

LEGAL UPDATE

CORPORATE LAW, INSOLVENCY

CASE COMMENT:

Duncan, Cameron Lindsay and another v Diablo Fortune Inc and another matter [2017] SGHC 172

In this decision, the Singapore High Court addressed the issue of whether a lien, over sub-freights and sub-hire, by way of contract should be considered as a charge under Section 131 of the Companies Act (Cap 50, 2006 Rev Ed) (the “CA”). Moreover, in deciding on this issue, the Singapore High Court had to consider what law governed the registration of charges as well as the priority of security interests in insolvency matters given that the lien was governed by English law.

Brief facts

On 6 June 2008, a company incorporated in Singapore was engaged in commercial vessel operations (the “Company”) entered into a BIMCO Standard Bareboat Charter (the “Bareboat Charter”) with Diablo Fortune Inc (“Diablo”) where the Company chartered a vessel from Diablo for five years. The Bareboat Charter was subsequently extended for a further five years. Clause 18 of the Bareboat Charter (“Clause 18”) provided that Diablo would have a lien upon all cargoes, sub-hires and sub-freights belonging or due to the Company for all claims under the Bareboat Charter (the “Contractual Lien”). Further, Clause 30(a) of the Bareboat Charter (“Clause 30(a)”) provided that the charter would be governed by English law and any dispute arising out of or in connection with the Bareboat Charter shall be referred to arbitration in London.

The Company also entered into a pooling agreement (the “Pool Agreement”) with V8 Pool Inc (“V8”) where V8 agreed that a proportion of their actual earnings from the pooling arrangement would be paid to the Company as charter hire.

The Company subsequently faced financial difficulties and filed a winding up application in Singapore. Soon after finding out about the Company’s winding up application, Diablo sent a notice to V8 purporting to exercise its lien under Clause 18. The liquidators of the Company (the “Liquidators”) applied to the Singapore High Court to determine whether Diablo’s lien over sub-freights or sub-hire due from V8 to the Company pursuant to the Bareboat Charter is void against them for want of registration pursuant to Section 131 of the CA (the “Liquidators’ Application”). In response, Diablo applied to have the Liquidators’ Application stayed in favour of arbitration.

The Singapore High Court declined to stay the Liquidators’ Application. Further, the Court held that Singapore law, and therefore Section 131 of the CA, governed the registration of charges and the priorities of security interests as the winding up proceedings were commenced in Singapore. Finding that the Contractual Lien was a charge within the ambit of Section 131 of the CA, the Court held that it was void against the Liquidators.

Stay of proceedings in favour of arbitration

Diablo had argued that the arbitration clause of the Bareboat Charter, Clause 30(a), was wide enough to include claims or disputes on the validity over the Contractual Lien.

The Court, however, held that the absence of express language in Clause 30(a) or anywhere in the Bareboat Charter suggesting that Diablo and the Company had intended to include disputes relating to the Company’s insolvency, meant that the Liquidators’ Application did not fall within the application of Clause 30(a).

The Court added that even if Clause 30(a) had included express language to include disputes relating to the Company’s insolvency, a stay

should not be granted in favour of arbitration because a dispute arising under Section 131(1) of the CA is non-arbitrable. The Court cited Section 11(1) of the International Arbitration Act (Cap 143A, 2002 Rev Ed) which states that, “[a]ny dispute which the parties have agreed to submit to arbitration under an arbitration agreement may be determined by arbitration unless it is contrary to public policy to do so”. Given that the dispute arose pursuant to an application under Section 131(1) of the CA, which involves the operation of the insolvency regime, the Court was of the view that public policy considerations would apply in order to protect the interests of the Company as a whole thus making the dispute before the Court non-arbitrable.

Governing law of registration of charges and priorities in insolvency matters

Diablo also argued that since the Bareboat Charter was governed by English law, the UK Companies Act should govern the registration of charges created pursuant to Clause 18. The Court did not accept this argument.

The Court held that the law governing the initial validity and/or creation of the charge between Diablo and the Company and the law governing the priority of the charge and distribution of assets in the insolvency of the Company are two separate issues.

The Court further decided that the law governing the registration of charges, the priorities of security interest and the distribution of assets in insolvency proceedings must be determined by the law of the country where the winding up is commenced. As the Company was incorporated in Singapore, Section 131 of the CA applied to the registration of the lien created by the Company as well as its effectiveness as against the Liquidators.

Is the lien a charge within the meaning of Section 131(1) of the CA and would it require registration?

The Court held that the Contractual Lien operates as an equitable assignment by way of a charge.

Given that the regime of the registration of charges in Singapore is modelled after English legislation, the Court noted that the English authorities were highly persuasive. The Court adopted the view expressed by a series of English cases on the characterisation of a Contractual Lien which is as follows:

1. A Contractual Lien arises from contract between the shipowner and charterer only, the lien does not give the shipowner a direct claim against the shipper, but only a right to have the charterer restrained from receiving the sub-charter hire or ordered to direct its payment to the shipowner.
2. The charterer has a chose in action against the shipper and the limited right to that chose can only be acquired by the shipowner by an equitable assignment by the charterer.
3. The equitable assignment is an assignment by way of security for only what is owed by the charterer to the shipowner.
4. Since an equitable assignment of a chose in action by way of security creates an equitable charge on the chose, the lien creates an equitable charge on the sub-freights or sub-hire.

The Court then found that a Contractual Lien had characteristics of a floating charge namely, it creates a charge over a class of assets of a company, the class of assets is one which would change from time to time in the ordinary course of business of the company and the Contractual Lien creates a right to receive the

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sub-freights or sub-hire to satisfy any outstanding sum due under the charter (if it has not been paid). At the same time, the charterer is free to deal with the sub-freights and sub-hire in its ordinary course of business until outstanding sums are due and unpaid under the charter and the lien is exercised.

It was clear to the Court that sub-freights or sub-hire due to a charterer can constitute a charterer's book debts (i.e. debts that arise in the ordinary course of business of a company and must be enforceable by action by the creditor directly against the debtor). Parties had also agreed that sub-freights and sub-hire would constitute book debts.

The Court found that the Contractual Lien came within the meaning of a charge under Section 131(1) of the CA, either as a floating charge under Section 131(3)(g) of the CA or a charge on book debts under Section 131(3)(f) of the CA.

Pursuant to Section 131(1) of the CA, the Contractual Lien, either as a floating charge or a book debt, should have been registered. Since Diablo failed to register their Contractual Lien, the Court held that the Contractual Lien was void as against the Liquidators.

Commercial implications

The Court noted that, from the perspective of an admiralty practitioner, the requirement for a Contractual Lien to be registered may be impracticable and inconvenient. This is due to the nature of a charterparty which can be for a relatively short duration or for only one voyage. A shipowner may have to register a charge, against the same corporate charterer, for each charter to ensure it does not fall foul of the consequence of the charterer's liquidation.

However, the potential inconvenience to a shipowner was weighed against the benefits that registering a Contractual Lien would provide creditors. The Court said that the registration would give creditors notice of the

lien, which would in turn help them better decide whether to extend credit or enter into transactions with the chargor. Further, the Court added that a shipowner with a Contractual Lien should not, without registering its security interest, be able to rank in priority to other claims.

In light of the Court's decision, it would therefore be prudent for a shipowner with Contractual Liens to register the same to secure their position in the event of insolvency of the charterer.

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