Why Arbitrators don't Arrest Ships

& 7 Maritime Lessons From the Superyacht, Equanimity[1]

By : Sitpah Selvaratnam[2]

(Tommy Thomas, Malaysia)

1. Thank you for this opportunity to share a part of my multi-dimensional adventure of learning with you at this Congress. It also made crystal clear why Arbitrators would not want to grant interim relief in the form of an arrest of a ship !

2. The Equanimity was not just another ship to be arrested and sold. She represented the aspirations of the people of Malaysia, that culminated in the amazing toppling of a Government of 62 years. A Government that was severely discredited and disgraced by allegations of corruption at unprecedented and international levels. The Equanimity was enmeshed in the notorious 1MDB Scandal. She had been purchased with the People's money.

3. Never before in 28 years of my shipping practice was I so filled with happiness at pouring hundreds of hours of billable work, without raising a bill. Actually, it wasn't work. It was national service.

4. In the short burst of 8 months between the arrest of the Superyacht Equanimity in August 2018 to her sale in April 2019, there were numerous lessons learnt; ranging from maritime law and procedure, to human behavior and the enticement of money and fame. The greatest of all was a spiritual lesson, that must wait another day to be shared. For now, 7 Maritime Lessons come to mind.

Lesson 1 – Equity and Justice within an Ownership In Rem claim

5. The 1MDB Scandal, categorized by the Department of Justice (DOJ) of USA as the world's worst kleptocracy, involved money laundering of an unparalleled scale. The number of bank accounts through which billions of USD passed undeterred, is astounding. It is not immediately obvious that the admiralty jurisdiction wielded such power, to bring to heel the illusive fugitive Jho Low, and to realize for Malaysia her first biggest recovery of USD 126 million in this ignominious saga. It clearly does.

6. As a former British colony, Malaysia's admiralty jurisdiction is derived from the United Kingdom[3]. Section 20(2)(a) of the *Senior Courts Act* 1981 provides that the admiralty jurisdiction of the High Court of England and Wales includes

> *"any claim to the possession or ownership of a ship or to the ownership of any share therein."*

consistent with the *Arrest Convention* 1952[4]. This was the limb of the admiralty jurisdiction invoked for the arrest and sale of the Equanimity.

7. 1MDB was established as a sovereign wealth fund. It is wholly owned by the Ministry of Finance Incorporated, which in turn is wholly owned by the Government of Malaysia. 1MDB, through 2 subsidiaries, had raised USD 2.7 billion from the issuance of Bonds to the public for the declared purpose of funding its investments in a joint venture with an Abu Dhabi investment fund (***"the Bond Proceeds"***); and had borrowed a further USD 240 million under a bridging loan for the specific purpose of retiring certain options granted under previous arrangements (***"the Loan"***).

8. USD 1.59 billion of the Bond Proceeds, and USD 175 million of the Loan, were instead siphoned out of the 1MDB Group. Of this, USD 260 million was traced into the purchase of the Equanimity. This 91.5 meter Superyacht, built by Oceanco to comply with

Passenger Yacht Code, designed by Winch Design using a variety of exotic materials and housing lavish facilities including a beach club, gym, massage room, an all glass baby grand piano, helipad, plunge pool, hammam, beauty salon, a glass lift, was registered with the Cayman Island registry in the name of Equanimity Cayman Ltd, a company owned by the infamous Jho Low. This was most definitely, not a purpose for which the Bonds were issued, or the Loan granted.

9. We amalgamated the tools of tracing and following afforded under constructive trust principles of equity and common law, with the rights *in rem* offered by admiralty law. An ownership claim was thereby cast to overcome hurdles posed by national boundaries. The net then drew tightly over the Equanimity as she entered Malaysian waters.

10. Simply put, the claim was premised on a breach of trust and fiduciary duties, owed by the then directors and officers of 1MDB Group, in fraudulently and dishonestly misappropriating monies of the 1MDB Group. It was coupled with the knowing assistance of, and knowing receipt by, Jho Low and his nominees, who were not *bona fide* purchasers for value without notice.

11. Jho Low and friends derived interest and title in the Equanimity, subject to the constructive trust imposed in law on the monies traced from the 1MDB Group, through multiple layers of accounts in several countries into the Equanimity. The Government of Malaysia, through the two 1MDB subsidiaries, asserted ownership over the entire Equanimity in proportion to the share of monies of each 1MDB subsidiary used to purchase the Equanimity.

12. We found no reported cases anywhere close to these fact pattern, or on the application of constructive trust to frame an ownership claim *in rem* over a ship. But the capacity of the law to give redress is inspiring. With the House of Lords' decision in *Foskett v. McKeown*[5] as the foundation, and sign postings given by the Australian Supreme Court of

New South Wales in *Alesco Corporation Limited ACN 008 666 064 v Te Maari* [6], and the further authority of *The Venture*[7] and *Haji-Ioanou v Frangos*[8], the *in rem* ownership claim over the Equanimity was sustained. As simple as it may now seem, it is indeed a huge slice of justice delivered under an infrequently used limb of the admiralty jurisdiction.

Lesson 2 – Clean Title upon a Judicial Sale : The Devil is in the Doing

13. It is considered the 101 of arrest and judicial sale that clean title underpins the entire admiralty *in rem* recovery process, designed by the Arrest Convention and supported by domestic laws and rules. Upon a vessel's sale, claims pending or inchoate against the vessel are redirected to her proceeds of sale. The slate is wiped clean, and title to the vessel passes free and clear of pre-existing encumbrances and claims.

14. In reality, this principle was not obvious to the superyacht world. Superyachts, by definition, venture into waters that boast exciting exploration, and idyllic land and seascapes. Buyers and their agents deployed the proclaimed uncertainty in the recognition of title under judicial sales in some regions of the world, to depress the value offered for the purchase of the Equanimity. Despite multiple assurances of clean and unencumbered title in law, through opinions of internationally reputed law firms and confirmation from the Cayman Island Ship Registry on the recognition of the judicial sale by Malaysia, the paranoia displayed by the elite superyacht community plagued the exercise.

15. Much is therefore, to be said for the study now underway under auspices of UNCITRAL, on the draft prepared by Comite Maritime International (CMI) in respect of an international convention on the Judicial Sale of Ships, otherwise known as the Beijing Draft.

16. In its current framework[9], the Convention intends to provide fundamentals to facilitate the de-registration of a ship by way of a Certificate of Judicial Sale. Upon notice of sale, given 30 days prior to the sale, to an identified class of interests, including relevant ship registries, mortgagees, holders of maritime lien, and owners of the ship, by press announcement and pursuant to the central repository system, a judicial sale would convey clean title. The ship however, needed to be physically within the jurisdiction of the State at the time of the sale, and the sale must have been in accordance with the laws of that State. A Certificate of Judicial Sale would be issued, which would preclude any right to arrest that ship for pre-existing claims. Unless that judicial sale is avoided in the State which issued such Certificate, no remedy against that ship or a *bona fide* purchaser or subsequent purchaser, shall lie. The judicial sale however, has no effect if it is contrary to public policy or the sale is procured by fraud.

17. The value of this draft will obviously be determined on its take-up by countries. It has the potential of providing greater certainty and limiting spurious allegations.

Lesson 3 – It's all about Balance : Public tender; Private treaty; A Hybrid

18. Associated with the concerns surrounding clean title, is the process that enables this end. The objective of the judicial sale is two fold - first, to maximize recovery for creditors, with the hope of some residue returning to the owners; and second, to widely advertise the sale of the vessel to ensure that all potential claimants are aware of the imminent loss of a right *in rem* against the vessel.

19. Wide publicity and notice are essential, to invite potential claimants to compete against the proceeds of sale of the vessel, or to forever hold their peace. That publicity also serves as an advertisement of the invitation to bid high enough to win the vessel.

20. The fundamental process of a public auction or public tender by sealed bids, which invites offers from a wide cross section of the market, and publicly advertises the incident of sale, is critical to a judicial sale. This has recently been reaffirmed in several courts, in England[10], Hong Kong[11] and Singapore[12]. Only in special or exceptional circumstances are judicial sales by way of private treaty permitted[13]. Given the notoriety of the Equanimity, publicity of the sale was paramount, to allow all pre-sale claims to merge into her proceeds of sale.

21. The difficulty this vital process posed was in its incompatibility with the style of purchase the elite superyacht market was accustomed to. The average time a superyacht was on sale was 12 to 18 months, and that too upon brokers' very private and exclusive approach. Hence, the concept of a public tender, with sealed bids to be submitted by the super rich to the Sheriff of the Court within 30 days, was something of an anathema to potential buyers of the Equanimity. The high-society who had the interest and appetite to acquire a superyacht comprised no more than 100 individuals. Also, there had been only 20 sales, ever, in the secondhand superyacht market at over USD100 million. The unfamiliarity with the process, and the level of investment involved, rendered the public tender process ineffective.

22. At the close of tender on 29 November 2018, the bids received did not result in a successful sale of the Equanimity. The second phase of sale had to be entered into, with the Malaysian Admiralty Court granting an order permitting a private treaty sale. This engaged a pattern recognition within the minds of the rich and famous, and resulted in a sale of the Equanimity within 4 months, at USD126 million; just shy of the USD130 million appraised market value.

23. The take-away from this is that the first and second objectives of a judicial sale may be separated, where the market is super sensitive or highly exclusive. The sale can proceed

as a hybrid sale. The Court can allow for wide publicity and advertisement to ensure that adequate notice to potential claimants is given, towards conferring a clean and unencumbered title upon sale. This advertisement however, does not have to invite bids. It would be akin to steps mandatorily taken to notify of the concluded sale once proceeds are paid into Court, but wider in the scope of publication to be made.

24. Simultaneously, parties may engage in private treaty, non-exclusive negotiations towards a direct private treaty sale to secure the highest price. The concern that the best price may not be achieved or this process is abused, is tempered by the value fixed by the independently appointed appraisers of the vessel. The private treaty sale may not be approved at below the Appraised Value, without evidence of best efforts at due negotiations. The negotiations and parameters of the private treaty sale may also be set by the Court.

25. Just how a sale is managed, whether as an auction or tender of sealed bids or by private treaty, impacts upon the price secured. The degree of expectation by the market of a bargain is reflected by elements of distress in conditions surrounding the vessel. Firesale within a short time to save costs, and an inferior state of maintenance of the vessel, are indicative of desperation.

26. So, the manner in which the sale is ordered and managed really matter. This leads me to Lesson 4.

Lesson 4 – Does a Confidential Appraised Value Help or Hinder ?

27. This is linked to the objective of ensuring the best price is obtained. The ethos of judicial sale is to obtain market value for the vessel, to preserve the integrity of the judicial sale process, which in turn protects the security value and the returns in ship financing. If

judicial sales result in a bargain, financiers would work that consequences into their financing.

28. The belief is that maintaining the confidentiality of the Appraised Value of the vessel, allows the vessel to fetch the best price possible. The glitch in this rationale is the market suspicion, and an expectation of a firesale, surrounding a *"secret"* pricing. It has long been the admiralty practice to have the vessel appraised, and the value kept under seal, until all bids are received and opened. This is meant to encourage the market to respond. To offer the highest price in a genuine attempt to secure the vessel, knowing that the Court would not approve a bid below the Appraised Value.

29. Over time, mindsets have changed influenced by the wide availability of vessels, and the readiness to make opportunistic offers. It has come to a point that potential buyers view judicial sale as a forced sale. A desperate sale to cut losses. An opportunity to wrest a bargain. Hence, the market instead of responding with a realistic offer commensurate with the value of the *res*, suppress the price offered to well below the Appraised Value. This leads to the spiraling down of subsequent floor values allowed by Court in order to complete a sale, to manage the Sheriff's costs of maintaining the vessel. The original intent of confidentiality in the Appraised Value, is lost.

30. In the case of the Equanimity, the bids received under the public tender phase, were well below the Appraised Value. When we moved into the second phase of private treaty sale, we sought and obtained the approval of the Admiralty Court to disclose the Appraised Value, which set a clear benchmark for negotiations. It had the immediate effect of weeding out opportunistic offers.

Lesson 5 – Migration of evidence collated for criminal proceedings to civil proceedings – not so straight forward

31. Given the extensive cross-border wrongdoings, much of the evidence to sustain the *in rem* claim on ownership was derived from mutual legal assistance (***"MLA"***) between Sovereign States, pursuant to multilateral or bilateral treaties between Malaysia and other countries. These treaties, alongside domestic legislation, allow Malaysia to request for information and documentation from other Sovereign States[14]. They however, carry limitations on the usage of the information obtained. The Treaties contain a provisio that consent may be sought from the requested State for further usage, subject to such terms and conditions imposed by the requested country.

32. *Gohil v Gohil*[15] emphasized the basis of such assistance, and that information or documents so secured could not be utilised for any purpose, whether civil or criminal, other than for that specified in the request, to ensure conformity with international obligations.

33. The documents that were relevant to establish the constructive trust and tracing rights to the Equanimity involved numerous bank statements and correspondence, secured by Malaysia upon MLA requests for specific use in criminal investigations. Their deployment in a civil admiralty action *in rem* was therefore, curtailed. Specific consent from the requested country was necessary. This was obtained for use in the admiralty action against the Equanimity, but was subject to an express condition; the retention of their confidentiality. Another hurdle to overcome.

34. There was a problem with maintaining confidentiality, given the public e-filing system that the Courts in Malaysia have embraced. Sealing of the documents and *in camera* hearing had to be contemplated. Malaysia adopts an open judicial principle, save where there are exceptional circumstances[16]. The inherent power to grant a sealing or protective

order exists[17]. The Admiralty Court has the power to hear any cause or matter *in camera* if the Court is satisfied that it is *"expedient in the interest of justice, public safety, public security or propriety, or for other sufficient reason so to do"*[18]. Notwithstanding the electronic filing system, there is a further provision that allows any class of document to be filed other than by the e-filing service[19].

35. Certain admiralty matters against a vessel however, are required to be in open Court[20]. Ultimately the balance to be struck must ensure that admiralty intervenors, caveators and Defendants who enter appearance, have access to such documents but are required to sign and honour the confidentiality imposed by Court. General access is denied to this class of documents.

Lesson 6 – Avoiding a Broker's conflict of interest

36. Vessel sales are invariably conducted through brokers. The admiralty Court in the United Kingdom has a system of appointment of a permanent broker in the form of CW Kellock & Co, who the Admiralty Marshall has used for over 150 years, earning a fixed commission of 1% on any sale. Admiralty Courts around the world have different practices on the engagement of brokers. The recent decision of the English Court in *The Sertao*[21] explains the fundamental need for the broker to be independent of the parties, to afford confidence in the process of sale.

37. The broker is engaged by the Sheriff or Marshall of the Admiralty Court. Intrinsic in this appointment are the principles of agency, and the requirement that

> *"No man can, acting as an agent, be allowed to put himself in a position in which his interest and his duty will be conflict."*[22].

38. An agent cannot at the same time serve two masters or principals in actual or potential opposition to one another, unless he has the explicit informed consent of both

principals[23]. Undivided loyalty is demanded of the broker, that nurtures a relationship of trust and confidence. Consistent with this principle is the English Court practice with regard to the permanent appointment of CW Kellock & Co.

39. Where there is no practice similar to that in England, as is the case in many countries, the broker is appointed based on the type of vessel up for judicial sale. Such a broker is chosen based on its expertise and experience, that necessarily comes from many years of engagement in the purchase and sale of such vessels in the market. Closely connected with such expertise therefore, is the relationship established between the broker and potential buyers in that market. The broker's clients would be an obvious pool of potential purchasers. The unconscious, if not conscious, bias or indeed outright conflict of interest, is not easily managed.

40. Taking a page of *The Sertao*[24], and the learning from the Phase 2 sale in the Equanimity, a single broker to market and sell the vessel attracts this vulnerability. The engagement of a non-exclusive broker, with one or two other brokers, to either share in the commission or to earn commission dependent on who brings in the successful buyer, could minimize or even avert this potential dilema.

Lesson 7 – The Fund Provider's priority – Does it cover legal costs in monitoring maintenance ?

41. The fund provider's costs in an arrest and sale of a vessel can get tricky, especially when the proceeds of sale are insufficient to meet all claims. The common ranking of priority for payment out from the proceeds of sale provides first, for Sheriff's Commission on the sale; second, Sheriff's costs and expenses; and third, the arresting party's costs, followed by other varied classes of claims.

42. The Sheriff's costs ordinarily includes the ship chandlers' costs to supply victuals, such as food, water and bunker to the vessel. Brokers and Managers of the vessel appointed by the Sheriff also have their costs and fees ordered by Court to rank as Sheriff's costs.

43. The uncontroversial aspect of the arresting party's costs that takes priority is the legal costs to secure the arrest of the vessel, and move for the Order for the sale of the vessel. More unclear would be the term costs of *"the administration of the fund"*. In *The Leoborg (No. 2)*[25], the necessaries men arrested the vessel and were entitled to the costs of arrest and costs incurred up to the date of the order for appraisement and sale. They were also granted priority for *"the proper costs incurred by them in the administration of the fund by Court"* relating to their correspondence with the Admiralty Registry on the investment of that fund, and the movement of the vessel whilst under arrest. In *The Ocean Glory*[26] it was held that "*in exceptional circumstances"* the costs in the administration of the fund "*reasonably incurred"* and *"aimed at producing or preserving the fund for the general benefit of all creditors"*, where incurred because the "*party incurring them was uniquely able to do something that did or might be for the general benefit of all creditors"* was, at the discretion of the Judge, recoverable in priority. Similarly, the Australian Court in *The Turakina No. 3*[27] held that priority is not earned unless the arresting party has *"by its action created or preserved a fund for the general benefit of all claimants"* on the basis of equity as producer of the fund.

44. In *The "Falcon"*[28], Sheen J , expressed it in terms of the measure of security realized. The costs of the Plaintiff in whose action the ship was arrested up to the moment of arrest, and all subsequent expenses of "*maintaining the arrest up to and including the completion of sale of the ship",* was payable in priority. It includes costs in preserving the property by arresting the ship and maintaining that arrest, but does not include the legal cost of the substantive claim of the Plaintiff[29].

45. In relation to the Equanimity, Managers based in the United Kingdom were appointed to attend to the maintenance of the Superyacht. The Managers' fee and costs were payable as part of the Sheriff's costs and expenses. However, the Equanimity was in Malaysian waters and in a very different part of the world from the Managers. The management of vessel in the circumstances of the Equanimity was quite unprecedented in terms of her exclusivity and high specifications, combined with her notoriety and legal formalities. These factors do not often all merge into one vessel.

46. As a result, the legal team of solicitors for the Plaintiff spent very large amounts of time attending to maintenance and management, safety and security, aspects of the Equanimity. We were almost acting as Receivers and Managers over the vessel in the daily practical affairs that needed to be addressed, to preserve this 7-star luxury Superyacht in the condition she was accustomed to, in order to fetch her market value on sale. This included sourcing day workers to polish her timber floor, negotiating with suppliers who had black-listed the Equanimity on account of her previous notoriety, expediting urgent delivery of spare parts and vessel inspections, coordinating security arrangements with the Police and Navy, and much much more.

47. The legal team's time spent on these did not matter in this case as all proceeds were paid to one Plaintiff, with no other competing creditor. But would such time costs of lawyers be recoverable as fund producers' costs in priority to competing claimants? This was the monitoring of the sale of the ship, maintaining her in the administration of the fund, to preserve and produce the fund for the general benefit of all interests. In hind-sight, seeking an Order of Court to that effect at the outset would have been beneficial, subject always to taxation of the quantum of such costs.

In Closing

48. Undisputedly maritime arbitrators have the power to grant interim relief and this often takes the form of a *mareva* or freezing injunction or an injunction to preserve cargo; or to restrain a call on bonds or guarantees. Arrest of ships however, remain the prerogative of the Courts. Primarily because the jurisdiction to seize assets lies in an action *in rem*. Arbitrators grant relief *in personam*. Further, the Arrest Convention and domestic legislation giving effect to it, only recognize an arrest by a judicial process under the authority of a Court.

49. Arguably, an arbitrator can order that the *parties* to refrain from moving or selling or scrapping a vessel. But the right to arrest and effect a judicial sale to confer clean title, remains the privilege of the Courts. Given the extensive obligations, including that of maintaining a general duty of fairness to satisfy payment to several creditors from the arrest and sale of a vessel; it is just as well that the arrest of ships is left out of the arbitrators' ring, alongside the winding-up of companies.

18 November 2019

---

[1] *Paper Delivered at the International Congress of Maritime Arbitrators (ICMA); 8 to 13 March 2020 at Rio De Janerio, Brazil*

[2] *Member of the ICC International Court of Arbitration*
Member of the Permanent Court of Arbitration
LLB (Wales), LLM (Cantab), Barrister (Lincoln's Inn), Dip ICArb
Advocate & Solicitor (High Court of Malaya), FCIArb, FMIArb
Consultant to the law firm, Tommy Thomas, Kuala Lumpur, Malaysia
E-mail : sitpah@tommythomas.net

[3] Section 24(b) of the Malaysian *Courts of Judicature Act*, 1964 states that the High Court shall have *"the same jurisdiction and authority in relation to matters of admiralty as is had by the High Court of Justice in England under the United Kingdom Supreme Court Act 1981."*

[4] International Convention for the Unification of Certain Rules relating to the Arrest of Sea-Going Ships, Brussel 1952

[5] [2001] 1 AC 102

[6] [2015] NSWC 469

[7] [1908] P 218 (Court of Appeal, England)

[8] [1999]2 Lloyd's Rep 337 (Court of Appeal, England); (See also *Avina v Sea Senor (Ship)(Canada)* 2016 BCSC 749, Supreme Court of British Columbia)

[9] First Revision of the Beijing Draft as at 10 September 2019 found at https://uncitral.un.org/sites/uncitral.un.org/files/wp_84_advance_copy.pdf

[10] *The "Union Gold"* [2013] EWHC 1696 (Admiralty High Court, England)

[11] *The Margo L* [1998] 1 HKC 217 (Court of First Instance, Admiralty Jurisdiction, Hong Kong)

[12] *The "Turtle Bay"* [2013] 4 SLR 615 (High Court, Singapore)

[13] Such as in *The Union Gold* when a private treaty sale was ordered as a prompt sale was crucial to preserve a long term contract and prevent it from being lost

[14] *Mutual Assistance in Criminal Matters Act*, 2002 (Malaysia), Section 8

[15] [2013] 2 ALL ER 56 (Court of Appeal, England); disapproving *BOC Ltd and another v Instrument Technology Ltd & others* [2002] QB 537 (Court of Appeal, England)

[16] Oder 60 rule 4(2), *Rules of Court* 2012

[17] Order 92 rule 4, *Rules of Court* 2012;
Kingtime International Ltd & Anor v Petrofac E&C Sdn Bhd [2019] MLJU 731 (High Court, Malaysia); and *BBW v BBX, BBY and BBZ* [2016] SGHC 190 (High Court, Singapore).
As in the sealing of a Preliminary Act under Order 70 rule 17(2), *Rules of Court* 2012

[18] Section 15, *Court of Judicature Act*, 1964

[19] Order 63A rule 7, *Rules of Court* 2012

[20] Order 70 rule 20 (11), *Rules of Court* 2012

[21] [2018] EWHC 1013 (Admiralty High Court, England)

[22] *Parker v Mckenna* [1874] LR 10 Ch App 96 (Court of Appeal, England) cited in *Richard Ellis Ltd v Van Hong Tuon* [1988] LRC (Comm) 900, at page 903 (Court of Appeal, Hong Kong) on double agency of an estate agent.

[23] *Richard Ellis Ltd v Van Hong Tuon* [1988] LRC (Comm) 900, at page 905 (Court of Appeal, Hong Kong)

[24] Supra, fn 21

[25] [1964] 1 Lloyd's Rep 380 (High Court, England)

[26] [2001] ALL ER (D) 344 (Admiralty High Court, England)

[27] [1999] FCA 1615

[28] [1981] 1 Lloyd's Rep 13 (Admiralty High Court, England)

[29] *The "World Star"* [1987] 1 Lloyd's Rep 452 (Admiralty High Court, England)

SITPAH SELVARATNAM, FCIArb

LLB (Wales, UK); LLM (Cambridge, UK); Barrister-at-Law (Lincoln's Inn). Admitted as Advocate & Solicitor (Malaysia) in 1990; Diploma in International Commercial Arbitration (CIArb, Keble College Oxford).

Founding partner of the law firm Tommy Thomas. Counsel in wide range of corporate, insolvency, commercial and maritime law disputes. Appearing at all levels of the superior Courts of Malaysia.

Member of the ICC International Court of Arbitration since July 2018.

Member of the Permanent Court of Arbitration since July 2019.

Arbitrator in international maritime and commercial disputes; appointed by parties, SIAC, HKIAC, and AIAC.

Recognized by Chambers Asia, Asia Pacific Legal 500 and others professional publications.