

Interlocutory Matters: From Arrest to Sale

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Part I: Arrest of Property

– Interlocutory Emergencies

- *An arrest of maritime property, such as a ship or cargo, interrupts commerce. The modalities thereof should be dealt with on an urgent basis.*
 - *FC Yachts Ltd. v. Vessel bearing Hull No. QFY10703E709 , [2007] F.C. 1257, per Harrington J at para 9.*

Motions to set aside arrest/strike out *in rem* action

- Before or after bail and release
- Rule 488:
 - On motion, the Court may, at any time, order the release of arrested property
- Rule 221(2):
 - No evidence shall be heard on a motion for an order under paragraph (1)(a)
- Typically, evidence admitted even where remedy sought and granted may include striking out of *in rem* action
- “Plain and obvious” test must be applied

Arrested property must be “the subject of the action”

- *Kremikovtzi Trade v. Cargo ex SWIFT FORTUNE* (FCA 2006; SCC 2007)
 - Rather, subsection 43(2) proposes identifiability of the property as the controlling factor so as to ensure that the scope of *in rem* proceedings is not unduly enlarged. In other words, the action *in rem* must relate to the specific property contemplated in the contract at issue.

Property owner must be liable *in personam*

- *MAERSK DEFENDER* (FCA 2007) – Action struck where respondent in arbitration never had been owner of arrested ship
- *ATCHAFALAYA* (FC 2009) – Must be “plain and obvious” property owner did not participate in or authorize the incurring of the debt by another

Intervening transfer of title defeats right to sue *in rem*

- *Federal Courts Act* s. 42(3)
- Applies to some but not all kinds of maritime claims
- Appears not to apply to *Marine Liability Act* s. 139(1) maritime lien

Other grounds for striking an *in rem* Action

- Not within Court's subject-matter jurisdiction
- Arrested property is not a "sister-ship" for purposes of s. 43(8)

Release of arrested property – Form of bail

- May be a private arrangement
- Generally only a consent to release will be filed (Rule 487(1)(c))
- Sometimes Court will review amount of private security (Rule 485)

Release of arrested property – Form of bail (Continued)

- Prescribed forms of bail
 - Guaranty of a bank
 - Rule 486(1)(a)
 - Bond of a surety company
 - Rule 486(1)(b)
 - Bail bond in Form 486A - *i.e.*, given by a person other than a surety company
 - Rule 486(1)(c)
 - Payment into Court
 - Rule 487(1)(a)

Objections to form of bail

- 24 hours to object
 - Rule 486(2)
- Questions as to form of bail or sufficiency of a surety “may be” determined by a designated officer or referred by that officer to the Court
 - Rule 486(4)
- Relatively uncommon in practice

Objections to amount of bail

- Somewhat common in practice
- Must be resolved by the Court on motion
 - Rule 485
- Test:
 - Plaintiff’s “reasonably arguable best case”, plus allowance for prejudgment interest and costs, limited to the value of the wrongdoing ship
- Amount may be reduced if there are “special circumstances” present

Movement of property under arrest

- Rule 484 – requires Court order or consent of all parties
- Often for practical/operational needs
- Must maintain physical safety/security and reasonable assurance against flight
- Movement otherwise than in accordance with Rule 484 is believed to be contempt of Court

Possession of property under arrest

- Rule 483(1) – Arrest *per se* does not change person in possession
 - *Query* – What if there is no-one in fact in possession?
- Rule 483(2) – Appears to permit an Order only to put a sheriff in possession
- Orders for possession are unusual in practice

Expenses to preserve/maintain arrested property

- It is not necessary to have the sheriff in possession in order to incur *custodia legis* expenses
- Reimbursed with priority as marshal's expenses only if authorized by prior Order
- Arrangements typically negotiated among plaintiff and other creditors
- Occasional need for judicial resolution of disagreements
- Typically limited as to both amount and time

Discharge of cargo from an arrested ship

- *KIMISIS III* (FC 1999) – Unsettled in Canada whether cargo discharge is a marshal's expense
- Ensure discharge logistics are available economically, and at all
- Ensure all parties' interests protected during and following discharge

Part II: Sale of Arrested Property

I. *Sale Pendente Lite*

II. The mechanics of an Admiralty Sale

III. Distribution of Sale Proceeds

IV. Wrongful Arrest

Sale *Pendente Lite*

- Security / Bail normally route to permit release of property under arrest
- Arrested property remains under jurisdiction of the Court until released or sold
- There may be rare cases where the owners do not respond to the *in rem* action and have the property released

Pendente Lite

- “Pending the lawsuit”
- If bail is not arranged, then following adjudication, the property can be ordered sold to meet the claims leading up to the arrest.
- In rare cases, the arresting party (or others) may seek to have the maritime property sold before the final determination of the case on its merits.
- Rule 490(1) of the *Federal Courts Rules*

Rule 490

Sale of Arrested Property

Disposition of arrested property

490. (1) **On motion, the Court may order, in respect of property under arrest, that**

- (a) **the property** be appraised and **sold**, or sold without appraisal, by public auction or private contract;
- (b) the property be advertised for sale in accordance with such directions as may be set out in the order, which may include a direction that ...
- (c) the property be sold without advertisement; ...
- (e) any steps be taken for the safety and preservation of the property;
- (f) **where the property is deteriorating in value, it be sold forthwith**; ...
- (h) where the property is perishable, it be disposed of on such terms as the Court may order; or ...

The Myrto

- 1977 English Case
- Honourable Justice Collier in *The “Alexandros G. Tsavliras”* (1987) adopted much of the reasoning
- Application by a bank enforcing on a mortgage for sale before judgment and by charterers for release of the vessel

Defence Required?

- The question of whether a ship under arrest should be sold *pendente lite* normally only arises where there is a default of appearance or defence.
- It is suggest that this is the starting point for the issue.
- If a defendant fails or refuses to provide security for the vessel then the plaintiff can move for an order for sale before the litigation is concluded.

“Good reason” to do so

Justice Brandon, in *The Myrto*, wrote:

I accept that the Court **should not make an order for the appraisalment and sale of a ship *pendente lite* except for good reason**, and this whether the action is defended or not, I accept further that, where the action is defended and the defendants oppose the making of such an order, the Court should examine more critically than it would normally do in a default action the question whether good reason exists or not. I do not accept, however, the contention put forward for the owners, that the circumstance that, unless a sale is ordered and continuing **costs of maintaining the arrest will be incurred over a long period, with consequent substantial diminution in the value of the plaintiffs’ security for their claim**, cannot, as a matter of law, constitute a good reason for ordering a sale. On the contrary, **I am of the opinion that it can and often will do so.**

...

It would, in my view, be **unreasonable to keep the ship under arrest at great expense** for seven months or more, with the result that, if the bank succeeded in their claim, **the amount of their recovery would be reduced by the costs incurred.**

Good reasons

1. That it would be at least 7 months until a final determination was made, and meanwhile, the bank was incurring the charges for maintaining the arrest, i.e. supply of necessaries and insurance, etc.;
2. Ongoing maintenance costs would have to be incurred to avoid physical deterioration of the ship; and
3. As a result, the plaintiff's security for its claim would be diminished.

“Karey T”

- Prothonotary Hargrave decision of 1994
- 38 foot wooden fishing vessel which had collided with another fishing boat.
- Review of elements considered by the Courts in *The “Myrto”* and *The “Alexandros G. Tsavliris”*, and conveniently enumerated them as follows:

“Karey T” factors

1. The value of the vessel compared with the amount of the claim;
2. Whether there is an arguable defence;
3. Can the owner carry on? Is it reasonable to assume that there must be a sale of the vessel at some point;
4. Whether there will be any diminution in the value of the vessel or of the sale price by the delay, including the cost of keeping crew aboard the vessel, the cost of maintaining the vessel and the cost of insuring the vessel;
5. Whether the vessel will depreciate by further delay;
6. Whether there is any good reason for a sale before trial.

“Karey T” factors

1. The affidavit evidence suggested that the value of the “Karey T” was about \$60,000.00. The amount of bail was set at \$42,000.00;
2. The defendant had admitted liability so whether there was an arguable defence was not a factor (the “Karey T” struck an anchored vessel);
3. The defendant was unable to raise satisfactory bail despite having use of the “Karey T” for the 1993 and (a substantial part of) the 1994 salmon fishing season, or through the vessel’s insurers. Notably, Prothonotary Hargrave stated that “the inability to post security is an indication that when the amount of damages is determined, the vessel will probably have to be sold in order to pay those damages”;
4. There would be a diminution in value of the vessel during the time it took to solve the damages issue;
5. The “Karey T” was an older vessel, and if uncared for, would tend to depreciate rapidly;

“Karey T” factors

6. Other reasons for sale before trial:

- The “Karey T” had a fishing license and there nothing to prevent the defendant from selling and transferring the licence to another vessel;
- The defendant moved the vessel despite a court order not to do so;
- The plaintiff only required a determination of damages, and the sale of the vessel would secure a fund against which to satisfy damages

Western Horizon

- Prothonotary Hargrave, 1996
- Enforcement of a mortgage on a vessel
- The “final and deciding issue” was whether there is any good reason for sale before trial. He concluded that there were four main reasons:
 1. Ongoing cost of moorage, which could result in a moorage bill in excess of the value of the vessel by the time trial is completed
 2. Ongoing depreciation
 3. Owner had no equity in the vessel
 4. Owner had not offered to share moorage, or to maintain the vessel, or put up value of vessel as security

Continuing costs

As we can see, the Court considered the crucial factor as noted in The “*Myrto*” that continuing costs of maintenance (in this case, moorage alone) would result in the consequent diminution in value of the vessel as a good reason for ordering the sale.

Essington II

- Prothonotary Hargrave, 2005
- \$380,000 was a reasonable market value for the vessel. The claims against the *Essington II* exceeded “even the most optimistic valuation of the vessel”;
- The pleadings did not disclose an arguable defence;
- In face of the balance of the claims, it was doubtful that the owner could carry on and avoid a sale;
- The value of the vessel continued to diminish, both in real terms by reason of deterioration and on paper, by reason of moorage and the cost of keeping an eye on the vessel, together with ongoing interest expenses;
- Other reasons:
- After seven or eight years of advertising there is a ready, able and willing buyer, prepared to pay a reasonable price.
- The *Essington II* was uninsured (no hull and machinery insurance)

Good reason and fairness

1. Continuing expenses associated with an idle vessel is a form of diminution of the value of the security;
2. Inability to post bail or security suggests that a sale is inevitable;
 - Claims subject to insurance (i.e. cargo damage) would normally result in security. Other claims (i.e. mortgage default) suggest a sale is inevitable.
3. Prevent the vessel from being at risk (lack of insurance);

Good reason and fairness

4. A plaintiff seeking security should not be frustrated by delays in adjudication;
5. Other concerns:
 - a) Protection of other potential creditors
 - b) Protection of environment or others
6. Promotion of maritime commerce
 - The historic goal of maritime law
 - Economic efficiency and use of resources

The principles and issues

1. Why has the defendant failed or refused to provide bail or security for the vessel?
 - a) Is it because the owners have failed to insure the vessel for potential liabilities in keeping with customary maritime practice or violated its insurance cover?
 - b) Is it because the defendant is in a difficult financial situation where it is no longer able to meet its obligations as they come due?

2. What is the cost of maintaining the vessel while under arrest?
 - a) The costs of keeping the vessel at her present location (berthage, ship-keeper etc.)
 - b) The costs of on-going maintenance to prevent deterioration of the vessel's value
 - c) Can the owner maintain these costs?

3. Who is paying for the expenses while the vessel is under arrest, the owner or another party?

The principles

4. Is the value of the vessel deteriorating?
 - a) Is there an offer to buy the vessel?
 - b) Is there a market for the vessel?
 - c) Where is the market for the vessel headed?
5. How long will it take until determination of the claim?
6. Will the plaintiff's overall security be diminished or frustrated by ongoing expenses?
7. Is the sale of the vessel inevitable?
8. Is the vessel adequately insured and will it remain so during the course of the arrest?

The principles

9. The value of the vessel compared with the amount of the claim;
10. Is there an arguable defence to the claim;
11. Are there other good reasons or public policy reasons for the sale of the vessel?
 - a) Concern over environmental or wreck removal liabilities
 - b) Better economic use of the assets involved?
12. Will sale of the vessel facilitate maritime commerce?
13. Will any party's economic position worsen by not selling the vessel?

II. Mechanics of an Admiralty Sale

- Rule 490 provides the Court with broad discretion and powers in relation to sale of the arrested property.
 - The property may be appraised and sold or sold without appraisal.
 - It may be sold by public auction or by private contract.
 - It may be sold with or without advertisement.

Key factors:

1. Be sold for fair market value;
2. Have an opportunity to attract the best price; and
3. That the best price be obtained with the lowest transaction cost.

Fairness to all interested

- A court ordered sale has a view to the protection of the interests of all parties
 - Owner
 - Others not arresting, but may have an interest
- Not the interests of the plaintiff alone
- Not a sale by the plaintiff with “the endorsement of the Court”

Special circumstances

- Private, pre-arranged sales can be acceptable
- Issues of timing, fair value, deterioration etc.
- Time involved in arranging and conducting a sale vs. offer on the table
- Likelihood of attracting better offers vs. ongoing expenses and potential deterioration

Options for sale

- Rule 490 (in combination with rule 492) provides the Court with broad discretion and wide powers, including:
 - That the sale of the vessel be advertised in various trade or industry publications;
 - That the sale be directed by the sheriff;

Options for sale

- That the sale be directed by a ship broker or other agent;
- offers be under sealed and are opened at the same time;
- the sale not necessarily be to the highest bidder, or at all, if there are no satisfactory offers or if the Court believes that further and better offers could be obtained through another process; and
- the bidding continue if the offers presented are unsatisfactory.

Considerations:

1. Is the order for sale fair and does it give the appearance of fairness to all concerned?
 - Does it work to protect the interest of all parties, not just the arresting party or the owner?
2. Is it structured to attract a fair market value or has a fair market value already been established in the evidence before the court?

Considerations:

3. Does it provide an opportunity to attract bidders to offer the best price?
 - Has there been sufficient notice and advertising of the pending sale and opportunity to respond?
 - Are there other reasonable means in which the best price could be attracted?

Considerations

4. Are the anticipated transaction costs reasonable in the circumstances?
 - Will the expenditure of further costs (i.e. the use of a different ship brokerage, wider advertising etc.) increase the overall sale price and the net result?
5. Are there special circumstances that gravitate towards framing a sale order in a particular direction?

Framing of Sale Orders

1. The order should provide for independent appraisal of the property, unless there has already been satisfactory evidence presented as to the fair market value or sale price which has been approved by the court.
2. The order should provide the process for identifying the buyer and settling upon the price to be paid (e.g. auction or sealed tender).

Framing of Sale Orders

3. The order should provide that, on completion of the sale, the purchaser acquires title to the property “free and clear of all liens and encumbrances.”
 - While this stipulation is not required by the Rules, the effect of a judicial sale is that it rids the maritime property of all liens, and as such this language is typically employed in a sale order.

Framing of Sale Orders

4. The order should provide for payment of the sale proceeds and execution and delivery of a bill of sale by the sheriff.
5. The order should also provide for the opportunity for the declaration of other aspects necessary to give effect to the sale and commercial deployment of the vessel, such as registration of the vessel to the new owners.

III. Distribution of Sale Proceeds

- *Comeau's Seafoods Ltd. v. Frank & Troy (The)*
- 1971 decision of Justice Keirstead
- Dealt with competing claims of: mortgagee, collision damage (maritime lien); and equipment supplier (right *in rem*)

Priority to proceeds

1. Costs of the sale itself
2. Costs of maintaining the vessel from arrest to sale -- “*in custodia legis*”
3. Legal costs of the arresting party
4. Maritime Liens
5. Possessory liens at time of the arrest
6. Marine mortgages
7. Rights in rem

IV. Wrongful Arrest

- *Armada Lines Ltd. v. Chaleur Fertilizers*,
 - [1997] 2 S.C.R. 617
- The standard that is required for a damages award for “wrongful arrest” is that the arrest must amount to malice or gross negligence.
- This rule was laid down in *The “Evangelismos”*, an English case from 1858.

The “Evangelismos”,

- The real question in this case, following the principles laid down with regard to actions of this description, comes to this: is there or is there not, reason to say, that the action was so unwarrantably brought, or brought with so little colour, or so little foundation, that it rather implies malice on the part of the Plaintiff, or that gross negligence which is equivalent to it?