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# Content

## Rules



## News



## Cases

## Rules

### 1. Policies on Chinese-funded Vessels Sailing under the " Flag Of Convenience" After Changing to Fly a Five-Star Red Flag

In order to further promote Chinese-funded vessels sailing under the "flag of convenience" returning to China for registration, on 18 January 2019, the Ministry of Transport of the People's Republic of China issued the *Notice of the Ministry of Transport on Issues concerning the Operation of Domestic Waterway Transport by Vessels that Enjoy the Import Tax Policy for the Registration in China of the Chinese-funded Vessels Sailing under the "Flag of Convenience" after Changing to Fly a Five-Star Red Flag*, cancelling the limitations on the returning vessels and enabling them to enjoy the same treatments as domestic vessels. For readers' better understanding of the said tax policy that has been amended from time to time, this article makes introduction and analysis from the following aspects, namely, the application conditions and preferences in the current policy, the origin of the policy, the changes of the policy, the effects of the policy, future trend of the policy and concerns of shipowners.

I. Application conditions and preferences in the current policy

1. Application conditions

1.1 The vessel has been registered abroad and sailed under the "flag of convenience" prior to December 31, 2012;
1.2 The emission of Nitrogen Oxides from the marine diesel engine of the vessel meets the Tier II emission limit regulated in Annex VI of MARPOL 73/78;
1.3 The proportion of the Chinese party's capital contribution to the vessel shall not be lower than 50%;
1.4 The age of the vessel (from the completion of building to 1 September 2016) shall meet the requirement of the *Provisions on the Administration of Old Transport Ships*.

2. Procedures

The applicant (the shipowner to be recorded on the certificate of registry after the vessel is registered in China) shall file an application to the Ministry of Transport. The materials required are as follows:
2.1 The application (including the time of registration of the vessel abroad, the age of the vessel) and list of vessels applying for tax exemption;
2.2 Certificate of Registry;
2.3 Certificate of Inspection, Certificate of Classification;
2.4 Documents regarding contributors (to prove the proportion of the Chinese party's capital contribution is not lower than 50%);
2.5 Written warranty on the authenticity and integrity of the materials submitted by the applicant.

3. Preferences in the current policy

3.1 Exemption from Tariff and import added-value tax;
3.2 Registration at any port of registry authorized by the Ministry of Transport with authority of registration of international trading ships;
3.3 Lower entry requirement on engaging in domestic transport. Except provincial passenger ships, dangerous goods ships and other ships that are still subject to macro-control requiring examination and approval, other vessels such as bulk carriers and container ships will only need to meet some basic requirements to engage in domestic transport (which is one of the preferences determined by the recently issued Notice).

II. The origin of the policy

Since the implementation of China's new tax system in 1994, the scale of Chinese-funded vessels flying "flag of convenience" (FOC) has expanded rapidly. According to statistics, by 2009, the tonnage of Chinese-funded vessels flying FOC has reached 60% of all Chinese-funded

vessels flying "flag of convenience" (FOC) has expanded rapidly. According to statistics, by 2009, the tonnage of Chinese-funded vessels flying FOC has reached 60% of all Chinese-funded vessels. Meanwhile, the average age of Chinese-funded vessels flying FOC is 12 years, with an average deadweight of 36,600 tons. The average age of Chinese-flagged vessels is 19 years and the average deadweight is 15,700 tons. In order to expand the size of China's international shipping fleet and promote the healthy development of China's international shipping industry, in 2007, the Ministry of Communications (the predecessor to the current Ministry of Transport) launched the tax exemption policy for special cases to attract Chinese-funded vessels to transfer the flag to the Chinese Flag. While approving the policy, the State Council asked the Ministry of Communications to work with relevant departments to fundamentally solve problems related to Chinese-funded vessels flying FOC.

III. Changes of the policy

1. In 2007, the original policy set up many limitations on the returning vessels regarding the age of the vessel, the port of registry, the scope of business and the time limit

1.1 Scope of vessel age:
Oil tankers (including asphalt carriers) and bulk chemical carriers aged between 4 and 12 years;
Bulk carriers and ore carriers aged 6-18 years;
Container ships, general cargo ships, multi-purpose ships, bulk cement ships, etc. aged 9-20 years.
1.2 The port of registry of the returning vessel is restricted to Shanghai, Tianjin or Dalian port.
1.3 The returning vessels in principle shall still engage in international transport, other than domestic transport.
1.4 The time limit of the policy is two years.

2. In 2011, restriction of ship registration was relaxed

A returning vessel may choose any port of registry in China to go through the formalities for the registration.

3. In 2016, limitation on vessel age and technical requirements were cancelled
The limitation on vessel age was cancelled and various import vessels were no longer required to meet the old requirements for import, but only required to meet the requirement of the *Provisions on the Administration of Old Transport Ships*.

4. In 2017, the returning vessels were conditionally permitted to engage in domestic transport

Chinese-funded vessels flying FOC that enjoy the preferential tax policy shall, in principle, continue to engage in international shipping and may engage in domestic shipping if they meet the following conditions and are approved by the Ministry of Transport:

4.1 There is no domestic Chinese-flagged ship meeting the shipping capacity of the applied shipment;
4.2 The safety and technical status of the vessels meet the requirements of domestic shipping.

At the same time, 25 ports of registry for returning vessels are explicitly specified.

5. In 2019, the returning vessels will enjoy the same treatments as domestic ships, and the relevant inquisition and inspection procedures vessels are meanwhile optimized.

Vessels that enjoy the preferential tax policy for the registration in China of Chinese-funded Ships Sailing under the "Flag of Convenience", after having complied with the relevant provisions in the *Provisions on the Administration of Domestic Water Transport* (Order No.79 [2016] of the Ministry of Transport), the *Announcement of the Ministry of Transport on Reinforcing the Administration on the Operation of Domestic Waterway Transport by Foreign (Overseas) Import Vessels and Chinese-*

*Flagged International Trading Vessels* (Announcement No.53 [2018] of the Ministry of Transport) and the *Announcement of the Ministry of Transport on Strengthening the Macro-Control on the Inter-Provincial Coastal Vessel Transport Market for Bulk Liquid Hazardous Goods* (Announcement No.67 [2018] of the Ministry of Transport), etc., may engage in domestic waterway transport.

So far, the returning bulk carriers and container vessels share the same standard with the domestic vessels engaging in domestic transport.

IV. Outlook of the policy

During the 12 years from 2007 to 2019, for the return of Chinese-funded vessels flying FOC, the State Council extended the time limit of the policy for three times, and the Ministry of Transport along with the Ministry of Finance and other departments has been constantly optimizing and perfecting relevant policies for returning vessels, optimizing the handling procedures, simplifying the procedures of registration of vessels, changing the process of ship inspection and certificate issuance from "series" to "parallel", realizing one-stop service and greatly saving time for enterprises.

Under the dynamics of the current policy, 2019 will be the first year witnessing return of a large number of Chinese-funded vessels flying FOC, but will not be the last year implementing the import tax exemption policy. The deadline of the current tax exemption policy is 1 September 2019, and the new policy for returning vessels that may engage in domestic transport comes into force on 1 February 2019 and will be valid for 5 years. In addition, the fundamental reason for the gradual extension of such preferential policies is that the effect is limited and the return of Chinese-funded vessels flying FOC is not obvious. Up to now, there are only a few dozen vessels returning to China for registration, too far away from the expected goal, so there is still a long way far to fundamentally solve this problem. Therefore, the extension after 1 September 2019 is highly probable.

V. Concerns of shipowners

1. Operating tax burdens

Although tariffs and import duties are exempted, the 3.3% sales tax and a 25% corporate income tax on each shipment is still a deterrents to many shipowners. In addition, crew members are also subject to individual income tax.

2. Financial market

Shipping companies are highly dependent on financing and sensitive to interest rates, financial products and the flexibility of financial innovation.

At present, major domestic banks provide narrow financing channels for the shipping industry, with few financing products, high financing costs and demanding repayment conditions. In contrast, a large variety of foreign financial products and their convenient ways of access, quality services and flexible operation mode are of great attraction to domestic shipping enterprises. However, the premise for an enterprise to obtain foreign financing is usually to sign a financial leasing operation agreement with the investor, which means that the actual owner of the ship is the foreign investor, who has the right to decide the nationality of the ship.

3. Employment of crew members

Currently, ships flying the Chinese flag are still only allowed to employ Chinese seamen, who are paid much more than their counterparts in other south-east Asian countries. For example, Chinese sailors earn about RMB 10,000 per month, while Bangladeshi sailors earn about only RMB 3,000, and greater salary gap exists in respect

of senior officers. Therefore, many Chinese-flagged ships tend to employ Chinese crew members only for key positions. For other positions, they employ seamen from countries with lower wage standards.

4. Foreign exchange

As we all know, China still implements a strict foreign exchange administration policy, which is also a concern of many shipowners.

5. Continuity of the policy

A few years ago, there was an upside-down phenomenon that the freight rate of domestic transport was much higher than that of similar international voyage, which has certain attraction for the return of Chinese-funded vessels flying FOC. However, in principle, the policy of the Ministry of Transport still hopes that these vessels can continue to engage in international shipping after changing to fly Chinese flag. Although the latest policy enables the returning vessels to engage in domestic transport under the same conditions, whether the policy will be adjusted after the returning vessels have met the expectation is still unknown.

## News

**1. WANG JING & CO. remained in the list of LEGALBAND China Law Awards Winners and once again awarded China Business Law Award**

Recently, the well-known legal rating institution LEGALBAND announced the list of 2019 LEGALBAND China Law Awards Winners, and this law firm, with long-lasting professional advantages in the shipping field, continued to be recognized as the "Shipping Law Firm of the Year".

The said list was finally determined upon months of independent investigation and urvey conducted by the LEGALBAND investigation and survey team stationed in China, including but not limited to getting feedback from customers and peers and collecting other survey data. WANG JING & CO. was "a strong traditional law firm in the shipping industry with outstanding strength," LEGALBAND commented. Such brief comment recognizes this law firm as a professional law firm engaged in the traditional maritime law field over the past two decades, and further inspires us to remain true to our original aspiration and forge ahead.

Meanwhile, the well-known legal media China Business Law Journal presented 2019 China Business Law Awards, and this law firm, for its high-quality legal services and outstanding service achievements in the shipping filed, was recognized as the "Shipping Law Firm of The Year (PRC Firms)" again.

The China Business Law Awards are annually presented by China Business Law Journal and always attract great attention in the Chinese legal market. The winners of the China Business Law Awards are selected by the China Business Law Journal team based on votes and recommendations from corporate counsels, senior managers and legal professionals around the world after having evaluated the landmark deals, cases and other notable achievements of the winning firms in the past year.

This law firm again winning the LEGALBAND China Law Award and the China Business Law Award further reflects the recognition by the clients and peers of our services, and we will live up to the clients' and peers' confirmation and trust, and try our best to provide better legal services.

**2. WANG JING & CO. created the first success in Mainland China in applying for property preservation prior to recognition and enforcement of Hong Kong arbitration awards**

On 20 March 2019, Guangzhou Maritime Court published its Typical Cases of 2018, and the application for property preservation prior to recognition and enforcement of Hong Kong arbitration awards in Mainland China handled by this law firm representing FARENCO SHIPPING PTE. LTD. (hereinafter referred to as "FARENCO") is one of the cases selected. This case, handled by Mr. Wang Weisheng, one of the partners of this law firm, with the assistance of an associate Mr. Liu Chunxu, is the first successful application for property preservation prior to recognition and enforcement of Hong Kong arbitration awards in Mainland China.

In this case, as disputes arose from the charter party concluded between FARENCO and EASTERN OCEAN TRANSPORTATION CO., LIMITED (hereinafter referred to as "EOTL"), an arbitration proceeding was commenced in Hong Kong pursuant to the arbitration agreement. Two final awards were successively made in respect of the substantive issues and the legal costs, both in favor of FARENCO. Having been aware that EOTL may have sums in an account it maintained with certain bank in Shenzhen, FARENCO authorized this law firm to freeze EOTL's such account relying on the arbitration awards.

Upon receipt of authorization from FARENCO, this law firm immediately conducted comprehensive legal analysis and argumentation on the feasibility of application for property preservation prior to recognition and enforcement of Hong Kong arbitration awards in Mainland China, assisted FARENCO in preparing all necessary documents, and coordinated the insurance company to issue guarantee for property preservation soonest possible. Based on careful and comprehensive preparation, this law firm representing FARENCO simultaneously filed with Guangzhou Maritime Court the application for recognition and enforcement of Hong Kong arbitration awards and the application for property preservation. Through rounds of communications with the court, the handling lawyer successfully eliminated many uncertainties in the case and finally succeeded in persuading the court to accept our opinions and render down a ruling approving FARENCO's application for property preservation and freeze EOTL's account, which secures the realization of FARENCO's claims against EOTL to the utmost extent. This case pioneers the successful practice of applying for property preservation prior to recognition and enforcement of Hong Kong arbitration awards in Mainland China, and will be a helpful reference for the handling of similar cases.

With a professional team specialized in solving foreign-related maritime and commercial disputes, this law firm has presented various domestic and foreign clients in many cases in connection with recognition and enforcement of arbitration awards made in a foreign country/Hong Kong/Macao/Taiwan and thus has rich experience in handling similar cases, which in addition to solid legal knowledge has laid a good foundation for the successful application in this case. This law firm will continue to adhere to the spirit of providing professional and excellent services, and provide domestic and foreign clients with efficient and professional legal supports.

**3. Mr. Zhao Shuzhou ranked as 2019 ALB China Top 15 Litigator**

On 20 February 2019, Asian Legal Business (ALB) published the list of 2019 ALB China Top 15 Litigators, and Mr. Zhao Shuzhou, the managing partner and the head of the maritime/maritime engineering and international arbitration team of this law firm, once again was ranked as one of these litigators.

As a leading law journal under Thomson Reuters, ALB is one of the most influential legal media in the world. It aims to provide clients and readers with cutting-edge legal and business information as well as professional ratings in respect of law firms. To determine the list of 2019 ALB

China Top 15 Litigators, the judging panel conducted detailed analysis on the candidates' achievements in litigation in 2018 mainly by reference to the candidates' achievements and high-profile cases in 2018 as provided by the candidates themselves and effective court judgments of the cases handled by the candidates obtained from publicly available resources, in addition to having regards to the third-party objective evaluation.

Mr. Zhao really deserves this award. During his practicing of over two decades, Mr. Zhao has successfully handled several complicated cases with large amount in dispute. With extensive experience in international and domestic litigations and arbitrations, he is unanimously praised in the areas of maritime, maritime engineering, international trade, shipping investment and insurance, and is generally recognized as one of the top Chinese commercial lawyers. Hence, this award is the best recognition of Mr. Zhao's professional services. Mr. Zhao Shuzhou and his team will continue to provide high-quality, efficient and comprehensive legal services for domestic and foreign clients as always.

# A new trend: Chinese courts dismissed SPROs' claims against shipowners

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With regard to claims for compulsory pollution clean-up costs, most of the claimants are SPROs who have followed orders by local MSA to undertake the substantial clean-up operations, and only a few claims are directly filed by MSA themselves. In years, although the legal relationship and basis for the SPROs to file their claims were not absolutely explicit or even arguable, most of such kind of claims were either fully or partially supported by the Chinese courts as per our research. In short, Chinese courts generally recognized the qualification of SPROs as claimants to file civil claims for compulsory pollution clean-up costs.

However, a landmark decision was handed down in May 2018 by Hubei Higher People's Court dealing with the issue on title of SPROs to file civil claims for compulsory pollution clean-up costs[1]. Following this decision, in a recent case before Xiamen Maritime Court (XMC), the Court rendered a decision in July 2018 and also dismissed the SPRO's claim against the shipowner for pollution clean-up costs[2].

**Background**

Both cases involved claims filed by SPROs against shipowners and their liability insurers for pollution clean-up costs.

In the case heard by Hubei Higher People's Court (hereinafter referred to as "Zhong Heng 9 Case"), the cargo vessel Zhong Heng 9 sank after her collision with another cargo vessel Chang Rong Men on Yangtze River in Baimaosha area on 13 July 2016. As notified by Baoshan MSA for oil pollution prevention, the SPRO, Shengmin Company dispatched four vessels to carry out the clean-up operation.

Circumstances of the case heard by XMC (hereinafter referred to as "XDY Case") are basically the same. After colliding with another vessel in Pingtan, Fujian area, the cargo vessel XDY sank on 19 August 2017 and oil spilled from the sunken vessel. As ordered by Pingtan MSA, the SPRO Xinhai Company got involved in the clean-up operation to have oil pollution under control.

**Key issues**

The main issue in both cases was whether SPROs were entitled to file civil claims for compulsory clean-up costs. If they were not entitled to sue against shipowners/insurers, then it would be unnecessary for the courts to review reasonableness of their claim amount.

**The court decisions**

The SPROs submitted that shipowners should be responsible for the clean-up costs in accordance with Article 90 of Marine Environmental Protection Law and Article 4 of the Interpretations of the Supreme Court of PRC, and that SPROs should have rights to choose and sue against shipowners even though they were ordered and instructed by the local MSA to do the clean-up work. Shipowners and insurers argued that they had no direct contractual link with the SPROs and thus SPROs should not be entitled to file civil claims against them.

For the Zhong Heng 9 Case, Wuhan Maritime Court (WMC) supported shipowners' arguments in their first instance judgement. They held that the SPRO had neither contractual nor tortious basis to claim against the shipowners and thus were not entitled to directly file the claim against shipowners or their insurers. The SPRO subsequently appealed but their appeal was dismissed by Hubei Higher People's Court later.

In the XDY Case, XMC basically followed the position of WMC and Hubei Higher People's Court and dismissed the SPRO's claim against the shipowner and insurer as well.

**Conclusion and Comments**

The aforesaid recent court decisions illustrate the importance of establishing a valid claim basis and show a completely new approach for Chinese courts dealing with the SPROs' claims for clean-up costs. In comparison with the old route, the Chinese courts start to pay more attention to reviewing whether these claims are on established legal basis.

It is interesting to note how the courts construed the legal link among the SPROs, MSA, and shipowners so as to deny the title to sue by the SPROs. By way of summary, as per the court decisions, the notice or order from the MSA constituted an administrative commission contract between MSA and SPROs, so there was no direct or implied contractual link between SPROs and shipowners.

It shall be noted that, in the Zhong Heng 9 Case, both WMC and Hubei Higher People's Court concluded that the clean-up work ordered by the local MSA was in nature an administrative performance, and further confirmed that SPRO were entitled to remunerations from the local MSA under their administrative commission contract.

The above two court decisions are stark reminders to SPROs who attempt to directly claim against shipowners with no contractual or other legal basis. Presently, these decisions can only represent the views of some Chinese courts whilst the PRC Supreme Court have not rendered any guideline to echo them yet. This may be good news for foreign shipowners who have to defend before courts clean-up claims by SPROs in China temporarily, but virtually it will be hardly possible for foreign shipowners to bypass the SPROs' clean-up claims in view that they have to pay up the clean-up costs to the MSA through different approaches ultimately.

As the above court decisions have already determined that the clean-up work carried out by SPROs is in nature an administrative performance, it follows that the clean-up costs shall be identified as administrative substitution performance fees, and the MSA in China are entitled to collect the compulsory clean-up costs through administrative approach according to relevant provisions in the Administrative Compulsion Law of the PRC. Apart from that, in light of the Chinese judicial practice that the MSA is actually recognized as the claimant to file a civil claim, albeit temporarily arguable, we consider the MSA shall be deemed as entitled to claim on behalf of the State against the liable party for the clean-up costs.

All in all, if the SPROs cannot succeed in directly claiming against shipowners and the MSA need to recover the clean-up costs in their own name, either through administrative approaches or civil claims, it will give rise to risks that the MSA probably would hold a vessel until her owners pay off the clean-up costs or provide sufficient security to guarantee the payment.

**Footnotes:**

1.See Case No.: (2018)EMZ No.664;

2.See Case No.: (2018)Min 72 MC No.176.

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# Avoidance of indirect claims in ship contact with terminal

**Yang Dongyang**

For incidents where the ship has contact with the terminal, especially where VLCC or oil terminals like Sinopec or Sinochem are involved, the terminal will inevitably sustain indirect loss, i.e., loss of use of the berth during time periods for claim handling and repairs. Although shipowners could argue reasonableness of the loss quantum, they have to take up a very heavy burden of proof and usually it is hardly possible for them to get liability exoneration for the terminal's indirect loss.

◆How the indirect loss occurs and how to avoid such claim?

Normally the repairs to damaged berth will involve at least four parties including the berth damage surveyor, the designer, the repair undertaker and supervisor and certainly the procedure consists of four steps. Before the physical rebuilding or repair works, the damage should first be inspected by competent institutions who will then advise on the extent of damage and whether the damaged structure could be reused or shall be demolished. Once the damage assessment report is issued, it will be reviewed by the designer of the terminal for giving suggestions on how to repair the damaged structure and repair cost estimate, which are the basis of budget preparation and choice of repair undertaker and supervisor. After the repair undertaker and supervisor are nominated, physical repair work will start. Once the repair is completed, subject to requirements by the local port authority, inspection and examination on the repaired structures will be carried out.

The terminal operation is under supervision by the local port authority. In occurrence of contact incident, if the damage is obvious, the port authority usually will suspend all operations at the affected berth. Only when the main structure such as the working platform is restored to normal condition and the terminal will undertake any operational risk, the port authority will temporarily allow operation at berth with imposing certain restrictions on the DWT of ships to berth alongside. For example, for a 100,000DWT berth, the port authority may only allow ship of 70,000DWT to get alongside. As such the terminal will blame Owners whose ship damaged their berth and request them to undertake the terminal's loss due to confined receipt of ships in smaller DWT. In other words, the terminal's indirect loss is incurred because the affected berth is shut down or downgraded in terms of its holding capacity.

In addition to berthing restriction imposed by the port authority, time is another key factor. As per relevant regulations and rules governing civil engineering projects in China, the nomination of survey institution, designer, repair undertaker and supervisor shall go through public bidding procedures. Terminals like Sinopec and Sinochem shall not bypass such procedures. The bidding procedure to select the capable contractors shall be separated and arranged step by step. Normally the bidding procedure for selecting each contractor will take around one month. So time required for merely selection and nomination of the contractors will cost around 3-4 months. Further plus the repair period, time basis to calculate the terminal's indirect loss is indeed substantial. Sometimes the terminal may deliberately prolong the repair period if they have

another available berth to support their business, following which, the indirect loss to incur could even be in more considerable amount than the repair cost. In a case precedent where M/T ASTIPALAIA contacted with the loading arm and auxiliary facilities at terminal on 18 August 2011, the final court judgment supported the terminal's claims for repair costs of RMB1.72m (around USD250K) and the loss of business interruption of berth in RMB4.63m (around USD670K). The indirect loss is over twice of the physical repair cost.

- Is it possible to avoid exposure to liability for the indirect loss claim raised by the terminal? Any way to bypass the statutory bidding procedures and expedite the repair works?

The answers are positive. A feasible and timely solution is to conclude a tripartite agreement covering the terminal, shipowners and the contractor. With the involvement by shipowners, the bidding procedures to select the contractor may be skipped as the terminal and shipowners could directly negotiate with the candidate contractor for a reasonable price on the repair work. Participation by shipowners will also save the terminal from financial troubles given the agreed repair cost could be directly settled by shipowners. With such incentive, it may also be feasible for shipowners to request the terminal to waive their indirect loss claims in return for shipowners' cooperation with the terminal in repairing the damaged berth.

The above approach was successfully adopted by us in handling the contact by M/T STI CONDOTTI with a dolphin of Berth No.3 of Sinochem Quanzhou Terminal in May 2017. The tanker collided with the berthing dolphin and caused breakage of 4 piles and the pile cap of the dolphin and the Terminal subsequently demanded security in amount of RMB35 million. The MSA concluded the tanker should be fully liable for the incident. The port authority restricted the berth usage after the incident. As suggested by the designer, the 4 piles should be rebuilt with a cost estimate at around RMB18-20million in total. Besides the repair fee, the Terminal also claimed for indirect loss in amount of RMB1.9million per month.

Following negotiations with the Terminal, we represented shipowners to conclude a tripartite agreements with the contractors in November 2017. The total repair costs were controlled to be RMB17million and the indirect loss claim was waived by the Terminal. The repair was completed in November 2018. In addition, time duration for case handling was merely about 19 months from occurrence of incident to completion of repair. The Terminal's claim for indirect loss of around RMB36.1million (USD5.23m) at rate of RMB1.9m/month was successfully avoided. Based on this case precedent, we tend to the view that it may be worthwhile for shipowners to consider direct involvement into the repair contract in exchange of the Terminal's waiver of the indirect loss claim for time/cost efficiency sake. Had the repair been arranged and conducted by the Terminal themselves who definitely would subsequently claim reimbursement against shipowners, the indirect loss claim was inevitably in much higher amount than the physical repair costs.

Therefore, to handle the incident of ship contact with terminals, presumably it may be wise for shipowners to cooperate with the terminals on expedient repair to mitigate or avoid the indirect loss claims.

# Coal cargo claim under Chinese law: application of the degradation rate method in measure of indemnity for coal self-combustion

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Under Article 55 of the Chinese Maritime Code ("CMC"), the damage to the goods during transportation of the goods by sea shall be calculated either on the basis of the difference between the values of the goods (i.e., CIF value) before and after the damage or by reference to the expenses for the repair.

The Hachiman Shipping S.A. v. Shanghai Shenfu Chemical Co., Ltd. and Dorval Kaiun K.K., Japan, a dispute arising from a contract of carriage of goods by sea over compensation for damage to the goods ("Hachiman Case") is one of the Belt & Road typical cases released by the Chinese Supreme People's Court on 7 July 2015. In this case, the Supreme People's Court overturned the first instance and 2nd instance judgments. Rather, the Supreme People's Court adopted the degradation rate method to calculate the indemnity amount, of which the formula is: (market price of the goods had they been sold undamaged at the port of destination−sales price of the damaged goods) ÷market price of the goods had they been sold undamaged at the port of destination. It was also noted that the Supreme People's Court made it clear in this case that the fluctuation of the market price shall be excluded when the compensation amount is calculated.

The same approach was taken by the Supreme People's Court and the application of the degradation rate method was carefully revisited in a coal cargo claim before Guangzhou Maritime Court, in which Wang Jing & Co., Xiamen represented the shipowner. After five-year court proceedings, we successfully settled this claim at about 20% of the claim amount. In March 2019, a formal court mediation award was handed down by the Court for this case.

**Backgrounds**

The 65,000 MT Indonesian steam coal cargo in question was carried on board M/V "GJ" from East Kalimantan, Indonesia to Quanzhou, China. The Vessel arrived at Quanzhou on 7 February 2014 and commenced the discharge operation on 18 February 2014.

The self-combustion of the coal occurred at Shage Terminal on 28 February 2014 when the discharge resumed after the Vessel was forced to shift to the anchorage and pending for re-berthing for more than eight days.

**Issues**

There are some issues raised in this case both from legal and technical perspectives.

Legal issues are as follows:

1.Whether the self-combustion of the coal cargo amounts to "fire" under Sub-paragraph (2) of Paragraph 1 of Article 51 of the CMC;
2.Whether the carrier shall be held liable for the alleged cargo damage;
3.Whether the carrier shall be entitled to invoke thetatutory exceptions of "fire", "act or omission of

the shipper" or "nature or inherent vice of the goods" under the CMC;
4. Whether the Quality Certificates issued by the local CIQ shall be recognized as the sole evidence to determine the damage condition of the goods;
5. The scope of application of the degradation rate method established by the Hachiman Case, and whether this method shall apply in this particular case for measuring the indemnity for the damage to the goods.

Technical issues were related to the determination of the causes of the cargo damage, the adoption of the degradation rate method, and the assessment of the selling price of the damaged goods as well as the market price of the goods had they been sold undamaged at the port of destination.

The above-mentioned issues were debated and resolved during the trials with the assistance of the Court and respective experts appointed by the parties, including nautical experts, coal experts, and coal cargo price assessment experts.

Of all these issues, our strong argument focused on the following two key disputes, which were quite convincing and contributed to a favorable position for the shipowner in the subsequent negotiation and led to a fairly good settlement at last.

First, when the cargo claimants argued that the cargo damage shall be determined as per their CCIC Quality Certificates, we applied to the Court for collecting the Quality Certificates issued by CIQ Quanzhou, and argued that: as the coal cargo belonged to the goods whose import shall be subject to legal inspection under the inspection and quarantine supervision as set out in the *Catalogue of Import and Export Commodities Requiring Inspection and Quarantine Applied by Entry-Exit Inspection and Quarantine Authorities*, CIQ Quanzhou was the legal authority who is entitled to issue an inspection certificate and the Quality Certificates it issued in respect of the cargo concerned shall have binding effect upon the consignee; to the contrary, CCIC was only a commercial inspection company unilaterally appointed by the consignee, so the objectivity and neutrality of its inspection result were doubtful. Therefore, the evidential effect of the CIQ Quality Certificates shall prevail;

Second, as to the question whether or not the degradation rate method shall apply, we successfully persuaded the Court to accept that, although the degradation rate method aimed to exclude the loss caused by the fluctuation/drop in the market price, there was no reason to conclude that the precondition for the application of this method should be the existence of a fluctuation of the market price in the first place, so the degradation rate method shall apply in this particular case.

**Our Comments**

As lawyers mostly making defence for shipowners in various cases, we regretfully have to say that it is extremely difficult for shipowners to defend themselves by revoking exemption of liability as a strict examination and verification standard is generally adopted on such arguments by Chinese courts. Nevertheless, shipowners can always focus on defending against the claim amount.

From our point of view, the degradation rate method is in fact a good illustration and interpretation on Article 55 of the CMC by the Supreme CourtSupreme People's Court. Since the Hachiman Case was officially released by the Gazette of Supreme CourtSupreme People's Court of PRC(《最高人民法院公报》) as a typical and guiding case, the degradation rate method established in this case has already been converted into a judicial opinion that has an important guiding significance for future judicial practice.

Although China's judicial reform and guiding case system have generated significant discussions among scholars and officials, as a form of "Chinese common law", the guiding case system still plays and will play an important role in the Chinese judicial practice.

# Legal practice on enforcement of Hong Kong Arbitration Awards in Mainland China—whether "recognition" is needed or not

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**Case background:**

In late 2015, Company N applied to the Fuzhou Intermediate People's Court ("Court") for enforcement of two final partial arbitration awards issued by HKIAC in June and September 2015 respectively on the basis of the same dispute, in which Company S was held liable for compensation.

The Court accepted the application of Company N and passed the case to its Enforcement Division for handling. Later in February 2016, Company S filed dissention holding HKIAC has no jurisdiction over the dispute concerned and requesting the Court to reject the enforcement application of Company N based on Article 7 of the *Arrangements of the Supreme People's Court on Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region* ("Arrangement for HK SAR"). The dissention was reviewed and finally rejected by the Court in September 2017.

Thereafter, Company N filed another application for enforcement in October 2017 referring to the third final partial arbitration award regarding the same dispute. The application was accepted by the Court and transferred to its Enforcement Division the same way as that to the enforcement application filed in 2015.

In December 2018, Company S again filed dissentions on both two applications arguing there existed breach of procedural law on the basis that both applications entered into enforcement without being "recognized" by the Court.

**Case Analysis:**

Legal practice of Mainland courts on enforcement of Hong Kong arbitration award is quite inconsistent. Different from the New York Convention (referring to foreign arbitration awards) and respective Provisions referring to arbitral awards of the Taiwan Region (*Provisions of the Supreme People's Court on Recognition and Enforcement of Arbitral Awards of the Taiwan Region*) and of Macao SAR (*Arrangement between the Mainland and the Macau SAR on Reciprocal Recognition and Enforcement of Arbitration Awards*) ("Other Provisions"), the word "recognition" is never mentioned throughout the full text of the Arrangement for HK SAR. During the past years, the legal practice of Mainland courts in this respect differs:

Some courts (courts in Fujian Province, etc.) relied on the difference in text in the Agreement for HK SAR from other Provisions (no word "recognition" can be found in the text), and took the view that "recognition" should be not necessary for arbitration awards from HK SAR. Under this viewpoint, arbitration awards from HK SAR are valid legal documents that can be directly enforced against, and courts in Mainland China will not initiatively review such awards unless the party being enforced against can provide sufficient evidence to prove the existence of any situation specified in Article 7 of the Agreement for HK SAR.

Some other courts (courts in Zhejiang and Guangdong Province, etc.) took the opposite viewpoint that the "recognition" is still necessary before a Hong Kong

arbitration award enters into enforcement. Here the practice on the form of "recognition" is also quite different. Some courts reviewed the awards and ruled for enforcement directly without mentioning "recognition", while others may rule for recognition and enforcement separately. Despite difference in the form, all these courts hold that prior recognition is needed in order for a Hong Kong arbitration award to become valid and enforceable in Mainland China.

Intending to end the chaotic situation, the Supreme People's Court takes action in May 2017 by issuing a Notice to courts in Mainland China (*Notice of the Supreme People's Court on Some Questions regarding the Centralized Handling of Judicial Review of Arbitration Cases*) specifying all arbitration awards formed in Hong Kong, Macau, Taiwan and foreign countries should be reviewed and recognized by specific trial division of the courts before they are passed to Enforcement Division.

The Court thereby made rulings on the aforesaid dissentions on the basis of such Notice. As the Notice was issued in May 2017, the Court ruled the first application made by Company N in 2015 complied with the then-current effective law and should be affirmed, while the second application filed in October 2017 was in breach of the Notice issued in May 2017 and should be rejected accordingly.

We believe the Notice of the Supreme People's Court is one significant step in unifying the judicial practice on handling the arbitration cases. However, there are still disputes in implementation of such Notice.

Since this Notice is issued in a form of "internal" notice to all courts aiming to unify the practice of the courts (although such Notice was also published by the Supreme People's Court on its official website), there are arguments on whether or not such Notice could be considered as a source of law that binds parties involving in such proceedings. For instance, in this case, when receiving the second application for enforcement from Company N, the Court passed the application directly to its Enforcement Division without review and recognition of the HK arbitration award. It is definitely against the Notice of the Supreme People's Court, but it seems not so convincing for the Court to subsequently base on such Notice to determine the enforcement application of Company N is "in breach of procedural law".

Furthermore, the consequence of such "breach" is also rather arguable, especially in the situation where the application for enforcement itself has no substantive defect. In this respect, the Supreme People's Court did not make clarification in the Notice. We opine the Court should take a mild way when handling this kind of "procedural" problem due to its own mistake in handling cases. For example, in this case, the Court could take actions to correct its mistake by suspending the enforcement procedure and passing the case to trial division for review and recognition.

Now both parties have filed reconsideration application to the Fujian Higher People's Court against the two Rulings made by the Court. The reconsideration is still in progress, and the outcome may be expected in the middle or latter half of the year 2019.

# An Overview of the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region

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The Supreme People's Court of the People's Republic of China and the Department of Justice of the Hong Kong Special Administrative Region (HKSAR) have signed an Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region (the "Arrangement") in the afternoon of 2 April 2019, marking the end of an era in which no legal framework was available to support arbitral institutions or parties to arbitral proceedings in Hong Kong in their application for interim measures to courts in Mainland China.

## Background to the Signing of the Arrangement

Prior to the signing of the Arrangement, the people's courts in Mainland China were not able to issue interim measures in aid of arbitral proceedings seated in any other jurisdictions, including Hong Kong, with the exception of maritime cases.

In maritime cases, interim measures, namely Maritime Claims Preservation, Maritime Injunction and Maritime Evidence Preservation, in aid of maritime claims were not bound by arbitral agreements pursuant to Articles 14, 53 and 64 of the Special Maritime Procedure Law and Articles 21, 41 and 47 of the Interpretation of the Supreme People's Court on the Application of the Special Maritime Procedure Law of the People's Republic of China. For a maritime claim contracted to refer to arbitration, wherever the seat of arbitration is and whether the arbitral proceedings commence or not, any party to arbitral proceedings has the right to, before or after the arbitral award is issued, request interim measures from maritime courts.[1]

However, strictly speaking, the property of the person against whom the maritime preservation claim is filed shall be limited to the scope of "the ship, the cargo carried by the ship, and the ship's fuel and supplies"[2]. If the maritime preservation is filed to other properties, then the provisions of the civil procedure law on property preservation shall apply. Therefore, due to lack of legal grounds, when dealing with applications for maritime preservation of other properties in aid of the arbitral proceedings in other jurisdictions, different maritime courts may make different rulings.

For example, in the case (2016) E No.72 CB No. 427, in which the applicant had submitted the dispute arising out of the time charter party to Hong Kong International Arbitration Centre and had during the arbitral proceedings applied to Wuhan Maritime Court for preserving the opponent's bank deposit of $300,000. The court referred to Article 28 of the Arbitration Law and supported the application.

Nevertheless, in the case (2010) YHFWBZ No.7, the parties agreed to refer the dispute over demurrage arising out of the charter party to the arbitration in Hong Kong. Before the commencement of arbitral proceedings, the applicant applied to Ningbo Maritime Court for freezing the opponent's bank deposit of ￥2,000,000. The court disapproved the application due to lack of legal basis.

As regards non-maritime cases, Articles 100 and 101 of Civil Procedure Law (2017 Revision), Article 152 of the Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law of the People's Republic of China and Articles 28 and 46 of the Arbitration Law have clearly provided that both the property preservation and evidence preservation can be filed before and during arbitral proceedings. Whereas Article 272 of the Civil Procedure Law and the judicial practice of the courts in Mainland China not recognising and enforcing interim awards issued by arbitral institutions in other jurisdictions show that the applications for preservation to courts in Mainland China are subject to arbitral proceedings lodged with arbitral institutions in Mainland China[3], and for those cases to be brought to foreign arbitral institutions, the requests for preservation may be only filed after the issuance of final awards[4].

Early in 2000, the Arrangements of the Supreme People's Court on the Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region signed between Mainland China and Hong Kong enabled the mutual recognition and enforcement of arbitral awards in these two jurisdictions, although no specific provisions were made on the interim measures. Parties to arbitral proceedings thus had no legal grounds to support their application for interim measures even if an arbitral award had been made in Hong Kong and they had applied to a Mainland Chinese court for recognizing and enforcing such award.

In view of the above, there was no legal basis to support parties to arbitral proceedings accepted by arbitral institutions in other jurisdictions, including Hong Kong, in their application to the people's courts in Mainland China for interim measures[5], and such applications were hardly approved by the courts. Although the courts may occasionally approve those applications made by parties to arbitral proceedings seated in Hong Kong, the ratio decidendi were still unclear.

For example, in the case (2014) SZFMSCZ No.42, the applicant applied to the Intermediate People's Court of Guangzhou for recognizing and enforcing the arbitral award made by Hong Kong International Arbitration Centre, and the court supported the applicant's request for preservation of assets. As the ruling on the said preservation of assets is not available online, the legal grounds for the court's support are unknown.

Another example is the Reply of the Supreme People's Court to the Request of the Higher People's Court of Hubei for Instructions on the Issue of Application of Property Preservation filed by AUTOMATIVE GATE FZCO During the Proceedings of Recognition and Enforcement of a HKSAR Arbitral Award (No.129 (2017) of the Civil Division of the Supreme People's Court), in which the Supreme Court pointed out that although there was no legal frame available to govern the current issue of whether the applicant can file an application for property preservation after applying to the court for recognizing and enforcing a Hong Kong arbitral award, Article 100 of the Civil Procedure Law could be adopted by reference here, namely the court could approve a property preservation request if the applicant provides sufficient security. Nonetheless, the Reply still do not stipulate whether parties to the arbitral proceedings in Hong Kong can apply to the courts in Mainland China before receiving final award.

On the other hand, even before the signing of the Arrangement, Hong Kong laws had expressly set out that the High Court of Hong Kong had the right to voluntarily or at request issue interim relief in relation to arbitral proceedings seated in other jurisdictions, including Mainland China.

Pursuant to Article 21M of the High Court Ordinance (Cap. 4), the Court of First Instance may by order appoint a receiver or grant other interim relief in relation to proceedings satisfying certain conditions[6]. Article 45 of the Arbitration Ordinance (Cap. 609) more specifically endows

the High Court with the power to, on the application of any party, grant interim measures in relation to arbitral proceedings[7].

A typical case is Chen Hongqing v Mi Jingtian and another[8], in which the parties had a dispute over the voting rights attached to the shares of a Hong Kong company and referred the dispute to arbitration in Beijing by China International Economic and Trade Arbitration Commission ("CIETAC"). In the course of the arbitral process, the plaintiff applied to the High Court of Hong Kong for the appointment of receivers and other interim measures such as injunctive relief. The court supported such application pursuant to Article 21M of the High Court Ordinance and Article 45 of the Arbitration Ordinance.

To sum up, prior to the signing of the Arrangement, the assistance offered by Hong Kong and Mainland Chinese Courts in interim measures in relation to arbitral proceedings was one-way rather than reciprocal. Parties to arbitral proceedings in Mainland China were able to apply to Hong Kong courts for interim measures pursuant to laws and ordinance in effect in Hong Kong, whereas no equivalent assistance from Mainland Chinese courts was available to parties to arbitral proceedings in Hong Kong.

**Introduction to the Arrangement**

The Arrangement comprises of 13 clauses with specific provisions mainly on the scope of interim measures, definition of arbitral proceedings in Hong Kong, and procedures for parties to arbitral proceedings in Hong Kong and Mainland China for applying to competent courts for interim measures.

Article 1 of the Arrangement sets out that "interim measures" referred to in the Arrangement include, in the case of Mainland China, preservation of assets, evidence and conduct, and in the case of Hong Kong, injunctions and other interim measures. Although preservation is a concept in continental legal systems while interim measure is a concept in common law systems, they are both in nature a preventive remedy to ensure the enforcement of binding arbitral awards and to protect the parties' legal rights and interests. The Arrangement thus collectively describes these two concepts as "interim measures" and gives separate explanations.

Article 2 of the Arrangement defines the scope of arbitral proceedings in Hong Kong. It expressly sets out that "arbitral proceedings in Hong Kong" shall be seated in the HKSAR and be administered by the following institutions or permanent offices:

(I) Arbitral institutions established in the HKSAR or having their headquarters established in the HKSAR, and with their principal place of management located in the HKSAR;

(II) Dispute resolution institutions or permanent offices set up in the HKSAR by international intergovernmental organisations of which the People's Republic of China is a member; or

(III) Dispute resolution institutions or permanent offices set up in the HKSAR by other arbitral institutions and satisfying the criteria prescribed by the HKSAR Government (such as the number of arbitration cases and the amount in dispute etc.).

It is worth noting that assistance provided under the Arrangement applies to commercial arbitrations between equal entities only, and not to investment arbitrations. It is further limited to arbitral proceedings administrated by institutions, whereas Ad Hoc arbitrations are not covered[9].

Article 3 to Article 7 of the Arrangement set out the rights of parties to arbitral proceedings in the two jurisdictions to apply to competent courts for interim measures as well as the procedures they need to follow

respectively for making such application.

Article 3 and Article 6 of the Arrangement respectively set out that a party to arbitral proceedings in Hong Kong may, by reference to the provisions of the Civil Procedure Law of the People's Republic of China, the Arbitration Law of the People's Republic of China and relevant judicial interpretations, make an application for interim measures before the issuance of final arbitral award or before the commencement of arbitral proceedings to the intermediate people's court of the place of residence of the party against whom the application is made (the "respondent") or the place where the assets or evidence are situated, while a party to arbitral proceedings administered by a Mainland Chinese arbitral institution may, pursuant to the Arbitration Ordinance and the High Court Ordinance, apply to the High Court of the HKSAR for interim measures.

Articles 4, 5 and 7 of the Arrangement further set out necessary materials to be submitted along with an application for interim measures and necessary particulars to be included in the application.

In addition, Article 11 of the Arrangement undertakes not to prejudice any rights enjoyed by arbitral institutions, arbitral tribunals or parties to arbitral proceedings in Mainland China and the HKSAR under each other's laws. This ensures that the Arrangement does not prejudice the right of arbitral tribunals to make decisions or orders on interim measures in international arbitral proceedings.

The Arrangement is yet to take effect. Article 13 states that the Arrangement will come into force on a date to be announced by both sides following the promulgation of a judicial interpretation by the Supreme People's Court and the completion of relevant procedures in the HKSAR.

**Significance of the Arrangement**

The Arrangement is the first document which Mainland China has signed with another jurisdiction in respect of interim measures in arbitration. Under the "One Country, Two Systems" principle, Mainland China provides closer judicial assistance to Hong Kong than to any other country and region. Moreover, according to the Arrangement, the parties to the arbitral proceedings in Hong Kong have right to file the application for property preservation, evidence preservation and conduct preservation before referring the case to the arbitration. To some extent, the Arrangement is comparatively more explicit and comprehensive than the provisions on the preservation measures in domestic arbitration, especially on the issue of conduct preservation[10].

Furthermore, the Arrangement also provides concrete legal basis for permitting the parties to the arbitration in Mainland China to make applications for interim measures to the High Court of Hong Kong and enables the High Court of Hong Kong to grant approval without having misgivings about interference of the jurisdiction of the courts in Mainland China[11].

Hong Kong as an international legal and dispute resolution services centre in the Asia-Pacific region has been an attractive seat for arbitrations favoured by numerous parties to commercial disputes. The signing of the Arrangement lays solid legal grounds for the mutual enforcement of interim measures in relation to arbitral proceedings in both jurisdictions. This will greatly stimulate the parties in transactions involving China or Hong Kong to stipulate institutional arbitration seated in Hong Kong or Mainland China, and will significantly support the legal services industry in Hong Kong and Mainland China, giving both jurisdictions yet another competitive edge in international arbitration services.

[1] See the case of Amoysailing Maritime Co., Ltd. vs. African Maritime Carriers Ltd. ((2005) HHFSBZ No.35), in which the parties had referred the dispute arising out of the time charter party to arbitration in London and Shanghai Maritime Court supported the application of one of the parties for preservation of assets by referring to the said provisions.

[2] See Article 18 of the Interpretation of the Supreme People's Court on the Application of the Special Maritime Procedure Law of the People's Republic of China

[3] See the request for preservation of assets in relation to the arbitral proceedings of DONGWONF & B ((2014) HYZSCZ No.2), in which the applicant had initiated arbitral proceedings before the Korean Commercial Arbitration Board and applied to Shanghai No. 1 Intermediate People's Court for preserving the respondent's assets. Pursuant to Article 272 of the Civil Procedure Law, the court rejected the application on the ground that the applicant had not initiated arbitral proceedings in China and therefore such application was legally groundless.

[4] See the case (2010) YHFWBZ No.7

[5] Article 11 of the Arrangement between the Mainland and the Macau SAR on Reciprocal Recognition and Enforcement of Arbitration Awards (Legal Interpretations [2007] No.17) signed between Mainland China and Macau in 2007 expressly provides that a Mainland Chinese court may, in its review of any arbitral award issued in Macao, grant the applicant's request for interim measures pursuant to local laws.

[6] S.21M(1) of Cap. 4 High Court Ordinance, Without prejudice to section 21L(1), the Court of First Instance may by order appoint a receiver or grant other interim relief in relation to proceedings which—

(a)have been or are to be commenced in a place outside Hong Kong; and

(b)are capable of giving rise to a judgment which may be enforced in Hong Kong under any Ordinance or at common law.

[7] S.45(2) of Cap. 609 Arbitration Ordinance, On the application of any party, the Court may, in relation to any arbitral proceedings which have been or are to be commenced in or outside Hong Kong, grant an interim measure.

[8] [2017] HKCFI 1148

[9] Improving Judicial Practice under the "One Country, Two Systems" Principle – Person in Charge of the Research Office of the Supreme People's Court Meeting the Press about the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region, released by the Supreme People's Court on 2 April, 2019.

[10] Except IP cases, there was no specific provisions for conduct preservation measures in aid of arbitral proceedings in Mainland China before the implementation of the Arrangement.

[11]See the case Chen Hongqing v Mi Jingtian and another [2017] HKCFI 1148