised either before or after the arrest has been ordered. Thus, this "after" option opens the doors to quicker arrests preventing the ships from escaping. I envisage that this new rule will improve the swiftness of the Court reaction, already quite fast, but the inertia of the old practice, ie countersecurity to be provided before the arrest, will be difficult to change.

Many of the provisions of the new arrest convention are in practice similar to the 1952 regime whist the wording has changed. The new changes are meat for lawyers and, given the reservation made by Spain in respect to the application of the 1999 Convention, we may see both, the 1952 and 1999 Arrest Conventions, being argued in the many Spanish ports available to get ships arrested.

In September 2011, a fuller update of the applicable law in Spain will be displayed at [www.shiparrested.com](http://www.shiparrested.com).

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## GIBRALTAR SHIP ARREST UPDATE

Shipping follows banking, that much is true. The global financial crisis sparked by the Lehmann Brothers collapse is well documented, as are the effects this had on international money and credit markets and, by implication, on the shipping industry as a whole. As banks recapitalized and sought to shore up balance sheets, debts and liabilities were reassessed and revisited, to the marked detriment of shipping's largest players worldwide.

The economic recovery analysts have been talking about so tentatively in the last twelve to eighteen months has done little to add confidence to a market battered by the winds of the sub-prime crisis and the heavy seas of the credit crunch. Despite some limited growth in demand and improving output figures for the World's largest economies, unemployment has continued to rise as business played the waiting game and re-learned sensibility in the capacity vs output context.

In Gibraltar, the effects of the crisis were, thankfully, hard to appreciate. In a community where it's economy continues to grow (and has throughout the global economic malaise) at 5-5.5%, unemployment is practically negligible. The banking and insurance sectors continue to drive the economy but, as would be expected, the jurisdiction has witnessed a limited knock-on effect.

Interestingly, between 2005 and 2009, the number of ship arrests in Gibraltar was negligible, not surprising given the bullish economic conditions prevailing at the time. Credit was easy to come by, too easy as it turned out and the finance market was a borrower's one. The mantra that the shipping industry follows banking would once again validate itself as, despite the economic crash in September 2008, there was no ship arrest activity whatsoever.

In the last 12-24 months, however, things changed. The downturn was palpable in the shipping industry. As the global economy underwent a wholesale correction and global output froze on the back of high volumes of stock remaining unsold, freight demand plummeted. As more and more ships laid at anchor on Gibraltar's east side anchorage, with nowhere to go, nothing to carry, so the enquiries started coming in to law firms locally seeking advice on arresting ships for defaults of many varieties. In the period of the last two years there have been, therefore, a comparatively high number of arrests.

During 2009 up to the second quarter of 2010 approximately 20 vessels were arrested in Gibraltar. A short hiatus followed during the latter stages of last year and through the festive season following a slight recovery in manufacturing output. In the first six months of 2011 however, it seems new woes have befallen the shipping industry, as illustrated by the arrest of 6 vessels from January onwards. Depression in the shipping industry lagged behind the banking crisis as freight rates were bolstered by high order levels from China and India.

The shipping industry faces a variety of problems, not least of which is the new economic reality of government cuts in spending allied to painful yet necessary programmes of austerity and cutbacks to reign in sovereign debt.

Despite these measures, the evidence points to a globalised economy unable to shake itself from the recession. The southern European countries are experiencing their hardest economic times since they joined the European Union with Greece, Ireland and Portugal already having agreed bailout packages. Greece's problems are now compounded by the fact that it seems unable to repay its debts in accordance with the terms it agreed last year, a development which has led European Finance ministers keen on the Euro's survival to come up with the latest innovation, a 'debt reprofiling' exercise, to avoid talk of what is, in effect, further restructuring of that debt. With new concerns emerging about Spain's ability to pay its own debts, many fear that the sovereign debt crises may have a longer term impact on the economy and global output demands than at first thought.

Unfortunately, the 'emerging' industrial powerhouses of China, India, Brazil and Russia offer little hope of picking up the demand where Europe and America drop it off. Economic output figures produced by China are, typically, so entirely unreliable and unbelievable that even Chinese analysts ignore them. A better, more reliable gauge of the performance of the Chinese economy is found in the figures relating to electricity generation, the theory going that when an economy is busy producing and selling, electric consumption goes up. If factories are turning off their lights and heading home early, a good omen it certainly is not. Electricity production in China is up just 6.2% year on year, the slowest rate of growth since July 2009, a fact which, when coupled inflation figures which suggest aggressive tightening measures will be required in the near term leading to a further slow down in growth, is very telling of the state of the global recovery. The other emerging markets are faring no better, confirming fears that, in addition to moderating growth in the developed economies, the emerging markets are showing a worrying lack of resilience.

For the shipping industry this is all plainly very bad news. Lazard recently alluded to the fact that the problems facing the industry were both of its own making and, certainly, owing to factors beyond their control. One of the main concerns, according to Lazard, was 'structural overcapacity in the shipbuilding industry. Peter Stokes, head of shipping at the finance firm speaking at an International Maritime Industries event in London explained that "artificially low interest rates have kept asset prices high, including ships. The continuing problem for shipping companies is not so much in the servicing of their existing debt, but the funding of their capital commitments on new buildings. So far, shipowners and shipbuilders have generally managed to muddle their way through this problem, but the problem has certainly not gone away.

The main issue is that the large volume of new builds sitting in docks around the world are waiting purchase by shipowners who can either no longer afford them or simply cannot finance them in the current environment. The impact this has on the value of new builds and the consequent effect this has on the values of existing tonnage will bring about loan to value defaults and further impacts across the industry. Stokes, however, believes that this re-setting of values may fall short of a complete collapse in values of existing tonnage. Multi-ship orders lodged on the back of a hope that delivery materialises at a time when freight markets recover are risky business indeed, even if there have recently been mild improvements in freight rates.

As one of the premier ship arrest jurisdictions in the world at the gates to the Mediterranean, Gibraltar expects an increase in ship arrest activity in the market owing to the worsening conditions in the global shipping industry. It is a reality, after all, that the legal profession endures and even thrives through good and, certainly, bad times.

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*"He is noted for expertise in non-contentious and disputes work in the admiralty area." CHAMBERS & PARTNERS 2007. "Christian Hernandez, head of the firm's admiralty and shipping team, is 'undoubtedly one of the heavyweights in the sector'" THE LEGAL 500, 2009*