WaveLength

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Editorial: Japanese Sentiment, Today & Tomorrow

TOMAC as an ADR Body with the Longest History in the World

In 1926 JSE set up its arbitral substructure, now named TOMAC (Tokyo Maritime Arbitration Commission), and has ever since (even during the Occupation by the Allied Forces in the wake of the end of WWII) been engaged in institutional arbitration as an alternative means of dispute resolution. JSE and TOMAC are uniquely capable of dealing with disputes arising out of most commercial contracts, especially bills of lading, charter-parties, contracts relating to the sale and purchase of ships, shipbuilding, ship financing and manning.

As I mentioned before in this column, however, the most effective way to handle your disputes is to prevent them from arising. The sources of dispute peculiar to an international commercial contract which involves parties from different jurisdictions are mainly: (1) the differences of trade practices which may give people different understandings as to satisfactory performance of contract and (2) the differences of legal systems which may help boost different attitudes towards breach of duties. In both cases, one party or other must eventually resort to a legal measure unless earlier negotiations for settlement are successful. It is therefore very important for a party to an international contract to bear in mind the different attitude/understanding the other party from a different jurisdiction may have as to performance of their contract. Then one should at least take necessary precautions in drafting its contracts: not only to expressly provide for the rights and duties in the normal course of performance but also for the rights and duties in case a breach arises.

However, a dispute does arise anyhow on day-to-day business and must be resolved. The Secretariat of JSE responds to inquiries, consults and advises its members on the interpretation of contract terms, Japanese law/cases, arbitration legislation/practice, maritime economy, and Japanese shipping policies, etc so as to equip members with knowledge to talk the other party out of its claim. For those who shy away from human contacts, we have a new electronic method of dispute prevention called Online Dispute Risk Management (case database), where members of JSE can retrieve information for prevention and early settlement of their disputes.

First Ever Arbitration under the "Internet Rules"

In the first ever arbitration proceedings brought under our "Internet Rules", the claimant submitted its statement and evidence via e-mail and enjoyed the Rules' advantages very much. TOMAC's new Rules, effective from 1 September 2001, allow parties to produce their statements/evidence by e-mails (See Section 9(5) of Ordinary Rules, Section 5(6) of Simplified Rules and Section 5(5) of SCAP Rules). Even a hearing may be held via Internet (Section 21(6) of Ordinary Rules, Section 8(5) of Simplified Rules and Section 9(4) of SCAP Rules).

In this arbitration the claimant shipowner of the M/V "Sea Pastrale" brought proceedings to TOMAC on 5 October 2001 against the time-charterer and the sub-time-charterer, claiming unpaid hire and damages for her injured No. 2 derrick in the total amount of about US$25,000. This arbitration proceeded under the SCAP (Small Claims Arbitration Procedure) Rules, because the claim amount was below Yen 5 million. Utilizing Section 5(5) of SCAP Rules, the claimant submitted its Final Supplementary Statement and documentary evidence as an e-mail attachment, thereby cutting time and cost considerably. The sole arbitrator granted the claim in part on 15 January 2002. (Note: under the SCAP Rules, after the claimant filed its Statement of Claim, against which the respondent advances its defense, each party is permitted to submit its Supplementary Statement only once before the award is rendered. See Section 5(3) and (4))

The exact way the claimant converted its statement to an e-mail attachment was: type up and print out the statement, sign it and scan it into a tif file, which is readable by a photo imaging software normally pre-installed in your computer system. They did a similar thing to the evidence, which was already in writing though. The Secretariat also used tif files in sending out notices as to appointment and disclosure of the arbitrator. The greatest benefits of a tif file are its size (very compact for an attachment to an e-mail) and clarity (superbly readable when printed out). In this way it might obviate, for the time being at least, the necessity for verification of digital signature. Although tif files are not entirely free from tampering, it is said, compared to other types, difficult to allow such malpractice. Moreover, our Rules direct the parties to forward statement/evidence both to the Secretariat and the other party, thereby lessening incentive to tamper.

Takao Tateishi – General Editor

The Shipowner's Liability for Death of Seaman by Suicide and Quarrel Assault

*Mitsuhiro Toda**

Introduction

We have sometimes sad accidents on board vessels resulting in death of crew members. If a crew member lost his life as a direct consequence of the marine accidents such as collision, explosion, stranding etc., then it would be perhaps no question about the nature of his death, that is, whether his death falls into the category of the job related death or not.

However, if a crew member dies by committing suicide or being stabbed by the fellow seaman after the quarrel, brawl or fighting, then, the question may arise whether his death is a job related death or just a private death. If the death can be said to be the one relating to the performance of the job duty, then the shipowner would be found to be responsible for his death and pay compensation to the bereaved family under Japanese law. This article would touch some of the points in those very special deaths of seamen.

1. The Shipowner's Responsibility for Maintaining Safety On Board Ship

Under Japanese law, an employer has general obligation to secure the safety in the workplace where his employees work. This theory has been extended to government officers as well. Typical examples for this theory to be applied are as follows:

A. The office floors collapse.
B. A burglar storms the offices and kills employees.
C. A working place caught a fire.
D. A truck plunging into the working place and hitting the worker to death.
E. A worker dies of very special disease because of working in unhealthy environment, e.g. coal mine or dirty factory.

As you will see, the above cases are all concerning physical safety of the working place. Therefore in case of a ship, if a seaman dies due to a defect of the ship's equipment or

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structure, the shipowner shall be liable for his death for reason of failure in securing the physical safety on board the ship. For example, a seaman fell down into the deck floor from the staircase because of insufficient handrails.

This concept is similar to seaworthiness to make the ship fit and safe for the navigation in respect of carriage of the cargo or passengers. It is possible that the seaworthiness of the ship can be extended to secure the safety of the seamen working on board the vessel. However, under Japanese Law, the seaworthiness conception is not applicable to the death or personal injuries of seamen. The conception of maintaining safety on board ship is much wider than seaworthiness.

This employer's duty is sometimes extended to safety of mental or psychological working environment. If a seaman commits suicide because he is psychologically so depressed because of his very hard working burden, then it is possible that the shipowner is found to be responsible for his death.

Further, if a seaman is killed by a fellow man, then the shipowner would sometimes be found responsible for his death in connection with this duty as set out below in details.

2. Conditions Which Make Suicide Fall Into the Category of The Death Relating to the Duty of the Job

It seems that there have been no court cases in Japan dealing with a case of a seaman who committed suicide on board the ship. We have, however, many court cases where workers committed suicide on land (eg. Judgments of Supreme Court of March 24, 2000, *Hanrei Jiho* 1707-87; Tokyo Appellate Court of September 26, 1997, *Hanrei Jiho* 1646-44; Sapporo District Court of July 16, 1998, *Hanrei Jiho* 1671-113; Tokyo District Court of April 26, 1996, *Hanrei Times* 926-171).

Studying these shore cases, we think that the following conditions seem to be required to make suicide the death arising out of the performance of the duty of the job.

(a) Whether suicide is a consequence of serious body injury or mental damage arising out of an extraordinary experience or accident which the worker met in the performance of his duty of the job.

For example, where a ship is attacked and detained by pirates or a seaman sustains seriously body injury affecting his future life (e.g. genital ability); as a

result he commits suicide due to depression coming from the mental damage or impairment to the body.

(b) Whether the worker is required not to comply with law or do illegal things.

If the worker is required by the employer to do illegal things or not to comply with law, it gives great psychological pressure onto the worker. For example, if the shipowner orders the master not to obey any orders from the port authorities or coast guard or that he should never care about oil pollution, then he feels very heavy mental pressure between his personal will to comply with the law and the shipowners' order to defy it.

(c) Whether the work order is beyond his duty.

If a chief engineer is ordered to prepare the storage plan for loading of the cargo, it gives him a great psychological pressure.

(d) Whether the conditions in which to perform the duty are very harsh, requiring long overtime.

There are a number of precedents in which it was ruled that the employer should be liable for the death of the worker who committed suicide after unreasonably long overtime, for example, 73 hours overtime in one month. Therefore, if a seaman is ordered to work overtime every nights continuously, and as a result of that the seaman chooses to hang himself, the shipowner would be found liable for his death.

3. Liability for Death by Quarrel Assault

We have from time to time serious fighting or brawl among the fellow seamen on board the vessel which is, in a way, a small society. The number of the ships on board which different nationality seamen work together is increasing. The difference of culture and difficulty in communication sometimes cause unhappy events of serious fighting between fellow seamen resulting in death or serious injury. Death of a seaman as a result of the fighting can be said to be the result of a serious crime, manslaughter or murder.

It is usual that the shipowner has nothing to do with such crime committed by the seaman. Therefore it seems that there would be no ground for the shipowner to be found

responsible for the crew's death.

However under Japanese law, in most cases, the shipowner shall assume responsibility for the crew's death arising out of such fighting because the shipowner has obligation to secure the safety of the working place. Further, the shipowner is responsible for any wrongful or negligent conduct of his employee seaman who killed fellow seaman.

However, there is, of course, exception. If the quarrel or the fighting resulting in the death is of the nature of the very personal and has nothing to do with performance of the job, then the shipowner would be found not to be responsible for the death. For example, the reason of the fighting is a love affair to the same lady, private gambling or personal insulting or bullying. However, if bullying to a particular seaman is made in connection with the job performance, then the shipowner should be liable for the death resulting from the fighting.

For example, the master insults the third officer for his delay in standing watch with very dirty words. Then the third officer gets angry very much with the dirty and insulting words and loses himself and stabs the master to death. In such case, the shipowner would be found responsible for the death of the master in breach of the duty to secure the safety of the working place and/or vicariously as an employer of the third officer.

Of course in these cases, compensation to the family of the killed master would be reduced to some extent for the reason of contributory negligence by the master to provoke the third officer with dirty and very insulting words.

It is said that under the Jones Act of United States, a shipowner is liable to a seaman if the assault was committed by the plaintiff's superior for the benefit of the ship's business, or the master or the ship's officers failed to prevent the assault when it was foreseeable (1993 AMC 1978). Under Japanese law, even if the assault was committed by the subordinate and the victim was the superior, the shipowner shall be responsible for the death of the victim seaman.

Further even if the seaman who was killed had caused the fight insulting the assailant crew member, his death should be compensated for by the shipowner since it is firmly established that killing human beings is the most blameworthy misconduct comparing with any other provocative willful one.

Conclusion

To sum up the above, in case of suicide, unless the shipowner gives unreasonable orders to seamen or let them work unreasonably harsh for a long period, the shipowner, generally speaking, would be found not responsible for the death of the seaman who committed suicide.

To the contrary, in case of the death of a seaman as a result of the fighting, the shipowner would mostly be found responsible unless the fighting among the seamen breaks out for the very personal reasons which have nothing to do with job performance at all.

I hope this would be of some help to understand these exceptional unhappy events.

February 6, 2002

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INQUISITORIAL APPROACH IN DISPUTE RESOLUTION

- A Japanese way to mete out justice

*Takao Tateishi**

INTRODUCTION

There are at present two distinguished approaches in the world to mete out justice in dispute resolution: inquisitorial and adversarial. In the inquisitorial approach, especially in maritime arbitration in Tokyo, the arbitrator puts emphasis on justice in substance or justice at the end of the day, and may sometimes do so at the sacrifice of justice in procedure.[1] What the arbitrator normally does here is to investigate *ex officio* into the factual relations of the dispute to find out truth, e.g. to request further documents and examine the parties. On the other hand, the arbitrator in the adversarial approach esteems procedural justice/due process and pays attention only to what the parties try to assert and prove.[2]

Take, as an example, arbitration proceedings where the claimant, in the absence of a valid arbitration agreement, seeks damages for a cargo loss. Under the Japanese inquisitorial system the arbitrator would be required to investigate whether there exists a valid arbitration agreement for resolution of that dispute and thus whether to have jurisdiction over the dispute, even if the respondent does not raise the issue. When finding there is none, the arbitrator is obliged to dismiss the application in favour of litigation to avoid unnecessary duplication of procedures. On the other hand, the arbitrator in an adversarial system would not be obliged nor even allowed to look beyond the statement/evidence advanced by the parties for the sake of judiciary economy. Therefore, the claimant here would have the claim time-barred and end up seeing its own attorney in court to recover damages for negligence. In this example, more justice exists on the part of the

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1 Curious enough, the Japanese inquisitorial approach where the parties have more justice at the end of the day than during the procedure, seems to be in complete harmony with the economic system the Government took in the wake of World War II. The Japanese Government is said to have taken such economic policies as to achieve equality in terms of benefit for all people by allowing unequal opportunities to avoid competition.

2 On the other hand, as implemented by US President Ronald Reagan and British Prime Minister Margaret Thatcher in early 80s, the governments in major common law jurisdictions have vigorously taken policies toward a market-oriented economy, thereby putting a great value on equal opportunities with a result of imbalanced distribution of wealth.

inquisitorial approach.

Although court proceedings in both civil and criminal cases in Japan have already made a noticeable turn towards an adversarial approach under the influence of American law after the end of World War II,[3] arbitration still retains an inquisitorial system. In this paper, I will overview the current inquisitorial approach as practiced in maritime arbitration in Tokyo. Further, the inquisitorial approach sometimes directs the arbitrator to intervene for mediation. This is to mete out more justice as well. I will also discuss the close relationship between inquisitorial arbitration and the occurrence of mediation during the course of arbitration.

1. THE FALL OF INQUISITORIAL APPROACHES IN COURT

As mentioned above, after the end of World War II, the Japanese lawmakers modified, under the influence of American law, the pre-war stance of an inquisitorial approach in civil and criminal procedures. Thus the Code of Civil Procedure now is more adversarial than inquisitorial.[4] Similar is the Code of Criminal Procedure.[5] In civil litigation, for example, the litigants owe responsibility to submit pleadings and produce evidence so that the court may elucidate the points in dispute and render a decision on the merits of the case. Further, the litigants retain the right to bring a motion/petition against proceedings and instructions of the court.

On the other hand, the court takes the chair as superintendent and bears the responsibility for facilitating smooth and expeditious proceedings. In certain circumstances, the court may, so as to clarify relevant matters of the case, pose questions to the parties, direct the parties to appear at the trial or to produce further evidence.[6] Particularly where a party is in a "weaker" position like a consumer, the Japanese court is said to often take a paternalistic approach and "tutor" the party about the way of submissions of statement/evidence. Therefore, the court has not entirely surrendered an inquisitorial approach.

However, the court will never take *ex officio* investigation into facts other than where expressly provided for in law. Express provisions for an inquisitorial approach in civil

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3 See, e.g., Takeo Kosugi, "Asia no Jidai no Ho" (Law of Asian Age) at 34.

4 See, Koji Shindo, "Shin Minji Sosho Ho" (The New Code of Civil Procedure), at 361 *et seq*; Takeo Kosugi, *supra*, at 35.

5 See, Morikazu Taguchi, "Keiji Sosho Ho - Dai 3-pan" (The Code of Criminal Procedure - 3rd Edition) at 21-22; Takeo Kosugi, *supra*, at 34-35.

6 See Articles 149 and 151 of the Code of Civil Procedure.

procedure can only be found in some special laws such as the Law on Public Notice Procedure and Arbitration Procedure (the "Law of Arbitration")[7] and the Law on Procedure for Resolution of Personal Status.[8] In the background to ordinary civil litigations lies the concept that issues related to private interests should be at the liberty of the parties for disposition. Some commentators even suggest that what is left to the parties for disposition under substantive private law may be better resolved in accordance with the intentions of the parties even when dealt with in court.[9] Even executive power abstains from intervening into civil disputes ("*Minji Fu-kainyu*").[10]

Therefore, in a claim for damages arising in contract, for example, the court will basically grant damages *only if* the plaintiff proves all of the following: (1) a contractual relationship between the plaintiff and defendant; (2) a duty owed by the defendant; (3) a breach of that duty by the defendant; (4) a causal connection between the breach and the loss; and (5) the amount of loss.[11]

1.1 Carrier's Liability under Bill of Lading

In a latest case where the plaintiff B/L holder sued the defendant carrier to recover damages for wrongful delivery of a cargo without production of the original bill, the Tokyo District Court granted judgment on 28 May 2001 in favour of the plaintiff when satisfied that the above test had been met.[12] There the defendant carrier issued bills of

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7 Article 794 of the Law of Arbitration <Procedure of Arbitration> provides: "(1) *The arbitrators shall, before rendering an award, hear the parties and make such inquiries into the causes of the disputes as they deem necessary.* (2) Where the parties have no agreement on the arbitral procedure to be followed, the arbitrators shall adopt such procedure as they think fit."(Emphasis added)

8 Article 14 <Ex Officio Inquiry> of the Law on Procedure for Resolution of Personal Status provides: "The court may, for the purpose of maintaining the current marital status, *ex officio* take evidence and/or consider whatever facts not submitted by the parties, provided that the court shall examine the parties with the results of such inquiries." Article 31 <Power and Ex Officio Inquiry of the Prosecutor> provides: "(1) The prosecutor may submit facts and a method of proof for the case mentioned in this Chapter. (2) The court may *ex officio* take evidence and consider whatever facts not submitted by the parties, provided that the court shall examine the parties with the results of such inquiries."

9 See, e.g., Shindo, *supra*, at 379.

10 For example, the police may not intervene in such pure civil disputes as arising out of a failure to pay a sum of money stipulated in a contract, unless and until certain violation of law, e.g., violence, is involved.

11 It is worthwhile to note, however, that the new Code of Civil Procedure now provides for the court's discretion in the assessment of the quantum of damages. Article 248 of the Code <Assessment of Damages> provides: "Where it is recognised that a loss was incurred, but it is extremely difficult to prove the amount of the loss due to the nature of such loss, the court may assess a reasonable amount on the basis of all the oral pleadings and the results of evidential examination."

12 Docket: Heisei 10 (wa) 16546; *Kaiji Ho Kenkyu Kaishi* (Maritime Law Review) No 163 at 86.

lading for the carriage of a cargo of electronic components from a port of Hong Kong or Mainland China to a port in Brazil. The carrier delivered the cargo at the destination to the terminal, which subsequently delivered the cargo to the consignee without production of original bills. In fact, the consignee failed to pay the contractual price (they had already become insolvent) and the shipper retained the original bills.

The Court granted damages holding *inter alia*:

> "(1) A bill of lading is evidence of the contract of carriage and also a document of title. The plaintiff is the lawful holder of the bill. (2) The carrier should be held liable in contract if, due to failure to exercise due diligence, the cargo sustained damage, as provided for in the Carriage of Goods by Sea Act 1992. (3) On the evidence, the super terminal delivered the cargo to the consignee in exchange for the certificate of loss of original bills issued by the carrier's agents. Thus the cause of loss of the cargo should lie in the act of the carrier's agents. (4) The agents committed a breach of duty in that they issued a certificate of loss of original bills to a person other than a lawful holder of the bill without conducting reasonable investigations. The carrier should be liable for its agents' breach. (5) The plaintiff also proved that it incurred loss."

1.2 Motion to Dismiss Suit in Favour of Arbitration Agreement

It is also the case that, where one of the parties to arbitration brought in the court a claim for the resolution of which an arbitration agreement validly exists, the court will dismiss the suit as illegal *only if* the other party objects by invoking the arbitration agreement.[13] Therefore, the court never exercises *ex officio* inquiry into the existence of an arbitration agreement. By way of example, I note a recent reported case in which the Nagoya District Court dismissed a suit in favour of arbitration upon motion of the defendant on 27 October 1995.[14] In that case, the Court appears to have enforced an arbitration agreement contained in a contract for the resolution of a claim arising in tort. The facts of the case were as follows:

A Japanese manufacturer entered into a sale contract of packaging machines with the

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[13] On this issue, the Supreme Court held on 15 April 1918 (24 *Daihan Minroku* 856): "An arbitration agreement provided for in the Law of Arbitration is an agreement to let the arbitrator to resolve civil disputes; *the parties to the agreement are thereby entitled to raise an objection to the suit before the court*." (Emphasis added)

[14] Docket: Heisei 6 (wa) 328; *Kaiji Ho Kenkyu Kaishi* (Maritime Law Review) No 150 at 33.

defendant UK distributor and those machines were delivered to the defendant. Prior to the conclusion of the sale contract the Japanese manufacturer and the defendant distributor had entered into a contract of exclusive distributorship on 25 March 1985. The distributorship contract contained an ICC arbitration clause, which provided for the place of arbitration in the forum of the responding party. On the other hand, the sale contract contained no arbitration agreement. When the defendant distributor defaulted in payment of the contractual price, the plaintiff, who had merged and acquired ownership of the manufacturer, claimed damages and costs against the defendant distributor and directors thereof for a tort of conspiracy to thieve the machines. The defendants moved to dismiss the claim, arguing *inter alia* that the arbitration agreement in their distributorship contract should apply to the disputes arising out of the sale contract.

Persuaded by the defendants' arguments, the Court applied the arbitration agreement in the distributorship contract to the dispute arising in connection with the sale contract and dismissed the suit, holding:

> "As the cause of action for damages arising in contract may, with a very rare exception, be also founded upon a tort, it would invariably frustrate the purpose of an arbitration agreement if the plaintiff could successfully contend that the arbitration agreement should be void in any event when the claim was brought against the defendant in tort. Accordingly, the Court must, in deciding whether to enforce an arbitration agreement, consider the substance of the dispute. The plaintiff sued the defendants in tort, but on the basis of evidence and contentions of the plaintiff, its claim is in effect a claim for payment of the contractual price.
>
> "The Court concludes that the intention of the parties was that other than what was stipulated in the sale contract should be subjected to the base contract, i.e. the distributorship contract, in view of the fact that no fresh agreement had been entered into between the parties, particularly as to the method of dispute resolution. The Court also accepts the argument of the defendants that the types of the machines delivered were included in the items in the distributorship contract. Therefore, the instant dispute should be within the scope of the ICC arbitration clause: 'All disputes, controversies or differences which may arise between the parties hereto, relating to this contract or to the breach thereof shall be finally settled by arbitration ...' and this case should be dismissed in favour of arbitration. The Court also dismisses the claim against the directors in favour of arbitration (who were not parties to the distributorship contract) on the ground that separate proceedings would not be reasonable in view of *Jori* (sense of justice). It would be

unnecessary therefore to decide whether the Court shall have international subject-matter jurisdiction over the case."

1.3 Motion to Dismiss Belatedly Brought

In addition, the court will normally not grant demurrer brought belatedly, i.e. after the defendant had already pleaded on the merits of the case.[15] For example, the Kobe District Court refused to enforce a TOMAC arbitration clause in an operation contract of a vessel on 27 May 1988,[16] where the defendant raised no objections to the court proceedings up until the 27th trial. The Court denied the validity of the arbitration agreement, holding:

> "At the third trial the defendant admitted the formation of the operation contract which contained an arbitration clause ... The defendant knew or should have known the existence of the arbitration agreement at that time. Nevertheless, it continued pleading on the merits of the case until it finally brought demurrer at the 27th trial. Furthermore, the said contract was entered into on the basis of the standard form of JSE. The operation contract should not satisfactorily constitute evidence to certify the existence of arbitration agreement. In the instant case, the arbitration clause must only have been a printed clause/an example for reference and should be short of an arbitration agreement as binding upon the parties."

1.4 Unique Features surrounding Enforcement of Arbitral Awards

Looking at the attitude of the court from a different angle, it may be said that the court would simply put priority to court proceedings rather than give freedom to parties to arbitration under the rubric of "adversarial."

Motion to Set-aside a Domestic Award

Therefore, even if the defendant failed to raise the issue of non-existence of an arbitration agreement up until the time for enforcement of an arbitral award, the court normally appears *not* to entertain freedom of the parties but to grant a motion to avoid the award. For example, the Supreme Court granted a motion to set aside an arbitral award on the ground of non-existence of a valid arbitration agreement on 2 May 1977.[17] In that case, the Court held: "An award, issued in the arbitral proceedings while there was no

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[15] See, e.g., Takeshi Kojima, "Chusai Ho" (The Law of Arbitration), at 127.

[16] Docket: Showa 55 (wa) 1310; WaveLength-JSE Bulletin No 39 at 8; *Hanrei Times* No 687 at 242.

[17] Docket: Showa 52 (o) 194; WaveLength-JSE Bulletin No 40 at 13; *Kinyu Shoji Hanrei* No 548 p 41.

arbitration agreement entered into between the parties, should not have the same effect as a final court judgment."

Motion to Set-aside a Foreign Award

When it comes to enforcement of a foreign arbitral award, the Japanese court appears to show a special willingness to abide by an international treaty. As far as reported cases are concerned, the Japanese court has not so far declined to enforce a foreign arbitral award.[18] It must be due to Japan's accession to the New York Convention.[19] In order to illustrate how difficult it is to resist enforcement of a foreign award, I cite the most recent reported case in which the Yokohama District Court enforced a CIETAC award on 25 August 1999.[20] There, the defendant Japanese buyers entered into sets of sale contracts of anti-freezing substances dated between 14 November and 5 December 1996 with the plaintiff Chinese sellers. Disputes arose in respect of performance of the contracts and the plaintiff brought arbitral proceedings to CIETAC on 20 August 1997 in accordance with an arbitration agreement in the contracts. CIETAC rendered an award in favour of the plaintiff on 6 December 1997.

The plaintiff brought suit for enforcement of the award in the Yokohama District Court and the defendant challenged the effect of the arbitration agreement, arguing that the contracts were terminated shortly after the conclusion thereof when the plaintiff and Japanese sub-buyers had agreed to trade the product directly between them, which the defendant maintained it had accepted. The defendant also alleged procedural irregularities in violation of the requirements for granting enforcement of a foreign award.[21]

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[18] See Takao Tateishi, "The Enforcement of Foreign Arbitral Awards in Japan," WaveLength-JSE Bulletin No 40 at 1 *et seq*, also at www.jseinc.org/

[19] Japan acceded to the New York Convention 1958 as soon as in 1961.

[20] Docket: Heisei 10 (wa) 3851; *Hanrei Jiho* No 1707 at 146.

[21] The Court first dismissed the allegation on the effect of the arbitration agreement, holding:
"In accordance with Article 7(1) of Horei, the formation and effect of an arbitration agreement should be decided firstly by the governing law of the agreement based on the parties' intention. In view of the facts that the parties agreed to CIETAC arbitration and that the text of the contract was in Chinese as well as in English, the Court has no way but to regard it appropriate, absent exceptional circumstances, that the formation and effect of the arbitration agreement should be decided in accordance with Chinese law. The Court then turns to look at Chinese Arbitration Law (Article 19) and CIETAC Arbitration Rules (Section 5) and finds out that those provisions provide for separability of an arbitration agreement from the main contract. The Court recognises it reasonable that those provisions provide that the disputes in respect of the validity of the main contract should also be resolved by arbitration. While the defendant contends that the contract had been terminated and thus the arbitration agreement *per se* had become void, in the Court's view it is the intention of the parties to an arbitration clause to agree, before a dispute arises, as to the means of

The Court dismissed the contentions as to procedural irregularities, holding:

> "The defendant contends that notice sent to it was written in Chinese with no Japanese translation, that CIETAC never arranged for Chinese attorneys for the defendant and that thus the award should be vacated for violation of the provisions of Article V.1(b) of the New York Convention. However, the parties agreed to CIETAC arbitration and Section 75(1) of the Rules stipulated that the language of arbitration should be Chinese unless otherwise agreed between the parties. Absent evidence that the parties had expressly agreed to the language of arbitration other than Chinese, and further on the fact that the contract was written in Chinese and English, the Court decides that the parties had agreed to arbitral proceedings to be conducted in the Chinese language.
>
> "The defendant further argues that the plaintiff submitted forged evidence to the arbitral tribunal and that this fact coupled with the above contentions should be satisfactory for the Court to decide in favour of the defendant in accordance with Article V.2(b) of the New York Convention (public policy ground). It is true that the invoice the plaintiff submitted to the tribunal bore a different figure as to the unit price of the product, from the one written on the invoice issued by the shipping company, but there was no evidence submitted to prove that the figure was forged by the plaintiff. Moreover, even if it was accepted that this was a forgery, forgery of this kind should not be regarded to violate public policy of Japan, because a contravention should be such that it falls foul of basic principles or rules of the Japanese judicial order. If judged this way, it would not be cruel to the defendant because the defendant could bring a motion to set aside the award in a Chinese court in accordance with Article 58(1)(iv) of the Chinese Arbitration Law."

2. INQUISITORIAL APPROACHES IN ARBITRAL PROCEEDINGS

As provided for in Article 794(1) of the Law of Arbitration, the arbitrators owe an obligation to investigate the affairs of the parties to arbitration whenever they regard it necessary.[22] In this sense, arbitration may be given a special role in Japanese dispute resolution as opposed to court proceedings, although the arbitrators may often face a

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dispute resolution particularly of such disputes as the termination of the contract. In addition, the defendant failed to discharge the burden of proving that the arbitration agreement *per se* had in fact been terminated. Accordingly, the Court decides that, even on the assumption that the contract had been terminated, the arbitration agreement is still in full force and effect."

[22] As note 7 above. See also Kojima, *supra*, at 226.

difficult task in balancing an inquisitorial approach with the original idea of dispute resolution, i.e., freedom of the parties to dispose their private interests.[23] Apart from the provision of law, however, the arbitrators at TOMAC have traditionally been pro-active and thus the approach taken by them tends to be inquisitorial.[24] This practice seems to arise out of a sense of fairness and justice.

The arbitrators' inquiry may extend to both procedural and substantive matters. Therefore, as opposed to court proceedings, the arbitrators should make inquiries as to the validity of the arbitration agreement, as seen in the example in Introduction. This should also be the case in view of the fact that an arbitral award rendered where there is no valid arbitration agreement must face the fate of being set-aside.[25] However, contrary to the paternalistic approach in court,[26] the arbitrator rarely renders help on such procedural matters as the way of submissions of pleadings/evidence, because the parties to maritime arbitration are deemed to be at arm's length.

In most cases TOMAC arbitrators can decide the liability matter at a very early stage of the proceedings, leaving the only issue as being the quantum of damages. One of the major characteristics of TOMAC arbitration lies in the proper measure of damages the arbitrators adopt in the assessment of damages. This is the place where the inquisitorial approach mainly steps in. However, from a viewpoint of fairness and justice, TOMAC arbitrators may often grant damages on the ground not necessarily pleaded by a party. This is the result of examination they conducted *ex officio*.[27]

2.1 Assessment of Damages for a Cause Not Pleaded by Claimant

TOMAC arbitrators exercised such an investigative role in LPG carrier "Shogen-Maru"

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[23] Furthermore, as Prof. Toshio Sawada, Vice-President of ICC, rightly pointed out during a private talk with the Author in Tokyo last June, a problem may arise out of the inquisitorial approach and make the task of an arbitrator more difficult - that is, the possibility that the arbitrator may be held liable for not having taken proper inquiries into the case.

[24] This is backed up by a relevant provision of TOMAC Rules. Section 22 [Hearings, etc. of Witnesses by the Tribunal] provides: "The Tribunal may, irrespective of there being any request by either party, request from the witnesses or expert witnesses their voluntary appearance, or from the parties presentation of further documents, and examine them by hearing and in any other way, in order to elucidate the points in dispute."

[25] See Chapter 1.4 above.

[26] See Chapter 1 above.

[27] As to the proper measure of damages, see Article 248 of the Code of Civil Procedure, note 11 above, and Section 29 [Assessment of Damages] of TOMAC Arbitration Rules.

arbitration.[28] There, the arbitrators granted damages for violation of good faith and trust, which the respondent time-charterers should have maintained during the course of performance. This ground for damages was not advanced by the claimant but granted by the arbitrators after exercising *ex officio* inquiries. The facts of the arbitration were as follows.

The claimant owners of the vessel brought arbitral proceedings to recover damages for wrongful termination of the time-charter by respondent charterers, despite the fact that there *prima facie* existed a contract of termination between the parties. The claimant alleged that it was coerced into agreeing to terminate the contract by the respondent who abused its superior position as charterers, notwithstanding the special approval given by the tonnage-regulatory authorities for the vessel's new-building in exchange for the guarantee by the respondent for chartering the vessel over the period of 16 years.

The arbitrators first dismissed the claimant's contention that the respondent forced the claimant to agree to terminate the charter, holding:

> "The claimant argues that the conversion of the Charter into the operation contract and the subsequent termination of that operation contract were intimidated/coerced by the respondent by an abuse of their dominant position as charterers and that therefore the termination was wrongful. However, there is no evidence before the Arbitrators to support the argument that the respondent coerced the claimant into agreeing the operation contract. On the other hand, on the evidence, it is recognised that the claimant thought that the Vessel could be sold at a reasonable price at that time. Moreover, the claimant itself requested an extension of the operation period when the sale of the Vessel was unsuccessful and an addendum was entered into to this effect. Based on these findings of fact, it should be unreasonable to hold that the operation contract/addendum were wrongfully concluded or terminated by coercion/abuse of the dominant position by the respondent."

However, the arbitrators took due note of the special background to the building of the vessel, and concluded that the respondent should compensate part of the loss of the claimant for violation of good faith, holding:

> "At the time of the building of the Vessel ... the Ministry of Transport (MOT) was careful not to induce over-tonnage in this ship type. Therefore, MOT, through the

[28] Decision on 10 November 2000. For details of this arbitration, see WaveLength-JSE Bulletin No 42 at 12 *et seq*, also at www.jseinc.org/

> Authorities, imposed strict criterion for approval of new-buildings of these special tankers... In short, the owners, charterers and shippers were in principle obliged to maintain the same transportation scheme for the vessel as originally approved at the time of the new-building... Therefore the shippers and the charterers guaranteed shipment/chartering for the period of 16 years.
>
> "When it became apparent to the respondent that the operational situations of the Vessel would drastically deteriorate due to a projected decline of LPG output by the shippers, the respondent, contrary to the above conditions for building and operating the Vessel, strongly persuaded the claimant, halfway through the charter period, to agree to convert in substance the Charter to an operation contract, thereby hedging the risk entirely upon the claimant... As a result the claimant's earnings sharply dropped with difficulties repaying the building cost to the bank, which in turn recommended the claimant to try to sell the Vessel overseas...
>
> "Moreover, the respondent maintains to the effect that the guarantees as to shipment/charter were solely made for the purpose of obtaining approval for new-building of the vessel from the Authorities and that it could terminate the Charter at any time even during the guaranteed period if and when ordinary formalities as to agreement were satisfied. However, those contentions fall foul of the guideline of MOT as to new-buildings of tankers of particular types. In those circumstances, it can be said that the respondent, as a party to a bilateral/reciprocal contract, acted against the obligations it owed under the principle of trust and good faith so as not to damage unduly the interests of the other party. Accordingly, the Arbitrators hold it necessary and equitable for the respondent to compensate part of the damage incurred by the claimant pursuant to termination of the contract."

Finally, the arbitrators adopted a measure of damages on the basis of the value of the vessel, holding:

> "In our view, it is most reasonable to assess the loss incurred by the claimant on the basis of the building cost, for both the claimant and the respondent submitted their building and operation plans of the Vessel based upon redemption of the construction cost (and the Authorities approved these). At the time of re-delivery of the Vessel at the end of August 1999, she was 8 years old. Therefore, her book value is estimated at Yen 286,000,000 after depreciation at 9% per annum from the original price of Yen 812,500,000 with a minimum remaining value of 10%, based on her legal term of life of 11 years.

"According to a market research the Arbitrators conducted, the Vessel has a market value at about Yen 200,000,000 as at November 2000.[29] Therefore, it is reasonably concluded that the discrepancy between the book value and the sound value, i.e. Yen 86,000,000, can be the net loss incurred by the claimant. Now the question is the quantum of damages for which the respondent should be held liable. The Arbitrators deem it appropriate, based on the above findings of fact, that the respondent should compensate Yen 40,000,000 for violation of the principle of trust and good faith between the parties..."

2.2 Where Arbitrators do not Exercise Ex Officio Inquiry

Inquisition by the arbitrators is not unqualified. In an arbitration where the claimant claimed restitution from the respondent but confirmed during the procedure that it had no causes for the claim other than unjust enrichment gained by the respondent, TOMAC arbitrators dismissed the claim because they found no grounds for restitution, despite the fact that the arbitrators could, by exercising *ex officio* inquiry, have granted at least part of the claim on other grounds.[30] There, the claimant first brought suit in the Hiroshima District Court on 10 August 1999 seeking restitution from the respondent in respect of a sunk vessel which was the object of a sale contract.[31] But upon motion by the respondent that the suit was illegal on the ground of existence of a TOMAC arbitration clause in the contract, the claimant agreed to strike out the application and brought arbitral proceedings to TOMAC on 17 January 2000, asserting that the respondent gained unjust enrichment out of the sale contract. The further facts of the case were as follows:

The claimant buyers agreed to purchase and the respondent sellers agreed to sell the vessel, and terms and conditions agreed were reduced to a sale contract dated 24 January 1998, with the claimant paying Yen 4,000,000 as a deposit to be appropriated as part of the purchase price of Yen 30,700,000. The contract provided at Article 9: "Any of the parties may rescind the contract should, before delivery, the vessel become a total loss or incur a damage not repairable physically or economically, or should it be deemed that the parties cannot perform the contract due to force majeure events. In any of these cases, the deposit shall be returned to the buyers." An addendum to the contract provided *inter alia*: "The title to the vessel shall be transferable upon full payment of the purchase price." In order to secure payment of the purchase price, as the parties alleged, the claimant buyers

[29] The Arbitrators requested an appraisal of the vessel from an independent sale & purchase expert to evaluate her sound value. This is also part of an inquisitorial approach.

[30] Decision on 10 July 2000 in *Dai-San Ghion-Maru* arbitration.

[31] Docket: Heisei 11 (wa) 205.

as charterers and the respondent sellers as owners entered into a bareboat charter of the vessel on the same day. The claimant took out an insurance policy for the respondent as the insured in accordance with the bareboat charter. The claimant paid the first installment of Yen 4,000,000. The vessel was delivered on 4 February 1998.

The vessel sank after grounding at sea on 3 February 1999 and was subsequently declared a total loss. The insurer paid to the respondent sellers, the insured, Yen 28,000,000 on 10 March 1999. The respondent also received the sum of Yen 20,000,000 as the value of a right to "scrap & build" attached to the vessel under the tonnage regulation scheme. The claimant asserted their title to the vessel and contended that as the amount of Yen 56,000,000 (deposit, first installment, insurance and "S&B" value) which the respondent had gained exceeded the purchase price (Yen 30,700,000), the difference in the amount of Yen 25,300,000 (what the respondent gained minus purchase price) should be unjust enrichment and that the claimant should be entitled to restitution of that amount from the respondent.

The arbitrators dismissed the claim on 10 July 2000 holding *inter alia*:

> "Based on the above findings of fact, the title to the vessel had not been transferable in accordance with the provision of the addendum. And also the insurer lawfully paid the insured in accordance with the policy and thus the respondent should be under no obligation to adjust the sum ... In conclusion, there should be no ground for restitution on the basis of the causes raised by the claimant. The arbitrators could not grant the claim particularly in view of the fact that the attorney for the claimant declared in an oral hearing that their cause of claim was solely based upon restitution and that they would no longer contend that the respondent committed a tort of conversion."

3. RELATIONS BETWEEN INQUISITORIAL APPROACH AND MEDIATION

Now I move on to discuss the close relationship between inquisitorial arbitration and arbitrators' intervention for mediation. As a tradition and also in accordance with the provision of the Arbitration Rules,[32] TOMAC arbitrators may sometimes mediate

[32] Section 27 [Mediation] provides: "(1) The parties shall be allowed to settle the dispute amicably during the course of the arbitration proceedings. (2) *The Tribunal may, at any stage of the arbitration proceedings, mediate between the parties for the whole or a part of the dispute.* (3) In case mediation conducted in accordance with the preceding Sub-Section fails, the Tribunal resumes the arbitration proceedings, provided however that it must not issue an award based on any of the information it gained during the mediation proceedings." (Emphasis added)

between the parties *during the course of arbitration* after exercising *ex officio* investigation. In my view, this came into practice because the arbitrators here may come to know well of the disputes to the extent that some of them can then better be settled by mediation from a viewpoint of fairness and justice.

3.1 How often is Mediation Achieved?

Let us first look at how frequently mediation takes place *during* arbitration in Japan.[33] At TOMAC, a total of 139 arbitration cases were terminated between April 1989 and September 1999. Of the total, arbitral awards were rendered in 58 cases (41.7%); 42 cases (30.2%) withdrawn; 39 cases (28.1%) settled by mediation initiated either by the arbitrator or the parties during the arbitral proceedings. Therefore, nearly one third of the cases have been resolved by way of mediation here.

3.2 Preference for Settlement to Save Time and Cost

I turn next to parties' attitude toward mediation - a factor which must contribute to the promotion of mediation during arbitration. Although the arbitrator may take the initiative to investigate into the dispute under the inquisitorial system, this does not mean that the parties are non-adversarial. In reality, parties here are adversarial in terms of submission of pleadings and production of evidence, insisting on their strict legal rights. For the part of TOMAC arbitrators, they clearly distinguish between arbitration and mediation. Even if they deem it proper to intervene, they are not entitled to mediate unless parties agree to it. On the part of the parties, they can walk out of it at any time after so agreeing. Furthermore, TOMAC arbitrators *never* disclose nor even hint at, during the mediation procedure, what their final arbitral award would look like, thereby giving the parties full autonomy to dispose their interests.[34] What the TOMAC arbitrator normally does here is to help bring the parties to an agreed amount of damages. Thus the role of the arbitrator is only that of a facilitator.

Why then can mediation take place relatively often in TOMAC arbitrations? The level is

[33] As for litigation, a total of 156,683 ordinary civil suits were terminated in the district courts nationwide in the year 1998. Of the total, 50,102 cases were settled by mediation; 79,632 cases by judgments (inclusive 32,691 default judgments); 23,178 cases withdrawn (the rest are unspecified). Roughly speaking one out of each three cases was terminated by way of mediation at the level of district courts. See also Group ADR (Takahisa Hirota, Shuichi Kashiwagi, Naoki Idei and Shinjiro Motoyama), "Study on the Necessity of ADR: A Proposal," at 46-48.

[34] Of course, in case the arbitrators are requested by the parties to recommend a settlement plan, they may do so in their discretion, but generally TOMAC arbitrators are very careful in suggesting an amount.

apparently beyond the range attainable by simple trial and error. There must be a practical reason. After all, unless parties are satisfied that settlement is advantageous to them, they never agree to mediation. One answer should be the parties' preference for amicable settlement. However, I do not mean that the Japanese prefer to settle out of their harmonious character, as claimed by most commentators as being one of the reasons why the levels of utilization of litigation/arbitration are low in Japan.[35] My point is that it does not necessarily mean that the Japanese prefer not to confront with the other party at all even when they disclose their preference for amicable settlement in arbitration. Japanese people can be more practical than sentimental at this stage. They would consider settling the dispute, weighing carefully the possible award which would be granted,[36] against time, money and business relationships which could be lost. In short, where Japanese parties manage to resolve their differences by amicable settlement during arbitral proceedings, it is most likely the result based on their business judgment rather than due to a cause driven by a certain character.[37]

3.3 Inclination of Arbitrator to Intervene

Now I discuss the tendency of the arbitrator to intervene. From a historical perspective, one can say that mediation in Japan has mainly been settlement by intervention in the course of litigation/arbitration.[38] Such other types as taking place independently of or prior to *litigation* appeared later.[39] When it comes to mediation as an alternative to

[35] Most commentators have attributed Japanese people's preference for amicable settlement and the low levels of litigation/arbitration in general to either the cultural/historical backgrounds or legal/institutional disincentives. The former can be categorized into (1) a tradition to value harmony and consensus; (2) a low legal consciousness; (3) a non-confrontational character as a rice-cropping nation. The latter places the blame particularly on (1) the costs and time required; (2) the lack of lawyers and judges; (3) the procedural/ arbitral rules which allow a surprising intervention of mediation.

[36] They may already have been plied to disclose their weaker cases by inquisition of the arbitrators, and thus may not be quite sure whether they can win or not.

[37] I do not however deny that a peace-loving character may be contributory to a smaller extent. As Prof. Sawada justly mentioned, Japanese people's certain nature to try to avoid confrontation and maintain good relations with a neighbor may also be in the background to this sort of business judgment.

[38] Japanese mediation dates at least as far back as in the Edo Era (1603-1867). For details, see Takao Tateishi, "Mediation as a Pre-stage to Arbitration," WaveLength-JSE Bulletin No 41 at 18, also at www.jseinc.org/

[39] Tateishi, *supra*, at 19. Incidentally, the current framework of independent types of ADR in Japan comprises three categories: (1) Court-annexed conciliation - conciliation in district and summary courts under the Law of Civil Conciliation and in family courts under the Law on Adjustment of Family Relations. Certain types of family disputes must first be conciliated. Further, the court of first instance may *ex officio* stay the proceedings and direct the parties to conciliate (Article 20 of the Law of Civil Conciliation). (2) Private ADR centres - TOMAC; JCAA; ICC; Arbitration Centres of local bar associations; Mediation Centre

arbitration, it has not yet been well developed in Japan.[40] Why is a Japanese arbitrator inclined to intervene?

The inquisitorial approach should have much to do with it. The mechanism in which arbitrators come to decide to intervene must be something like this: the more they are able to know about the dispute after exercising *ex officio* inquisition into the facts not pleaded or relied upon by the parties, the more obscure becomes an otherwise clear-cut, winner-and-loser situation and hence more difficulty they may face in the assessment of damages. For example, there might simply be some loopholes in the law or the respondent may have been so deliberate in an attempt to evade obligations in contract (see *Shogen-Maru* in 2.1 above). Or there is a case where a strict construction of a contract term may run counter to commercial reality and practice.

Nevertheless, the arbitrators must, as long as they act as arbitrators who are to render a binding award, properly apply law in reaching their award (otherwise a fate of being set-aside will await it). In those circumstances, the arbitrators may often feel urged to recommend an amicable settlement from a viewpoint of fairness and justice, which means, as contrary to criticisms worldwide, an effort to help bring the parties to an agreed amount of damages, as seen above.[41] (Of course, in case mediation fails, the arbitrators must render an award in accordance with the proper construction of law.)[42]

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for Traffic Accidents; Japan Credit Counseling Association; Arbitration Centre for Industrial Property, etc. (3) Administrative ADR agencies set up under separate laws for particular disputes - Marine Accidents Inquiry Agency; Labour Relation Commissions for labour disputes; Commission for Settlement of Environmental Pollution Disputes; Japan Consumer Information Centre and its local Centres for consumer disputes; Consumer Product Liability Centre; Settlement Committees for Construction Disputes; ADR bodies for housing disputes, etc.

[40] Tateishi, *supra*, at 20, 23. To attack this problem, TOMAC has introduced a hybrid Med/Arb system in the new Arbitration Rules. Section 8 [Attempt of Conciliation] provides: "(1) The Secretariat may, after it accepted the application for arbitration, recommend the parties to first conciliate the dispute which is the subject of arbitration. (2) Where the parties agree to conciliate their dispute in accordance with the preceding Sub-Section, TOMAC suspends the arbitration proceedings until the termination of conciliation proceedings... (6) The conciliator may become an arbitrator in the arbitration proceedings subsequent to the failure of the conciliation attempt only if the parties so agree." In view of the fact that about 30% TOMAC cases are withdrawn after officially filed, as seen in 3.1 above, (most of which are believed to be settled between the parties after eliminating the problem of a time-bar), parties may find a good reason in utilizing Section 8 of the Rules at the very beginning of the proceedings.

[41] In *Shogen-Maru* arbitration, 2.1 above, the arbitrators in fact intervened several times for amicable settlement before rendering an award.

[42] The way that a judge comes to intervene may be analyzed similarly - although court proceedings are in principle adversarial, there should be certain aspects of an inquisitorial approach too. See Chapter 1 above. In addition, Article 89 of the Code of Civil Procedure provides for the power of the judge to intervene for

Furthermore, in certain cases especially where no legal point (fault or liability) is involved or difficult to be decided with the only issue being the quantum of damages, mediation may be for the benefit of both parties, because it could save time and cost considerably. In the event, an arbitrator could become a good mediator for the same dispute under the inquisitorial system. The risk that the arbitrators may base their award on the one-way information obtained during the mediation proceedings may be circumvented by certain safeguards: for example, by expressly prohibiting the arbitrators from doing so unless tested by cross-examination in the resumed arbitral proceedings as in TOMAC's new Arbitration Rules at Section 27(3).[43]

CONCLUSION

The inquisitorial approach in Japanese arbitration is designed to mete out justice in substance, at the little sacrifice, if any, of justice in procedure. The prevalence of this approach particularly in maritime arbitration can mainly be attributed to the initiative of the arbitrator to investigate into the points in dispute for the sake of justice as well as for the benefit of the parties. This attitude of the arbitrator may have been interconnected with the economic policies the Japanese Government took pursuant to the end of World War II. In my view, the provision for an inquisitorial approach in the Law of Arbitration has almost nothing to do in this context.

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mediation at any time during the course of litigation. And by way of Article 267 of the Code, a settlement agreement reached in court terminates the entire litigation and has the same binding force as a court judgment.

[43] See note 32 above.

SOME UNIQUE CHARACTERISTICS OF CANADIAN LAW CONCERNING PRIORITIES TO THE PROCEEDS FROM THE JUDICIAL SALE OF A VESSEL

*Robert Margolis**

In the last few years an unusually high number of vessels arrested in Canada have been sold by order of the court when the owners failed to defend the claims. In these cases the claims against the vessels invariably ended with a priorities hearing in which the distribution of the sale proceeds was determined.

The decisions in these recent cases have highlighted some unique characteristics of Canadian priorities law, the most important of which is that foreign maritime liens are recognised and accorded priority in Canada notwithstanding that the underlying claim would not give rise to a maritime lien under Canadian law. The consequence of this rule is that the arrest and sale of a vessel in Canada may be advantageous to certain claimants not generally privileged under English law.

As well, in Canada courts exercising *in rem* jurisdiction have primacy over bankruptcy courts, at least when the subject vessel has been arrested before commencement of the bankruptcy proceeding. Thus the proceeds of sale of a vessel arrested and sold in Canada may be distributed to secured *in rem* claimants according the Canadian law of priorities and are not necessarily paid to the trustees in bankruptcy for distribution to all creditors of the vessel's owners according to the applicable bankruptcy law.

A third unusual feature of Canadian priorities law is that the courts have in recent cases indicated a preparedness to exercise their equitable jurisdiction to vary the usual ranking of priorities, often at the expense of the mortgagee. It is now common for unsecured claimants to challenge the priority of mortgagees on the basis that the usual ranking would result in an "obvious injustice".

These characteristics of Canadian priorities law usually operate to the prejudice of the mortgagee of the vessel or other secured creditors of the owner but, as we shall see, they

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* Barrister and solicitor in British Columbia, solicitor in England and Wales. A good part of this paper is based on work done by my partner Christopher Giaschi. Mr. Giashi's two papers on Canadian priorities law are posted on our firm's website at www.AdmiraltyLaw.com under the heading "Papers". To declare my interest: please note that Mr. Giaschi or I appeared as counsel in several of the cases discussed herein.

may operate to the prejudice of Canadian unsecured creditors as well.

In this paper I will first outline briefly the usual order of priorities under Canadian law. I will then discuss the unique position of foreign maritime liens under Canadian law, the priority of secured *in rem* claims over a trustee's claim to the vessel of a bankrupt owner, and finally, the conditions for varying the usual ranking of priorities. I will conclude with the suggestion that depending on his particular circumstances a claimant may find it advantageous to arrest a debt-laden ship in Canada or he may find that Canada is about the worst place for him to do so.

The Usual Order of Priorities

The usual order of priorities is well established under Canadian maritime law to be as follows:[1]

1. Court costs[2] and marshall's expenses;[3]
2. Possessory liens predating other liens;[4]
3. Statutory liens (including the statutory liens for master's and seaman's wages and master's disbursements under the *Canada Shipping Act*);[5]
4. Maritime liens (including foreign maritime liens);

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1 *The Nel* [2001] 1 F.C. 408 at 419-420. See also *The Frank and Troy* [1971] F.C. 556 (FCTD), *The Ionnis Daskalelis* [1974] 1 Lloyd's Rep. 174 (SCC), *The Lowell Thomas Explorer* [1980] 1 F.C. 339 (FCTD), *The Atlantis Two* (1999) 170 F.T.R. 1 (FCTD) and *The Alarissa* (commonly known as *The Edmonton Queen*) [1996] 2 F.C. 883 (FCTD), aff'd (1997) 125 F.T.R. 284.

2 Regarding the legal costs of a claimant, generally no legal costs are awarded in a priorities hearing except those costs relating to the arrest and appraisement and sale of the vessel. Such costs are paid out of the sale proceeds and are given the highest priority on the ground that they are incurred for the benefit of all the claimants: see *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212 and *The Brussel* [2000] F.C.J. No. 197.

3 Third parties who provide necessaries (for example, diesel fuel) or services (for example, moorage facilities) to a vessel after the vessel has been arrested will on application to the court usually be granted a priority equivalent to marshall's expenses, provided the order is made before the necessaries or services are supplied: see *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212; cf. *The Ships Aquarius, Sagran and Admiral Arciszewski* (March 26, 2001) No. T-16-01 (FCTD), where an agent who supplied services to a vessel subsequent to its arrest was granted priority equivalent to marshall's expenses even though the application for priority was brought after the services were supplied.

4 A ship repairer in possession has a common law possessory lien that ranks in priority ahead of mortgages and subsequent maritime liens to the extent of the value of the repairs plus interest, but does not include storage, moorage or other charges related to the preservation of the repairer's interest: *The Barkley Sound* (March 4, 1999) Vancouver Reg. No. A983054 (BCSC).

5 *The Brussel* [2000] F.C.J. No. 197 at paras. 26-27.

5. Possessory liens arising after other maritime liens;
6. Mortgages; and
7. Statutory rights *in rem*, including claims for the supply of necessaries, which rank *pari passu* among themselves.

Foreign Maritime Liens

Canadian maritime law recognises the same few maritime liens as does English law, that is, the traditional liens for salvage, collision, bottomry and respondentia, seaman's wages and master's disbursements[6] as well as the statutorily created maritime lien for master's wages. Regarding the liens for master's and seaman's wages and master's disbursements, these appear to rank ahead of other maritime liens.[7]

However, Canadian law differs fundamentally from English law in that Canadian law also recognises foreign maritime liens, that is, maritime liens arising under the laws of a foreign country, even if the underlying claim would not give rise to a maritime lien under Canadian law.[8] In addition, Canadian law accords such foreign maritime liens the same priority it would give a Canadian maritime lien even if the foreign maritime lien would not be granted such a high priority by its own law. That is, Canadian law recognises all foreign maritime liens, whatever be the underlying claim, and accords them the priority of a Canadian maritime lien in Canadian proceedings.[9]

In many cases the application of the Canadian rule is straightforward. For example, under American law a necessaries supplier has a maritime lien for his claim. In a number of cases in which an American supplier has furnished necessaries to a vessel in American ports the Canadian courts have recognised the supplier's American maritime lien and

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6 *The Bold Buccleugh* (1851) 13 E.R. 884 (P.C.)

7 Maritime liens for master's disbursements rank *pari passu* with the master's and seaman's lien for wages, and both rank ahead of other maritime liens. A lien for master's disbursements is rare because it is a requirement that the master must have been unable to communicate with the owner before making the disbursement. In *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212 the owner abandoned his vessel in Vancouver and disbursements for victuals made by the master were held to have given rise to a maritime lien which ranked equally with the seaman's lien for wages (para. 27).

8 *The Strandhill* [1926] S.C.R. 680 (SCC), *The Ionnis Daskalelis* [1974] S.C.R. 1248 (SCC), *The Har Rai* (1984) 4 D.L.R. (4th) 739 (FCA), aff'd [1987] S.C.R. 57 (SCC), *The Brussel* 2001 SCC 90 at para. 41. English law only grants priority to foreign maritime liens if the claim underlying the foreign maritime lien would give rise to a maritime lien under English law: *The Halcyon Isle* [1980] 2 Lloyd's Rep. 325 (P.C). That is, under English law, whether or not a claim gives rise to a maritime lien and has the priority of a maritime lien is a matter for the lex fori.

9 *The Brussel* 2001 SCC 90 at para. 43.

granted the American supplier priority over a mortgagee (and, indeed, priority over Canadian necessaries suppliers, who have no maritime lien under Canadian law).[10]

Moreover, since under Canadian law all maritime lien holders rank ahead of mortgagees, and as Canada accords a foreign maritime lien the same status as a Canadian maritime lien, the anomalous situation may arise where the foreign lien holder is granted priority over a mortgagee when he wouldn't have such priority under the foreign law. For example, in *The Atlantis Two*[11] the Federal Court of Canada recognised an American maritime lien in favour of a sub-charterer for breach of charterparty. The Court further acknowledged that if the priorities were to be determined according to American law the sub-charterer's lien would rank behind the prior registered mortgage. However, the Court held that priorities were to be determined according to Canadian law and under Canadian law maritime liens rank ahead mortgages. Thus the sub-charterer received a higher priority in Canada than it would have been given by an American court.

While the Canadian recognition rule operates easily in cases of American suppliers furnishing necessaries in US ports, in many cases its application raises considerable difficulties. As frequently occurs in the law, such difficulties were probably not anticipated at the time the rule was formulated.

In every case where a foreign maritime lien is asserted two primary questions must be answered. First, the law governing the claim must be ascertained. Then it must be determined whether the circumstances of the particular transaction or incident give rise to a maritime lien under the governing law. The answers to these questions depend on, first, the choice of law rules of Canadian maritime law[12] and second, on expert evidence from

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[10] See, for example, *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212 and *The Brussel* [2000] F.C.J. No. 197. In *The Zoodotis* (No. T-186-99), a priorities case currently before the Federal Court of Canada, the vessel was sold following arrest and the sale proceeds were sufficient to pay all *in rem* claimants other than the mortgagee. Claimants ranking in priority behind the mortgagee would receive nothing. On the mortgagee's application the Court ordered that the mortgagee's lawyers should hold in trust a sufficient part of the sale proceeds to pay all the *in rem* claimants, other than the mortgagee, in full and to pay the remainder to the mortgagee. The mortgagee, as the only party interested in challenging the priority of the other claimants, then began settling such claims as it was able. Based on the well established law that a supplier's American maritime lien would be recognised in Canada and accorded priority over the mortgage, the mortgagee settled the claim of a Florida-based necessaries supplier who furnished goods to the vessel in New Orleans at 100 per cent of the claim amount (ie, the full invoice price) plus 8 per cent interest per annum.

[11] [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212.

[12] Cf. *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212, where the Federal Court of Canada accepted affidavit evidence from American attorneys as to the governing law of a charterparty. As

foreign legal experts.

The conclusion is not always clear from the outset, but a recent series of decisions of the Federal Court of Canada provides some guidelines.

Where a bunker supplier furnished bunkers to a vessel in Panama pursuant to a contract which provided that the bunkers were to be supplied on the terms and conditions of the fuel agent who made the actual delivery, and those terms and conditions stipulated that American law was to apply, the Court held that American law applied and that the supplier had an American maritime lien which ranked ahead of the mortgage.[13] It will be noted that although under American law the supply of bunkers to a vessel outside the United States gives rise to a maritime lien, such a maritime lien does not, according to American law, rank ahead of a mortgage. Nevertheless, as all maritime liens under Canadian law have priority over mortgages, the bunker supplier was paid ahead of the mortgagee.[14]

Similarly, the Federal Court of Canada has granted priority over a mortgagee to a Norwegian supplier who furnished necessaries to a vessel in Mexico and Vancouver through an American agent on the ground that the supply of necessaries in such circumstances gives rise to a maritime lien under American law.[15]

However, it is not clear that a Belgian supplier who supplies spare parts directly to a vessel in an American port via an air cargo shipment (that is, without the intervention of an American agent) would have priority over a mortgagee, notwithstanding that the supply of necessaries in such circumstances would certainly give rise to a maritime lien under US law.[16] If the court were to hold that American law governed the supply

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Chris Giaschi has pointed out in a paper presented at a Seminar with the Judges of the Federal Court of Canada and Members of the Admiralty Bar in April 2000, the approach taken by the Court in this case may have been inconsistent with recognised authority, which suggests that the determination of the applicable law of the contract is to be made according to the conflict of laws rules of the forum deciding the dispute, that is, Canadian law. The authorities to which Mr. Giaschi refers include *The Federal Calumet*, [1992] 1 F.C. 245 at 252, affirmed on appeal (1993) 150 N.R. 149 (FCA).

13 *The Nel* [2001] 1 F.C. 408. Similarly, in *Imperial Oil Limited v. Petromar Inc.* [2000] F.C.J. No. 1222 the Federal Court of Canada held that an American supplier who had supplied marine lubricants to Canadian vessels in Canadian ports had a maritime lien which ranked ahead of a mortgage because the supply contract contained a choice of law provision stipulating American law as the governing law.

14 *The Nel* [2001] 1 F.C. 408.

15 *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212. It will be noted that in this case the Court was silent on the issue of the governing law of the contract.

16 This situation arose in *The Ypapadi* (No. T-119-99), a case currently before the Federal Court of Canada;

contract, the American maritime lien would certainly be recognised in Canada, but if the court were to determine that the contract was governed by Belgian law (or some other law), under which no maritime lien arises in such circumstances, the Canadian court apparently would not recognise the claim as being secured by a maritime lien.[17]

In the recent case of *The Nel*[18] a Belgian supplier furnished necessaries to a Cypriot vessel in Belgium. The Court accepted the expert evidence of a Belgian lawyer that the supply of necessaries in such circumstances did not give rise to a maritime lien under Belgian law and therefore the Court did not grant the supplier priority over the mortgagee. This is the usual way the court will determine such questions.[19]

The advantage of the Canadian recognition rule to certain classes of foreign maritime lien claimant is readily apparent. Where the claimant has a maritime lien according to the applicable foreign law but not according to English law, he is well-advised to arrest a vessel burdened with debts (that is, a vessel whose owner is unlikely to defend the claim) in Canada rather than in England, Hong Kong, Singapore, the Bahamas or any other country which follows the English rule regarding recognition of maritime liens. In

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the Belgian supplier and the mortgagee, who would have received the residue of the proceeds of sale after payment out of all other secured claimants, settled the supplier's claim prior to the priorities hearing.

[17] In *The Brussel* [1997] 3 F.C. 187 MacKay J said at para. 23 that "Where a right in the nature of a maritime lien exists under foreign law *which is the proper law of the contract giving rise to the lien*, this Court is bound to recognise it and to give it priority which such a maritime lien has under Canadian maritime law" (emphasis added). See also *The Brussel* 2001 SCC 90 at para. 42. Cf. *The Nel* [2001] 1 F.C. 408, in which Prothonotary Hargrave, when discussing the ways a supplier of bunker fuel may secure priority over a mortgagee, said at 453 "Among the ways that a maritime lien may be obtained are through supplying fuel in a jurisdiction favourable to the fuel supplier". This may suggest that when a supplier furnishes necessaries in a country where such an act gives rise to a maritime lien, the maritime lien will be recognised in Canada, whatever be the proper law of the supply contract. (It will be noted that a term in a contract which purports to give a supplier a maritime lien cannot alone give the supplier priority against third parties: *The Brussel* [2000] F.C.J. No. 197 at para. 81.)

[18] [2001] 1 F.C. 408. See also *The Brussel* [2000] F.C.J. No. 197 at paras. 76-78 where, relying on the expert evidence of a Belgian lawyer as to the circumstances in which the supply of necessaries will give rise to a maritime lien under Belgian law, and applying the evidence before the Court to the Belgian law as stated by the expert, the Federal Court of Canada held that a Cayman Islands company, which had supplied bunker fuel to the defendant vessel in the Belgian port of Zebrugge, did not have a maritime lien.

[19] In *The Brussel* [2000] F.C.J. No. 197 numerous foreign repairers and suppliers made claims against the vessel but did not provide any evidence of foreign law at the priorities hearing. The Court applied the Canadian conflict of laws rule that in the absence of proof of foreign law the court must assume it is the same as the law of the forum. As repairers and suppliers of necessaries are not given a maritime lien under Canadian law, these foreign repairers and suppliers were held to rank in priority behind the mortgagee (at paras. 86-88).

addition, if by the applicable foreign law the foreign maritime lien ranks behind the claim of a mortgagee or some other maritime lien holder, the foreign lien claimant is also advised to pursue the claim in Canada, where his maritime claim will be accorded the same priority as any traditional Canadian (or English) maritime lien.

Primacy of a Court exercising *in rem* Jurisdiction over the Bankruptcy Court

Under Canadian law, secured *in rem* claimants can pursue their claims against a vessel notwithstanding that bankruptcy proceedings have been commenced against the vessel owner in a foreign country,[20] provided the vessel was arrested before commencement of the bankruptcy proceedings.[21] Moreover, the class of secured *in rem* claimants includes holders of foreign maritime liens even when the underlying claim would not give rise to a maritime lien under Canadian law and even when the foreign maritime lien would not be recognised by a foreign bankruptcy court seized of the matter.

The leading case is *The Brussel*[22] wherein an American stevedoring company, pursuant to an arrest warrant issued out of the Federal Court of Canada, arrested the "Brussel" in Halifax, Nova Scotia claiming over US $400,000 for unpaid stevedoring and related services supplied to the vessel in US ports. Shortly after the arrest the owner was judged to be bankrupt by the Commercial Court of Antwerp. The Antwerp court appointed trustees to the bankruptcy and these trustees were in due course added as party defendants to the Canadian *in rem* proceedings.

In the discharge of their responsibilities under Belgian law, the trustees sought to take possession of all assets of the bankrupt owner, wherever situated, for the purpose of orderly liquidation and distribution of the proceeds to the creditors of the owner in accord with Belgian bankruptcy law. The bankrupt owner's principal asset was, of course, the vessel then under arrest in Halifax.

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[20] In the case of bankruptcy proceedings commenced in Canada, it appears that the question of whether a claimant has a secured interest entitling him to priority to the proceeds of sale of the vessel is a matter for the court exercising its *in rem* jurisdiction, at least in the case where the vessel was arrested by warrant issued out of the Federal Court prior to commencement of the bankruptcy proceedings: *The Brussel* [1999] F.C.J. 337 at paras. 10-11 (FCA).

[21] Where the arrest is made after bankruptcy proceedings are commenced it appears that the court out of which the arrest warrant is issued will stay the maritime action in deference to the existing bankruptcy proceedings: *The Soledad Maria* (April 30, 1981) No. T-744-81 (FCTF), where the registered owner of a vessel had already been determined to be a bankrupt by a Spanish court at the time the vessel was arrested.

[22] [1997] 3 F.C. 187 (FCTD), aff'd [1999] F.C.J No. 337 (FCA), aff'd 2001 SCC 90.

The owner did not defend the claim within the time required by the Federal Court Rules and the American stevedoring company made a usual application to the Court for appraisal and sale of the vessel. The sale was vigorously opposed by the trustees, who went so far as to bring an *ex parte* application before the Quebec Superior Court, sitting in bankruptcy, for an order requiring that the "Brussel" be delivered to the trustees in bankruptcy. This order was in fact made, but following a series of applications to both the Federal Court and the Quebec Superior Court the vessel was sold by order of the Federal Court and the proceeds were paid into court.

The trustees then applied to the Federal Court for an order that the proceeds from the sale of the vessel be paid out to them for distribution to all creditors of the owner according to Belgian bankruptcy law. The Federal Court, Trial Division rejected the trustees' application, holding that the validity and priority of claims made by secured[23] *in rem* claimants were to be determined by the Federal Court exercising its *in rem* jurisdiction[24] notwithstanding that (subsequently commenced) bankruptcy proceedings were continuing elsewhere.[25] Moreover, whether an *in rem* claimant is "secured" or not is a matter to be

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[23] Regarding unsecured *in rem* claimants, MacKay J said at para. 84 "Creditors with unsecured claims, in my preliminary view, must look to the trustees in another court for satisfaction, but I acknowledge that issue has not been argued before me". In the event, the proceeds of sale were not enough to satisfy the mortgage claim and so there was, of course, nothing left for the unsecured creditors: *The Brussel* [2000] F.C.J. No. 197, para. 6 (FCTD).

[24] It will be noted that by s. 183 of the *Bankruptcy and Insolvency Act* RSC 1985, c. B-3, only the superior courts of the provinces, and not the Federal Court of Canada, can sit as a bankruptcy and insolvency court. On the other hand, the Federal Court of Canada is the country's primary maritime court exercising *in rem* jurisdiction. The superior court of only one of the provinces (British Columbia) has enacted Rules which provide for the arrest of ships, although there is some Ontario case authority to support the argument that all superior courts have inherent jurisdiction to issue warrants for the arrest of ships and to determine priorities among *in rem* claimants. Thus almost all disputes between courts exercising *in rem* jurisdiction and courts sitting as bankruptcy courts are in fact disputes between the Federal Court and a superior court of one of the provinces.

[25] In *The Ships Aquarius, Sagran and Admiral Arciszewski* (No. T-16-01), a case currently before the Federal Court of Canada, a trustee in bankruptcy was appointed by the Polish court in respect of the bankruptcy of the owner of three vessels already under arrest at Vancouver. The vessels were subsequently sold by court order. As required by the Federal Court's procedure, all *in rem* claimants having a claim against the vessels then filed affidavits of claim within a time ordered by the Court. The trustee in bankruptcy filed an affidavit of claim in which it stated that it was entitled to be paid the full amount of the sale proceeds on behalf of all the creditors of the owner of the vessels. One of the other claimants then made an application to the Court for an order that the trustee's affidavit of claim be struck on the ground, *inter alia*, that the trustee did not have an *in rem* claim and therefore was not entitled to participate in the distribution of the sale proceeds. The application was successful and the trustee's affidavit of claim was struck out on this and other grounds: 2001 FCT 1311 at paras. 18-26.

determined by Canadian maritime law. The Court in *The Brussel* was of the view that a maritime lien is a secured *in rem* claim and that "a maritime lien created under applicable foreign law is a secured claim under the laws of Canada".[26]

The decision of the Trial Division was upheld by the Federal Court of Appeal. An appeal to the Supreme Court of Canada was dismissed on the narrow ground that the trial judge did not err in exercising his discretion to deny the trustee's application for a stay of the proceedings in the Federal Court. In doing so the Supreme Court of Canada recognised that the Federal Court could order the sale of an arrested vessel and distribute the proceeds to secured claimants notwithstanding the existence of subsequently commenced bankruptcy proceedings.

A final point may be noted about this case. The mortgagee supported the trustees' application that the proceeds from the sale of the "Brussel" be paid to the trustees for distribution according to Belgian bankruptcy law. It may be inferred that such support was given because under Belgian law the claims of American suppliers would either not be treated as secured claims or would in any event rank behind those of the mortgagee.[27] In fact the mortgagee was right to try to have the sale proceeds, some US $4.6 million less the cost of appraisement and sale, paid to the trustees in bankruptcy, because at the subsequent priorities hearing the Federal Court of Canada awarded roughly US $620,000 plus interest to US maritime lien claimants.

Varying the Usual Order of Priorities

Under Canadian maritime law the court has an equitable jurisdiction to vary the usual order of priorities, but such jurisdiction will be exercised, it is said, only "where it is necessary to prevent an obvious injustice".[28]

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[26] *The Brussel* [1997] 3 F.C. 187 at paras. 81 and 83, 2001 SCC 90 at para. 41.

[27] In *The Brussel* case itself no evidence was led as to whether Belgian law would recognise the maritime liens accorded American suppliers under US law (para. 76). On appeal it was conceded in argument that it was "unlikely that the [American stevedore's] in rem rights could subsist in one form or another under Belgian bankruptcy laws": [1999] F.C.J. No. 337, fn. 5. See also the comments of Binnie J. at 2001 SCC 90, paras. 47-49.

[28] *The Galaxias* [1989] 1 F.C. 386, 423 (FCTD). The "obvious injustice" test as formulated in *The Galaxias* does not seem to differ significantly from the test stated in the English case of *The Lyrma (No. 2)* [1978] 2 Lloyd's Rep. 30 (QB, Ad Ct), where Brandon J, as he then was, in upholding the usual priority of a salvage lien over a pre-existing lien for wages, said at 33: "I do not consider that I should be justified in departing from it, unless perhaps it could be shown that, on the special facts of a particular case, the application of the principle produced a plainly unjust result".

A leading discussion of the Canadian approach is found in *The Edmonton Queen*,[29] a 1996 decision of Prothonotary Hargrave. However, this discussion only set the stage for later developments, as the Court in that case refused to vary the usual priority of builder's possessory lien over a mortgage.

In *The Atlantis Two*,[30] a case heard three years later, Prothonotary Hargrave was again asked to vary the usual order of priorities, and this time, relying heavily on his judgment in *The Edmonton Queen*, the Prothonotary granted an unsecured Canadian repairer priority over a mortgagee.

In *The Atlantis Two* a ship repairer not in possession argued that the usual order of priorities should be varied and that it was entitled to priority over the mortgagee on two grounds: first, that because the mortgagee was dilatory in enforcing its mortgage it should lose priority over unsecured claimants whose claims arose after the time the mortgagee should have moved against the vessel; and second, that the Court should exercise its equitable discretion to grant the repairer an enhanced priority because the repairs done to the vessel immediately prior to the arrest had added value to the vessel for the benefit of all the creditors.

On the first point, the Court accepted that a dilatory mortgagee might lose its priority just as a holder of a maritime lien might lose his privileged position by negligence or delay.[31] In particular, the mortgagee's priority over a repairer would be at risk where "the mortgage holder in fact stood by, knowing full well that repairs to a ship were being undertaken, repairs for which the owner could not pay and the value of which would fall into the pocket of the mortgagee on a forced sale of the ship".[32] According to the Court, the elements needed to postpone a mortgagee's claim are, first, strong and reliable evidence of knowledge of money being spent on the ship which would be of direct benefit to the mortgagee and second, concurrent knowledge that the mortgagor was insolvent.[33] As it was found as a fact by the Court that the mortgagee was neither aware of the insolvency of the mortgagor nor fully apprised of the extent and value of the repairs, the mortgagee was held not to have lost his priority on this ground.

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29 *The Alarissa* (commonly known as *The Edmonton Queen*) [1996] 2 F.C. 883 (FCTD), aff'd (1997) 125 F.T.R. 284.

30 *The Atlantis Two* [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212.

31 *The Atlantis Two* [1999] 170 F.T.R. 1 at para. 178.

32 *The Atlantis Two* [1999] 170 F.T.R. 1 at para. 178.

33 *The Atlantis Two* [1999] 170 F.T.R. 1 at para. 179. The Court adopted this test from the judgment of Hewson J in *The Pickaninny* [1960] 1 Lloyd's Rep. 533.

Nevertheless, it will be noted that as a result of Prothonotary Hargrave's clear statement of the law regarding dilatory mortgagees, unsecured claimants participating in several subsequent priorities hearings have gone to great lengths to cross examine mortgagees on their affidavits of claim with a view to finding a point in time prior to the time the claimant supplied necessaries or services when the mortgagee should have exercised its rights under the mortgage.[34]

The second argument of the repairer, that its priority should be enhanced because the repairs increased the value of the vessel for the benefit of all creditors, met with more success. Relying on a 1920 decision of the Supreme Court of Canada,[35] the Court held that the mortgagee, who might perhaps have moved earlier (although he was not so dilatory as to lose his priority) and the secured claimants (some of whom were American necessaries suppliers who had slept on their claims for years) would be unjustly enriched by the repairs if the usual order of priorities were not varied. That is, to distribute the proceeds of sale according to the usual order of priorities would result in an "obvious injustice". The Court therefore granted the repairer a priority on par with that of the American lien claimants for the amount of US $220,000, this being the amount by which the repairs were found to have increased the value of the vessel.[36]

The Atlantis Two may be considered a high water mark in the varying of the usual order of priorities. For example, in a 1999 case[37] the British Columbia Supreme Court exercising its *in rem* jurisdiction refused to give a supplier of goods priority over a mortgagee on the basis of unjust enrichment and in *The Nel* a bunker supplier's argument that the usual order of priorities should be varied on the ground that the mortgagee delayed in moving against the vessel was rejected because such an allegation was based upon "supposition, innuendo and assumption".[38]

On the other hand, the Court in *The Nel* did vary the usual order of priorities to give a Canadian supplier of medical services a priority equivalent to that of a maritime lien.

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[34] See, for example, *The Zoodotis* (No. T-186-99), *The Kimisis III* (No. T-38-99), *The Ypapadi* (No. T-119-99) and *The Golden Trinity* (No. T-32-99), four cases still before the Federal Court of Canada, and *The Nel* [2001] 1 F.C. 408 at paras. 61-63.

[35] *Montreal Dry Docks Co. v. Halifax Shipyards* (1920), 60 S.C.R. 359, where a ship repairer was, on the ground of unjust enrichment, granted an enhanced priority to the extent of the increase in the value of the vessel as a result of the repairs.

[36] It will be noted that the actual repair bill was significantly more than this amount, but as regards the remainder, the repairer had only an unsecured statutory right *in rem* which ranked behind the mortgage.

[37] *The Barkley Sound* (March 4, 1999) Vancouver Reg. No. A983054.

[38] *The Nel* [2001] 1 F.C. 408 at para. 63.

Prothonotary Hargrave distinguished suppliers of medical services from other suppliers, who had a choice whether or not to supply necessaries to a vessel on credit, on the basis that suppliers of medical services have no ethical choice but to supply such services and cannot choose to provide medical services only to those vessels which can pay cash. "In this instance", said the Prothonotary, "the circumstances are such that it is appropriate, proper and in keeping with the concept of justice, that the usual priorities be varied so as to place Mariners' Medical Clinic in a position analogous to that of the holder of a maritime lien".[39]

Conclusion

These three features of Canadian priorities law, that is, the recognition of foreign maritime liens, the primacy over a foreign bankruptcy court of a Canadian court exercising prior *in rem* jurisdiction and the relative willingness of the Federal Court to vary the usual order of priorities, show that the arrest and sale of a vessel in Canada may be advantageous to certain claimants not generally privileged under English law.

Usually the advantage to such a claimant is at the expense of the mortgagee since in most cases the proceeds of sale are insufficient to satisfy the mortgage itself, let alone all the secured *in rem* claimants. But even in cases where some part of the sale proceeds are available to unsecured *in rem* creditors, such creditors rank *pari passu*, and a supplier who can be elevated to the status of a lien holder will recover the whole of his claim at the expense of the unsecured creditors.

The conclusion is, then, relatively simple: mortgagees should for the most part avoid arresting a debt-laden vessel in Canada if arrest is possible in an alternative port where English rules apply; on the other hand, holders of a maritime lien of a class not recognised by English law should where possible arrest the vessel in Canada, and certainly should avoid arresting the vessel in a country where English priorities rules obtain.[40]

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[39] *The Nel* [2001] 1 F.C. 408 at para. 139.

[40] Of course, once the vessel is arrested by another claimant, the "foreign lien holder" will have no choice but to accept whatever priority he is accorded by the law of the place of arrest. For this reason a foreign lien holder, even if he has a relatively small claim, should at the earliest opportunity arrest the vessel in a place where his claim will be given priority.