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To: Transport Industry Operators

**Cargo misdelivery and arbitration clause**

The Hong Kong High Court issued a Decision on 4 March 2020 dismissing a shipowner's application for a stay of proceedings in favour of arbitration in a case of cargo misdelivery without presentation of original bill of lading. [HCAJ 5/2019] [2020 HKCFI 375]

*Background*

Kai Sen Shipping ("**Kai Sen**") was the owner of the "YUE YOU 903" ("**the Vessel**") and carrier of **Cargoes** described in 4 tanker bills of lading all dated 12 April 2018 ("**the Bills of Lading**"). The Cargoes were to be shipped from Dumai, Indonesia to Huangpu, China. The Bills of Lading were negotiable bills marked "To order". OCBC Wing Hang Bank ("**OCBC**") claimed to have granted facilities in late April 2018 to Twin Wealth (Hong Kong), with Twin Wealth Macau named as guarantor (collectively the "**Borrowers**") and received from the Borrowers the original Bills of Lading and commercial invoices. OCBC thus claimed to be lawful holder of the Bills of Lading and entitled to immediate possession of the Cargoes. Kai Sen released the Cargoes without presentation of the original Bills of Lading. OCBC claimed damages against Kai Sen for breach of the contracts of carriage contained in or evidenced by the Bills of Lading, and breach of Kai Sen's duty as carrier or bailee. On 22 January 2019, OCBC issued the writ of summons, seeking damages against Kai Sen arising from alleged misdelivery of cargo.

On 16 April 2019, Kai Sen applied for a stay of the legal action pursuant to Section 20 of the Arbitration Ordinance (Cap 609) ("**the Ordinance**") on the grounds that OCBC's claim was subject to an arbitration agreement that had been incorporated into the Bills of Lading by reference. Kai Sen also claimed that OCBC had unequivocally elected to proceed with arbitration by issuing a notice to commence arbitration dated 28 March 2019 ("**the Arbitration Notice**").

OCBC submitted that the validity of the purported arbitration agreement in this case was to be governed by English law, which provides that an arbitration agreement can only be incorporated into a bill of lading by specific words of incorporation. The position under Hong Kong law is the same. There were no such specific words of incorporation in respect of the Bills of Lading. Further, OCBC had no knowledge of the terms of the Charterparty until this dispute arose. OCBC only processed documents on D/P basis (documents against payment) subject to the Uniform Rules for Collections. The Arbitration Notice was issued to beat the limitation time and was not a submission of OCBC to arbitration.

*The relevant arbitration clause*

The relevant provision of the Bills of Lading provided as follows:

> "This shipment is carried under and pursuant to the terms of the Contract of Affreightment/ Charter Party dated 2nd March 2018 between [Kai Sen] as owner and TWIN WEALTH MACAO COMMERCIAL OFFSHORE LTD As Charterers, and all conditions, Liberties and exceptions whatsoever of the said Charter apply to and govern the rights of the parties concerned in this shipment…"

Clause 36 of the Charter Party dated 2nd March 2018 ("**Charterparty**") as referred to in the Bills of Lading provided an arbitration clause as follows:

> "ARB, IF ANY, IN HONGKONG UNDER ENGLISH LAW."

*The relevant provisions under the Ordinance governing arbitration agreements*

The Ordinance applies to an arbitration under an "arbitration agreement", whether or not the agreement is entered into in Hong Kong, if the place of arbitration is in Hong Kong: Section 5 of the Ordinance.

Section 20(1)(1) of the Ordinance (which gives effect to Article 8 of the UNCITRAL Model Law) provides that:

> "A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed."

Section 19 of the Ordinance (which gives effect to Article 7 of the UNCITRAL Model Law (Option I) defines "arbitration agreement" as follows:

(1) Section 19(1)(1): "Arbitration agreement" is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement."; and

(2) Section 19(1)(6): "The reference in a contract to any document containing an arbitration clause constitutes an arbitration agreement in writing, *provided that the reference is such as to make that clause part of the contract*."

In *Yun Kwan Construction Engineering Ltd v Shui Tai Construction Engineering Co Ltd* [2019] HKCFI 1841, §5, G Lam J explained the legal position as follows:

"(1) By Art 8(1) of the UNCITRAL Model Law, given effect by s 20(1) of the Arbitration Ordinance (Cap 609), this court must refer any matter which is the subject of an arbitration agreement and, therefore, stay further proceedings in the action to that extent.

(2) Art 7 of the UNCITRAL Model Law (Option I), given effect by s 19(1) of the Arbitration Ordinance, makes provision as regards what constitutes an "arbitration agreement". In particular, Art 7(6) prescribes how an arbitration clause in a separate document may be incorporated as part of the contract:

> "The reference in a contract to any document containing an arbitration clause constitutes an arbitration agreement in writing, provided that the reference is such as to make that clause part of the contract."

Section 19(3) of the Arbitration Ordinance likewise provides:

> "A reference in an agreement to a written form of arbitration clause constitutes an arbitration agreement if the reference is such as to make that clause part of the agreement."

(3) For the purpose of Art 7(6), <u>it is not essential for there to be an explicit reference to the arbitration clause itself</u>. <u>Reference to a document, which contains the arbitration clause relied upon, may be sufficient, provided "the reference is such as to make that clause part of the contract"</u>.

(4) The document referred to <u>need not be a contract between the same two parties</u>. It is possible under Art 7(6) to incorporate into a contract between A and B an arbitration clause, by reference to an agreement between B and C or even between X and Y or to an unsigned standard form of contract, which contains the arbitration clause.

(5) Insofar as authorities in other jurisdictions suggest that for incorporation of an arbitration clause into a contract between A and B by reference to an agreement between B and C or X and Y, there must be a specific reference to the arbitration clause itself, they do not reflect the law of Hong Kong which is based on Art 7(6).
(6) The question of incorporation, in particular whether the reference is such as to make the arbitration clause part of the contract, is one of construction. The task of the court is to ascertain, with no preconceived notions, the parties' intentions when they entered into the contract by reference to the words that they used.
(7) Like other questions of contractual construction, this involves examining the wording of the documents against the relevant background to identify what a reasonable person would have understood the parties to be using the language in the contract to mean."

The onus is on an applicant seeking a stay in favour of arbitration to show that there is a *prima facie* case that the parties are bound by an arbitration clause. Unless the point is clear, the court should not attempt to resolve the issue and the matter should be stayed for arbitration.

The applicant only needs to show an arguable case. If whether or not an arbitration clause has been incorporated is capable of giving rise to respectable arguments from both sides, the issue should be resolved in favour of arbitration.

*The parties' respective case and the issues*
Kai Sen submitted that in view of the statutory provisions, the arbitration clause in the Charterparty had been incorporated into the Bills of Lading and so this action should be stayed for arbitration.

OCBC did not dispute the above general principles but heavily relied on *T W Thomas & Co Ltd v Portsea Steamship Co Ltd* [1912] AC 1 for the proposition that an arbitration clause can only be incorporated into a bill of lading by express reference. OCBC submitted that to see if an arbitration clause had been incorporated into a bill of lading, one had to see if the purported arbitration clause had stipulated the governing law. If it had, it was the governing law which would decide whether or not the arbitration clause was incorporated. The purported arbitration clause in question stipulated English law to be the governing law. *Thomas v Portsea* is still valid English law.

The issues are therefore as follows:
(1) What was the governing law of the arbitration agreement which governed the obligation to arbitrate?
(2) Under that governing law, are specific words of incorporation required to incorporate an arbitration clause into a bill of lading?
(3) Under Hong Kong law, are specific words of incorporation required to incorporate an arbitration clause into a bill of lading?
(4) Whether OCBC's commencement of arbitration amounted to unequivocal election to arbitration?

*Issue 1: What was the governing law of the arbitration agreement which governed the obligation to arbitrate*
In the case in question, the governing law, as stipulated in the purported arbitration agreement under the Charterparty, was English law, although the seat of arbitration was Hong Kong. It was English law that should govern the incorporation of an arbitration agreement into the Bills of Lading.

*Issue 2: Under English law, are specific words of incorporation required to incorporate an arbitration clause into a bill of lading?*
Under English law, specific words of incorporation are necessary to incorporate "collateral" or "ancillary" clauses such as arbitration clauses or jurisdiction clauses. The leading authority is

*Thomas v Portsea*, §6, which held that general words of incorporation in a bill of lading will not normally be sufficient to incorporate an arbitration clause in a charterparty. This continues to be good law.

Incorporation of the "conditions" of the charterparty does not suffice to incorporate an arbitration clause into a bill of lading: *The Varenna* [1983] 2 Lloyd's Rep 592, p597lhs, CA. The addition of the words "whatsoever" makes no difference: *The Delos,* §16; *Siboti K/S v BP France SA* [2004] 1 CLC 1, §46.

The rationale for the rule in *Thomas and Portsea,* which has existed for over a century, is as follows.

Firstly, bills of lading are negotiable instruments which may pass through many hands internationally. There are jurisdictional consequences to incorporation of an arbitration clause.

Secondly, charterparties commonly contain terms that are not relevant to the legal relationship between the carrier and the holder of the bill of lading. Terms of the charterparty are only incorporated by general words to the extent that they are directly germane to the matters covered by the bill of lading, *ie* those clauses relating to the shipment, carriage and delivery of goods; but does not include an arbitration clause.

Thirdly, this is an area where the law should be clear, certain and well understood and the court should try to give effect to settled authority as best as possible.

Applying English law, the arbitration agreement in the Charterparty had not been incorporated into the Bills of Lading by specific reference. Whether OCBC had knowledge of the terms of the Charterparty was irrelevant. Kai Sen's application for stay must be dismissed.

*Issue 3: Under Hong Kong law, are specific words of incorporation required to incorporate an arbitration clause into a bill of lading?*
There is no difference to the result even if Hong Kong law applies to the Bill of Ladings.

Two Privy Council decisions on appeal from the Hong Kong courts confirmed that *Thomas v Portsea* only applied to bills of lading or negotiable instruments but not to other contracts: *The Pioneer Container* [1994] 2 AC 324; *The Mahkutai* [1996] 2 HKC 1, pp 15I-16A, Lord Goff.
In *The Pioneer Container,* the Privy Council acknowledged that application of the *Thomas v Portsea* principle in bills of lading occupied a "special corner of the law".

Kai Sen pointed out that the Bills of Lading did *not* contain separate provisions on matters such as choice of law or dispute resolution, which were of particular importance to shipments involving multiple parties and jurisdictions. The absence of choice of law/ dispute resolution clause in the contract itself was an important factor that the Court should consider that an arbitration clause must have been incorporated.

However, the Judge was of the view that if an arbitration clause was not incorporated by express words into a bill of lading, the lack of separate provisions on matters such as choice of law was irrelevant.

In summary, in Hong Kong, the rule in *Thomas v Portsea* is still good law in relation to bills of lading. An incorporation by general reference to the arbitration clause in the Charterparty could not meet the proviso in Section19(1)(6) of the Ordinance. If Hong Kong law applied, Kai Sen's application for the stay of the legal action would still be dismissed.

OCBC's evidence was that it was not aware of the terms of the Charterparty. Kai Sen submitted that the arbitration clause was a usual term in a typical charterparty, so with more than 30 years' experience in the business of handling export bill transactions, OCBC must have been aware of it. However, the Judge held that such were irrelevant to the question of whether the arbitration clause had been incorporated to the Bills of Lading.

*Issue 4: Whether OCBC's commencement of arbitration amounted to unequivocal election to arbitration?*

Parties may impliedly agree to arbitration by commencing or participating in arbitration without reservation. Such an *ad hoc* agreement may constitute an arbitration agreement which binds the parties. In *The Amazonia* [1990] 1 Lloyd's Rep 236, Staughton LJ stated (p 243rhs):

> "The rule ought to be that if a person wishes to preserve his rights by taking part in arbitration under protest, he must make his objection clear at the start – or at least at a very early stage. Otherwise he ought to be bound."

In *The Marques de Bolarque* [1984] 1 Lloyd's Rep 652, the respondent to an arbitration had written to the claimant to say that, "without prejudice to such rights as owners may have", they were nominating an arbitrator. Hobhouse J held that those words were a sufficient reservation of the right to object to the jurisdiction of the arbitrator, and so did not confer jurisdiction on the arbitrators which they did not otherwise have.

Kai Sen submitted that OCBC had submitted to arbitration by giving the Arbitration Notice. That notice expressly referred to Clause 36 of the Charterparty (*ie* the arbitration clause). Kai Sen had accepted the commencement of arbitration.

OCBC explained that its reason for commencing arbitration was to beat the limitation period. For a claim in misdelivery of the Cargoes under the Bills of Lading, Kai Sen had a one-year limitation period pursuant to Art III, r6 of the Hague-Visby Rules. OCBC was caught in a difficult situation. The Bills of Lading were issued on 12 April 2018. OCBC did not know when the Cargoes were delivered. The limitation period would have expired in April 2019 if the misdelivery occurred in April 2018.

In February 2019, OCBC invited Kai Sen to withdraw its dispute to the court's jurisdiction but it was not accepted. In March, OCBC invited Kai Sen to consent to a general extension of time for commencement of arbitration due to the jurisdictional challenge in question. Again, that was not accepted.

The notice to commence arbitration was issued on 28 March 2019. The cover letter of the same date expressly disclaimed admission to Kai Sen's position and maintained OCBC's pleaded position that Hong Kong courts had jurisdiction. The cover letter stated that:

> "All our client's rights (including but not limited to their rights to continue with the Hong Kong court proceedings, action numbered HCAJ 5/2019) and remedies remain expressly reserved."

This stay summons was issued by Kai Sen on 16 April 2019.

Given OCBC's clear position in the pleadings and the cover letter, the existence of the arbitration agreement had been clearly denied by OCBC.

The Judge found that commencement of arbitration was plainly OCBC's act to preserve its claim pending resolution of the jurisdictional dispute rather than submission to arbitration. The Judge dismissed Kai Sen's argument.

*Conclusion*

Although the general position under the Ordinance is that an arbitration agreement can be incorporated into a contract by reference, it is not the same with a bill of lading. The starting point

of the court is to look at the bill of lading to ascertain the intention of the parties. In the case in question, the governing law under the purported arbitration clause was English law, which requires incorporation of an arbitration clause into a bill of lading by express wording under the authority of *Thomas v Portsea.* That special principle has been preserved under Hong Kong law by the Privy Council and applies to bills of lading and other negotiable instrument. For other contracts, incorporation of an arbitration clause is permissible by virtue of Section 19(1) of the Ordinance. As the arbitration clause in the Charterparty was not incorporated, the Judge held that the Hong Kong Court had jurisdiction.

The Judge therefore ordered that the summons for stay of proceedings in favour of arbitration be dismissed.

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

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