Korea Maritime Law Research Centre

Maritime Law News Update

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oKorea University Maritime Law Research Centre aims to provide information regarding domestic and foreign maritime law trends regularly to practitioners, for the future development in Korean Maritime Law. We kindly ask for your support and interest.

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I. Introduction of Court Decisions

1. Securities company's duty of explanation during the solicitation of purchasing ship investment company funds (Daegu District Court 2015.2.4. Docket No. 2014Na203202 decision)

(1) Facts

Individual investors purchased, through a securities company, funds issued by a ship investment company. Under this fund, a ship investment company and its overseas subsidiary are established with the capitals financed by the investors, and subsequently the subsidiary purchases a ship, using the ship investment company's fund (subordinated loan) and loans from a creditor (senior loan). The purchased ship is chartered to a charterer and the charterage is used for repayment of the principal and interest of the loan. When the charter is terminated, the ship is sold to the charterer and the sales payment is used to repay the investor's principal.

However, in order to guarantee the payment of the ship's sales price for the repayment of investor's principals, a RVG (Residual Value Guarantee) agreement was concluded with an overseas bank. According to this agreement when certain terms are met by the charter agreement, the overseas bank bears a duty to purchase the ship at a certain price. On the other hand, the agreement loses its effect when the charterage is unpaid, since the conditions are not met.

When the payment of the charterage was delayed by the charterer, the overseas bank terminated the RVG agreement and the ship was sold to another third party. Its sales payment was appropriated for performance to the principal and interest of the senior loan. The investors ended up not being able to retrieve the investment cost. The individual investors filed a lawsuit against the securities company whichsolicited the fund purchase, claiming the existence of tort

since its employee breached his duty of explaining the risks of the RVG agreement upon solicitation.

(2) Court's Decision

The following contents were included in the investment prospectus: "the investment is made in a single dry cargo carrier(149,477 DWT), break up will be promoted through the sales of the ship, under the circumstances of which the charterer becomes insolvent or fails to perform its obligations within 5 years from when the ship was delivered", "the investment in your stock shall not be subject to protection under the relevant laws, and therefore the investors hold risk of suffering loss in relation to the investment principals". It was also written in the RVG agreement that "upon the charterer's failure to meet the terms of this agreement, the agreement shall lose effect. There is a risk of losing the investment principal in the case where full repayment is impossible due to the difficult situation of the charterer's company and the secondhand ship market".

The typical investment risk in relation to the business structure of the ship investment company is the risk of the charterer or its holding company (payment guarantor) not being able to pay the charterage, and the decrease in residual value of the ship when selling it due to the termination of charter. As long as the charterer and its financial information was stated in the investment prospectus or pamphlets, plaintiff may investigate the financial structure and assets of the charterer and make a decision on the investment. Since the fund was a subordinate loan and it was specified that the amount of the senior loan was up to 60 – 70% of the ship's purchase price, it appears the plaintiff could easily foresee the fact that the profit of this ship's fund would be effected by the senior loan or the ship's residual value. There is no unlawful act by the securities company employee.

(3) Comments

Ship investment companies are designed to raise funds from individual investors in order to invest in and supply ships to maritime corporates, while returning high profits to the investors. There are varies systems in the Ships investment company act which protects investors for the purpose of achieving this goal. A ship investment company may only establish 1 subsidiary for each ship, and the creditors of other subsidiaries may not carry out theirs bonds on that ship (Paragraph 3, Article 3 of the Act). The provision stating that the ship cannot be sailed directly by the ship investment company (Article 26 of the Act) serves the same purpose.

During the charter period, the charterage of the purchased ship guarantees a certain amount of the investment principals. The investment principal may be retrieved by the sales payment of the ship after the charter period is over. Therefore, stability in the payment of charterage and propriety in the sales price of the ship is essential to the ship investment structure. Under reserved ownership or charter (BBC/HP: bare boat charter hire purchase) agreements, the parties agree that the charterer acquires the ownership of the ship through purchase, upon the termination of the charter period. In other cases, the parties agree that an overseas bank will purchase the ship. The agreement between the ship owner and bank, containing such contents

is called an RVG agreement. However, this agreement automatically terminates when the payment of the charterage is delayed several times.

In this case the charterer delayed the payment of charterage for several months, and the overseas bank terminated the RVG agreement accordingly. The charter agreement was also terminated and the ship was sold to another third party. Most of the sales payment were retrieved by the senior loaner and thus the subordinate creditors (ship investment company and the investors) could not retrieve their investment principal. As a result, the investors sought compensation by claiming for loss of damages to the securities company which solicited the fund purchase, based on the ground that it had neglected to explain the risks of the investment.

The court found that such risks were described in the investment prospectus, and since the fund was subordinate, the investors could have understood of the uncertainties of retrieval. Furthermore, the court took into account the fact that the investors had experience in investing in a ship fund before, and therefore the securities company and its employee had no duty to explain, and no tort was constituted. (similar case where the securities company's liability was 20% recognized, Seoul High Court 2016. 1. 29 Docket No. 2015Na2031665 Decision) (written by In-Hyeon Kim)

2. Tugboat Company's duty to investigate under Liens on Ships (Supreme Court 2016.5.12. Docket no. 2015Da49811 Decision)

(1) Facts

A tugboat company provided tow service to a Liberian ship. The ship was time chartered and under the agreement there was a clause stating that the timer charterer could not have lien on "necessities". When the towage was not paid, the tugboat company applied for voluntary auction on the ship, after the ship entered a port in Korea.

Korean International Private Law (KIPL) applies to cases with foreign factors, and the governing law is determined by the law of the flag of the ship. The ship in this case was registered in Liberia. Plaintiff (ship owner) objected to the voluntary auction and filed a lawsuit for confirmation of the nonexistence of liabilities.

During the lawsuit, the plaintiff argued that under the Liberian law paragraph 3, article 114, the supplier of necessities has a 'duty to investigate whether or not the supply of necessities is permitted under the charter agreement'. However, the supplier neglected this duty and therefore could not exercise the lien under the Liberian law. The defendant rebutted that the Liberian law required for the General Maritime Law of the United States of America to be applied and since the article in the US law was deleted, the supplier had no such obligation.

(2) Courts Decision

Article 114 of the Maritime law of Liberia regulates liens on ships. Paragraph 3 especially regulates the investigation duty of the supplier of goods, by stating that "the lien under this article does not come into effect if the supplier of goods knew or could have reasonably known through provisions of the charter contractor the ship's sales contract that the orderer did not

have any right to restrain the ship". Article 30 of the Maritime law of Liberia also states that given that it does not conflict with this law, the non-statutory General Maritime Law of the United States of America may apply *mutatis mutandis*. In relation to the 'performance of reasonable investigation' under article 973 of the United States Federal Maritime Law, the Federal Supreme Court decided that the supplier had an obligation to investigate whether or not the orderer had a right to grant liens on the ship. Therefore, when the charterer agrees to waive its security rights through the charter agreement, even if the supplier did not know of this he could not exercise lien on the ship, had he not done an investigation. The Court maintained this position thereafter. However, in 1971, the court changed its position on the suppliers' investigation duty after the Federal Maritime Law was revised.

The case laws of the United States Maritime law become an essential ground in interpreting Paragraph 3, Article 114 of the Liberian Maritime Law. If the cases after 1971 (when Article 973 was deleted from the United States Federal Maritime Law) are to apply, they cause a conflict between the current Paragraph 3, Article 114 of the Liberian Maritime law. Therefore, it is a more reasonable approach to interpret such article according to the Federal Court cases that were left when Article 973 was still existing. In conclusion, pursuant to Paragraph 3, Article 114 of the Liberian Maritime Law, the supplier of goods of services has a duty to investigate whether or not the boat was chartered and whether or not the charterer had right to restrain the ship. If the supplier did not perform this duty, he could not exercise lien on the ship.

(3) Comments

According to the Korean International Private Law (KIPL), which applies to cases with foreign factors, the governing law is determined by the law of the flag of the ship. Since many of the ships that depart from Korea sail under a flag-of-convenience, the creditors of these ships bear the burden of having to know all the laws of Panama, Liberia, Marshall Islands etc.

In this case, under the Liberian Maritime Law, the supplier could not exercise lien on ships if the charter contract stated that no liens could occur through the supply of necessities. Therefore, the supplier had a duty to investigate such circumstances. Such obligations are not required under the Maritime Law of Korea. In the United States the equivalent provision had been deleted due to its unfairness. However, since it remained in the Liberian Law, it had become an issue.

The Seoul High Court and Supreme Court decided that, since the provision still remained in the Liberian Law, the supplier had an investigation duty. The General Maritime Law of the United States is a non-statutory case law. Statutory Law prevails case law. Therefore, the court's point is valid to have seen that the currently existing statutory Liberian Law prevails.

However, such conclusion may be unexpected in practice, especially to creditors who have no such obligation under the Korean Law. This gap occurs due to the fact that the Law of the flag applies to lien on ships in Korea. This differs from China, which applies the *lexfori*. The law of flag can widely protect the ship owner. However, it is hard for the creditors to locate the applicable law (Panama, Liberia etc.) when the ship under voluntary auction is sailing under a flag of convenience. Extending the scope of application of the lien on ships will protect the creditors, but may harm the interest of the bank (mortgagee) and ship owner, and *Vice versa*. The Liberian Law protects the ship owner. When applying *lexfori*, there is a burden of having to

know all the laws of the counties the ship enters port. Since many persons are related in the lien on ships (including the ship owner and creditors from each port), revising the KIPL to apply lexfori is necessary in order to give stability to the person related to the operation of the ship.

Until the revision is made, relevant personnel should familiarize themselves with the lien of ships under the law of flag. In the academic field, there is a need to conduct research on liens on ships and provide studies to practitioners. Meanwhile, the application of Article 7 (Mandatory Application of Acts of Republic of Korea), Paragraph 1 of Article 8 (Exception to Designation of Applicable Law) and Article 10 (Provisions of Foreign Law Contrary to Social Order) of KIPL must be reviewed, when applying the law of flag brings a completely different conclusion to actual practice.

II. On Private (Ad Hoc) Arbitration

When parties to a maritime business agreement agree to arbitration in Seoul as the dispute resolution method, without mention of the Korean Commercial Arbitration Board (KCAB), the arbitration proceeds according to the Arbitration Act. Under the Arbitration Act, each party appoints an arbitrator, and the appointed arbitrators also appoint a third arbitrator as the chairman of the tribunal (Articles 11, 12 of the Arbitration Act).Arbitration where the three (3) arbitrators arbitrarily decide the fee and procedure of the arbitration is called *Ad Hoc* arbitration, which differs from institutional arbitration. It has recently been noticed that the annual number of maritime arbitration cases though the KCAB has been between 20 to 30, whereas the number of ad hoc arbitration cases has been about 5.

Since arbitration through KCAB is institutional arbitration, the proceedings follow the arbitration rules of KCAB (Articles 40, 41 of the Arbitration Act). The appointment of arbitrators is generally done by selecting arbitrators out of the candidate list provided by the institution. A significant amount of the arbitration fee is used for administration expenses, instead of fees given to the arbitrators. On the contrary, in ad hoc arbitration there is no institution, and therefore the claimant, respondent and tribunal lead the arbitration. Thus, the parties have a merit in appointing the best expert of their choice as an arbitrator, and determining his fees. The arbitral award has the same effect and enforcement as a judgment made by the court. Therefore, the parties may receive an execution clause by presenting the arbitral award. This is the same for ad hoc arbitration (Articles 35, 37 of the Arbitration Act).

Unlike arbitration done through KCAB, ad hoc arbitration may take more time for the parties to reach an agreement and it may be less stable, since no uniform standard is provided for the procedures, fee etc. Also in KCAB arbitration, the institution stores the arbitral awards and sends them to the parties, while organizing statistical data from the arbitration. However, in ad hoc arbitrations the tribunal only sends the awards to each party. Since there is no institution managing ad hoc arbitrations in Korea, the organizing and utilizing of data from arbitration is insufficient.

It is time for a more organized and systemized management regarding ad hoc arbitration (including the establishment of its relationship with KCAB). LMAA (London) and SCMA (Singapore) have a minimum managing team of 1 general secretary and 1 assistant to assist with ad hoc arbitrations lead by the parties. (written by In-Hyeon Kim).

III. Newly-released Books

1. Treatises on Ship Building and Finance Law(I)

- "Treatises on Ship Building and Finance (I)" was released by combining 12 theses presented at the Ship Building and Finance Law Research Association from January 2013.
- Lawyer Chang-Jun Kim (Choi&Kim), professor In-Hyeon Kim(CKorea University), Young-Suk Hyun (KDB), lawyer Sung-Won Kwon (Yeosan), professor Sung-Hwa Hong (Korea Maritime University), Chang-Hee Lee (Korea Institute of Maritime and Fisheries Technology), lawyer Chul-Won Lee (Kim&Chang), Ji-Sun Kim (Samsung Fire& Marine Insurance), Chan-Young Kim (Korea Maritime Transport Co. Ltd) participated as authors.
- The book was released on September 5, 2016.

2. Textbook on Ship Collision Law(The 2nd Ed) (In-Hyeon Kim)

- It covers legal matters on ship collision which is a particular field of study in Maritime Law.
- It covers Marine collision avoidance rules, compensation for damages, limitation of liability proceeding for ship owners, execution of claims and insurance involved in collision etc.
- The second edition especially inserted a chapter on ship's allusion, apart from ship collision regulated by commercial law
- The book was released on September 5, 2016.

IV. Korea University Maritime Law Lectures (2nd semester of 2016)

1. Masters course

- Studies on maritime law court decisions, adjunct professor Byung-Suk Chung (Kim&Chang), 19:00 – 22:00 (Tuesdays)
- Charter Party law, adjunct professor Woo-Young Jung (Lee&Ko), 19:00 – 22:00 (Fridays)
- Ports and Logistics law, professor In-Hyeon Kim (Korea University) 10:00 – 13:00 (Saturdays)

2. Law School

- Carriage of goods by sea (English), professor In-Hyeon Kim (Korea University) 9:00 – 12:00 (Wednesdays)
- Ship Collision law, professor In-Hyeon Kim (Korea University) 17:00 – 19:45 (Tuesdays)

V. Events

1. Korea University – Southampton University Maritime Law Lectures

- September 19 (mon)– 24 (sat), 13:00 – 22:00

- Lectures on the comparison between Korea-UK maritime law. The best professors and maritime lawyers from Korea and UK are invited as lecturer.
- Registration is required (captainihkim@korea.ac.kr).

2. The 9th East Asian Maritime Law Forum

- November 11 – 12, 2016, Incheon Harbor park Hotel
- Hosted by Korea University (South Korea) and sponsored by Waseda University (Japan), Dalian Maritime University (China)
- Title: Focused on duty of care for seaworthiness and the carriage of dangerous goods
- Anyone is welcomed to attend(captainihkim@kore.ac.kr)

<Notice 1> Maritime Law Research Centre is open to anyone who wishes to learn more about Maritime Law at room 402 and 408, CJ Law Building, Korea University. Maritime law related professors on sabbatical, maritime lawyers, professionals in the maritime industry and doctoral students are welcome. Anyone who is interested may contact the Head of Centre In Hyeon Kim at captainihkim@korea.ac.kr.

<Notice2> The Korea University Maritime Law Research Centre homepage (www.kumaritimelaw.com) has opened.