SUN MOBILITY
Insurance and Claims Services Limited

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To: Transport Industry Operators

2 sets HAWBs for 1 lot cargoes

The Hong Kong High Court issued a Judgment on 27/5/2011 in relation to an air shipment that a forwarder issued two sets of its House Air Waybills to two different parties for one lot of cargoes. [HCCL 117/1994]

This was the re-trial of the forwarder's third party action against the consignee and its agent. The consignee Lerner was the ultimate purchaser of goods which the consignor Nantong manufactured. Lerner had placed a purchase order for the goods with Drake. Drake in turn sub-contracted the manufacture of the goods with Nantong. Silking was Lerner's Hong Kong-based sourcing agent. Lerner and Silking were long-time VIP customers of the forwarder.

The issue was whether the forwarder was entitled to be indemnified by Silking and Lerner against damages and costs paid by the forwarder to Nantong in respect of the misdelivery by forwarder of 903 cartons of the goods. By a Letter of Instruction (LOI) dated 23/2/1994 Nantong consigned 903 cartons of silk garment with the forwarder for carriage by air from Shanghai to Columbus (Ohio). The LOI specified Citibank Hong Kong as consignee of the goods. But eventually Nantong agreed for the goods to be consigned to Lerner in Columbus. The forwarder issued 2 sets of House Air Waybills in relation to the goods. One set (Lerner HAWBs) consigned the goods from Shanghai to Lerner in Columbus. On Lerner's instruction (given around 1/3/1994), the forwarder also issued another parallel sets of House Air Waybills (the Silking HAWBs) in relation to the goods. The Silking HAWBs consigned the goods from Shanghai to Silking in Hong Kong. Lerner had told the forwarder to carry the goods to Hong Kong, rather than Columbus, because it was Lerner's intention that the goods should be delivered to Silking. Silking would then carry out a complete inspection of the goods in Hong Kong. Lerner had cancelled whatever plans it had originally had to sell the goods in Columbus. Lerner believed that the goods were defective, at least in part. But Lerner did not want to cancel its purchase of the 903 cartons entirely. Lerner wished Silking in the course of its further inspection to sort out which goods were defective and which were not. Silking could then sell off any sound goods on Lerner's behalf. Neither Lerner nor Silking wished Nantong to know that the goods were to be delivered in Hong Kong. Nantong was unaware (and never approved) of the issue by the forwarder of Silking HAWBs. The forwarder caused the goods to be carried by China Eastern Airlines to Hong Kong. Because of the limited capacity of the aircraft involved, the cartons arrived in Hong Kong in 3 lots on 3/3/1994 and 5/3/1994. One carton went missing. It was never delivered.

On 3/3/1994 Nantong instructed the forwarder by phone and fax not to release the goods to Lerner until Nantong told the forwarder otherwise. On 4/3/1994, in consideration of the forwarder's acting upon Lerner's instruction to carry the goods from Shanghai to Hong Kong (rather than Columbus), Silking provided the forwarder with a letter of indemnity. The letter stated:-

> "As an agent act for Lerner, we were instructed that the ... shipment [of 903 cartons] should be routed via HKG and not direct fly to Columbus.
>
> Due to the above said route changed. We hereby confirm to you that we will undertake and agree to bear full responsibilities/ liabilities whatsoever directly or indirectly arising from or relating to the said route change."

The wording of the second paragraph quoted above was suggested to Silking by the forwarder. The forwarder had written to Silking on 1/3/1994 stating that:-

> "you will be much appreciated if you can sign a letter of indemnity to our company, indicate precisely that you will undertake and agree to bear full responsibilities/liabilities whatsoever directly or indirectly arising from or relating to the said route change".

Despite the 3/3/1994 instruction from Nantong, the forwarder did not prevent Silking from taking delivery of the goods on 5/3/1994 and on 7/3/1994.

Nantong sued the forwarder for breach of contract and bailment and for conversion of the 903 cartons of goods. The forwarder joined Silking and Lerner as third parties and sought an indemnity from them. The matter (including the third party action) went to trial before Stone J in November 2002. During the trial, the forwarder admitted liability and consented to judgment being entered against it for the sum of US$370,000. The sum was all-inclusive in the sense that it covered the invoice value of the 903 cartons (US$284,840), interest, and Nantong's legal costs.

Stone J dealt with the third party proceedings in the absence of Silking and Lerner. Having heard the forwarder, Stone J gave judgment against Silking and Lerner. The latter companies were ordered to reimburse the forwarder on the basis of Silking's 4/3/1994 letter of indemnity.

Two years after the trial, Silking and Lerner applied to set aside Stone J's judgment against them. Their application failed before Stone J. But in September 2005 the Court of Appeal set aside Stone J's judgment in the third party proceedings. In the Court of Appeal's view, Silking and Lerner had a reasonable prospect of success and, despite the lapse of 2 years, the overall justice of the case required that Stone J's judgment in the third party proceedings be set aside.

Whether Silking and Lerner were liable to indemnify the forwarder depended on whether Silking and Lerner had the right to obtain the goods consigned under the Silking HAWBs. If Silking and Lerner had such a right, they should not in the ordinary

course of events be liable to indemnify the forwarder. That would be regardless of whether the forwarder itself became liable to Nantong for releasing the goods to Silking contrary to Nantong's instruction. The Judge said "in the ordinary course of events" since in this case there was the additional element of Silking's 4/3/1994 letter of indemnity. Having determined whether or not Silking and Lerner were entitled to receive the goods, the Judge must also deal with the separate question of the effect of the letter. Silking provided the letter in consideration of the forwarder releasing the goods. On a true construction of the letter, did Silking and Lerner (as Silking's principal) undertake to indemnify the forwarder against liability to Nantong, regardless of whether Silking and Lerner were entitled to delivery of the goods in Hong Kong?

There was no dispute among the parties that the Warsaw Convention, either in its Original or Amended forms, applied to the air carriage of the goods. If the operative air waybills were the Lerner HAWBs, the latter concerned a carriage from Shanghai to Columbus. The Mainland was (and remains) a party to the Amended Warsaw Convention (AWC). On the other hand, although the United States had signed the AWC, the AWC had yet to be ratified there. Accordingly, a contract for the carriage of goods by air between the Mainland and the United States would have been subject to the Warsaw Convention. If the operative air waybills were the Silking HAWBs, the latter concerned a carriage from Shanghai to Hong Kong. In 1994 Hong Kong was subject to the AWC as extended to it by the United Kingdom. Accordingly, a carriage of goods by air between Shanghai and Hong Kong would have been subject to the AWC.

Arts. 12 and 13 of the Warsaw Convention and AWC are in similar terms. They provide:-

"Article 12

(1) Subject to his liability to carry out all his obligations under the contract of carriage, the consignor has the right to dispose of the cargo by withdrawing it at the aerodrome of departure or destination, or by stopping it in the course of any journey on any landing, or by calling for it to be delivered at the place of destination or in the course of the journey to a person other than the consignee named in the air waybill, or by requiring it to be returned to the aerodrome of departure. He must not exercise this right of disposition in such a way as to prejudice the carrier or other consignors and he must repay any expenses occasioned by the exercise of this right.

(2) If it is impossible to carry out the orders of the consignor, the carrier must so inform him forthwith.

(3) If the carrier obeys the orders of the consignor for the disposition of the cargo without requiring the production of the part of the air waybill delivered to the latter, he will be liable, without prejudice to his right of recovery from the consignor, for any damage which may be caused thereby to any person who is lawfully in possession of the air waybill.

(4) The right conferred on the consignor ceases at the moment when that of the consignee begins in accordance with Article 13. Nevertheless, if the consignee declines to accept the air waybill or the cargo, or if he cannot be communicated with, the consignor resumes his right of disposition.

Article 13

(1) Except in the circumstances set out in the preceding Article, the consignee is entitled, on arrival of the cargo at the place of destination, to require the carrier to hand over to him the air waybill and to deliver the cargo to him on payment of the charges due and on complying with the conditions of carriage set out in the air waybill.

(2) Unless it is otherwise agreed, it is the duty of the carrier to give notice to the consignee as soon as the cargo arrives.

(3) ...."

Silking and Lerner submitted that the operative HAWBs were the Silking HAWBs. The Silking HAWBs would thus evidence an agreement between Nantong as consignor and the forwarder as carrier to deliver the goods to Silking as consignee in Hong Kong. The goods having arrived in Hong Kong, Silking and Lerner suggested that Silking became entitled to have the goods delivered to it pursuant to Warsaw Convention Art. 13(1). Silking and Lerner concluded that, whether or not the forwarder became liable to Nantong for ignoring the instruction to hold on to the goods, Silking and Lerner could not be faulted for having taken delivery of the goods in Hong Kong. Soon after the goods arrived in Hong Kong and a few days prior to obtaining physical delivery of the goods, Silking obtained a pouch from the forwarder containing the Silking HAWBs. Armed with those Silking HAWBs, Silking obtained the goods. Even if Nantong's instruction to the forwarder preceded Silking obtaining actual physical delivery of some or all of the goods, Nantong's instructions to the forwarder (Silking and Lerner said) for the disposition of the goods came too late. Nantong's rights as consignor (Silking and Lerner stressed) ceased when those of Silking and Lerner began, at the very latest when the Silking and Lerner received the pouch with the Silking HAWBs.

Silking and Lerner's analysis would be the correct one, if the Silking HAWBs constituted the operative contract between Nantong and the forwarder. But in the Judge's view the operative contract was contained in or evidenced by the Lerner HAWBs. The forwarder pointed out that Nantong was wholly unaware of the Silking HAWBs. In fact, that the goods were going to be routed through Hong Kong and delivered to Silking here for full inspection was deliberately kept secret from Nantong by the forwarder, Silking and Lerner. As far as Nantong was concerned, the goods were being consigned to Lerner in Columbus. In those circumstances, it could not have been that the forwarder was contractually obliged to Nantong to deliver the goods to Silking in Hong Kong. Instead, the forwarder had contracted with Nantong to carry the goods from Shanghai to Lerner in Columbus. The fact that the forwarder secretly and unilaterally prepared the Silking HAWBs could not transform the latter HAWBs into the operative contract. The evidence was that the forwarder issued the Silking HAWBs solely to accommodate Silking and Lerner as the forwarder's VIP customers. Thus, the goods never having reached Columbus (the airport of destination under the operative Lerner HAWBs), Lerner's rights as consignee (much less those of Silking as Lerner's agent) never arose. The requirements of Warsaw Convention Art. 13 for the consignee to become entitled to delivery of the goods were not met. Nantong remained in control of the goods as consignor and, as long as the goods had not reached Columbus, could divert the goods from delivery to Lerner or Silking. In short, neither Silking or Lerner ever became entitled to receive the goods. The corollary was that the forwarder as carrier was bound to follow Nantong's orders regarding the disposition of the cargo. To the extent that it was still possible because the goods had not yet reached Columbus, the forwarder ought to have withheld delivery from Lerner and Silking. But, by secretly undertaking to deliver (and actually delivering) the cargo to Silking in Hong Kong (as opposed to Lerner in Columbus), the forwarder rendered itself unable to comply with Nantong's directions. The forwarder acted contrary to Nantong's right under Warsaw Convention Art. 12(1) and thereby became liable to Nantong.

The forwarder was fully aware of the risks it was running by delivering the cargo to Silking in Hong Kong, instead of to Lerner in Columbus. It knew that it was not complying with Nantong's instructions as consignor. For that reason, the forwarder pressed Silking for the letter of indemnity. On its terms the letter of indemnity undertook "full responsibilities/liabilities whatsoever directly or indirectly arising from or relating to the said route change [from Shanghai-Columbus to Shanghai-Hong Kong]". Plainly, the terms were wide enough to encompass liability incurred by the forwarder for delivering the goods in Hong Kong pursuant to the terms of the Silking HAWBs, rather than in Columbus pursuant to the Lerner HAWBs. Consequently, in the Judge's judgment, Silking and Lerner (as Silking's principal) were liable to indemnify the forwarder against liability to Nantong.

Silking had argued that, as Lerner's agent, it should drop out of the picture and not be held liable. But, on the wording of the letter of indemnity, Silking was accepting liability on its own behalf as well as on behalf of its principal Lerner. It was noted, for instance, the use of the plural pronoun "we" and the signature "for Silking" on the face of the letter. It was true that the second paragraph of the letter referred to Silking being "an agent act for Lerner". But this was stated simply as background. Silking came to know that the shipment would be routed through Hong Kong because it was so informed by Lerner as principal. Given that background, Silking was confirming that "we will undertake and agree to bear full responsibilities/ liabilities". The undertaking by Silking was unqualified. Lerner, on the other hand, would also be liable on the indemnity as disclosed principal under ordinary principles of the law of agency.

There were 3 further points.

First, Silking and Lerner submitted that, if liable on the indemnity, their liability should exclude compensation for the 1 missing carton which they never received. That seemed to the Judge to be correct. The loss of that carton was an unrelated event which could not be attributed to the route change. Taking a rough proportionality, the Judge would estimate the amount (including interest and cost) to be attributed to the missing carton to be 1/903 or about 0.001 of US$370,000 (US$370).

Second, it was suggested that the US$370,000 paid by the forwarder to Nantong was unreasonable. The Judge disagreed. The invoice value of the goods was about US$285,000. Adding interest for the period from misdelivery of the goods in 1994 up to the trial in 2002 and adding legal costs on top, one could easily end up with a significantly greater amount than US$370,000. In this light, the settlement sum paid by the forwarder to Nantong seemed conservative and reasonable.

The Warsaw Convention limits the damages payable by a carrier to a consignor for misdelivery of cargo. The Warsaw Convention also strikes down any limit stipulated in a contract of carriage which is lower than the Convention limitation. But the Convention limitation is not available where a carrier causes damage by "wilful misconduct" (under Art. 25 of the Warsaw Convention). The forwarder was fully cognisant of the risks it was running by delivering to Silking in Hong Kong. That was why the forwarder pressed for the letter of indemnity. The forwarder acted wilfully or knowingly. Accordingly, on the wording of Art. 25 in the Warsaw Conventions, the forwarder would be liable to compensate Nantong without recourse to the limitation.

Third, it was suggested that, because Nantong might not have been the owner of the goods at the time of misdelivery, there must be doubt as to the forwarder's liability to Nantong. There was nothing in this argument. Under the Warsaw Convention, the carrier is liable to compensate a consignor for loss or damage to cargo. Whether or not Nantong owned the goods which it had manufactured, Nantong had bailed the same to the forwarder. As bailor or consignor, Nantong had the right under Warsaw Convention Art. 12(1) to direct how the goods were to be handled before their arrival in Columbus. That right included the right to instruct the forwarder not to release the goods to Lerner or anyone else pending Lerner's full payment of the price of the goods to whomever might have been the owner of the same. The value of that right to hold on to the goods as security for payment must be equivalent to the invoice value of the goods.

The forwarder was entitled to be indemnified by Silking and Lerner. There would be judgment against Silking and Lerner for US$369,700 (that is US$370,000 less US$300 (the notional cost of the missing carton)). Interest would run on the amount of US$369,700 at 1% over HSBC US$ prime from 27/1/2003 (when the forwarder paid the last installment of its settlement with Nantong) until date of judgment. Thereafter, interest would run at the judgment rate. There would be an Order Nisi that the forwarder had its costs of the third party proceedings against Silking and Lerner. Costs were to be taxed, if not agreed.

Please feel free to contact us if you have any questions or you would like to have a copy of the Judgment.

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The robust freight industry in 2009 did not sustain well to the last quarter of 2010 as worldwide governments were not in unison in their fiscal policies. The worldwide government interference in 2011, such as the U.S. QEII, is likely to impact the worldwide movement of freight even more.

As uncertain as it was the economy in 2010, we believe the number of E&O, uncollected cargo and completion of carriage claims will continue the major concerns for transport operators in 2011. If you need a cost effective professional solution to defend claims against you, our claim team of five are ready to assist. Feel free to call Carrie Chung / George Cheung at 2299 5539 / 2299 5533.