

## Arrest of naval ships as security for foreign arbitral proceedings - An update

Now is an opportune time to review the efficacy of surrogate ship arrests. The Commonwealth has recently released its Defence White Paper, billed as the most comprehensive regeneration of the Australian naval forces since WWII. Australia proposes investing 25% of its Defence capital expenditure to 2025/26 in its maritime capabilities. The expanded capabilities include the commissioning a fleet of 12 new offshore patrol vessels to replace the existing 13 Armidale Class patrol boats. Will these new builds provide renewed scope for surrogate ship arrests under *the Admiralty Act 1988 (Cth) (AA)*?

Surrogate ship arrests was examined by the Federal Court of Australia in *Virtu Fast Ferries Ltd v The Ship "Cape Leveque"* [2015] FCA 324 and [2015] FCAFC 58. The case considered: (a) whether a partly constructed hull is a "ship" under AA, (b) who "owns" a partly constructed hull for purposes of surrogate ship arrests, and (c) the immunity of government ships from *in rem* proceedings under s 8(2) AA.

Austal Shipyards allegedly defectively designed and constructed a ferry for a disgruntled owner, who commenced arbitral proceedings in London against Austal (as the "Relevant Person" under AA) seeking damages under the shipbuilding contract. As security for the London arbitral proceedings, the ferry owner also issued *in rem* proceedings against a patrol vessel that was being constructed in WA by Austal for the Australian government. The patrol boat was arrested as a *surrogate* of the ferry under s19 AA. The only nexus between the ferry and the partially constructed patrol boat was the relevant person, Austal. Both at first instance and on appeal, the *in rem* proceedings were set aside, albeit for different reasons.

The Cape Leveque makes it more difficult for a dissatisfied ship-owner to secure its damages claim

for the defective construction of one ship by arresting another ship being constructed by the same

shipbuilder, under s19 AA. This decision has been well received by shipbuilders and is of renewed

interested particularly given the billions of dollars earmarked for expansion of Australia's maritime capacity in the next decade.

**Ship building contracts must be carefully drafted to ensure the purchaser is able to seek specific performance of the shipbuilder's obligations to complete construction of and to deliver the vessel. In such cases, the purchaser may be "own" the partly constructed hull, thereby possibly protecting it from falling prey to a surrogate ship arrest under s19 AA.**

#### Facts

Virtu Fast Ferries Ltd had commissioned Austal Ships Pty Ltd to build a ferry, the Jean de la Vallette, which was launched in April and delivered to Virtu in August 2010. In 2013, Virtu commenced arbitral proceedings in London against Austal alleging defective design and construction of the ferry.

On 18 February 2015, in order to obtain security for the arbitral proceedings, Virtu commenced in rem proceedings under s19 AA against the Cape Leveque, a patrol vessel being built by Austal for Australian Customs and Border Protection Service. Virtu's claim was a general maritime claim under section 4(3)(n) AA - a claim in respect of the construction of the ferry Jean de la Vallette. Virtu alleged that the ferry was not properly designed and constructed and, as a result, suffered cracking to the hull and superstructure. The patrol vessel was unconnected to Virtu's claim against Austal.

Under the terms of the contract for the construction of the patrol boats, Austal was obliged to design, manufacture, verify, validate and

[Click here to enter text.](#)

deliver eight patrol boats and all supplies necessary and incidental by specified milestones. Ownership of the patrol boats and related supplies, passed to the Commonwealth upon payment for completed milestones. Under the shipbuilding contract, Austal was unable to register any of the patrol boats in Austal's name at any time.

At the time the *in rem* proceedings were commenced, construction of the Cape Leveque was 96% complete, with delivery expected to occur on 1 May 2015. The Commonwealth had paid Austal \$199.8 million of the total contract price of \$296.7 million.

Austal filed an interlocutory application to set aside the writ in rem on the grounds that:

- under s19(a) AA, Austal was not the owner, charterer or in possession or control of Jean de la Vallette when the cause of action in respect of that ship arose;
- under s19(b) AA, Austal was not the owner of Cape Leveque when the writ was issued; and
- the Cape Leveque was a "government ship", as defined in s 8(4) AA, and hence was "immune" from in rem proceedings under s8(2) AA.

The Commonwealth intervened to support Austal's application.

#### Decision at first instance – Ownership of surrogate vessel Cape Leveque

Austal and the Commonwealth succeeded at first instance. The judge found that the jurisdictional requirements in s19(b) AA were not satisfied – ie when the proceedings were commenced, Austal was held not the "owner" of the Cape Leveque. The beneficial ownership had passed

### Key issues

- Under s19 AA, the test of ownership is "the true or real or beneficial owner of the ship", even if the entity is not the registered owner of the vessel.
- A ship under construction prior to launch is not a "ship" for purposes of s19(a) AA.
- The cause of action that grounds the in rem proceedings must be adequately particularised and supported by evidence, failing which the in rem action may be set aside.

to the Commonwealth, who had a "real interest" in the partly constructed hull, sufficient to support a claim against the shipbuilder for specific performance, so as to secure completion and delivery of the ship. Relevant factors in the court's determination included:

- when the *in rem* proceedings were commenced, the Cape Leveque was 96% complete and the Commonwealth had paid a substantial portion of the purchase price;
- damages for breach of contract would not have been an adequate remedy for the Commonwealth, whose purpose in purchasing the vessel was to discharge its responsibilities to protect the national interest;
- Austal was prohibited from registering the vessel in Austal's name, and
- the design of the vessel made it inherently unsuitable for use by any other owner.

Virtu failed to satisfy s19(b) AA. Accordingly, the court did not have jurisdiction to order the arrest of the surrogate vessel. The judge at first instance was not required to determine if s19(a) AA was satisfied.

This decision is consistent with earlier Australian authorities establishing that the test for "ownership" under s19 AA is "the true or real or beneficial owner" even if that entity is not the registered owner of the vessel: *Shagang Shipping Co Limited v The Ship "Bulk Peace" (as surrogate for the Ship "Dong-A Astrea")* [2014] FCAFC 48 and *Tisand Pty Ltd v Owners of the Ship MV "Cape Moreton" (ex Freya)* [2005] FCAFC 68.

#### **Patrol vessel Cape Leveque – a "government ship"**

It followed from the finding at first instance that the Commonwealth, and not Austal, was the "owner" of Cape Leveque when the writ was issued, that the vessel was a "government ship" as defined in s8(4) AA. As such, s8(2) AA protected the vessel from in rem proceedings.

Virtu sought to challenge this finding on appeal to the Full Court, however, as the Full Court did not rule on the question of ownership, the primary judge's finding on this issue was not expressly disturbed.

#### **Appellate decision – is the ferry Jean de la Valette a "ship" under s3 AA?**

On appeal, the Full Court also dismissed the writ in rem, albeit for reasons that differed from those adopted by the judge at first instance, focussing instead on the jurisdictional requirements in s19(a) AA. This required consideration of whether Austal (as the "Relevant Person")

owned the ferry at the time the cause of action in the London arbitral proceedings accrued.

Virtu submitted that s19(a) AA was available to support its arrest of the surrogate Cape Leveque for its general maritime claim in respect of the ferry under s4(3)(n) AA i.e. it was a claim "in respect of the construction of a ship [the ferry] (including such a claim relating to a vessel before it was launched)". The Full Court rejected that argument, finding that the ferry was not a "ship" under s3 AA when the cause of action accrued. Section 3 AA carves out "a vessel under construction that has not been launched" from the definition of "ship".

In the alternative, Virtu asserted that Austal breached an implied term not to tender the ferry for delivery knowing it had construction defects. Virtu argued that this cause of action arose post launch and pre-delivery of the ferry to Virtu. As such it was said to avoid the carve out in s3 AA, but at the same time, to be owned by Austal at the time the cause of action accrued for purposes of s19(a) AA.

The Full Court held that on the matters pleaded, the cause of action did not have reasonable prospects of success, and dismissed the writ under s31A of the *Federal Court of Australia Act 1976* (Cth).

The Full Court concluded that as the writ *in rem* was based upon mere assertions, supported by little or no evidence, it should be set aside. This decision highlights the need to ensure that adequate evidence can be adduced to support any pleaded cause of action.

The Full Court also noted that the asserted obligation to disclose the

possibility of a latent defect is not one which business efficacy would routinely require.

#### **Conclusion**

- a vessel under construction prior to launch is not a "ship" for purposes of s19(a) AA.
- how an arresting party frames its claim and which causes of action are raised will fix the particular point in time at which the jurisdictional facts must exist under s19(a) AA.
- for purposes of s19 AA, "ownership in equity" may suffice to ground a right to specific performance of a shipbuilding contract.
- it is not necessary for the Commonwealth to be in physical possession of a vessel under construction or to have paid the full purchase price in order for it to be the beneficial or true owner of that vessel for purposes of the AA. Whether this concept is equally applicable to non-government vessels under construction remains to be seen. Depending on the specific terms of the shipbuilding contract, an extension to non-government ships appears logical.
- all causes of action relied upon should be adequately particularised and supported by evidence. Failure to do so risks the in rem action being set aside, with potential cost ramifications.

**Food for thought** – a question for future determination in the further is whether a government vessel under construction (and therefore not a "ship" for the purposes of s19 AA) could be a "government ship" for purposes of section 8(2) AA?

## Contacts

### **Dr Pat Saraceni**

Director

T: +61 8 9262 5524

E: pat.saraceni@cliffordchance.com

### **Nicholas Summers**

Associate

T: +61 8 9262 5538

E: nicholas.summers@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

DOC ID#500986-4-8566

[www.cliffordchance.com](http://www.cliffordchance.com)

Clifford Chance, Level 7, 190 St Georges Terrace,  
Perth, WA 6000, Australia

© Clifford Chance 2016

Liability limited by a scheme approved under professional standards legislation

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta\* ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

\*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.

[Click here to enter text.](#)