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ARREST, INSOLVENCY & PRE-EMPTIVE REMEDIES IN A GLOBAL SHIPPING CRISIS:

ARREST, ATTACHMENT AND PRE-EMPTIVE REMEDIES (CHARTERPARTY DISPUTE RESOLUTION AND INSOLVENCY)

- THE MALAYSIAN PERSPECTIVE*

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It is my pleasure to address you this afternoon on the Malaysian perspective of Arrest, Attachment, Pre-emptive Remedies and Insolvency, and I thank the organizers for this kind invitation. As the 4th Speaker of the 2nd Session on Arrest, Attachment and Pre-emptive Remedies, I face the inevitable – all that needs to be said, has been said. So, a "nutshell" to Malaysian issues of arrest and insolvency is what I offer you.

2. It does come as a surprise that since November 2008 my table has got progressively more cluttered. Shipping disputes seem to have mushroomed. Considering that Malaysia has substantial international trade, and several active ports, with a decent local ship tonnage, this "phenomenon" should be natural with any economic downturn. The surprise to me was not the existence of disputes, but the fact that the disputes were chosen to be fought, resolved and determined in Malaysia.

3. It would appear that Malaysian shipowners and charterers have finally given some attention to the often neglected dispute resolution clause in their contracts of trade and affreighment. More importantly, their choice of Malaysian forum for dispute resolution have been accepted by their international counterparts. I hazard a guess at the possible reasons for this welcomed change:

(i) increased awareness of the importance of a choice of forum clause in contracts, particularly from an angle of convenience and cost;

(ii) better bargaining position viz-a-viz their trade partners, resulting from the fairly active project Construction, and Oil and Gas industries in Malaysia; and

(iii) greater confidence in the Malaysian dispute resolution mechanism, inspired by recent legal reforms including the passing of the Malaysian *Arbitration Act* 2005, framed on the UNCITRAL Model law.

4. Whatever may be the reason, the increase in legal maritime activity warrants a brief review of rights and remedies that Malaysia recognize and protect.

5. The current wave of disputes are generally prompted by corporate bottom-lines. Fall in freight rates, equals termination of charter of vessels for better rates; and withdrawal from loading fixed quantities of cargo. Fall in fuel rates, equals termination of fixed price contracts for the supply of fuel; and the like. The legal niceties surrounding these disputes largely turn of the interpretation of competing, sometimes conflicting, clauses in the relevant contract, to justify the contractual exist. Clever arguments on *force majuere* (release from obligation by events beyond a party's control) are advanced, but usually without much success if founded on an exercise of economic choice.

6. The factual matrix vary, but the legal principles involved are often based on settled law. In the context of admiralty and contract laws, Malaysia applies English principles, well accepted within the Commonwealth countries. Our admiralty jurisdiction in particular, directly imports the application of the *Supreme Court Act* 1981 of England that governs the English admiralty jurisdiction[1]. The Malaysian *Contracts Act* 1950 is founded on the Indian Contracts Act, which in essence codifies English contractual principles. With the passing of the Malaysian *Arbitration Act* 2005, the sanctity of the parties' choice of arbitration is keenly upheld by the Malaysian Courts, through a stay of Court proceedings for reference to arbitration[2], and by recognizing the principle of "competenz-competenz" that acknowledges the arbitrator's competence to determine the width of his jurisdiction over the referred dispute[3].

[1] *Court of Judicature Act* 1964 Section 24
[2] *Innotec Asia Pacific Sdn Bhd v Innotec GmbH* [2007] 8 CLJ 304
[3] *CMS Energy Sdn Bhd v Poscon Corp* [2008] 6 MLJ 561

7. Hence, charterparty disputes for the use and hire of a ship; claims under bills of lading; recovery by unpaid suppliers of bunker, would all be within the category of claims that permit an arrest of a ship within Malaysian waters, upon the commencement of an in rem action before the Malaysian Court.

8. Arrest of ships for arbitration is permissible, subject to the satisfaction of the principles of the *Rena K*[4] which, in brief, requires evidence of the likelihood that the arbitration award would remain unsatisfied by reason of the insolvency of the shipowner to be placed before the Court to justify the arrest. In the face of the increasing popularity of arbitration, the proposed amendments to the Malaysian *Arbitration Act*, which is pending legislative sanction, will soon remove this evidential requirement, to facilitate arrests for arbitration.

9. With the global crisis and its implication on financial institutions, the form of alternative security accepted to effect a release of vessel from arrest, has come into issue. In fact, a ship as security has become unattractive, with the decline in demand for, and the value of, ships. Arrests are now for prolonged periods of time, at the initial expense of the arresting party. Shipowners are in no hurry to have their vessel released, for want of fixtures. Alternative security when offered, is at a value much below sums claimed, purporting to reflect the current value of the ship arrested.

10. The provision of Bank Guarantees and P&I Club Letters of Undertaking as alternative security, have become susceptible to rejection, motivated by the fear of uncertainity in thier long term creditworthiness. As a result, the choice of payment of cash into Court is actively asserted.

[4] *[1979] 1 All ER 397; The NORMA SPLENDOUR* [1999] 6 MLJ 652; *The SWALLOW* [2003] MLJU LEXIS 237

11. In a fixed price bunker contract dispute I have current conduct of, where the claim runs in excess of USD25 million; a Rule B Attachment was secured by the bunker supplier through New York Attorneys in December 2008. The offer of alternative security has been under discussion for 4 months, with lengthy submissions ultimately filed on this issue in the New York District Court. 1 or 2 years ago, this would have been a non-issue.

12. Where the nature of the breach does not permit an arrest of ship as security, as in the fixed price contract case, alternate remedies to obtain security are inevitably explored. Malaysian Courts may be moved for a Mareva injunction, or to enforce a worldwide Mareva injunction secured abroad, to restrain the dissipation of assets of the target company or the overreaching of its creditors. Evidence of dealings not ordinarily incident to trade is critical, to make out a case for a Mareva injunction with assets. Remedies available in other jurisdictions around the world may be invoked, such as the Rule B Attachment, to assist in the satisfaction of what will eventually be a Malaysian Judgment.

13. The forum of security obtained becomes quite critical in the insolvency of the counterparty. Let's call the counterparty 'ABC', registered in Malaysia. Where a ship is arrested, the priorities are usually determined by the laws of the forum of arrest. If arrested in Malaysia, maritime liens such as collision claims, wages of master and crew take priority, followed by claims of mortgagees, possessory lien holders and finally other statutory liens advanced by an action in rem. All other unsecured creditors of ABC rank thereafter. Although the extent of security would depend on value of the ship, and the magnitude of prior ranking claim, maritime claimants would generally fair better then non-maritime creditors of ABC. But this pre-supposes that the arrest is initiated before the Petition to wind-up ABC is filed. Timing matters, for proceedings against ABC including arrest proceedings are automatically stayed by operation of law upon the presentation of the Petition, save with leave of Court. Would leave of Court be granted to arrest a ship for a claim that does not enjoy

preference save through a sale by Court, since this would alter the status quo? That question remains to be decided in Malaysia.

14. A Bank Guarantee or Protection & Indemnity Letter of Undertaking in contrast, would be dedicated security for that individual claim and it would stand outside the insolvency of ABC, to be shared by none other. It is however, only as good as the creditor worthiness of the guarantee provider.

15. At the other end of the spectrum are Mareva injunctions, and pre-judgment attachments, which provide no priority in payment. The monies are preserved, but no preference in payment is conferred. In the liquidations of ABC, these monies would come to be distributed to all creditors in order of the liquidation priority – payment of preference debts comprising wages and taxes of ABC, and then unsecured creditors, including the party securing the injunction or attachment, equally.

16. Should ABC be placed under private receivership pursuant to a debenture, an arrest is still permissible and would often be necessary. Repairers in particular, would be slow to give up possession and their lien to a Receiver, to avert a loss of priority.

17. Corporate schemes of arrangement often carry with them Restraining Orders of Court that preclude any proceedings against ABC, or her assets, pending finalizing and approval of a proposed scheme of arrangement. Proceedings restrained would include an arrest of a ship, or any form of injunction within Malaysia, and dependent on the width of the Restraining Order, possibly foreign arrests and attachments too. In such circumstances, intervention into the scheme proceedings would be necessary to ensure that rights over ships that could otherwise be proceeded against, are not jeopardized or accrued rights diminished, pending finalisation of the scheme.

18. In the context of schemes, Malaysia has potentially 2 other manner of schemes – under the *Danaharta Act*[5] and under the *PIDM Act*[6]. The *Danaharta Act* was passed in September 1998 during the 1998 Asian Crisis, to legislate for the formation of Malaysia National Asset Management Corporation. Though it is now dormant having successfully accomplished its objective, similar powers of the *Danaharta Act* are captured in the *PIDM Act* of 2005. Hence, its relevance as a source of precedence. Theoretically, if ABC has a significant exposure to a financial institution, which in turn is heavily weighed down by bad credit, ABC could find its management taken over by Conservators under the *PIDM Act* (Special Administrators under the *Danaharta Act*) who have the objective of formulating a scheme to settle the indebtedness of ABC, including that owed by ABC to the relevant financial institution. A moratorium against suits would prevent proceedings for arrest or injunction against ABC, except with leave of the Conservator. Will leave be granted, and if refused can the refusal be challenged? That remains a moot point.

19. And so, these issues will continue to work themselves out, along with the changing economic climate.

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[5] *Pengurusan Danaharta Nasional Berhad Act 1998*
[6] *Malaysia Deposit Insurance Corporation Act 2005*