



THE MARITIME LAW
ASSOCIATION OF SINGAPORE
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The 2nd Asian Maritime Law Conference

24 April 2009 | Suntec Singapore



**Arrest, Insolvency and Pre-Emptive
Remedies in a Global Shipping Crisis**

ARREST/PRE-EMPTIVE REMEDIES & RELATED ISSUES FOR BUNKER SUPPLIER'S CLAIMS UNDER U.S. LAW

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I. Introduction

Vessel owners who lease vessels to charterers that later go bankrupt often walk about with the sword of Damocles hanging over their heads.

On the one hand, suppliers that provide bunkers to charterers, and are not paid, understandably want their money; and when the charterer disappears off the radar screen, the supplier has a nice target in the vessel. On the other hand, owners may be blind-sided upon receiving a call that their vessel has been arrested. What if the vessel is in a U.S. port?

II. Arrest Options

U.S. Federal Supplemental Rules for Admiralty or Maritime Claims provides these arrest/pre-emptive procedures:

- Rule B (in personam) Attachment
- Rule C (in rem) Arrest

III. Rule B Attachment

Under a Rule B attachment (*in personam* action), a plaintiff must (a) have a maritime claim (e.g. breach of bunker contract), and (b) show the defendant “**cannot be found** within the district.” This procedure allows a plaintiff bunker supplier to assert personal jurisdiction over a defendant, e.g. a vessel owner who cannot be found, via the attachment of its property (*quasi-in-rem* jurisdiction). Unless the defendant is personally served with process, plaintiff’s recovery is limited to the value of the property attached.

Basic Requirements

Step 1 for a supplier is to ensure it has a bunker agreement in place. Step 2 requires an investigation into whether defendant can be “found” in the district – this is key to whether plaintiff can file suit and depends on defendant’s connections to the local federal court district (e.g. Los Angeles vs. San Francisco), not on its connections to the state or a geographical area (e.g. California).

Is Defendant “Found” in the District?

If a defendant is “found” in the district, there is no basis for a Rule B. This requires a 2-pronged investigation: (1) can defendant be found in terms of jurisdiction – does it have sufficient contacts with the district; and (2) can it be found for service of process? If a diligent search shows defendant has absolutely no contacts at all with the district e.g. Los Angeles, then plaintiff must determine if it can be found for service of process.

Business owners are resourceful: suppose the vessel owner has filed for corporate status in California (registration is in Sacramento, which is a different “district” from Los Angeles) and has a registered agent for “service of process” (an individual required under state law), is this sufficient for a court to say “yes” and defeat the Rule B?

Consider the following scenario:

- Defendant is represented by a ships agent & lists its address as such agents address
- Agent confirms defendant has no physical office and no employees at such address
- Agent advises the “registered agent” is physically in Oregon
- Listed telephone number for defendant had been disconnected
- Telephone number for the registered agent rings through to ships agent in Oregon
- Google search finds the registered agent participated in a golf tournament in Oregon and on the application listed “hometown” as Seoul, Korea

Based on these facts, a plaintiff could argue that the California incorporation and agent registration is a “sham transaction” intended solely to defeat a Rule B:

First, defendant is evidently not doing business in the district “on a continuous and systematic basis,” since it had no real office, staff or telephone there. Second, the registered agent is not “found” within the district to receive service of process, and is likely in Oregon or Korea.

California Case Law re “Being Found”

No California court has *yet* ruled on whether being incorporated in California and having a registered agent listed as in the district would defeat a Rule B.

However, the 2nd Circuit (where most Rule B action takes place due to EFTs) has dealt with this issue. In a 2008 case, plaintiff went to great lengths to show the registered agent was not actually within the particular district, and the court held that having an agent in the Northern district of NY did not suffice for a Rule B filed in the Southern district of NY.

IV. Rule C Arrest

A Rule C Arrest (*in rem* action) can be brought to enforce a **maritime lien** against a vessel or other maritime property (cargo & freight); plaintiff must (a) file verified complaint, (b) describe the property, and (c) state property is/will be in the district while action is pending.

Basic Requirements

Plaintiff must have a valid maritime lien.

U.S. law recognizes liens for crew wages; salvage; general average; breach of charter party; preferred ship mortgage; breach of maritime contract; maritime tort; cargo damage/loss; unpaid freight & demurrage; and pollution. Further, under the U.S. Federal Maritime Lien Act (FMLA) “a person providing **necessaries** to a vessel on the order of the owner or person authorized by the owner” has a maritime lien on the vessel, which can be enforced by an *in rem* action. “Necessaries” include bunkers supplied to a vessel on the “credit of the vessel.”

U.S. maritime lien law differs from most other nations, and courts broadly construe “necessaries” to include goods or services that are “useful to the vessel, keep her out of danger, and enable her to perform, her particular function.” The applicable governing law may therefore be critical to whether a maritime lien exists.

V. Can U.S. “Choice of Law” Clause Create Maritime Lien for “Necessaries”?

In a typical bunker transaction, an owner or charterer may request a price quote from a supplier via fax or e-mail, which results in a confirmation and supply to a vessel. Correspondence may incorporate the supplier’s “standard terms and conditions.”

If they contain a U.S. choice of law clause, does the supplier have a maritime lien under U.S. lien law – even if the supplier is not a U.S. entity, the supply did not occur in a U.S. port, and the vessel is not flagged in the U.S.?

U.S. courts generally enforce “choice of law” clauses in contracts, but if there is no such clause, they engage in a *Lauritzen v. Larsen* analysis (7-factors: place of act; **law of flag**; allegiance/domicile of injured party; allegiance of vessel owner; place of contract; inaccessibility of foreign forum; law of forum). By weighing the factors like a score card, a court can determine which foreign legal system most strongly touches the transaction.

Background Facts: TRANS-TEC V. M/V HARMONY CONTAINER

The supplier’s “terms and conditions” stated that they related to “every sale;” that seller was entitled to assert a lien in any country where it found the vessel; and that each transaction was to be governed by U.S. law, without reference to any “conflict of law” rules. Further, they stated that U.S. law would apply as to the “existence of a maritime lien” regardless of the country where seller took legal action.

When the charterer failed to pay for bunkers supplied in Korea (and disappeared owing millions of dollars to creditors around the world), the Singapore supplier arrested a Malaysian flag vessel in Chile. To expedite release, the P&I Club put up a LOU and agreed to litigate the dispute in federal court in Los Angeles. The supplier then filed claims for breach of contract, unjust enrichment and maritime lien for “necessaries.” The vessel owner denied liability for the charterer’s debt.

Question: what law governed the dispute? In applying such law, were the supplier’s terms & conditions (and U.S. choice of law clause) enforceable? And if so, did the supplier have a maritime lien for a transaction not touching the U.S., thereby holding the vessel owner liable?

Case of “First Impression” in California (Feb 2006)

The supplier raised 3 clever theories:

First, it argued the vessel owner was liable under the bunker contract with the charterer (even though the owner was not a party to it) via a “joint venture.” Second, it contended the owner was “unjustly enriched” by the bunkers while the vessel was operated by the charterer (via receipt of charter hire). Third, it sought to create a maritime lien for “necessaries” by application of the contractual U.S. choice of law clause in its standard terms and conditions (thereby avoiding the laws of Malaysia or Singapore, which otherwise might have applied but which do not provide a maritime lien for bunker supply).

Ruling re Governing Malaysian Law

Since the **choice of law** was critical, the court invited the parties to file instructional briefs on applicable law before it could decide which legal regime should govern its analysis; based on the briefs, the judge was inclined toward Malaysian or Singapore law. He then ordered formal briefs (he was taking no chances), and ruled Malaysian law should apply.

It was apparently a “close call” as to Singapore law, but the vessel’s flag (under the *Lauritzen* factors) clinched the deal.

Ruling re No Joint Venture or Unjust Enrichment

Applying Malaysian law, the court ruled the owner was NOT a party to the bunker contract via a “joint venture” with the charterer (based on “puffery” in a Website boasting on how the owner and charterer were doing business “together” – beware what you write).¹ The court then ruled there was no evidence the owner received a “direct benefit” from the actual bunkers (for example, charterer failed to pay hire to owners during that time), and charter hire payments received by owners was not sufficient to support an unjust enrichment claim.

Ruling re no Maritime Lien under U.S. Law

The court granted summary judgment against the supplier on the ground that Malaysian law, not U.S. law, governed the bunker contract formation; and under Malaysian law, the U.S. “choice of law” clause *was* incorporated into the bunker contract.²

After dispensing with Malaysian law, the court then ruled that under U.S. law the supplier could *not* obtain a maritime lien on the vessel since U.S. law did not grant a maritime lien to a foreign supplier of necessaries (bunkers) to a non-U.S. flagged ship in a foreign port. The court entered final judgment for defendants and awarded their costs – a victory for vessel interests.

Reversal by 9th Circuit Court of Appeals (March 2008)

The 9th Circuit agreed with the Central District’s initial two rulings:

The court agreed that it first had to determine the applicable law, before it could decide if the U.S. choice of law clause was a valid contractual term and legitimately incorporated into the bunker contract. Then, on its own analysis, it confirmed the Central District’s ruling on the application of Malaysian law.

The court noted Malaysian law’s reliance on English law, which requires an examination of the parties’ language and conduct to see if they intended to incorporate the supplier’s terms and conditions into the contract (even though no such document was exchanged in the flurry of e-mails and faxes that preceded the supply). It concluded that under the specific language of the bunker confirmation, coupled with the charterer’s acceptance of the bunkers without protest after receipt of the confirmation, the answer was “yes” as a matter of Malaysian law. Therefore, U.S. law applied to the contract.

Importance of U.S. “Choice of Law” Clause & Interpretation of FMLA

Here is where the 9th Circuit took a different path from the Central District:

Having determined that the U.S. choice of law clause was part of the contract, the court emphasized a long-recognized principle in the U.S. of honoring the expectations of parties to a contract; absent a strong showing otherwise, the parties’ choice of law clause in a “freely

¹ When the supplier saw this claim was to be denied, it requested more time to conduct discovery on corporate transactions between owner & charterer; however, owners pointed out supplier had sat on its hands for 9-months since the case was filed and the court refused its Rule 56(f) request.

² Disputed by Malaysian counsel as an incorrect interpretation of Malaysian law by a California judge.

negotiated private international agreement” should be given effect. *Bremen v. Zapata*.³

The 9th Circuit then reviewed FMLA and stated that its plain language provided a maritime lien in favor of a supplier since it provided necessities to a vessel on the order of the charterer – and charterers are presumed to have authority to bind the vessel when ordering bunkers. The court held FMLA did *not* impose any restriction on the nationality or identity of the supplier or vessel, or any geographic restriction on the place of provision of necessities.

The vessel owner had argued FMLA did *not* grant a maritime lien to a foreign supplier for supply to a foreign vessel in a foreign port, and that no reported case had so held.⁴ But while the court admitted the U.S. Congress had **American suppliers** in mind, it stated FMLA on its face (apparently) (i) recognized a maritime lien in favor of *any* person providing necessities; (ii) applied to “any vessel, whether foreign or domestic” and was not restricted to “American” vessels (drawing on its interpretation of inferences in the legislative history); and (iii) did not discriminate between necessities provided in a vessel's home port or a foreign port.⁵

VI. Petition for Writ of Certiorari Denied (Dec 2008)

After the 9th Circuit refused to rehear the appeal “en banc” (full bench – 9 judges), the owner filed a petition to the U.S. Supreme Court for a Writ of Certiorari (basically, a request for permission to address the issues before the highest court in the nation), on the grounds that:

- FMLA was improperly extended to a “wholly foreign” transaction (never done before) and there was no “Congressional intent” to extend FMLA extraterritorially
- FMLA’s reach was improperly extended by a contractual “choice of law” clause
- The expanded FMLA application conflicted with 1st and 11th Circuits (limited to only American suppliers), and 2nd Circuit (no maritime lien by agreement of parties)

Even though the petition was supported by an amicus brief from the Malaysian Government, it was denied (only 5% of all petitions are accepted for hearing by the U.S. Supreme Court).

³ Relying on the 5th Circuit decision in *Queen of Leman*, the court recognized this view was in “tension” with the 2nd Circuit's view in *Rainbow Line, Inc. v. M/V Tequila*, where the court refused to apply a U.S. choice of law clause on the question of whether a charterer was entitled to a maritime lien (application of U.S. law would have adversely affected rights of a third-party creditor).

⁴ The court rejected owner’s reliance on *Trinidad Foundry & Fabricating v. M/V K.A.S. Camilla* (11th Circuit) (“house of cards that quickly tumbles with even the gentlest examination”); *Swedish Telecom v. M/V Discovery* (Fla); *Tramp Oil & Marine v. M/V Mermaid I* (1st Circuit); 2 BENEDICT ON ADMIRALTY, §38, 3-35 (7th ed.1997); SCHOENBAUM, ADMIRALTY AND MARITIME LAW, §9-8 (4TH ed. 2004).

⁵ The court dismissed the argument that by extending FMLA to completely foreign transactions, this interfered with other nations' regulation of their commercial affairs. It opined that recognizing a maritime lien against the *m/v Harmony Container* did not interfere with Malaysian law, and stated “our conclusion does not curb the sovereignty of any other nation or [its] ability to regulate its maritime affairs... recognition of freely negotiated contract terms encourages predictability and certainty in the realm of international maritime transactions.” As a result, the court did not believe that, as an American court, it was unilaterally imposing FMLA on other nations.

VII. Considerations Going Forward

Here are a few considerations and observations for the road ahead:

Lack of Uniformity between Circuits

It is possible the 1st, 2nd and 11th Circuits may find the 9th Circuit ruling unpalatable and refuse to follow it (the 9th Circuit is universally seen as too “liberal” and regularly overturned by the U.S. Supreme Court – in some instances as much as 95% of the time – although in this case, the Supremes refused to consider the matter). It is not certain that other courts would be quite so generous (based on FMLA legislative history, which is specifically directed at *American* supplier protection) to extend FMLA lien status to foreign suppliers.

If a vessel is arrested in Boston, New York or Miami for a maritime lien for the supply of bunkers (or any other “necessaries”), the owner might want to contend there is a “split in the circuits” and raise the 3 bullet point arguments referenced above.

Certainly, a willing and well-heeled supplier or vessel owner might want to find a test case and take it all the way to the U.S. Supreme Court for a definitive ruling.

Impact of Subsequent Decisions

Since the *m/v Harmony Container* rulings hit the news stands, there has been some activity:

Relying on the Central District’s ruling in *m/v Harmony Container* (pre-9th Circuit decision) and *Trinidad Foundry*, a Maryland District court ruled there was no maritime lien for bunker supply where bunker confirmation included a U.S. choice of law clause and involved foreign supplier to foreign flag vessel in foreign port (Norwegian owner, Russian charterer, Cayman sub-charterer, Malta flag & Odessa supply). *Triton Marine v. m/v Pacific Chukotka* (Aug 2007).

This case is on appeal to 4th Circuit and will be heard during 2009, so stay tuned.

A Canadian Appeals court recognized a maritime lien for necessities under FMLA where there were U.S. “choice of law” clauses in various bunker contracts and an array of foreign players. The court noted there was a divergence of opinion in the U.S. where a non-U.S. supplier provided necessities to a foreign vessel in a foreign port, and that one circuit was not “binding precedent” on another circuit. However, it relied on 9th Circuit decision in *m/v Harmony Container* since it was the “latest expression” from a U.S. appellate court. *Kent Trade et al v. J.P. Morgan Chase* (Dec 2008). See also *Kirgan v. Panamax Leader* (Dec 2002).

Canadian law has no precedential value in the U.S., but the rationale in those cases may be instructive for both vessel owners and bunker suppliers.

Strategy for Suppliers

The first order of business, if not already done, *may* be for a bunker supplier to consider inserting a U.S. choice of law clause into its supply contracts, standard terms and conditions, and reference such clause in its bunker confirmations.

Standard terms and conditions should be placed on the Website. Further, reference should be made to the Website and terms and conditions in all documents and e-mails for the world to see and read, thereby making it difficult for an owner or charterer to claim ignorance.

If a U.S. choice of law clause is included in a bunker contract, English law and London arbitration clauses should be removed.

Strategy for Owners

The “accounts receivable” of charterers should be carefully monitored (ask around, although this may cause problems in U.S. discovery proceedings).

Request a list from charterers of their suppliers and then provide those (and all other suspected) suppliers with notice of no-lien provisions, thereby effecting actual notice and preventing charterers from burdening a vessel with a maritime lien. Ensure the supplier is advised in writing that the charterer is NOT authorized to create a lien against the vessel, and that if it does supply the vessel on direction/instruction of the charterer the supplier relies only on the credit of the charterer, and not the vessel or its owner.

Have the Master & Chief Engineer use a stamp “for charterer’s account only, despite any contrary terms and conditions of supplier” or similar appropriate wording.

Efforts by Other Nations

If other nations want to preclude U.S. law from pervading supply contracts, they may want to (i) draft laws that would prohibit contracting parties from inserting U.S. choice of law clauses, and (ii) require charterers to inform ALL suppliers of any no-lien clause in their charter parties.

Increase in Arrest Litigation in U.S.

The 9th Circuit decision in the *m/v Harmony Container* opens the door for an increase in maritime lien claims by suppliers (with a U.S. choice of law clause in their contracts) against vessels in the U.S., since the protection normally given to only *American* suppliers has now been extended to astute suppliers around the world.

Suppliers and owners alike should be clear on their strategies for vessels bound for U.S. ports.

Biography

Neil Klein was born and raised in South Africa. He graduated from Natal University in 1977 and worked for an international shipping and trading company for a few years. He served Articles (under the British system) and practiced as a Solicitor in Johannesburg for several years before immigrating to the U.S.

Neil joined the Houston office of a New York maritime firm in 1986 before moving to California a few years later. He was licensed in California in 1989, and worked for a maritime firm in Long Beach before becoming a founding partner at McKasson & Klein LLP in 1998.