20 ESSEX STREET

BULLETIN

IN DIRE STRAITS: THE TRUE NATURE OF BUNKER SUPPLY CONTRACTS, AND WHERE NOW FOR AFFECTED SHIPOWNERS AFTER OW BUNKER'S INSOLVENCY?

(1) PST Energy 7 Shipping LLC; (2) Product Shipping & Trading S.A. v. (1) O.W. Bunker Malta Ltd; (2) ING Bank N.V. [2015] EWCA Civ 1058 ('Res Cogitans')

Judgment of the Court of Appeal, 22 October 2015

Yesterday, the Court of Appeal handed down judgment in this case, which has been anxiously watched by those in the industry following the insolvency of OW Bunker in November 2014. The case centres on the question of whether the contract between a shipowner and the OW Bunker subsidiary company for the provision of bunkers is or is not a contract for the sale of goods.

A unanimous Court of Appeal, the lead judgment being given by Moore-Bick LJ with a brief postscript from Longmore LJ, upheld the previous decision of *Males J ([2015] EWHC 2022 (Comm))*. Males J had himself upheld the decision of the arbitral tribunal in the first instance. The decision's impact will be widely felt by the many parties who have been affected by the collapse of OW.

The decision of the Court of Appeal affirms the conclusion that the contract that the shipowner entered into with its counterparty, a subsidiary of the now-insolvent OW Bunker parent company, was not one to which the Sale of Goods Act 1979 applies. The practical effect of this is that OW Bunker subsidiaries are entitled to sue for the contract debt and shipowners may find themselves liable to pay the price twice for the bunkers that they procured.

Factual & contractual background

The Appellants in this case, together 'PST', contracted with the First Respondent, OWBM, for the provision of bunkers to the vessel *Res Cogitans*. The vessel was owned and managed by the 2 respective Appellants. OWBM was the local subsidiary of the ultimate parent company, OW Bunker & Trading A/S ('OWBAS').

The bunkers to be supplied to the vessel were procured under contract by OWBAS from a supplier, Rosneft (who in turn procured the bunkers from one of its subsidiaries). This contract was on Rosneft standard terms, which provided for retention of title by Rosneft until payment, which was to made 30 days following delivery.

OWBAS provided the bunkers to OWBM under contract, who then supplied them to the vessel. The contract that PST entered into

> THE DECISION'S IMPACT WILL BE WIDELY FELT BY THE MANY PARTIES WHO HAVE BEEN AFFECTED BY THE COLLAPSE OF OW

KEY TAKEAWAYS

The critical factor in whether or not a contract is or is not one for the sale of goods is whether the transfer of title to the subject goods is, on a proper construction, an essential or fundamental part of the contract.

In the bunker supply context, the OW subsidiary does not have to transfer title to establish its claim on the contract price where the OW terms apply. Shipowners may still find themselves liable to both ING / the OW subsidiary and the physical supplier.

The continued progress of the *Res Cogitans* dispute will be watched closely by the shipping and other industries, as it sets the template that the many other pending disputes will be based upon.

incorporated the OW standard terms. The OW terms provided that OWBM would retain title to the bunkers until payment, which was to made 60 days following delivery. The OW terms also provided that, until payment,

"the Buyer agreed (sic) that it is in possession of the Bunkers solely as Bailee for the Seller, and shall not be entitled to use the Bunkers other than for the propulsion of the Vessel, nor mix, blend, sell, encumber, pledge, alienate, or surrender the Bunkers to any third party or other Vessel".

The arbitration and appeal were conducted on the basis of a number of assumptions proposed by the parties, which in essence amounted to an assumption that this particular pattern of bunker supply contracts was well known in the industry. Specifically, it was well known that there would commonly be a chain of supply contracts in place and that such contracts contained retention of title and credit clauses.

A hole in the middle

PST were supplied with bunkers under the contractual scheme described above on 4 November 2014. Following supply, but before payment had been made, OWBAS applied to court for restructuring on 6 November 2014. This had 2 consequences:-

First, this triggered default provisions under OWBAS' financing agreement with the second Respondent, ING, who took the benefit as assignee of any debts owed to OWBM. ING thereby asserted a right to the debt that PST owed to OWBM.

Second, Rosneft asserted that it remained the owner of the bunkers and that it was entitled to payment from PST.

Accordingly, following the link in the middle of the chain falling away, the party at the bottom of the supply chain – PST – was faced with 2 claims in respect of the value of the bunkers that it held.

The claim to date

The parties in this case commenced arbitration. OWBM & ING contended that a debt was due and owing under the PST-OWBM contract, the 60 credit period having expired, and that PST were therefore liable for this sum.

In defence, PST argued that the supply contract was a contract for the sale of goods and that the claim was an action for the contract price under s.49 Sale of Goods Act 1979 ('SGA'). If PST were correct, payment was only due following the transfer of title to the bunkers. Since title was being asserted by Rosneft, who would not transfer it to OWBM, if PST were correct then they would not be liable to OWBM.

The arbitrators heard a number of preliminary issues. By an interim award, the tribunal held *inter alia* that the OWBM-PST contract was not one to which the SGA applied and that the s.49 SGA remedy was not available to OWBM & ING. The contract price therefore fell due on expiry of the 60 day credit period and could be recovered as a debt claim against PST irrespective of the question of title to the bunkers.

> "The question for the Court of Appeal was whether the OWBM-PST contract was a contract for the sale of goods within the meaning of s.2 SGA, and whether OWBM (& ING) could therefore sue for the price under s.49 SGA.

On appeal to the High Court, Males J upheld the arbitrators' decision. Males J expressly approved paragraph 51 of the interim award, which read as follows:

"Stripped of all unnecessary detail, the deal between the parties was that OWBM would ensure delivery of the bunkers, the use of which would be immediately available to the Owners, who would pay for them according to OWBM's invoice. Such an agreement does quite obviously resemble in some respects a contract of sale, but its terms and their performance do not to any extent rely on property or title or their transfer."

PST appealed to the Court of Appeal.

The issue on (further) appeal

The question for the Court of Appeal was whether the OWBM-PST contract was a contract for the sale of goods within the meaning of s.2 SGA, and whether OWBM (& ING) could therefore sue for the price under s.49 SGA.

Advocating the road less travelled: PST's argument on appeal

PST, who were supported on appeal by written submissions from Rosneft, sought to persuade the Court of Appeal to decide this issue differently to both the arbitral tribunal and

Males J, who had each found in favour of OWBM and ING.

PST argued that OWBM and PST intended to enter into a relationship of buyer and seller and to therefore create a contract for the sale of goods governed by the SGA. s.2 SGA provides that "*A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration called the price.*" PST argued that this contract was one where OWBM had agreed to transfer the property in the goods on a future date, specifically on payment, and that PST was therefore liable to pay the contract price only in exchange for that property.

The difficulty with PST's argument was that property cannot be passed in a non-existent thing. As the bunkers were consumed, they were destroyed and title to the now non-existent bunkers could therefore not be passed. Given the 60 day period of credit, it was probable that the bunkers would have been consumed before the price fell due and title to the bunkers purportedly transferred to PST.

PST's answer to this difficulty was to contend that the transfer of title on payment would be deemed to have retrospective effect, with title then deemed to have passed on delivery. Support for this was sought from cases concerned with retention of title in manufacturing cases, where the parties included a retention of title clause in their contract but anticipated that the goods would be destroyed in the manufacturing process before payment was made. Nonetheless, PST asserted, the parties in those cases had all treated the contract as though it was one for the sale of goods.

Following the well-trodden path: the approach of the Court of Appeal

Longmore LJ disagreed with PST's analysis of the retention of title cases. Giving the lead judgment of the Court of Appeal, the Judge held that those cases were concerned only with the question of whether the 'seller' had title to the manufactured product that incorporated part of the goods that they had 'sold' to the 'buyer'. The cases did not, however, deal with the current issue of whether the contract provided for property to pass retrospectively at a time when the goods or part of them had ceased to exist.

Longmore LJ held that the starting point must be the terms of the contract and what the parties had thereby undertaken to do. The Judge held that the critical terms were (i) the term providing for 60 days' credit, (ii) the retention of title clause, and (iii) the clause giving permission for the limited use of the bunkers. In these circumstances, the "*essential nature*" of the contract was as described by the arbitrators and approved by Males J. Though capable of being labelled commercially as a contract for the sale of goods, the terms painted a different picture of the true nature of the bunker supply contract.

The Court of Appeal therefore concluded that the OWBM-PST contract was one where OWBM undertook to procure bunkers for PST's use and PST agreed to pay the price on a fixed future date. The contract therefore fell outside the s.2 SGA definition and was accordingly not one to which the Act applied. OWBM & ING's remedy was therefore not under s.49 SGA, but was rather a simple claim in debt under the contract. Given that the 60 day period of credit had expired, the contract debt was due and owing.

> "THIS NEW APPROACH TO THE EXISTENCE OF A SALE OF GOODS CONTRACT MIGHT ALSO INFLUENCE THE RIGHTS OF PARTIES IN OTHER CONTEXTS WHERE PREVIOUSLY IT MIGHT HAVE BEEN THOUGHT THAT ONE PARTY HAD THE PROTECTION OF THE SGA.

Conclusion

The critical factor in determining whether or not a contract, such as the instant bunker supply contract, is or is not a contract for the sale of goods is whether the transfer of title to the subject goods is on a proper construction an essential or fundamental part of the contract. This inevitably raises the spectre of a future debate as to what the precise threshold is – for example, what of the retention of title clause that provides that bunkers are to be paid for 60 days following delivery alternatively when half of the bunkers have been consumed, whichever is sooner? Although an artificial example, it is plain that there is scope for an argument as to when precisely the parties are taken to have considered the transfer of title to be fundamental to their contract. However, there are 3 more pressing issues arising out of this decision:-

First, how will the parties now move forwards with their dispute? It is not known whether PST intends to seek permission to appeal to the Supreme Court, but that avenue seems likely

given the extent to which the instant issue is both uncharted territory and of global public interest.

Second, considering that global impact, what will happen to the hundreds of other disputes – all on OW Bunker standard terms – where the same factual matrix as the instant case is the backdrop to other claims brought by ING and OW subsidiaries? Anecdotally, ING and the physical suppliers (such as Rosneft in the instant case) are still identifying potential claims and seeking to arrest vessels as security. PST's next steps will doubtless be followed closely by the many interested parties, who will otherwise now be on the hook to pay both ING and their physical supplier for the bunkers received.

Third, what effect will this decision have on sale of goods more broadly? It will certainly affect industries other than bunker supply, since other sectors (such as manufacturing) also use similar contractual structures for the supply of consumable goods. This new approach to the existence of a sale of goods contract might also influence the rights of parties in other contexts where previously it might have been thought that one party had the protection of the SGA. We will no doubt be considering the ramifications of this case for some time.

About the author

Matthew became a tenant at 20 Essex Street in 2014 upon completion of pupillage and has a broad commercial practice. He is regularly instructed to advise or act in national & international litigation & arbitrations across chambers' practice areas. He is familiar with using interim relief to protect his clients' positions, having recently obtained an emergency injunction in the High Court in relation to a company of doubtful insolvency.

Matthew's recent instructions have concerned issues arising in the context of shipping & commodities, energy, and company & insolvency law. These have included matters such as a claim to recover a range of debts and losses arising from the sale and shipment of various grains, the construction of a termination clause in an oil well services agreement, and a dispute between the parties to a number of shareholders' and investment agreements.

Matthew regularly speaks at conferences and seminars on a variety of subjects across his practice. If you are interested in hearing more about this or any other topic, please contact SnrClerks@20essexst.com

To view full website profile, please click here.

Matthew McGhee
20 Essex Street, London

London
20 Essex Street London WC2R 3AL
Tel: +44 (0)20 7842 1200
Fax: +44 (0)20 7842 1270
Email: clerks@20essexst.com

Singapore
Maxwell Chambers #02-09
32 Maxwell Road
Singapore 069115
Tel: +65 62257230
Fax: +65 62249462
Email: clerks@20essexst.com