Sub-bailment on Terms: A Case Note on The KH Enterprise (aka *The Pioneer Container)*

Martin Davies'

THE CASE

In *Campania Portorafti Commerciale SA* v *Ultramar Panama Inc (The Captain Gregos)(No 2),* Bingham LJ said that the law relating to sub-bailment on terms was 'ripe for authoritative consideration'. That authoritative consideration has recently been given by the Privy Council in *The KH Enterprise* (also known, rather conf usingly, as *The Pioneer Container).* Although decisions of the Privy Council are no longer binding in Australia, there can be no doubt that the decision in *The KH Enterprise* will be regarded as highly influential in Australia; it is, of course, binding in New Zealand.

The plaintiffs were the owners of goods laden on the defendant's Taiwanese container ship the KH *Enterprise,* which sank with all its

* Associate Professor, Faculty of Law, Monash University, Melbourne, Australia; Editor MLAANZ Journal.

1 [1990] 2 Lloyd's Rep. 395 at 405.
2 [1994] 1 Lloyd's Rep. 593.
3 The case is reported as *The Pioneer Container* in [1994] 3 WLR1 and [1994] 2 All ER 250. Because the carrying ship was *The KH Enterprise* and *The Pioneer Container* was a surrogate, this case note uses the name *The KH Enterprise.*

cargo of f the coast of Taiwan following a collision in fog with another ship, the *Oriental Faith.* There were three groups of plaintiffs, but the sub-bailment-on-terms issue arose only in relation to two of those groups. Each of the plaintiffs in those two groups was the holder of a bill of lading issued by a carrier other than the defendant.

One of the two groups of plaintiffs was referred to by the Privy Council as 'the Hanjin plaintiffs'. Their goods had been shipped on board another ship in the USA under bills of lading issued by Hanjin Container Lines for carriage from the USA to Hong Kong. That ship had carried the goods as far as Taiwan, where the goods were transshipped to the *KH Enterprise* for carriage from Taiwan to Hong Kong. The defendant issued a single 'feeder' bill of lading to Hanjin in respect of all the transshipped goods. The 'Hanjin plaintiffs' were the holders of the Hanjin bills of lading.

The 'Scandutch plaintiffs' were holders of bills of lading issued by Scandutch I/S for carriage from Taiwan to ports in Europe and the Middle East via Hong Kong. Scandutch sub-contracted the Taiwan-to-Hong-Kong leg of the voyage to the defendant; the goods were shipped on board the KH *Enterprise* in Taiwan. The defendant issued a single 'feeder' bill of lading to Scandutch.

All the plaintiffs proceeded *in rem* against the defendant's ship *Pioneer Container* as surrogate for the KH *Enterprise* in the High Court in Hong Kong. The defendant applied for a stay of those proceedings on the ground (inter alia) that cl 26 of the feeder bills of lading stated that any claim should be determined at Taipei in Taiwan, according to the laws of the Republic of China.

Thus, in relation to the Hanjin and Scandutch plaintiffs, the defendant raised a sub-bailment-on-terms defence. It sought to rely on one of the terms of its own feeder bills of lading, even though the plaintiffs were not parties to those contracts, on the basis that it had accepted sub-bailment of the goods from Hanjin and Scandutch on

The third group of plaintiffs, referred to in the judgment as the "Kien Hung plaintiffs", contracted directly with the defendant in terms identical to those of the "feeder" bills of lading. No sub-bailment-on-terms issue arose in relation to them, because they were in a direct contractual relationship with the defendant.

the terms of those feeder bills. The plaintiffs argued that because they were not parties to the feeder bills, they were not bound by the Taiwanese exclusive jurisdiction clause therein. The Privy Council held that the defendant was entitled to rely on cl 26 of the feeder bills; the proceedings were stayed on the basis that the plaintiffs were bound by cl 26.

Although the Privy Council held that the defendant could rely as sub-bailee on the terms of the contract under which it took possession from Hanjin and Scandutch (the head bailees), it disagreed with the reasons that had been given for a similar conclusion in *Johnson Matthey & Co Ltd* v *Constantine Terminals Ltd* and *Singer Co (UK) Ltd* v *Tees and Hartlepool Port Authority.* In *Johnson Matthey,* Donaldson J had said:

> But the plaintiffs cannot prove the bailment upon which, in my judgment, they must rely, without referring to terms upon which the silver was received by [the sub-bailee] from [the head bailee]...! really do not see how the plaintiffs can rely upon one part of the contract while ignoring the other. Consent seems to me to be relevant only between the bailor and the head bailee. If the sub-bailment is on terms to which the bailor consented, he has no cause of action against the head bailee. If it was not, the sub-bailee is still protected, but if the bailor is damnified by the terms of the sub-bailment he has a cause of action against the head bailee.

In other words, according to Donaldson J in *Johnson Matthey,* the sub-bailee was to be protected by all of the terms of the sub-bailment contract whether or not the bailor had consented to them, because by seeking to hold the sub-bailees liable as bailee of the goods, the bailor-plaintiffs were *ipso facto* bound by all of the terms of the sub-bailment contract.

The Privy Council in *The KH Enterprise* held that Donaldson J's analysis was incorrect, and that the bailor was only bound by those terms of the sub-bailment contract to which it had consented. That

5 [1976] 2 Lloyd's Rep. 215.
6 [1988] 2 Lloyd's Rep. 164.
7 [1976] 2 Lloyd's Rep. 215 at 222.

conclusion derived from the Privy Council's analysis of the relationship between the original bailor and the sub-bailee, which was drawn from its earlier decision in the case *of Gilchrist Watt and Sanderson Pty Ltd v York Products Pty Ltd,*[8] an appeal from the Court of Appeal of New South Wales. Relying on *Gilchrist Watt,* the Privy Council in *The KH Enterprise* held that when the defendant voluntarily took possession of the plaintiffs' goods, it assumed an obligation to take due care for them as bailee; that is, the sub-bailee owed the owners of the goods the duties of a bailee. The Privy Council quoted from the judgment of Diplock LJ in Morn's v *CW Martin & Sons Ltd,* saying that the sub-bailee's voluntary taking of the bailors' goods into its custody brought into existence between them 'the relationship of bailor and bailee by sub-bailment'. Furthermore, the sub-bailees owed the owners of the goods the duties of a bailee/or *reward,* notwithstanding the fact that the reward was payable to the sub-bailee (the defendant) by the head bailees (Hanjin and Scandutch) and not by the owners of the goods (the plaintiffs). To hold otherwise would be to impose on the sub-bailee two different standards of care in respect of the same goods: the duties of a bailee for reward owed to the head bailee/sub-bailor, and the duties of a voluntary bailee to the owner of the goods. This inconsistency could only be avoided by holding that the sub-bailee owed the same duty, that of bailee by reward, to both the head bailees/ sub-bailors (Hanjin and Scandutch) and the owners of the goods.

According to this analysis, there are not two separate bailments without overlap (one from the head bailor to the head bailee and one from the head bailee as sub-bailor to the sub-bailee), but rather two bailments that effectively collapse into one, by which the sub-bailee owes the same duties as bailee to both the head bailor (the owner of the goods) and the sub-bailor.

8 [1970] 1 WLR1262.
9 [1966] QB 716 at 731.
10 [1994]! Lloyd's Rep. 593 at 601.
11 Id at 599.

Because the sub-bailee's duties arose out of the direct bailment relationship between it and the owners of the goods, it followed that those duties could only affected by the sub-bailee's contract terms to the extent that the original bailor had consented to them. Delivering the judgment of the Privy Council, Lord Goff expressed that conclusion as follows:

> Once it is recognised that the sub-bailee, by voluntarily taking the owner's goods [ie, the original bailor's goods] into his custody, *ipso facto* becomes the bailee of those goods vis-a-vis the owner, it must follow that the owner's rights against the sub-bailee will only be subject to terms of the sub-bailment if he has consented to them, ie, if he has authorised the bailee to entrust the goods to the sub-bailee on those terms. Such consent may, as Lord Denning pointed out, be express or implied; and in this context the sub-bailee may also be able to invoke, where appropriate, the principle of ostensible authority.

On the facts of *The KH Enterprise* itself, the Privy Council held that both the Hanjin plaintiffs and the Scandutch plaintiffs had consented to the Taiwanese exclusive jurisdiction clause in the feeder bills because the Hanjin and Scandutch bills expressly stated that the carriers (that is, Hanjin and Scandutch) had authority to sub-contract 'on any terms'. Because the plaintiffs had thereby consented to Hanjin and Scandutch sub-bailing the goods on *any* terms, it followed that the bailment obligations voluntarily assumed by the defendant when it took possession of the plaintiffs' goods were subject to all the terms of the feeder bills of lading, subject to one minor caveat. Lord Goff said:[14]

> Where, as here, the consent is very wide in its terms, only terms which are so unusual or so unreasonable that they could not reasonably be understood to fall within such consent are likely to be held to be excluded.

12 Id at 601.
13 In Morris *v CW Martin & Sons Ltd* [1966] QB 716.
14 [1994] 1 Lloyd's Rep. 593 at 605.

Because the exclusive jurisdiction clause did not fall into this category, the plaintiffs were held to have consented to it.

Having disposed of these matters of fundamental principle, the Privy Council then turned to consider arguments that turned upon the particular facts of the case, and the particular clauses to be found in the relevant contracts. First, there was the matter of the interpretation of cl 26 of the feeder bills of lading, which was the exclusive jurisdiction clause on which the defendant sought to rely. It provided that any claim or dispute arising under 'this bill of lading contract' should be determined at Taipei in Taiwan. The plaintiffs argued that because their claims against the defendant shipowners were not claims for breach of the feeder bills of lading, but were claims in tort or bailment, they were not caught by the terms of cl 26. The Privy Council rejected this argument, commenting upon its 'extreme technicality'. Lord Goff noted that by regulating the shipowner's obligations in relation to the goods while in its care, bill of lading contracts thereby regulate the shipowner's responsibility for the goods as bailees. Lord Goff said:

> In these circumstances, their Lordships find it difficult to believe that a clause providing for the governing law and for exclusive jurisdiction over claims should be held not to be apt to cover claims by the cargo owners against the shipowners framed in bailment rather than in contract, simply because the clause refers to claims under the bill of lading contract as opposed to claims under the bill of lading.

Secondly, the plaintiffs argued that the defendant should not be allowed to rely on the terms of the feeder bills of lading, because they were also entitled to the protection of the terms in the Hanjin and Scandutch bills of lading, which contained Himalaya clauses extending their protection to sub-contractors of Hanjin and Scandutch. The plaintiffs argued that to allow the defendant to rely on the terms of their own feeder bills was not only unnecessary but might create an

15 Id at 603.
16 Ibid.

inconsistency between the two sets of terms. The Privy Council rejected this argument, too. Lord Goff said:

> [Their Lordships] are satisfied that, on the legal principles previously stated, a sub-bailee may indeed be able to take advantage, as against the owner of the goods, of the terms on which the goods have been sub-bailed to him. This may, of course, occur in circumstances where no Himalaya clause is applicable; but the mere fact that such a clause is applicable cannot, in their Lordships' opinion, be effective to oust the sub-bailee's right to rely on the terms of the sub-bailment as against the owner of the goods.

Thirdly, the Privy Council disposed of an argument which affected only the Scandutch plaintiffs. These plaintiffs argued that there was no evidence that Scandutch had ever taken actual possession of the goods in Taiwan. Accordingly, the Scandutch plaintiffs said that so far as they were concerned, the defendant shipowners were not sub-bailees at all, but quasi-bailees. The Privy Council pointed out that this point had not been raised in the courts below, and that Sears J at first instance had found as fact that the defendants were sub-bailees of the goods owned by the Scandutch plaintiffs. For those reasons alone, the Scandutch plaintiffs' argument failed, but the Privy Council went on, obiter, to comment that it was unlikely that the conclusion would have been any different even if the defendants *had* been quasi-bailees rather than sub-bailees. Lord Goff said:[18]

> [I]t is difficult to see why the shipowners should not, when they received the goods of the Scandutch plaintiffs into their possession, have become responsible as bailees to the owners of the goods even if the goods were never in the possession of Scandutch.

Fourthly, the Privy Council considered whether the general terms of the very broad consent clauses in the Hanjin and Scandutch bills of lading were effective to constitute consent to an exclusive juris-

17 Ibid.
18 Id at 604.

diction clause such as cl 26 of the defendant's feeder bills. Relying on the line of cases about incorporation of charterparty terms into bills of lading, the plaintiffs argued that a generally-worded consent clause should be interpreted as giving consent only to such sub-contract terms as were directly germane to the subject-matter of the bill of lading, which did not not include an exclusive jurisdiction clause such as cl 26 of the feeder bills. The Privy Council rejected this argument, saying that the analogy with the charterparty incorporation cases was inexact, and that there was no similar need to limit the terms to which consent was given by the generally-worded clauses in the Hanjin and Scandutch bills of lading.

Finally, the Privy Council considered whether to grant the defendant's application for a stay of the plaintiffs' actions in Hong Kong. The applicable principles were stated by Brandon LJ *in Aratra Potato Co Ltd v Egyptian Navigation Co (The El Amria):* the court should exercise its discretion to stay proceedings brought in breach of an agreement to refer disputes to a foreign court, unless strong cause for not doing so is shown. The plaintiffs' strongest argument against a stay of the Hong Kong proceedings was that they could not now proceed in the Taiwanese courts because their actions were time-barred. That argument elicited little sympathy from the Privy Council. Lord Goff observed that:[22]

> [T]he plaintiffs had deliberately and advisedly allowed the time limit to expire in Taiwan.

In the circumstances, the Privy Council found no reason to disturb the order made by the Court of Appeal in Hong Kong, that the plaintiffs' actions should be stayed because of cl 26, the Taiwanese exclusive jurisdiction clause.

19 See, eg, *Thomas & Co Ltd* v *Portsea Steamship Co Ltd* [1912] AC 1.
20 [1994] 1 Lloyd's Rep. 593 at 604.
21 [1981] 2 Lloyd's Rep. 119.
22 [1994] 1 Lloyd's Rep. 593 at 606.

COMMENT: WHOSE CONSENT IS RELEVANT?

The Privy Council placed great stress on the consent given by the owners of the goods to the terms of the sub-bailment to the sub-bailee. Without such consent, the owners of the goods would not have been bound by the terms of the sub-bailment contract evidenced by the feeder bills of lading issued by the defendant to Hanjin and Scandutch. There can be little doubt, though, that most of the Hanjin plaintiffs, at least, had not expressly consented to anything and had not done anything to indicate their willingness to be bound by the terms of the feeder bills. Most of the Hanjin plaintiffs would have been Hong Kong-based consignees or indorsees of the Hanjin bills of lading, who would have taken title to the goods by consignment or indorsement of those Hanjin bills during the voyage across the Pacific, before the *KH Enterprise* sank after leaving Taiwan. In contrast, most of the Scandutch plaintiffs were probably the Taiwanese shippers under the Scandutch bills of lading, who would not have had time to transfer title to the goods to their European and Middle Eastern receivers by the time the ship sank. Nowhere in *The KH Enterprise* is this distinction regarded as significant. Nowhere was the point made that although the Scandutch plaintiffs had *themselves* given Scandutch general consent to sub-contract 'on any terms', the equivalent consent in the case of the Hanjin plaintiffs was initially given by the American shippers under the Hanjin bills of lading, and not by the Hanjin plaintiffs themselves. By the single, simple act of taking consignment or indorsement of the Hanjin bills of lading, the Hong Kong-based consignees or indorsees were thereby bound not only by the terms of the Hanjin bills of lading, but also by the terms of the defendant's feeder bills of lading. Presumably, the Privy Council thought it immaterial whether the plaintiffs were the original bailors or parties who had received title from them. Some support for that proposition can be found in *Gilchrist Watt and Sanderson Pty Ltd* v *York Products Pty* Lfd,[23] the case on which the Privy Council in *The KH Enterprise* relied for its analysis of the nature

23 [1970] 1 WLR1262.

of the relationship between the owner of the goods and the sub-bailee. In *Gilchrist Watt,* the plaintiff was the holder of a bill of lading originally issued to a German shipper, for carriage of goods from Hamburg to Sydney. Thus, the German shipper bailed the goods to the ocean carrier who issued the bill of lading. The ocean carrier sub-bailed the goods to the defendants, who were ship's agents and stevedores at the port of Sydney. The plaintiffs were the holders of the bill of lading, which had presumably been indorsed to them by the German shippers. As noted above, the Privy Council held that the defendants had voluntarily assumed the responsibilities of bailee vis-a-vis the plaintiff, by taking custody of the goods from the carrier (the head bailee), knowing that they had been bailed to it by someone else (the German bailor). At no point did the Privy Council regard it as significant that the original bailment had been made by the German shipper, and that the Australian plaintiff had merely assumed the rights and obligations of the German shipper on indorsement of the bill of lading. The Privy Council said:

> Both on principle and on old as well as recent authority it is clear that, although there was no contract or attornment between the plaintiffs and the defendants, the defendants by voluntarily taking possession of the plaintiffs' goods in the circumstances assumed an obligation to take due care of them and are liable to the plaintiffs for their failure to do so. (Emphasis added.)

In *The KH Enterprise,* the Privy Council justified its adherence to the *Gilchrist Watt* decision in the following terms:

> [I]f the effect of the sub-bailment is that the sub-bailee voluntarily receives into his custody the goods of the owner and so assumes towards the owner the responsibility of a bailee, then to the extent that the terms of the sub-bailment are consented to by the owner, it can properly be said that the owner has authorised the bailee so to regulate the duties of the sub-bailee in respect of the goods entrusted to him, not only towards the bailee but also towards the owner.

24 Id at 1270.
25 [1994] 1 Lloyd's Rep. 593 at 600.

Only the shipper of the goods, the original bailor, can properly be said to have given such authorisation to the head bailee. Receivers of the goods (such as the Hanjin plaintiffs) will have done nothing to authorise the head bailee to sub-bail on the terms dictated by the sub-bailee, and the sub-bailee will have performed no positive act of attornment to the receivers as new bailors. Nevertheless, it is implicit in *The KH Enterprise* (and fairly explicit in *Gikhrist Watt)* that a receiver of goods must be in the same position as the original bailor vis-a-vis the sub-bailee. The receiver might say, with some justification, that *it* did not consent to the sub-bailee's terms, and that it should therefore not be bound by them.

As always, though, the matter takes on an entirely different complexion when viewed from the other side in the terms suggested by *Gilchrist Watt* and *The KH Enterprise.* When the sub-bailee voluntarily takes possession of the goods from the head bailee/sub-bailor, it assumes the duties of a bailee for reward, which it owes directly to the head bailor as well as to the head bailee/sub-bailor. The duty so assumed is subject to those terms of the sub-bailment contract to which the head bailor consented. Why should the sub-bailee's position be adversely affected by transfer of the property in the goods from the original bailor (the shipper) to a new owner (the consignee or indorsee)? This point gains added weight when one remembers that a sea-carrier sub-bailee such as the defendant in *The KH Enterprise* would almost certainly not be aware of when such a transfer of rights from shipper to receiver had occurred. Is it not more appropriate to say that the new owner (the consignee or indorsee) acquires the same rights in respect of the goods as the original bailor (the shipper) had, namely, the right sue the sub-bailee for breach of the obligations undertaken by it as bailee by sub-bailment. If the new owner suffers loss as a result of its inability to recover damages from the sub-bailee, that may be a reason for it to sue the original bailor (the shipper) for breach of the sale contract, but it is difficult to see why the sale contract should affect the content of the duties undertaken by the sub-bailee.

IMPLICATIONS: HOW FAR DOES IT GO?

There are very many sub-contractors in modern shipping practice. To take but a few examples: sea-carriers routinely sub-contract to stevedores and terminal operators the processes of loading, discharging and storing goods; any time charterer that is a contracting carrier under its own bills of lading necessarily sub-contracts the actual carriage to the shipowner (or disponent owner); freight forwarders who contract as principal to carry goods from 'door to door' often sub-contract almost every stage and every function of the voyage, from land carriage to sea carriage to packing and unpacking. The Himalaya clause was developed to ensure that some sub-contractors, at least, would be protected by contract if they were to be sued by the owners of goods that they had lost or damaged. That protection comes, of course, from the contract between the owner of the goods and the principal carrier, which is usually in the terms of the principal carrier's bill of lading. The decision in *The KH Enterprise* suggests that *every* sub-contractor is protected by the terms on which it contracted with the principal carrier (the head bailee/sub-bailor) if two requirements are satisfied: (1) that the original bailor of the goods consented, even in very general terms, to the principal carrier sub-bailing the goods on terms that might be different from those of the principal contract of carriage; and (2) that the terms on which the sub-bailee seeks to rely are not so unusual or so unreasonable that they could reasonably be understood to fall outside the scope of the original bailor's consent. Thus, for example, if the consignee or indorsee of goods under a bill of lading sues a terminal operator, the terminal operator may be entitled to rely on the exclusions and limitations in its own standard form contract with the sea-carrier, whether or not it can also rely on the terms of the sea-carrier's bill of lading with the owner of the goods, by virtue of a Himalaya clause in that bill. Similarly, any sub-contractor of a freight forwarder may be able to rely on the terms of the contract between it and the freight forwarder in an action brought by the owner of the goods, whether or not the freight forwarder's 'house' bill of lading

or consignment note issued to that owner contains a Himalaya clause.

How far do the principles stated in *The KH Enterprise* go? That remains to be seen, of course, but there is at least one possible limitation on their application. In both *Gilchrist Watt* and *The KH Enterprise,* the goods the subject of the bailment were *lost,* not merely damaged. In such a case, where the plaintiffs are complaining of the defendants' failure to return the goods to their possession, the plaintiffs have no option but to rely on the fact of bailment, the giving over of possession to the defendants. In contrast, where the goods are merely damaged, the plaintiffs (the owners of the goods) maybe able to allege negligence without the need to rely on the fact of bailment. In *Johnson Matthey & Co Ltd v Constantine Terminals Ltd,*[27] Donaldson J said:

> If [the sub-bailee] had themselves damaged the silver, quite different considerations would have been involved. The plaintiffs could then have set out to prove negligent conduct without any reference to the bailment. Whether, in those circumstances, [the sub-bailee] could have relied upon the contract of sub-bailment to which the plaintiffs were strangers or upon the contract of head bailment to which they themselves were strangers, seems to me to be a problem of some nicety to be tackled only when it arises.

I have elsewhere expressed my doubts that this 'problem of some nicety' can properly be resolved by holding that the sub-bailee owes a duty of care to the bailor under the principles of the tort of negligence, without reference to the fact of bailment. It might be argued that the defendant's duty under the tort of negligence arises because of its actions in handling the goods in such a way that they

---

26 This should be so whether or not the freight forwarder ever takes actual possession of the goods. Even if the forwarder does no more than co-ordinate the carriage functions to be taken by others without taking possession itself, it seems that the principles stated in *The KH Enterprise* extend to protect its sub-contractors, by virtue of the fact that the Privy Council said, obiter, that the relevant principles would apply to quasi-bailees in the same way as to sub-bailees.

27 [1976] 2 Lloyd's Rep. 215 at 222.

28 See Davies, 'The elusive carrier' (1991) 19 ABLR 230 at 237-245.

might foreseeably suffer damage: in other words, that the duty arises because of the defendant's positive conduct rather than because of the bailment relationship. The fact remains, though, that the defendant (the bailee or sub-bailee) only engages in that positive conduct in relation to the plaintiffs' goods because it has possession of them. The bailment relationship is the context of and the reason for the positive conduct that causes the damage, and therefore it must necessarily shape the content of the duty owed by the bailee, even if it is bailee by sub-bailment.

Whether or not the principles stated in *The KH Enterprise* do apply to damage to goods as well as loss, it is undoubtedly a very significant decision. It gives some sub-contractors a second string to the bow provided by the Himalaya clause, and provides a source of contractual protection to other sub-contractors, who would not otherwise be protected by the presence of a Himalaya clause in the head bailee's bill of lading.